Richard Gusanie
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

Freightliner Group Limited
Basford Hall
Off Gresty Road
Crewe CW2 5AA

Web: www.freightliner.co.uk

2 September 2011

Dear Richard

PERIODIC REVIEW 2013 FIRST CONSULTATION – FREIGHTLINER RESPONSE

This is the response of Freightliner Group Ltd (representing Freightliner Limited and Freightliner Heavy Haul Limited) to the Periodic Review 2013 first consultation. Freightliner is content for this response to be published on the ORR's website with the exception of any text in *italics*, which we consider to be commercially confidential.

Freightliner is keen to engage with the Office of Rail Regulation (ORR) in detail with regard to the Periodic Review as the decisions made will directly impact on our business and future ability to grow rail freight in the UK.

In particular we are keen to understand how we could contribute to ORR's work on future Network Rail efficiencies and how the freight sector could contribute to the overall efficiency of the rail network.

OVERVIEW - RAIL FREIGHT SECTOR

The rail freight sector has been successful since privatisation achieving considerable growth and modal shift. Most notable is the steady growth of the intermodal sector, which has grown by 61% since 1998/99 but most markedly has grown by 20% in the last 4 years despite the recession. Market share by rail in the deep-sea container sector by rail has grown from 17% in 1996/7 to 28% now. The rail freight companies have achieved this because of private sector investment, on-rail competition and focus on customer service.

However another important influence has been the policies of the Office of Rail Regulation in promoting rail freight through the reduction in track access charges in CP4 but also in supporting the needs of freight customers through the oversight of Network Rail. It is vital to the rail freight industry in Great Britain that there is an independent regulator such as ORR. In a future world of devolved infrastructure the role of the Regulator in ensuring that the rail network is protected as a national entity to enable competition with the national road network and to support freight operators' needs to offer services to customers that can compete with road will be particularly important.

The rail freight industry's strategic importance to the growth of the GB economy is significant. For example:

- Over 25% of the electricity consumed in the UK is generated by coal that has been moved by rail

- 28% of all deep-sea containers that arrive or depart from the major deep-sea ports are transported by rail carrying goods ranging from food, clothes, televisions & white goods, raw materials, chemicals for retailers and manufacturers

- Rail moves aggregates and cement into major conurbations to enable developments that in turn enable our economy to grow. In London, over 40% of raw materials are delivered by rail

- Rail freight plays a major role in the maintenance, renewal and enhancement of GB's transport infrastructure supplying raw materials and plant to the railway, underground and motorway works

The efficiency of the logistics sector has a direct impact on the efficiency of UK businesses and the competitiveness of the UK's industries against other countries. Moving freight by rail can help relieve congestion that has a high cost to UK business on the road network. Without rail freight there would have been some 6.58 million lorry kilometres extra travelled by road in 2010/11.

The rail freight sector itself is competitive as well as being in direct competition with road. This competition has pushed operators to become more efficient by reducing unit costs and investing in new more reliable and efficient equipment. The McNulty report stated "Faced by a competitive environment with other transport modes and with each other freight operators have focused on reducing costs and improving service" and showed that staff per freight train km have reduced by 36% since 1998/9.

Like the road freight sector the margins in the rail freight sector are very low, this is inevitable in such a competitive market. The McNulty report showed that the combined profit after tax of the 4 largest rail freight companies for the year ending March 2009 was a profit after a tax (excluding the sale of fixed assets) of minus £24.3 million or minus 2.8% of turnover. The equivalent figures for the following year are now available and they show a profit after a tax (excluding the sale of fixed assets) of minus £17.8 million or minus 2.3% of turnover.

OVERVIEW - TRACK ACCESS CHARGES

The part of the Periodic Review that has the greatest impact on freight operators is the overall level of charges that it is deemed that freight operators should pay, the detailed structure of how those charges are paid, although important, are a secondary issue. In this context we are also keen to engage with Network Rail more to work in partnership to reduce their costs and make our own business more efficient.

The level of charges paid to freight operators directly impacts on the rail freight sector's ability to compete with road. The charges that road operators pay are simple; annual VED on lorries and fuel duty on diesel. There are no restrictions on when or where lorries can enter the UK road network, they are free to do so at any time and without any charges.

The overall level of freight charges is a small part of Network Rail's overall income. Making changes to the freight charges will make little difference to Network Rail's income but could make a huge difference to the ability of freight operators to compete with road.

Increases in freight track access charges will lead at best to frozen investment and curtailment of growth, at worst a sector that has proved so successful since privatisation will spin into terminal decline, this in turn will hit UK economic productivity. If charges were to increase in any of the market sectors it would be very hard for freight operators to pass on any or all of the increase to customers, inevitably the freight operators would have to absorb at least some of the increase to retain customers. This would impact on the viability of the whole rail freight sector as margins are already very low and for the last 2 years have been negative.

An early a decision as possible on the overall level of freight track access charges would enable the rail freight industry to continue to plan and invest in their businesses.

Stabilising freight access charges into the future rather than a complete review every 5 years would give confidence to customers and potential customers to use rail and to continue to invest in a more efficient logistics chain, in turn improving the efficiency and competitiveness of UK industry.

OBJECTIVE FOR PR13

Freightliner agrees that the need for significantly greater efficiency and value for money from the rail industry must be a top priority for CP5. It is also vital at this juncture in the economic cycle that a structure to encourage private sector investment and growth in the UK railways that in turn will lead to economic growth in Great Britain is put in place.

Freightliner, since privatisation has generated investment of over £450 million in rolling stock, terminals and IT, this in turn has enabled us to become more efficient and thus more competitive and to offer the reliable and consistent service that is demanded by our customers and is needed to compete with road and other operators. In order to continue to be competitive we must continue to invest and a stable structure with market based incentives will assist in this.

We strive to be ever more efficient, always looking at new ways of pushing the boundaries by doing more e.g. longer trains or pushing efficiencies such as resource utilisation. This is a business necessity, if we cannot keep up with road competition and our business will simply decline. To achieve these goals we need the support of both Network Rail and the ORR. There are many people in and outside the industry who do not understand our business and who do not consider what we need to be successful: reliability, consistency of product and ever better resource utilisation. Many consider that holding freight trains up in loops or taking longer routes or even not running during the day are acceptable. The independent ORR therefore plays a particularly important role for the freight operators, not only in setting access charges but in ensuring that industry decisions are made in a balanced way that take into account the competitive needs of our sector.

We would like to see incentives on the industry to work more closely together which enable Network Rail to reduce their costs, and operators to become more efficient. However, in our view, a key element missing at the moment is Network Rail’s focus on delivering the needs of the consumer. Network Rail considers their main customers to be the ORR and the DfT and do not act as a supplier focussed on the needs of the consumer. We would like to see a greater focus in this area in the Periodic Review.

During a period of time when Network Rail are going through a devolution process, and there is a possibility of one of more concessions being established, or even a vertical integration trial, the role of the ORR will be especially important in ensuring that national operators’ needs are protected and can continue to offer a seamless service to customers. In particular national train planning, national planning of possessions, a national approach to infrastructure maintenance and renewals planning and a national approach to capacity allocation will be important, but it will also be important to ensure that contractual incentives such as the performance and possessions regime are aligned across boundaries and that perverse behaviour is not created.

HIGH LEVEL TIMETABLE

Freightliner recognises that the Periodic Review process is complex and requires multi-agency input. In this regard we have no particular comments on the timetable laid out.

We re-iterate that in order to continue to promote rail freight, as early as possible settlement on freight access charges would support successful contract negotiations with customers and enable private sector investments to be secured. We note that there is no specific reference in your timetable as to when in the process such a decision could be made and it would be very helpful to understand your intentions here so we can reassure customers and investors.

We also urge the ORR to space out consultation documents as much as possible so there is not multiple consultation open at the same time, including consultations that are out with the Period Review itself. In most organisations, with the exception of Network Rail it is the same person or very small group of people that have to deal with all these issues. Similarly as much notice as possible of industry consultations would be helpful; a programme of future dates for 2012 when major consultation days were going to take place, would enable industry members to ensure that these days were kept free.

REGULATORY FRAMEWORK AND KEY ISSUES

Price Control Separation and Network Rail Devolution

We agree with the ORR that at this stage there should not be separate price controls other than those already in place for England & Wales and Scotland.

We assume that when you refer to train operators producing information you refer to passenger franchised operators. As a privately owned company in a competitive market we do not think it is appropriate that freight operators provide information.

Outputs

Network Rail is a difficult company to incentivise with only the contractual framework, management pay and bonuses and reputation available as tools. Tools such as fines that have a real impact on private sector companies have no real impact on Network Rail. We think this is one of the biggest challenges for ORR in CP5.

We believe that the current approach of measuring outputs rather than outcomes is the best approach as it is more controllable and directly linked to behaviour. We do not think that Network Rail should be measured on outputs or outcomes over which it does not have full control.

We think it will be difficult to get the right balance of regional and national targets for Network Rail. A balance of both approaches would hopefully encourage the right behaviours. We can see strong advantages in creating separate route level targets for efficiencies, performance etc as this will create a competitive edge between the routes. However freight is a national business that competes with a national road network with no boundaries and we therefore need a seamless service from Network Rail, and we are therefore keen that Network Rail also have some national targets and incentives. It will also be important to have a balance of “carrots” and “sticks” in the range of incentives.

As well as the current measures on performance and network availability some new defined output measures in key areas will be important to ensure that Network Rail are focussed on the needs of the end-user and helping operators to become more efficient. The Rail Freight Operators’ Association wrote to Network Rail in July suggesting some new measures, which we envisaged to be a mix of regulatory enforceable measures and bi-lateral commercially confidential plans. These included incentives on longer trains, retention/improvement of journey times on key routes, a capacity measure and reduction of speed restrictions related to weight and gauge. We are currently in discussion with Network rail with regard to this suite of measures. We believe that these would give a more focussed output than continuation of the current customer survey measure for freight.

We would also like to see Network Rail measured against their compliance to train planning timescales laid out in the Network Code. This has been a consistent theme of the freight operator surveys over many years but delivery to these timescales appears to be deemed as optional by Network Rail with respect to freight operators.

Current Financial Incentives

Outperformance

We support this financial incentive in principle but going forward we think that there should be greater clarity and transparency between doing less and doing the same for less. For example the incentives on renewals should be based on unit targets not the total amount spent on renewals. On enhancements there needs to be a clear difference between saving money on the implementation of enhancements and doing a lesser scheme.

Schedule 8 Performance Regime

The current performance regime works in that it creates a clear financial incentivise on both Network Rail and operator to continually improve their performance. It is simple in the fact that all delay minutes are bad so it is easy to brief to staff on what is required of them. There is also well established infrastructure to manage the large amounts of data that would need to be managed whatever the form of a performance regime. Although some parties have criticised the current regime for being too antagonistic our experience is that the volumes of data to be processed are so large that both parties have to (and are) be pragmatic about resolving the allocated cause of delays.

We believe that it is of paramount importance that the Performance Regime continues to be a national regime. Whilst it may be appropriate to set Network Rail performance targets on a regional basis to ensure that there are clear incentives for local staff it would be very difficult if the contractual regime was anything but national. It is also important that perversities are not created which encourage one route to blame another or “game” against other routes so that there are arguments about which route caused delay.

We note the ORR’s comments about planning to undertake a full recalibration as part of PR13. This will also directly impact on freight operator payments made to Network Rail as freight operators pay on the basis of the star model. This is also an important factor in balancing the freight performance regime where the other half of the regime is Network Rail payments to freight operators to contribute to their costs and losses. We would be concerned if the regime became unbalanced i.e. if the payments made by freight operators to Network Rail were not at the same ratio (once the appropriate balance of minutes is taken into account) to that paid by Network Rail to freight operators.

In this context we also note that the ORR is intending to review whether the Schedule 8 should be “turned off” where there is vertical integration. We are unsure that this would work unless the vertical integration area was exclusive to one operator as the regimes of other operators including freight operators would need to be accounted for as part of the “star” model.

Schedule 4 possessions regimes

We agree with the ORR that the existing Schedule 4 offers broadly the right incentives on Network Rail. In terms of freight operators the simple liquidated regime gives clarity to both parties when possession are being planned and is much simpler to administrate than the actual costs and losses arrangements that were in place in CP3.

We do remain concerned that the value of payments made by Network Rail to passenger operators still tends to incentivise them to disrupt freight services rather than passenger services, even though the economic value of the freight services may be greater.

Freight operators already explore innovative timetabling as they will always try and find a way of still operating a service rather than not running it, as cancellation will frequently put freight operators in breach of their contracts with customers or at best mean the customer will be unable to get their goods to market in the manner they were expecting. The challenge of route closures does not affect road operators as there is always a way round on the road network, and no capability issues.

Volume Incentive

Freightliner is keen that Network Rail is incentivised to grow the rail freight business. As freight operators pay the Variable Charges only, there is no obvious incentive at the margin for Network Rail to grow freight volumes. Frequently when we are trying to grow business we come across local staff in Network Rail who see more freight as a threat to their performance targets or ability to take possessions rather than an opportunity. The current volume growth incentives are not well briefed or understood throughout Network Rail and because of the recession and changes to electricity coal volumes moved by rail will not be reached. Once it is know that the incentive target will not be reached for the rest of the Control Period there is no on-going incentive at the margin for Network Rail to want growth.

We would like to see an incentive on Network Rail to grow freight at the margin, i.e. a credit for every new service that is launched, based on a % of the economic and environmental benefits. This would create an incentive to grow rail freight but also recognise that Network Rail have little impact on the overall market. This would recognise that the benefits of rail freight fall in the main outside the railway balance sheet (i.e. the benefits are reduced road congestion, carbon etc). Other incentives such as performance and network availability as well as contractual penalties should be used to encourage the right behaviours on existing business.

We do not support the auctioning off of capacity, noting that this would impact on freight's ability to compete with road and in the case of passenger franchise this would ultimately be funded by government (through increased or reduced subsidy depending on the operator).

Customer Satisfaction

We do not think that customer satisfaction is an easy measure to use in the context of freight, mainly because the number of customers and decision makers in the industry is statistically very small so it is difficult to get sufficient answers to make a statistically consistent survey. It should also be noted that customers in different markets have different priorities; Freightliner deals with this by tailoring the performance data and other information individually to the requirements of each customer.

There have been several customer surveys over the last few years, which have been mainly targeted on bulk customers, conducted by various parties. These are useful from time to time to ensure that the market is working as it should but are difficult to directly translate into a Network Rail output. Given the small number of actors, care is needed not to over survey and create survey fatigue.

Network Rail have run a satisfaction survey on freight operators for many years now, the questions are designed for passenger operators, not freight, the answers tend to reflect issues of the last few weeks and Network Rail have never made any more than a token effort to resolve the issues raised in the survey many of which the same ones every year. We therefore conclude that this mechanism has not really worked as an incentive on Network Rail.

Efficiency Benefit Sharing

Freightliner supports the principle of efficiency benefit sharing whereby the operators are incentivised to make Network Rail more efficient.

In CP4 there is a mechanism for freight operators to partake in this arrangement. It is not clear how this mechanism works at the moment for the following reasons:

- It is unclear to the operator what cost savings are required to reach NR's efficiency targets and what savings enable them to outperform their targets
- It is unclear whether efficiency includes doing less or just doing the same for less. For example if an operator agrees to reduce the capability of the Network, is this an efficiency saving?
- Any local arrangement to save NR costs are consumed into the national figure so the linkage between the saving and any reward is lost especially if other areas do not outperform this will (especially noting Freightliner are 2-3% of Network Rail's nationwide business)

- There is little transparency currently on cost savings achieved for example by agreeing different possession patterns or agreeing to Network Changes
- A clearer incentive on the operator is needed so positive actions that reduce costs have definite rewards

None the less we are keen to undertake further work in this area with Network Rail and have asked to meet them to discuss opportunities for costs savings and discuss how they see this mechanism working in CP5. We also hope that this will enable further constructive input into the Periodic Review 13 discussions.

Obviously changing the current mechanism on a route by route level will help to focus each route and local operators but we think that further work is needed on the details of the regime. We also think that a mixture of bespoke arrangements and route arrangements could be unfair and further work is needed on what elements of cost savings could be suitable for bespoke arrangements. For example if an operator makes a bespoke arrangements to change engineering patterns which saves Network Rail money should all operators who have accepted those changed arrangements also receive pro-rata credit?

We note that the ORR has stated that its current view is that efficiency impacts should be distributed across train operators in proportion to the level of track access charges paid in the operating route. It is unclear whether the intended calculation is based on Variable Charges only or Fixed and Variable Charges. Freightliner is concerned that if the intention is to use both Fixed and Variable Charges as a base that the proportion available to freight operators would be very small and not in proportion to the traffic operated and that this would not create a balance of incentives among operators. In order to make the incentive effective all operators need to be roughly equally incentivised to co-operate so that they take positive action to work with Network Rail to achieve efficiencies; Variable Charges or a similar measure based on traffic volumes would be the most appropriate.

The efficiency benefit sharing scheme should also not be a mechanism to force secondary operators to make or accept changes against their will which are not in their interests, for example to possession patterns. One way to lessen the impact of this scenario is to make the incentives equal to all.

Care will be needed in implementing regional efficiency benefit sharing schemes in ensuring that 10 separate and different schemes are not implemented adding to the management and administrative burden of national operators.

Freightliner does not support a mechanism that enables Network Rail to share in train operator revenue and/or costs. In the case of freight operators we do not believe that freight operators can afford to pay part of their revenue to Network Rail. Margins in the sector are very low, at best just 2-3% (-2.8% in the year ending March 2009) so any payment to Network Rail would mean that prices to customers would have to increase which would impact on the competitiveness of the rail freight sector versus road. More generally we think that this would be an unusual arrangement and we are not aware of any other sector where a supplier shares in the revenue of its customers.

Capacity Utilisation

Freightliner would support incentives on Network Rail to make better use of capacity. We believe that more emphasis should be placed on Network Rail in ensuring that they have the optimum use of existing capacity rather than capital investment solutions. In this regard Freightliner is keen to work with Network Rail with regard to the use of capacity for freight services and whether any improvements can be made. Of course the freight patterns of use are very different to those of passenger, with freight services running when there is demand but predominantly full, whilst passenger services run to a timetable whether there are any passengers or not.

We and other freight operators are worried about whether capacity will be available in the future for freight growth on in particular the key freight route of the West Coast Main Line but also on other major routes, particularly where new services are planned (IEP and Crossrail being examples).

With the support of ORR and DfT freight operators have been pushing Network Rail to identify available freight capacity on key growth routes for freight. We are frustrated by the progress of this work stream but we do believe it is very important not only to the rail freight industry and giving comfort to customers and potential customers but also to passenger operators who have their own business plans which will use existing spare capacity on key routes. In this context we would like Network Rail outputs not only to include a measure on better utilisation of capacity but more transparency and clarity on what capacity is available today.

We are of the view that Network Rail do not place sufficient emphasis on the importance of train planning in their organisation and capacity utilisation is one key element of this. Empirically we believe that there is an opportunity in this area to get better value of the existing rail network by better capacity utilisation.

Given that freight services predominantly do not operate during the peak in the large conurbations when the highest economic value passenger services operate we are particularly interested in off-peak capacity. We think that there would be some merit in reviewing the use of off-peak capacity and the level of off-peak passenger services. There may be some routes where the best value solution is a thinning out of off peak passenger services (and perhaps increasing the length of the remaining services) to create freight capacity rather than capital investment. We recognise that this is not appropriate on all routes and also that this is potentially controversial but in some cases it may offer the best value solution to UK plc. This should also be reviewed in the context that increasing numbers of off-peak passengers are purchasing inflexible advance purchase tickets negating the benefits of a 3 or 4 trains an hour service pattern.

In this context we think it is important that as long as trains are possible are operated to make the best use of paths. This is a key aim of the Strategic Freight Network. We therefore see that mechanisms to incentivise Network Rail to operate longer services go hand in hand with capacity utilisation.

Incentives for greater energy efficiency

We are very supportive of Network Rail being incentivised for greater energy efficiency. The cost of energy for traction be it diesel or electric is increasing sharply and the indications are that these costs will continue to increase in the future as the world demand for energy increases. The cost of traction energy is approximately 25% of the cost of train operations and therefore is a very major part of the overall costs of the railway. It is therefore very important in order to control the costs of train operations and therefore the overall cost of the railway that energy efficiency is a high priority for the industry and that Network Rail are incentivised to help operators reduce energy usage.

Another key benefit in reducing fuel use is that fuel saved equals less carbon outputted. The railway must make a significant contribution to the government’s 80% reduction in carbon by 2050 target. It is also important that the rail industry keeps and improves on its carbon saving differential in comparison to other modes of transport.

Freightliner believes that there are several measures that would be appropriate for Network Rail to help the industry reduce energy usage as much as possible.

There is currently no incentive on Network Rail to manage the electrical network efficiently and this seems an imperative for CP5.

We would also like to see incentives on Network Rail to consider energy usage in their development of the timetable. It is estimated that every time a freight train stops and starts again 45 litres of additional gas oil are used. Timetables that are designed to minimise the number of times trains stop (apart from at station for passenger trains) would help the whole industry to reduce costs and carbon outputs. One key issue for freight services is the amount of time spent in loops when the locomotives are still using diesel but are not going anywhere. We would like to see an incentive on Network Rail to reduce the average amount of time that freight trains spend in loops, this would have the added benefit of reducing journey time for freight trains which in turn would enable freight operators to be more efficient as better utilisation of capital intensive rolling stock..

FINANCIAL FRAMEWORK

Duration of the control period

In terms of the setting of track access charges Freightliner would like to see more certainty going forward in the level of charges rather than a review every 5 years starting from first principles. We see no reason that given that existing variable track access charges are set on the long run costs of an efficient infrastructure provider that this should not be the basis for charges into perpetuity. Obviously there would need to be an occasional refresh of charges but that could be done against a base of assumptions rather than from first principles. As a first step it would be a great help to the rail freight industry if charges could be set over 2 control periods rather than 1 in the first instance.

Existing customers signing up to new contracts and new customers considering making the switch from road to rail need certainty to enable them to decide to use rail freight, the same uncertainties do not exist when using road freight. Additionally freight operators, terminal operators and customers all need certainty to enable investment decision to be made. Typical assets such as rolling stock, cranes and terminals are all 30 year assets and it is difficult to secure financing when there is uncertainty ahead.

In terms of investments a more rolling programme, such as the arrangements that have been put in place for Great West Main Line electrification rather than a fixed 5 year programme might be more appropriate, and would be more akin to the processes in a normal business. The 5 year fixed programme does rather force the bringing forward of decisions on investments before in some cases they are really ready to be made. However there are advantages to the railway system in having a fixed 5 year programme that cannot easily be unpicked at the whim of governments.

The Strategic Freight Network programme whereby the final decisions on the investment programme have been made by the industry has worked well in ensuring that investments are made in the locations where they will bring the highest value. Having a more flexible sum for investment has enabled the decisions on which investments to be done to be made throughout the first couple of years of the Control Period rather than in a rush before the start of the Control Period. We would strongly support a similarly structured fund for CP5.

In terms of Network Rail's financial targets and output measures a 5 year Control Period feels to be the right length to enable Network Rail to plan and implement the changes necessary to meet their targets.

We do not think that it would be appropriate for the Network Rail RAB and debt to be separated by Route for a couple of reasons. Firstly many investment schemes (e.g. Felixstowe to Nuneaton route upgrade) that are RAB funded are cross-route and it would be difficult to split these up. Secondly by splitting up the debt it would potentially make it harder for Network Rail to raise its own funding with government guarantee as each Route would not be able to spread the risks in a way that a national company could do.

Compared to freight operators a company like Network Rail faces little outside risks with a stable income set every 5 years. Companies like freight operators and to a certain extent passenger operators have to deal with risks all the time that are outside of their control. Network Rail acts like a very risk adverse company, for example the GRIP process used for assessing enhancement costs includes very considerable amounts of contingency for unknown risks. We do not think that it is necessary allow Network Rail anything other than normal inflation risk. We know during this control period that Network Rail has benefitted from low contractor prices as contractors are desperate for work. Network Rail should not be able to claim this as efficiency yet when contractor prices rise be able to use this as a reason not to have meet targets.

Network Grant

We understand the reasons for the ORR's proposed position with regard to Network Rail's grant being paid through track access charges. However we do see that this could cause some issue in the freight industry.

In particular assuming the continuation of the same policy on rail freight charges we are concerned how the freight only lines costs for commodities that are unable to afford the freight only costs would be handled. Given the competitive nature of the industry and the fact that contracts and business frequently move between operators it would be difficult to pass this via operators. This would also imply a grant paid directly to operators to pay these charges which would add an administrative burden for all, and presumably subject to EU state funding rules. In this area we do not see any reason why the freight sector should not be dealt with in a different way to the passenger sector.

Ultimately this may mean that individual flows of freight by rail are deemed inefficient by dent of the fact they are unlucky enough to have a terminal at the end of a branch line. This may not only mean a direct loss of business but also an indirect loss as many customers want the railway to serve a portfolio of destinations and do not wish the most lucrative flows being cherry picked by rail while less attractive parts of their portfolio are discarded.

On a more macro scale paying all Network Rail's grants via train operators would mean that freight operators were very much the poor relation in terms of payments made to Network Rail. This would inevitably lead to freight operators being treated as secondary customers by Network Rail and would create behaviour that is very much in conflict to the service offering that rail freight companies must make to their customers in order to compete with road.

Lorry companies simply do not face such complexities.

STRUCTURE OF CHARGES

The overriding priority for rail freight operators is the overall level of charges that they must pay. In order to promote rail freight this must be set at a level that allows direct competition with road freight. Given that road freight pays only Vehicle Excise Duty (VED) and fuel duty simplicity of charges for rail freight operators is also important. Complexity is one of the key barriers to entry for customers wishing to use rail rather than road.

The ORR should in making this decision take into account its duties to promote rail freight and of course any decision must comply with the EU regulations. It would not be very helpful for the ORR to reach conclusions that may be considered economically perfect but would lead to major restructuring and downsizing of the rail freight business in the UK, which contradicts both UK and EU government policy.

Freight operators are already bearing many increased costs which are outside of their control such as fuel price, electricity costs, insurance, port charges and increased pension costs, as well as facing uncertainties in markets caused by the fragile global financial position and government policies such as on longer semi-trailers.

Freight operators need stability of charges so they can reasonably plan their businesses going forward and make investments in new equipment and terminals. Investment in terminals, locomotives and wagons are made for a 30-year period and it is not helpful for access charges to change every few years. A programme that is finalised 3 months before implementation would be unhelpful in terms of planning our business and negotiating with customers, who do not have the same uncertainties when moving goods by road. We therefore urge the ORR to make a decision as soon as possible.

ORR should be aiming to reduce freight track access charges to continue promote rail freight growth. A reduction in charges at the last periodic review has clearly contributed to the growth in the intermodal sector by rail. Despite the recession intermodal volumes by rail have increased by 9.8% over the last 2 years (since the beginning of the CP4) and the market share by rail in the deep-sea container market has increased from 25% to 28%.

Intermodal is not only the market where the market and rail freight is forecast to grow most rapidly but also the market where rail most directly competes with road.

Unless road operators have to pay more for the use of the road network rail operators are unable to afford to pay more for the use of the rail network. The coalition government has announced that it intends to introduce lorry road charging before the end of their current term in office. Through discussions with the Department of Transport (DfT) we understand that their intention is to introduce a time based scheme, which is cost neutral to UK hauliers. We also understand that no work is being undertaken at this time with regard to a distance based lorry road-charging scheme. Such a scheme has been successfully introduced in many other European countries including Germany, where it raises a considerable income for the German government.

Variable Charges

We understand that there is a desire by parts of the passenger industry to increase the variable portion of passenger track access charges and are concerned that an unforeseen knock on affect of this could be a considerable increase in freight track access charges. We see no reason why passenger charges and freight charges could not be on a different basis and our only concern about this would be that freight could be deemed by Network Rail to be secondary customers.

The deemed split between fixed and variable costs is a key decision that will impact on freight. It may also be important to Network Rail in their plans to raise unsupported debt and the affordability of doing so. To a certain extent any such split of costs can be interpreted in different ways and there is no one right answer. Generic engineering relationships can show a decrease or an increase depending on the consultant and their remit. It should be borne in mind that any increase in the variable costs would disproportionately affect freight operators who are self standing and in the private sector and with limited affordability.

Fixed Charges

There appears to be outside pressure from some parties for at least some freight markets to pay more and contribute towards the fixed charges of the network. It would be very hard for freight operators to pass on all of the increase to customers, even if it is deemed that a particular market can afford it. Inevitably the freight operators would have to absorb at least some of the increase to retain customers, and this could impact on future viability of the sector and the number of competitors in the sector.

Regionalised Charges

Freightliner does not support regionalised track access charges. In the context of freight where services are constantly changing they would be very difficult to calculate and would add considerable administrative burden to both operator and Network Rail. As there is usually only one suitable route with the right capability for freight traffic to traverse we do not see how different charges on different routes would create any incentives. Particular problems would be created when trains are diverted due to perturbation or because of engineering works as to the level of charges applicable.

Noting that road operators do not face such complexities we would be extremely worried about our ability to quote customers quickly, in this respect the current charges are already complicated enough. Having to work out how many miles would be traversed in each route would add considerable time to quoting as there is no easy way of doing this.

Scarcity Charges

We do not consider scarcity charges are a direct cost and therefore do not consider that charging freight operators would be in line with EU directive EU/2001-14. Unless distance based lorry road charging is introduced there is no equivalent for road freight operators and such a charge would only serve to make rail less competitive versus road.

Reservation Charges

In theory we support reservation charges as long as they don't increase the overall level of charges paid by freight operators. Given that rail freight operators only pay the variable and capacity charges we do see how reservation charges could be introduced without reducing the variable charge; it would then be unclear whether freight operators were paying less than their direct costs in line with EU/2001/14.

Additionally the more one thinks about a path reservation fee the more complicated it seems. When would you start paying, when you secure a path in the timetable or when you secure an access right? How would it be billed, per path mile, per path? How would diversionary paths that are in place purely to cater for regular engineering work be dealt with? Would it encourage freight operators to spot bid for more business, and would that not just add risk and workload to both freight operator and NR? We conclude that it would not be practical to implement, and support instead the current work stream to make Access Condition J more effective.

Capacity Charges

The current capacity charge is a flat charge across the Network. It is supposed to be a payment for the marginal impact on performance of more trains on the rail network, i.e. if there is an incident the delay per incident increases. When the CP4 charges were set there was a complete lack of transparency of how this charge was calculated or how or when the benchmark for business levels were set, or on what assumed growth it had been calculated.

Given that overall freight volumes have reduced in CP4 and the number of freight trains has reduced even further (because operators have driven efficiencies and are now moving longer and better loaded trains on average) we are currently in a position whereby every freight train is paying a capacity charge for the marginal impact on performance of growth yet Network Rail are not only receiving the charge but additionally actually benefitting in this respect because of less freight trains.

Going forward if this charge is to continue it must be on a transparent basis whereby the benchmark and the assumed growth trajectories are clearly understood by all parties. Given that the charge is supposed to reflect the marginal impact of the increase to delays caused by growth only the current freight charges of approximately £2.5 million per year seem high. The current charge creates no incentives and the title of capacity charges is misleading.

Traction Electrification Charges

During CP4 Network Rail have enabled train operators to buy tranches of electricity through their framework agreement with Network Rail, this has the benefit of securing prices for a set period. However, this arrangement is not currently available to smaller operators whose consumption is 5% or less of Network Rail's overall consumption, unless they use the ATOC clearing house. This means that smaller operators are unable to benefit from this arrangement in the same way as larger operators. As a smaller user Freightliner is keen to participate in such an arrangement directly and would like to see this made available to all operators during CP5.

Freightliner has been involved in the industry discussions regarding metering and broadly supports the framework that is proposed by ORR. We note ORR's proposal to apply an uplift to non metered operators; while we understand the desire to strengthen the incentivise non-metered operators we would like to understand where the additional monies from the would go, i.e. recycled through the wash-up, transferred to metered users?

We also note that the proposed framework is to allocate the volume wash-up in each ESTA between unmetered services and Network Rail. How is it proposed to allocate the volume wash-up? We do not believe that currently sufficient evidence is available of either Network Rail or train operator losses to accurately allocate these costs.

With regard to the use of sampling in lieu of full metering we do have some concerns. In particular we are aware that consumption is affected by various factors including weather and service pattern (more trains in a section increases the power past through the lines and therefore the losses) and we do not believe it is appropriate that operators using sampling should be excluded from the wash-up. Sample metering appears to us to be in effect the same as recalibrating of modelled rates. Sampling may be more appropriate for the DC operators where metering is more expensive and the major passenger operators probably have a very high percentage usage in a particular area.

Connection Agreement Charges

Connection agreement charges are rarely discussed and are not raised in the ORR consultation but we are increasingly concerned by the potential burden of these charges to the rail freight sector.

The ORR has previously advised us that the basis of these charges should be, as other freight charges, on a marginal basis. We aware that Network Rail has produced a bottom up cost model with unit costs but we have been unable to clarify on what basis this has been calculated despite requesting this information on numerous occasions.

We do not have the detailed information to enable us to do the calculation but based on our understanding of the charges that have been quoted for our own sites we believe that if this model was applied to all rail freight sites in the UK the total charges would be higher than the total currently paid by freight operators for all track access charges.

Connection Charges income is part of Network Rail's single till income but there is no currently no transparency what the current income is from freight sites.

We believe that as part of the CP5 review the basis for future connection agreements charges should be made more transparent and that a review of the Network Rail cost model should be undertaken.

SUMMARY

Above all the overall level of freight access charging require serious consideration, and we urge the ORR to consider the affordability of freight business in their considerations, especially bearing in mind other increased costs we are having to bear. A regime to kick start growth and add real value to UK GDP would be a great legacy compared to the alternative of decline of rail freight.

Freightliner also urges the ORR to keep the structure of freight charges simple and not introduce complicated but economically correct structures which are just not practical to implement, and in reality make no difference to behaviour.

Freightliner is keen to work more closely with Network Rail with the aim of making each other more efficient. A carefully balanced efficiency benefit sharing model will be important in this regard.

The financial and regulatory measures set by the ORR are important to Freightliner and we are keen to get involved in the development of these metrics to reflect our business needs and those of our customers.

Please do not hesitate to let me know if you would like to discuss any of these points. I confirm that we are content for the letter to be made available in its entirety on your web site and in your library.

Yours sincerely

Lindsay Durham
Head of Rail Strategy