

RESPONSE TO NETWORK RAIL OCTOBER 2007 STRATEGIC BUSINESS PLAN

INTRODUCTION

Overall Freightliner is pleased with the Strategic Business Plan (SBP) produced by Network Rail. It is exciting that the industry is now looking forward to how we can deal with growth rather than simply providing the bare minimum service.

Freightliner is only able to respond in summary to the SBP, particularly within the 5-week response period allowed. We have found the 12,000-page document rather over-whelming and simply cannot read it all to respond to all the detail.

Where we have not included a response or comment on any particular proposal this should not be taken as acceptance or endorsement of that proposal or plan.

When we receive further information particularly with regard to the details and models behind the proposed access charges we will respond further and in more detail.

SUMMARY

Freightliner does believe that Network Rail has made considerable progress over the last few years. We feel more confident that Network Rail understands its assets and how they are looked after. There is also a more positive attitude to growth and certainly a can do attitude on medium to large investment schemes, if not smaller schemes. The introduction of the Customer Relationship Executive has improved the focus on our needs and business. We also note that Network Rail is meeting the performance, safety and efficiency targets set by ORR for the current control period, and at the same time has enabled growth. This achievement should not be under-estimated.

We have been disappointed by the trend in Network Rail delays to Freightliner trains over the last few years, which have materially worsened at a time when passenger delay minutes were reducing. So far this year we have seen some improvement in this trend (with the exception of the flooding during June and July) and we would like to see firm plans in place to ensure that improvements continue.

Access charges are real to freight operators and directly affect our bottom line and our ability to compete with road freight. We therefore take a keen interest in Network Rail efficiencies and the structure of charges. Our initial comments can be found below.

There are multiple challenges in the control period ahead; one key issue in our view undertaking a massive enhancement and renewals programme whilst keeping the railway running and trying to implement a "seven-day railway" at the same time. We are not sure that Network Rail understands how this will be achieved and are concerned that an expectation is being created that can not be delivered. Freightliner cannot accept huge disruptions to its business whilst Network Rail undertakes enhancements and renewals, if we cannot offer a consistent and reliable service to our customers they will simply choose to move goods by road.

We are concerned about the deliverability of projects by Network Rail. The West Coast Main Line upgrade project continues to fail to undertake all the planned work, this has resulted in the request for many disruptive possessions during 2008. We are particularly concerned about the deliverability of major re-signalling work planned for 2008 on this route.

Network Rail has a large peak of enhancement and renewals work during 2009-11 which is exactly the same time that construction work for the Olympics will be taking place. We would like to see the ORR and DfT assisting Network Rail to the greatest extent possible to

ensure consistent levels of work over the next control period and the future to enable Network Rail to employ and retain the skilled staff they need to implement large projects.

As a national operator we still see considerable discrepancies in how we are treated, regarding different processes and attitudes between Routes. We would like to see freight performance and cost data published by routes so that there is internal competition created to raise standards in performance and efficiency. Freightliner would also like to see more decision-making authority delegated within Network Rail. We perceive a culture of individuals in fear of making decisions and decision making by consensus- this inevitably slows processes down. Freightliner suggests that there is a pressing argument for a Head / Director of Freight to resolve this.

We note Network Rail's laid out case that it has a complex set of deliveries to achieve and cannot be pushed too far to make efficiencies as well. However we do not believe that Network Rail can really argue that it is already an efficient company. There are still many engineering practices that have not changed for decades. Changes to more efficient engineering techniques through challenging the Rule Book and investment in technology and shorter engineering access to the Network can, in our view enable considerable efficiencies.

We note that Network Rail estimates that there is a difference between the DfT SOFA and Network Rail's assumptions of £220 million per year plus £200million in increased expenditure plus £400 million to increase performance levels. It is disappointing that Network Rail have not clearly laid out where the differences are so these can be clearly understood by the rest of the industry. We are sure that the ORR will thoroughly assess all of Network Rail's costs and assumptions and we hope that this gap can be filled or at least narrowed.

We are concerned that if a way of filling this gap cannot be found the funding of schemes already committed by the DfT such as the Strategic Freight Network funding or the upgrade to the Reading area will be affected. This would mean that the benefits of these schemes such as rail freight growth and enhanced performance would not be realised.

PERFORMANCE

Freightliner would like to see improved data available on freight performance to be measured by ORR alongside passenger performance. It is essential that Network Rail staff are clearly and separately motivated by freight performance and understand why it is important that our trains are on time.

Freightliner would like to see data published on Network Rail minutes delay, service variations and cancellations. Delay minutes cannot be the only measure, as we have seen an increasing trend in cancelling of train schedules to be replaced with retimed train schedules. It is essential that these events are also monitored as otherwise the true extent of delay being caused is hidden.

We are confused by Network Rail's forecast for improvements in freight delays as the main document page 182 states that NR will improve freight performance by 16.5% whilst the Freight Strategy page 3 states a 25% improvement. We request that Network Rail clarify their position.

We note Network Rail's statement that £400 million extra over the control period is needed to increase PPM levels from 91.6% to 92.6%. This does not appear prima-facie to be good value for money and we would like the ORR to consider if this could be spent on better value for money schemes.

SEVEN-DAY RAILWAY

We support Network Rail in developing the "seven-day railway" concept. There is a huge opportunity for growth in rail freight if 24/7 access was reliably available throughout the

network, both in new markets such as the domestic intermodal market but also in existing markets such as deep-sea containers and aggregates, where increased efficiencies would enable competition with road.

We are concerned however with Network Rail's intentions to carry out more maintenance and renewals work on mid-week nights. These periods are core business times for rail freight and we cannot accept longer journey times or worsening in reliability for our services as these will effect our ability to compete with road. We are also concerned that this proposal will reduce the available capacity for growth, much of which has already been pre-assigned through the Freight RUS process.

Single line working does not create a half-capacity railway as stated by Network Rail; this is a very misleading statement by Network Rail, which we have consistently questioned. Where there are trains going in different directions single line working severely restrains capacity as trains are unable to follow each other but have to wait for the train going in the opposite direction to pass by.

We have not seen any evidence of bottom-up route plans that will enable the delivery of a seven-day railway, whilst not interrupting overnight services and we are worried by the slow progress. We are concerned that Network Rail has created an expectation to customers of what will be achieved without actually having a plan to achieve it.

Freightliner looks forward to working with Network Rail to develop solutions that will enable the seven-day railway to be delivered in manner that it beneficial for both freight and passenger operators.

We note that Network Rail have estimated that their initial assessment of the additional cost to achieve a seven-day railway is £300 million including £150 million for additional crossovers and bi-directional signalling over the control period. We believe that continuous access is the right goal to aim for but in order for it to be reached considerable investment in diversionary routes (for which no expenditure is included) will be needed and this will take some years to undertake, assuming that funding will be available.

The SBP does not state and we are unclear what the outputs would be for the £300 million additional funding.

FREIGHT GROWTH

Freightliner was very pleased by the work undertaken by Network Rail in producing the Freight RUS and we think that this document laid out for the first time predicted growth in rail freight and where the capacity gaps were which would prevent such growth. We would also like to thank Network Rail for their work in developing the schemes and the business cases for the recent DfT TIF approvals.

The Freight RUS forecasting work was undertaken about 2 years ago and in our view needs re-visiting. There have been some important developments since the publication of this documentation; notably the planning approval for new ports at Thames Gateway and Bathside Bay as well as announcements over expansions at the ports of Felixstowe and Southampton. In addition, the publication of the Eddington Report and Stern Review reports last autumn has led to an increasing realisation of the congestion-relieving and environmental benefits that increasing rail freight volumes can bring by Government and customers alike.

The Freight RUS forecasts only project to 2014/5. It would seem appropriate to now revisit these forecasts over a longer time horizon to enable planning to commence for beyond CP4.

EFFICIENCY, INPUT PRICES AND CHARGES

Efficiency and input prices - Freightliner is pleased that Network Rail have recognised that their charges have a direct impact on our business. Of course this means that we take a keen interest in understanding the efficiency levels that Network Rail are proposing.

We recognise the efficiency achievements that Network Rail is on target to deliver during CP3. However it is important to recognise these achievements in context of the overall funding of railway infrastructure not just since Hatfield, when costs massively exploded but also in terms of the long-term expenditure on railway infrastructure in the UK.

We note the bottom up approach that Network Rail has taken to assessing future achievable efficiencies. Network Rail has over CP3 made great strides to ensure that the basics of its business are in order following the takeover of Railtrack. Network Rail must now drive forward in the next 5 years introducing new working practices and technically innovative solutions in order to achieve the efficiencies required by both UK government and freight operators. We believe that in the face of such step changes it is difficult to realise the cost savings opportunities using a bottom up approach. It is therefore particularly important that the ORR assess what is achievable using a top down approach.

Overall the targets for efficiency that Network Rail is proposing are disappointing. These are the level of targets that an already efficient company might expect to achieve over a 5-year period. We do not believe that Network Rail could yet put themselves in this category as many practices have remained unchanged for several decades.

We are disappointed that Network Rail states the need to offset their efficiency targets with increases in input prices. Input price increases are a reality for all businesses. Whilst we accept that the price of metals in particular has risen over the last few years, we are less convinced that prices will continue to rise after 2009. Like all businesses we would expect Network Rail to be able to manage a basket of input prices within RPI levels.

It is unclear from Network Rail's proposals how much efficiency will be derived from which initiatives; it is therefore difficult to comment in detail.

Maintenance efficiencies - we note the considerable list of initiatives that Network Rail is undertaking in this area. It is disappointing that all of these together are only expected to deliver savings of about 10%. We would have expected such a level of savings from improved front line productivity alone over a 5-year period. Reducing time taken to take possessions must also have a big impact: if in a five hour possession half an hour can be saved this alone would improve productivity by 10%.

We note that there is no particular work stream to challenge and change Group Standards for required maintenance and inspection levels. Many of the current practices are directly linked to the laid down standards. A bottom-up assessment and challenge of the standards would seem to us to be a vital part of improving efficiency.

Renewal efficiencies - one of our biggest concerns in this area is that possession planning remains inefficient with many jobs being planned, cancelled and replanned or altered. This cannot make efficient use of resources and we know that our own resources are pushed because of considerable replanning of works. We would like to see a drive to a "plan it once, plan it right" philosophy.

We welcome the proposal by Network Rail to move to modular S&C wherever possible and the associated reduced blockade requirements. Whilst other costs may increase there must be a huge reduction in manpower required to undertake the fitting of these modular points simply by virtue of the fact that 54-hour possessions will initially be reduced to 27 hours and ultimately to 8 hours. We do not understand how this is taken account of in Network Rail's plan.

Signalling renewals- We note Network Rail's plans to introduce ERTMS on the route from the Great Eastern to Peterborough. With the committed gauge enhancement on this route

this is expected to become a major freight artery. This will be followed by the ECML and the GWML. Once a major freight route becomes ERTMS it will be necessary to fit all freight locomotives with ERTMS equipment. Freight locomotives are not constrained to one part of the country but work in diagrams all round the country primarily for maintenance purposes. In addition all freight operators must be allowed to compete with each other for new business as now, not fitting all freight locomotives would prevent such free competition. We note the expenditure that Network Rail have included on train fitment but is unclear how much of this fitment is for freight locomotives and whether this is sufficient to fit all locomotives.

STRUCTURE OF CHARGES

Due to the time constraint for responding to the SPB these are only initial opinions and we would like to comment further once more information becomes available. We have already commented in detail in our response to the ORR dated 2nd January 2007.

Variable Charges- We note that NR has included the impact of tangential forces within the variable charge. In addition we note that the inclusion of this factor, alongside a change to the split between fixed and variable costs leads to a 7% reduction in variable charges for freight, before efficiency is taken into account.

The table of costs for individual wagon types has been supplied to us but without any transparency on how the charges are made up or how they have been modelled. On evaluation of the initial information of individual wagon costs, it appears that significant anomalies exist. Freightliner notes that the charges on some wagons have increased, rather than decreased as indicated by TTCl, but we do not understand why. We expect Network Rail to be totally transparent with regard to the modelling and the inputs to the model. Once we have more information we will expect the opportunity to comment further.

Route-based charges- Freightliner is very concerned about NR's proposal to introduce route based charging. Our largest concern is that this would distort the market with road. Rail is a price taker in the majority of freight transit markets and any imbalances would directly impact the ability for rail freight to compete with road freight. If lorry road charging were to be introduced at the same time then there would be some justification for a similar system on rail. However any road based charging system would be based on congestion costs not road repair costs so it is unlikely that the two systems would have parallel incentives.

We are also concerned from an administrative point of view. In order to compete with road rail freight operators have to quote customers quickly. We would not want to be reliant on Network Rail to provide us with a quotation for track access; we are concerned that Network Rail could not provide this information quickly enough.

In addition there are concerns over the detail and how diverted trains would be dealt with on both a planned and unplanned basis. Trains are diverted for many reasons on a daily basis including in particular because of engineering work. How would this scenario be dealt with? We would not want to employ someone specifically to deal with billing queries over route charges; this would be a further distortion of our costs against road.

Freightliner does not believe that route-based charging would create any incentives for train operators as passenger trains have to pick up passengers where they live and work and freight trains are usually restricted on their route by gauge, weight, length restrictions and where the terminals are.

Overall, the introduction of route-based charging would introduce unnecessary cost and would not change train and freight operator behaviours. One alternative would be to put a weighting of route type against each wagon type depending on the predominant type of route currently used by that wagon type when setting the initial list of charges. This would have to then remain fixed for the 5-year control period to give certainty to operators.

Inevitably there would be some distortions but it would potentially improve the accuracy of the costs charged.

Freight-only line charges - We note the position of ORR and DfT with regard to payment for freight-only lines by the ESI coal market. We are pleased to have reached agreement with NR over the list of routes deemed for the purpose of the freight-only charge to be freight-only. We remain concerned by the level of costs that are still estimated to be £56,657 per track km or over £90k per track mile.

We would like to understand what assumption has been made about renewal of freight-only lines, as we are sure that many of these routes are not renewed every 35 years as implied by Network Rail's renewals cost model. Furthermore, Freightliner would like to understand how whole life renewal costs have been calculated with regards to the time value of money. Renewals scheduled towards the end of a 35-year cycle will result in Network Rail being significantly over-funded, as RPI-uptifted annual cost contributions will be collected from the charges for multiple periods. Conversely, renewals scheduled for early in the cycle, e.g. year 1 may be insufficiently financed. It is unclear whether the costs stated in the Strategic Business Plan documentation includes just direct costs or direct and related costs or even a contribution to overheads.

Capacity Charges- We remain unconvinced why capacity charges are payable for base-load traffic when Schedule 8 payments are being reset from the beginning of CP4. We understand the concept for incremental traffic over the baseline. We note that NR will write to us with a proposal for how the additional performance costs incurred by freight operators when other operator's traffic increases are proposed to be dealt with.

Electricity for traction charges

Asset Charge - We welcome the revised asset cost of £9.3m against the collected £30m per annum from the mark up on the variable charge. The method of charging the cost that, in our opinion, best reflects the purpose of the charge is pence per electrified vehicle-km. As noted the other options are insufficiently reflective or too complex. Especially the route based option that we feel is, as a general methodology, burdensome, distorting and extremely difficult to implement. We would support a network-wide charge for simplicity. Freightliner's use of the electrified rail network is essentially marginal and should therefore only pay incremental costs.

Pricing- As noted freight operators opted out of the interim solution to EC4T costs. The MLUI calculation differed between passenger and freight operators such that there was not as dramatic a reduction in cost for freight. Combined with freight's share of the CP3 recovered costs for Network Rail meant freight paid a price to import the risk of cost variability.

The longer-term solution has not been forthcoming to the freight operators from either Network Rail or ATOC and as such freight operators are nervous of what could be presented as the solution. We would urge greater transparency on this. We do not disagree with the principle behind the development of the alternative, but do have concerns over the transition to and administration of such a scheme.

We welcome the option of continuing with MLUI into CP4 but are concerned about a rebasing of cost. We would request sight of the matrix and an explanation of the structural changes in the price of electricity that warrants such a revaluation. Freight has already moved away from electrified traction due to a lack of diversionary routes and uncertainty over electricity charging models. Furthermore, freight operators have undertaken significant new investment post-privatisation in diesel locomotives. Freightliner's current use of electric traction is governed by the acceleration constraints required for interaction with passenger services within the timetable. The next phase of investment in General Electric locomotives may facilitate the removal of some or all of remaining electric locomotives off the network.

We see great difficulty in predicting the indicative price of electricity based on the factors identified and any assumptions therein could be challenged. We would request

transparency on the assumptions and relationship developed between each factor and the indicative pricing.

We would be interested to know which inflationary measure Network Rail propose using for the annual pricing increases.

Regeneration, Wash-up, Metering & Consumption- We would hope for greater analysis and support to the discounts offered for effect of regenerative brakes back into the network. Our understanding assumes that there needs to be regular and close running traffic for the regeneration to have any positive benefit as it cannot be captured but merely rejoins with a limited shelf-life.

The reason for freight's exclusion from the wash-up was on the grounds of its inability to pass on the cost to customers through pricing. This has not changed and thus we feel that our inclusion could be damaging to our competitive position with road.

The return from the installation of meters in Freightliner's electric traction fleet (Class 86s and Class 90s) is not rapid enough to justify the investment. We would however welcome a sight of the UIC model business case.

We have a keen interest in the replacement to TRATIM. We would like to be involved and offer input into the validation of the replacement's findings.

Capability- Network Rail have been flagging to us for some time their concerns regarding capability of the Network. It is therefore disappointing that we have not yet seen any clarity with regard to which routes are able to take additional costs or which ones would require additional expenditure to enable growth in traffic.

Network Rail has indicated to us that 94% of the Network is not capable of accommodating growth without additional expenditure. It is not surprising that we are therefore very worried about the implications of the measure that Network Rail are proposing introducing. If NR came up with a sensible list of routes where they considered there was a risk of inefficient renewals we would be able to have a reasoned discussion. Currently, with issues seemingly so wide spread across the network we are very seriously concerned about the implications of this proposal for our business.

Freight operators must have certainty of charges. Road operators do not have to worry about whether they will have to pay additional charges in order to traverse a new route, the tax they pay on fuel is the same whatever route they choose. Network Rail's proposals show a lack of understanding about the market in which we are operating.

We support Network Rail in managing their Network efficiently and understanding more about their own network but are very concerned that we will not be able to develop our business when we are uncertain about which routes are fit for purpose and what future charges maybe.

We do not support the introduction of contractual measures obliging us to provide advance notice of increases in tonnages. We are happy to provide this information where we know it but sometimes a new business opportunity arises very quickly and at short notice. Network Rail normally handles this very well but we are afraid that contractual provisions would get in the way of the common sense and practical approach that usually prevails now. We are also concerned that contractual measures would slow down the processes.

We do have concerns about confidentiality. We are in direct competition with other freight operators and as such do not want these competitors to find out about our business plans. We trust a small circle of Network Rail employees who directly look after our business and understand these sensitivities but do have concerns once plans for new business get spread wider within Network Rail.

We have repeatedly asked for more information about specific routes but continue to only get general proposals that we are unable to properly evaluate.

Coal Spillage- There are 2 core issues here. Firstly we have not seen any demonstration by Network Rail about the measures that are being taken to actively clean up any coal spillage from the network before the coal build-up causes point failures or seeps into the ballast. We would expect Network Rail to cost up these preventative measures rather than the reactionary costs of points failures and re-ballasting.

Secondly it is absolutely imperative that freight operators are given incentives to prevent coal spillage in the first place. Currently whichever wagons or loading equipment are used the charge is the same. A discount or zero charge must be offered where it can be demonstrated that coal spillage has been minimised or eliminated. This will enable investment to be made in equipment to brush off or capture coal.

As previously stated in responses to the ORR, the profile and type of coal wagons operating have changed significantly. Consequently we would expect that the impact of coal spillage has fallen. We do not accept that £5 million aligns with the ORR's conclusions of 2001 as tonne miles have increased by a greater proportion than tonnes moved. It is counter-intuitive to suggest an increase in miles travelled without regards to tonnage increases coal spillage. On the basis of this flawed assumption, Network Rail receives a higher charge per tonne than assumed by ORR in 2001.

CHARGING STRUCTURE- CONCLUSION

It must always be remembered that road charging is a simple tax on fuel used. The more complicated that rail freight charging is made the more difficult it will be to attract more business to rail.