

Draft Determination of Network Rail's Outputs and Funding for 2014-2019

Response from Rail Freight Group

August 2013

1. Rail Freight Group (RFG) is pleased to respond to the ORR's Draft Determination of Network Rail's Outputs and Funding for 2014 – 2019. This response may be placed on ORR's website in full.
2. RFG has responded to consultations throughout the periodic review process and this response does not seek to replicate comments already raised during the process.
3. Overall, we consider that the draft determination provides a broadly balanced and achievable outcome for the next Control Period, subject to the resolution of the remaining issues and concerns.

PR13 Process

4. The PR13 programme has been extensive, and we hope that ORR will, once it is concluded, reflect on the strengths and weaknesses of the programme. This should be concluded ahead of PR18, and the proposed work to look fundamentally at the structure of charges, expected to start early in CP5.
5. We would be happy to provide input to any such review of lessons learnt, and would expect there to be particular focus on;
 - a. Whether the scope of activities undertaken was appropriate for the resource base of the industry, and whether the timing of activities was also appropriate (for example, the late requirement for the SERCO work into variable access charges).
 - b. How the combined effect and impact of proposed changes to charges and incentives on industry sectors could have been addressed earlier, and whether this analysis could have led to more effective prioritisation.
 - c. Whether ORR could have done more to maintain confidence and reputation in the wider industry including with end customers and investors.
 - d. Network Rail's ability to provide adequate data and information on costs to support the charging proposals under debate.
6. We are pleased that ORR was ultimately able to conclude a position for charges for the freight sector for CP5 that is, broadly, balanced and affordable.

Specific Comments

Chapter 2 Background and Context

7. *Industry Reform* The establishment of the Rail Delivery Group (RDG) has clearly been an important step in delivering rail industry reform. RDG and its various sub groups have played a key role in PR13 and in establishing consensus on the conclusions in the draft determination.
8. For freight, PR13 has also highlighted the strong interest and input of the wider stakeholder community including ports, developers, suppliers and end customers. Their input to the process has been significant and important. In moving forward with industry reform it is important to ensure that these parties continue to have a voice in the debate alongside that of RDG.
9. Network Rail are increasingly developing their own relationships with freight end customers, for example, the current initiative to work together with the operators to improve performance and capacity at Immingham. This is welcome. We would also support the establishment of the ORR's proposed freight customer panel.
10. We support the principle of aligned incentives, but as has been highlighted during the PR13 process it is necessary to take a long term view of such proposals, and to be clear on the priority areas to incentivise. Based on the conclusions of the PR13 analysis, we consider that NR and the industry must now clarify the nature of freight vehicle and track design necessary to reduce costs, and establish clear and long term plans for encouraging uptake, rather than rely on five year cycles of analysis.
11. We note the fundamental review of the structure of charges which ORR and RDG will undertake. We support the principle of such a study, subject to the details of its scope and approach. It will be important that the study remit takes into account;
 - a. The envelope of affordability for the rail freight sector, and its competitive position in the market;
 - b. Cross modal freight and logistics policy, and the place of rail within that, cognisant of the non cash benefits which rail freight also delivers;
 - c. The need to grow and maintain investor and customer confidence in the sector, through long term stability in incentives, charges and the payment of rail subsidy;
 - d. The need to avoid anti competitive outcomes between different operators, ports and terminals.

Chapter 3 – Output Framework

12. *Performance* We support the output for freight performance of FDM at 92.5%, supplemented by indicators of delay minutes by strategic freight corridor. However, as this is a new metric, there needs to be close assessment of its usefulness and incentive effect. Although FDM is more closely aligned to customer requirements than delay minutes alone, it is still not an overall measure of performance as it only includes NR caused delay. Freight performance measure, as published by ORR, should be retained for that purpose.
13. We remain concerned at the suggestions (para 3.76 and elsewhere) that growth, or improvements such as higher speed, are necessarily detrimental to performance. ORR should monitor carefully to ensure that NR are not disincentivised from progressing such measures.
14. *Enhancements* We support the approach to enhancement outputs. It is vital that freight enhancements are aligned to deliver benefits across the strategic corridors, which differ from NR routes, for example, the projects which comprise the F2N upgrade at Ely, Peterborough and Leicester.
15. *Network Availability* We agree that PDI-F is imperfect, and also understand the difficulties in determining a revised approach. To that end, we support a PDI-F target that is more challenging than that for CP4.
16. Any revised approach needs to incentivise the use of aligned diversionary routes, and seek ways to encourage more use of the network for freight overnight and at weekends. 7 day availability is key for many potential customers, particularly in the domestic market, and should, if properly managed, offer a good opportunity to increase effective network capacity for freight.
17. *Network Capability* We recognise that the position with recording and managing network capability, particularly gauge, is considerably better than at previous reviews. However, we note that there are still some areas where actual capability is below what it should be. Para 3.95 states that *The baseline capability of the network will be that in place as at 1 April 2014*, but this should explicitly capture those locations where the capability is deficient at that date, and not remove the requirement on NR for reinstatement. This would be consistent with the approach at previous reviews.
18. *Asset Management* We strongly support the outputs on asset management and data quality. Although the data availability for PR13 has improved over PR08, there were still clear weaknesses in some areas (for example structures, and impacts of coal spillage). Although we recognise that from an asset management perspective, freight only infrastructure may be a lower priority for attention, the high level of scrutiny applied throughout the charges review process (for example in assessing freight avoidable costs, coal spillage charge etc.) suggests that data requirements do need to be prioritised.

19. *System Operator* We support the need to develop the system operator function and to encourage this through the output framework.
20. We note the comment on alliancing in para 3.145 '*We recognise that there is a risk that alliancing and more bespoke arrangements between Network Rail and TOCs could increase Network Rail's ability and incentive to discriminate between those with competing demands for access to the network*'. Although there is no evidence that such behaviour is occurring on the existing SWT/NR deep alliance, we share these concerns. ORR may wish to consider whether the alliancing model can be improved to prevent such hazards, and whether the legal requirement for independent infrastructure management can be met if such concerns perpetuate.
21. *Journey Time* We note the proposals to develop a journey time metric, and the link between journey time, network capacity and performance. For freight, improvements in the efficiency of freight paths (for example, time in loops, use of resources, etc.) are equally important and ORR may wish to consider how this could be incentivised.
22. *Cross Border Service Availability* We support this measure but as part of a general point on use of diversionary routes to maintain network availability for freight (see above).

Chapter 9 – Enhancements Expenditure

23. We welcome the extensive enhancements confirmed for CP5 and support the outlined approach to managing the programme, including for those schemes at an early stage of feasibility. In particular we welcome the inclusion of the Strategic Freight Network fund and the Scottish Strategic Freight Fund.
24. We agree that there is merit in encouraging early involvement by TOCs and FOCs in scheme development. We note that there is no mention of early involvement with contractors - experience of the freight projects in CP4 suggests that such approaches have yielded considerable cost savings and should also be encouraged.
25. However, we are slightly concerned that such early involvement by train operators does not encourage behaviour which is partisan to particular interests. For example, it would be easy for a passenger TOC to identify cost savings through removal of freight capability and vice versa. Given ORR's comments on alliancing in para 3.145 we would expect this to be an area for particular scrutiny, especially where commercial cost saving agreements are introduced.
26. As the feasibility work progresses, and value choices are made over scheme priorities and development, we are concerned to ensure that the resulting programme maintains the through benefits for freight. This is particularly important with enhancement works now managed on a route basis. Of particular concern are the schemes at Peterborough, Ely and Leicester which together form the basis of the capacity upgrade for freight from Felixstowe to Nuneaton. It is presently wholly unclear how they will be managed across the NR routes to

ensure that the end to end outcome is coherent. This is also relevant on Electric Spine where some aspects of the work are likely to be accelerated.

27. We support the proposals on Governance arrangements for funds. We note the proposals to include passenger representative groups on funds, and question whether this should be included for the SFN funds where the investment priorities are securing benefits for freight. This might be clarified.

Chapter 15 – Overall Incentives

28. Overall, and as above, we consider that ultimately PR13 draft determinations deliver an outcome for freight which is broadly balanced and affordable. We also note that the process for achieving that outcome could be improved.
29. As set out in paragraph 11 above, we consider that ahead of the fundamental review of charges and incentives, the scope and boundaries of the work should be defined, including the criteria listed. This is particularly important for the freight sector which is not protected through franchise contracts. ORR may also wish to consider the political impacts of different policy choices for charges and incentives and their impact on the long term stability of different parts of the rail business, and also consider how non cash benefits and value can be maximised.
30. Whilst the passenger franchise operators remain largely shielded from the impact of incentives through the franchise specification and contract, we remain concerned that incentives are not aligned and that the freight and open access passenger sectors may be unduly affected by future proposals.
31. We support the concept of aligning incentives to help reduce NR's costs. This should also be extended to incentivising NR to help reduce costs for operators e.g. through designing track that is cheaper to maintain for heavy freight, and helping to improve FOC efficiencies. Incentives which help operators increase revenues should also be considered, particularly if the long term direction is for charges to increase.

Chapter 16 – Access Charges

32. The work on setting access charges has dominated the PR13 debate for freight and our previous consultation responses outline the key concerns and issues that have been debated. Overall, we consider that the draft conclusions represent a broadly balanced and affordable position for CP5. However, the underlying research continues to raise issues of principle to be considered in the fundamental review.
33. Although we recognise the need to improve rail's value for money, the rhetoric around the subsidy of freight services needs to be considered against the value of rail freight, the modal comparison, political imperative and the overall subsidy case for the rail network. For example, the statistic in the key messages, and elsewhere, that rail has covered less than 30% of the costs it incurs has gained

some popularity, although the LEK analysis, from which it is derived, actually shows the proportion to be higher than this in the majority of scenarios (a range of 27-50%, with only 1 of 6 scenarios below 30%). Although this is a detail in many respects, the overall message remains unhelpful when presented outwith the broader context. The legal framework for freight charges remains relevant.

34. *Variable Usage Charge* We have set out our comments over the calculation of VUC and the SERCO analysis in previous responses. We remain concerned to ensure that development work continues and that further analysis of (e.g.) the VTISM work continues to be progressed. We note with concern the comments in 16.47 regarding the difference between the VUC as calculated by incremental changes and that calculated through total removal of traffic, and the apparent conclusion that the latter is 'accurate' particularly as VTISM was designed to assess incremental costs. In our view, the difference in these results has not been satisfactorily explained.
35. We are also concerned with the closing remark of that paragraph which suggests a 'trading off' of capacity charge and VUC. Whilst such pragmatic approaches are relevant in reaching a package of measures, it should not be an excuse for accepting the capacity charge in its current format.
36. Despite our concerns over the analysis, we note and support the overall draft conclusion on VUC for freight including the reduced cap and the phasing of increases and support this approach. The fundamental review of charges will need to assess how the SERCO (etc.) work can be progressed in an acceptable way for the longer term.
37. It is important that consistent and long term incentives are provided to the freight sector. As the VUC conclusions are particularly targeting increases at heavy freight, it will be important that NR and the freight industry work to mitigate the impacts on these sectors. For example, any charging framework should consider how heavily loaded services which make best use of capacity can continue to be supported.
38. *Capacity Charge* The recalibration of the capacity charge proposed for CP5 raised significant implications for freight, and we note and support the proposals in the draft determination, and in the follow up letter, to seek an solution for CP5 ahead of the more fundamental recast of the charging regime to be considered for CP6. The proposals are of course part of an overall package of freight charges for CP5 which aims to balance affordability, incentives and complexity for freight operators and their customers.
39. We recognise that the interactions between Schedule 8, the capacity charge and to some extent the volume incentive are complex and need to be considered in the round. The current arrangements are clearly imperfect, and the two proposals in the draft determination each have strengths and weaknesses. However we question whether, given the long term review for CP6, it is appropriate to seek to refine these models further now given the tight timescales ahead of the final determination.

40. It is not apparent that any of the proposed refinements would make any significant difference to the incentive effect or industry affordability yet could add additional complication and complexity to otherwise straightforward proposals, and risk perverse or unintended outcomes.
41. To that end, we would support the RFOA proposal as the basis of the capacity charge for freight in CP5. We would suggest that issues relating to new entrants – which are of potential concern – could best be addressed by ORR on a case by case basis if and when new entrants enter the market during the control period.
42. *Coal Spillage Charge* We note the conclusions on coal spillage charge. Whilst these are probably reasonable in the context of the overall conclusions, the process has highlighted a lack of data and information, a lack of clarity from NR on how they are managing the costs down, and a lack of information on the impact of investments. Overall, this suggests that this charge has been purely about cost recovery, and as such does not incentivise NR to manage coal spillage effectively with the industry. If the charge is to continue in CP6, then NR should be encouraged to be more proactive in managing spillage, and in data collection, during the CP5.
43. *Freight Only Line Charge* We note the conclusions on freight only line charges. We support the decision not to apply a FOL to biomass in CP5. With reference to the earlier discussions on asset management and data, it may be timely for NR to assess outturn costs against modelled results for freight only lines as part of that analysis.
44. *Freight Specific Charge* As noted above, the discussion on the freight specific charge has raised a number of issues which need to continue to be developed. The rhetoric around freight contribution, the legal framework and the non cash benefits also needs to be progressed.
45. Although the LEK analysis was a comprehensive study, concerns do remain over some aspects of the analysis and its presentation, as outlined elsewhere in this response.
46. With reference to para 16.239, we note that the benefits of rail freight are not only associated with modal shift to road. The discussions over the coal charges in PR13 has highlighted, for example, the role of rail freight in supporting UK businesses and jobs, even where the traffic is captive to road.
47. We support the decision not to extend the FSC to biomass traffic in CP5.
48. We note and support the work suggested in para 16.280. This should be extended to include understanding how NR can help reduce the costs to freight through its investment choices, e.g. in track design, promoting efficiency etc.

49. We would expect this work to also take into account the views of freight end customers, particularly where they are investing in their own facilities and equipment in support of rail freight.

Chapter 19 – Financial Incentives

50. We have commented previously on the REBS mechanism, and remain concerned over the resource implications for FOCs who participate in this scheme. However we note the opt outs which are available. The scheme must be closely monitored during the control period. We have no specific comments on the outstanding questions.

51. We note the discussions over exposing the franchised operators to changes in access charges, and the on-going dialogue with DfT. Although this is not a matter for freight *per se*, if franchises, which comprise over 90% of all traffic, remain insulated from any changes or incentives levied through access charges, then we question whether there is benefit in seeking to introduce more complex regimes which only apply to the freight and open access sectors. This is particularly important in considering route and capacity based charges in the future.

52. We support the approach on R&D funding.

53. We have commented previously on the Volume Incentive, and note the conclusions.

Chapter 23 – Monitoring, Enforcing and Reporting

54. *Whole Industry Scorecard* We support the proposals for reporting via a whole industry scorecard. However, it is important that the dialogue around the report is holistic. For example, different freight sector will have different trends associated with shifts in the UK and global economy, power generation trends etc. An informed commentary will help improve understanding and help drive future decisions.

Chapter 24 – Review of Wider Impacts

55. As outlined above, we consider that the process for assessing the wider and total impacts for the freight sector must be improved in future reviews. We will be interested to see the results of the ORR's freight customer survey in due course.

56. We note that this service indicates that price is the main priority for freight customers, which supports the decision on a balanced approach to freight charges.

Annex B: Decision on a Freight Specific Charge for Biomass

57. We support the decision not to apply a freight specific charge to biomass in CP5.