HS1 Ltd – Five Year Asset Management Strategy

Response from Rail Freight Group

November 2013

1. Rail Freight Group is pleased to respond to HS1's consultation on the Five Year Asset Management Strategy. No part of this response is confidential.

2. We recognise that HS1 has done much during CP1, in conjunction with DfT and the freight operators, to enable freight traffic to successfully operate on the route. We also note that HS1's approach to this review has been open and comprehensive. Nonetheless we cannot support the conclusion of this document, which states that freight costs should rise by 450%.

3. We note that HS1 acknowledge that this will almost certainly lead to a cessation of traffic on the route, This is unacceptable and we consider that;

    a. ORR must urgently clarify its position on the application of the charging framework, and justify the differences to those elsewhere on the UK network.

    b. The freight charges should be based only on the variable element, as is the way on the Network Rail infrastructure.

    c. If avoidable costs are considered, HS1 should review the level of freight costs associated with the low traffic levels assumed and reduce them accordingly. The treatment of mothballing costs should also be considered.

    d. Alternative solutions to managing Ripple Lane should be urgently reviewed, to ensure that only efficient costs are passed on.

    e. Traffic forecasts should be discussed in more detail to produce a more balanced approach during the next five year period. An increased level should be used as the base, reflecting current proposals.

    f. In conjunction with these measures, DfT should consider options for closing any remaining gap, which might include use of the MSRS scheme.

    g. Measures should be taken to ensure stability of charges for freight traffic over the control period.

Freight on HS1

4. Whilst the majority of traffic on HS1 is passenger trains, the route has some particular advantages for rail freight. These can be summarised as;

    a. Superior loading gauge, which means that train loads can be increased by using larger sized containers. This helps to improve the price competitiveness of rail.

    b. Ability to use standard European wagons. This means that costs are reduced – as these wagons are cheaper to hire – but most critically means that the UK can link effectively into pan European rail flows without the need for additional handling.

    c. Access to Barking, which is becoming a logistics cluster for the London and South East area.

5. It is well understood that international rail freight via the Channel Tunnel has not thrived as originally anticipated, and that solutions are complex. There is no 'silver bullet' to solving this market, but measures such as EuroTunnel's ETICA scheme, the current investigation into charges, and the European Rail Freight Corridor currently being established all have the potential to improve conditions. Use of HS1 for certain traffic is part of that story.

6. It is recognised that for many flows, the conventional route from the Channel Tunnel is perfectly suitable. Indeed, the ability of freight to operate on HS1 is limited, by path availability only being offered at night, by weekday only operation and by performance regime conditions which are higher risk than those on the main UK network. The existing discounted charges for HS1 are at least double those on the Network Rail infrastructure. Nonetheless there is a market for which the benefits offered by HS1 are sufficiently high to overcome these disadvantages. The current services, and the proposed extension of these demonstrates customer interest and the potential for market growth.

7. We are therefore deeply concerned by the proposals in this consultation, the effects of which are to price freight off HS1 in its entirety. This would be an unfortunate outcome; it would further stifle cross channel rail freight and it would cause the UK to lose the effective rail links to the wider European and Asian mainland which are being established now.

8. We note the productive discussions which are already underway between the operators and HS1 to consider potential options which can drive efficiency, reduce costs and support freight services. We hope that these can be progressed ahead of the determination next year.

Legal Framework

9. We note HS1's position on the Legal Framework. We also note that HS1's interpretation of the legal framework for freight charges differs to Network Rail's on the rest of the UK network. We are unclear how ORR can justify a different interpretation of the same legal framework in two railways within the UK, and this should be clarified.

10. We note that the European Commission is to consider how directly incurred costs should be evaluated. We consider that, until this review is complete, HS1 should be treated in the same way as the remainder of the UK network in determining freight costs.

11. This means that freight charges should be based on variable charges only (OMRCA1) with avoidable costs included only where it is judged that the market can bear it.

12. We note the proposed reopeners. Whilst we understand the principle, a mechanism should also be introduced to ensure that 'businesses can plan with a reasonable degree of certainty', and that traffic which has been established on the basis of a reasonable charge should not be suddenly subject to increased charges if some other services ceases operation. Charges should be largely stable over a control period.

13. We understand that DfT do not wish to continue with the freight supplement in its current form. However, we do consider that, if appropriate charges are established, mechanisms to manage the potential for traffic volumes to fluctuate over a control period should be reasonably accommodated by HS1, in conjunction with ORR and if necessary DfT.

14. ORR should clarify how its statutory duties apply to this charges review, and how they are being balanced and applied.

Freight Costs

15. We note and welcome the reduction of CP2 costs over CP1 costs driven by renegotiations at Ripple Lane. We also note those costs which have fallen due to reduced traffic levels. However, we question whether these reductions have gone far enough, and whether the resulting costs are reasonable compared to the assumed traffic levels.

16. As outlined later, we do not fully support the assumed traffic forecasts – however we do consider that there must be a proper alignment between assumed costs and traffic levels, and if the lower level is to be used, further cost efficiency measures are required.

17. Taking each item of cost in turn;

    a. Ripple Lane costs of £350k per annum. We consider this to be excessive for the 2 return workings per week (208 trains). This is an equivalent cost of £3,365 for each return working. At this traffic level, we would expect long term renewal costs, and operating costs to be very much lower. Although we recognise that some renegotiation has been achieved, we do not yet consider this to be an efficiently incurred cost.

       We would be interested to see benchmarked costs for similar, lightly used facilities elsewhere on the UK network. We also consider that HS1 should consider other operating models for the sidings to reduce costs, for example, transferring management of the facility to Network Rail.

    b. NR(HS) costs. The £64k variable costs appear to be fairly reasonable, although as they are at least twice the level of the nationwide average we would expect ORR to validate that they are efficiently incurred.

       We understand that the £84k avoidable costs relates particularly to freight chords and loops. At the assumed traffic levels these loops are not necessary – as the two return trips per week do not operate on the same nights. As such these loops are not required to be maintained in service and the costs should be reduced accordingly.

    c. HS1 costs of £480 per train /£960 per return working appear excessive and more detail is required to justify these costs.

18. We understand that 'avoidable costs' do not necessarily all vary with traffic levels. Nonetheless, we would expect that, if HS1 are planning on only a continuation of 208 trains per year, that they would seek ways to efficiently reduce avoidable costs further over the control period.

19. We also understand that HS1 estimate that, if freight were to cease, they would incur mothballing costs of around £200k pa. As these costs will be incurred by HS1 when freight ceases, we consider this cost should be netted off the avoidable cost estimates.

20. In summary therefore, we consider that, despite the progress made, there are still several areas where we do not consider the costs to be efficient. Costs do not appear to be managed to suit the reduced traffic level, and the treatment of mothballing costs should be considered.

Traffic Forecasts

21. We note the market analysis undertaken by Oliver Wyman. As outlined above, we also note the difficulties of the cross channel market. However, over the period to 2020 we would expect to see that the impact of reduced Tunnel charges (via ETICA and potentially regulatory intervention), the European rail freight corridors and growth in pan European rail services will lead to some modest

growth.

22. Network Rail have recently concluded their Freight Market Study, as part of their Long Term Planning Process. This provides long term projections for the cross channel market under a range of scenarios, and it may be worth cross checking against the Oliver Wyman study.

23. We also note that DBS are considering options for extending their current service offering in the short term, and this should be included.

24. Even modest increases in assumed traffic volumes make a significant difference to affordability, particularly combined with improved cost assumptions as described above.

25. It is also important that a 'vicious circle' is not created where customers will not use HS1 because they are concerned over potential cost increases, which then increases charges for the remaining traffic. Mechanisms to ensure stable charges over a control period need to be established.

Specific Questions

Q1 Are there any gaps in how we have addressed the Concession Agreement requirements for the 5YAMS? If yes, please explain?

No comment.

Q2 Do you believe that the NR(HS) asset management plan assumptions are appropriate? Are there any additional assumptions required that we have not captured in this section?

No comment.

Q3 Can you please confirm that we have properly captured the output requirements for customers?

We acknowledge the work done in CP1 to develop appropriate measures for freight services as described. We are disappointed that the increased charges proposed will most likely render this useless.

The consultation makes no wider reference to the benefits to the UK of increased rail freight use, effective transport corridors or to the employment and economic effects in the Barking area, all of which will be undermined by the proposed charges. The previous investment by Network Rail under the Strategic Freight Network will also be written off. We would have expected all these points to be captured.

Q4 Do you have any comments on the appropriateness of our safety policy and approach in CP2?

No comment.

Q5 What other factors should we consider in developing our asset management plans?

No comment.

Q6 Are there any other upgrades that we should be considering for CP2?

No comment.

Q7 Do you have any comments on the appropriateness of NR(HS)'s CP2 cost plans?

No comment.

Q8 Please comment on the benchmarking work performed - and its application in the CP2 plans and usefulness in driving efficiency from CP3 onwards?

No comment.

Q9 Do you have any comments on the appropriateness of HS1's CP2 cost plans?

No comment.

Q10 Do you have any comments on the appropriateness of pass through costs in CP2? Have we properly captured the options to reduce pass through costs in the remainder of CP1 and CP2? Would you consider a rates review within the next 12 months?

No comment.

Q11 Please provide comments on the robustness of our freight cost forecasts. Are there any factors that we have not considered?

See paragraphs 15-20 above

Q12 Do you support the work we are doing on reducing traction and non-traction power costs? Are there any other opportunities which you believe we should be considering?

No comment.

Q13 Does our CP2 renewals annuity proposal of £16.5m p.a. correctly balance affordability with meeting long term asset renewal obligations?

No comment.

Q14 Do you agree with the assumptions/cost allocation in the financial model used to generate track access charges? If not, please provide an explanation.

No comment.

Q15 Do you believe that an alternative to the CP1 freight supplement is required to support the continuation of freight traffic in CP2? If so, what is the right mechanism for this support?

See paragraphs 9-14 above.

If costs can be reduced sufficiently, operators may be able to use existing MSRS mechanisms – either for intermodal or via the bespoke scheme – to close the gap. However this will not work at the currently proposed levels.

Q16 Do you agree with our proposal for each regulatory framework item?

See paragraphs 9-14 above.

Q17 Do you believe we have properly and completely identified the key risks?

The risk to freight traffic is correctly identified, however we consider that more can be done to manage, and eliminate that risk.

Q18 Overall do you believe that this 5YAMS plan when delivered is the right balance of affordability and asset stewardship and that it will support a safe, reliable and great customer experience railway?

No, the 5YAMS plan if delivered as the consultation is likely to eliminate rail freight, causing customers to revert to road transport. As such it provides no balance for freight customers.

Q19 What are the three most important issues for you within these plans?

The affordability of freight charges; their calculation, the legal framework and the impacts.