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Tim Griffiths
Office of Rail Regulation
1 Kemble Street
London
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Dear Tim

Freight Only Lines: Track Access Charging

This is the response of Freightliner Group Ltd (incorporating Freightliner Ltd and Freightliner Heavy Haul Ltd) to your letter dated 22nd June 2007 entitled Periodic review 2008: Charge to recover the costs of freight-only lines.

Charge to recover the costs of freight-only lines

We remain very concerned over the ability of our coal power station customers to pay a premium on track access charges. Coal-fired generation was 24% down for the first four months of 2007 compared to last year, predominantly because of low gas prices, this has demonstrated just how sensitive to price the cost of coal burn is. Coal generators will face increasing carbon costs during the next charging period, which will also affect their ability to pay increased track access charges.

We are also very aware that changes in coal track access charges could dis-proportionately benefit or dis-benefit some power stations and loading points over others and that any increases in track access charges could distort the market.

The priority of the ORR should remain in ensuring that NR carries out the maintenance and renewal of freight only lines in an efficient manner and that the cost model reflects this. It would be helpful in giving confidence to customers if after Network Rail's October submission the range of costs for freight-only lines is reduced to a smaller range. It is very difficult for ourselves and our customers to plan based on the current wide range, although we acknowledge this is better than having no range at all.

Ultimately both ourselves and our customers are only concerned with the total freight access charges that we will have to pay, whether they be variable charges, coal spillage, capacity charges or freight only line costs and we urge the ORR to reduce the range for all these elements as soon as possible to give both freight operators and customers confidence to invest in a future of using rail freight.

Cost Allocation

We support the allocation of costs across the FOLs under the bespoke allocation mechanism as we agree with the ORR that this should provide the most accurate costs at a granular level. Furthermore, we welcome the inherent pressure this exerts on Network Rail to minimise costs and the transparency and comparative nature of this approach.

We would endorse the train length then train-km metric as the best metric for allocating the FOL costs across the market segments.

Charging Mechanism

It is very difficult at this stage without knowing the total cost of freight only lines or whether other elements of the cost base such as variable charges and coal spillage charges are going to go up or down to assess which method of charging will be most suitable. The affect on the whole market needs to be taken into account when all these elements are firmed up. For this reason we suggest that ORR do not make a decision about charging method at this stage. Taking into account this view we write below with our initial thoughts.

We urge the ORR to stand back from the detail and consider what you are trying to achieve in the charging of freight only lines. These are fixed costs, which reflect the provision of the infrastructure, not the damage caused by varying levels of use. Any charging methodology should reflect actual costs as accurately as possible and must be administratively simple. Any opportunity should be taken with the charging methodology of freight costs to encourage efficient use of network capacity provided, including freight only lines (FOLs).

Logically charges should fall where the costs occur but care should be taken that through these charges one loading point or power station does not gain advantage over another simply because through history where their location is situated. If charges fall on one location and not another traffic could transfer between locations leading to closures on some freight only lines. If closures were to occur the policy applied by the ORR, this would demonstrate charges would not have been in line with EU2001/14, which only allows these charges where the market can bear the cost.

We do have concerns regarding the suggested charging mechanism for FOL's costs. The three options outlined each carry significant disadvantages or are not suitable for the purpose of charging FOL costs. Implicitly each of the options each favour some power stations or loading points over others just by dint of whether their location is near a main line or at the end of a freight only line.

At this stage when the overall costs of freight track access charges are unknown it is difficult to assess which option is most suitable and which will distort the market less, and therefore we suggest that ORR does not make a decision with regard to the allocating of charges until it is known whether other charges will go up or down. Significantly we do not know at his stage whether variable charges will increase or decrease. If the ORR concludes

that a considerable decrease in variable charges is appropriate it will soften the blow of customers having to pay additionally for FOLs. If overall charges increase there will be extreme sensitivity amongst our customers about who is hit most by any increases and the subsequent distortions to the current market position.

Option 1 suggests a fixed charge, charged to user via kGTM, which would most accurately represent and recover the costs incurred by Network Rail. This would clearly hand a price advantage to those power stations and loading points who are not connected to the network via a freight only line and penalise a coal customer if their power plant, for example, was at the end of line that had a significant number of bridges, tunnels etc. This could lead to some consolidation of loading points and power stations. The application of this method would be administratively overly burdensome and in a fluid world of contracts being won and lost lead to disputes between NR, operators and customers.

Option 2 is a specific to individual FOLs variable charge. As per Option 1 the disadvantage of this method is the market distortion it would create between the haves and have nots. Additionally, we would suggest there is a risk of over and under recovery of costs as some power stations or loading points could close or reduce tonnages if they are unable to compete with others. Finally, we see the billing system required to accurately charge this method as being very complex.

Option 3, ORR's preferred method, is a blanket uplift on all of the affected market segment's variable track access charge. We question the validity of this in its purpose of recovering the FOL costs, these are fixed costs which are not variable by use. Such an uplift on tonne miles will result in long distance movements subsidising short distance movements and we suggest that ORR thinks very carefully about the consequential distortion to the market that could incur. Another possible variation on this charge could be an **Option 4**, this is a variable charge across the whole network but to be charged on tonnes moved rather than tonne miles. Short and long distance coal movements use on average the same number of miles of freight only lines, as they are by their nature only at the loading point end or at the power station end of a journey, not in the middle of a route. However this is still fundamentally a variable charge to collect a fixed cost.

We sympathise with ORR and understand the trickiness of finding a suitable charging mechanism that will not distort the market.

We urge that ORR also strongly consider an **Option 5**, which is more reflective of fixed costs and the provision of lines and capacity. This would be to charge the costs of FOLs by path/access right (possibly 50% on each element so as to not cause any distortions). This would be particularly appropriate if the ORR decides not to go down the line of reservation charges. This method of allocation would of course have the added benefit of incentivising the efficient use of the Network.

However as stated above we suggest that ORR do not decide at this stage but consult the coal industry again once the overall position on charges is clearer including freight only line charges. The lower overall charges and FOL charges are the less controversial or distorting any particular mechanism would be.

We are unhappy with Network Rail's position that charges for FOLs should be used to encourage freight traffic to optimise the length of their routes. Network Rail recover the marginal costs of freight on its network whatever the route and should not use an unrelated charge to try and distort the market. In any event a shorter route may be nearer capacity than a longer route. A charging methodology based on paths held and access rights actually creates a far better incentive for efficient use of the Network.

Finally, we would stress that the key to all this is ORR's confidence in Network Rail's ability to accurately identify and allocated costs and ORR's ability to challenge Network Rail on attributed FOL costs.

I can confirm that we are content for the letter to be made available on your web site and library.

Yours sincerely

Lindsay Durham
Head of Rail Strategy
Freightliner Group Limited