

Joe Quill
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN

10th August 2012

Dear Mr Quill,

Periodic Review 2013 – Consultation on the variable usage charge and on a freight-specific charge

I am pleased to respond to the Consultation dated May 2012 on behalf of CoalImp (the Association of UK Coal Importers).

CoalImp represents major coal users (including most of the coal-fired generators), rail companies, ports and other infrastructure operators in the coal supply chain. The nineteen members (listed in the Appendix) account for the handling, transportation and use of the majority of imported supplies into the country, and are responsible for the transportation and receipt of the majority of all coal carried on the rail network for the electricity supply industry (ESI), accounting for over a quarter of electricity produced last year in the UK.

The views set out here are the consensus views of the Association's members (excluding Network Rail) and have been approved by them for submission in this form. The interests of individual members may be affected differently by the detailed implementation of the proposals. It is therefore open to any member to make further individual representations to ORR on such detail.

In summary, CoalImp believes that these unprecedented proposals are wholly unacceptable in terms of their likely impact on the railborne coal market.

We recognise that Government is trying to reduce costs across the board, but CoalImp is concerned that the proposals contained within this consultation document will have many far reaching effects other than merely reducing Government expenditure on rail freight. A proposal that reverses the previous direction of policy on track access charges, reduces the rail freight market, and distorts that market from the status quo, will put at risk past and future investment decisions, create uncertainty about future track access reviews and put jobs at risk (both in the rail industry and in the supply chain, including mines and ports). We believe it is well outside of ORR's remit to impose changes which could have such serious impacts on the rail network, and its customers in the electricity supply industry, which is of national strategic importance.

Our principal concerns are set out below in the main body of this letter. Answers to specific consultation questions are set out in a separate section at the end. Although necessarily involving some repetition, our comments have been restated, as appropriate, under the relevant consultation question.

1. Introduction

- 1.1. In 2011 coal generation supplied 30% of the UK's electricity, and in peak times, during last winter, this level rose to well over 50%. Throughout the winter coal provided over 40% of electricity demand, and even in early Summer 2012, coal was producing a higher proportion of electricity than gas. In the first quarter of 2012, coal burn at power stations was at a higher level than any equivalent quarter since 2006 – which itself was at a higher level than any equivalent quarter since the late 1990's.
- 1.2. Coal therefore provides a vital component of UK energy supply. In recent months we have seen generators switching between fuels within their portfolio to keep generation costs down. This has resulted in fuel switching from gas to coal, and the UK consumer has benefitted as a result.
- 1.3. However, the energy market is embarking on a period of major change, largely driven by environmental and climate change objectives. Keeping the lights on during this period, and ensuring that ageing assets (including existing coal stations) do not close prematurely, before new low-carbon generation (including coal with carbon capture and storage) comes on stream, will be particularly challenging.
- 1.4. Government policies and initiatives are aimed at providing security and diversity of supply, affordability of electricity and decarbonisation of the sector. A whole series of complex initiatives is being put in place under the Electricity Market Reform (EMR) programme, now being taken forward in Parliament in the Energy Bill. This adds to other EU and UK regulation, already announced, but still to take effect. Policies and regulation which will impact coal-fired generation are summarised below:
 - The Large Combustion Plants Directive (LCPD) will lead to the closure of several coal-fired power stations by the end of 2015 at the latest, namely Cockerzie, half of Ferrybridge, Ironbridge, Didcot, Tilbury and Kingsnorth;
 - The Industrial Emissions Directive (IED) will come into effect in 2016; plant may opt in or out of the Directive or pursue a 'Transitional National Plan' approach, entailing differing consequences for operating hours, closure dates and levels of investment required on abatement equipment (principally for NO_x);
 - Carbon Price Support – essentially a carbon tax – coming into force in 2013, will make coal-fired generation less economic compared to gas;

- A Capacity Mechanism – part of the EMR programme – still has to be set out in detail, but may enable existing coal-fired plant to provide secure back-up for intermittent renewables generation;
 - The Government response to the consultation on the UK Renewables Obligation Banding Review proposals has not made decisions on biomass conversion or co-firing at coal-fired stations any easier; consequent investment decisions are likely to be finely balanced and will also be intimately connected with decisions on the host coal plant, for example on the installation of selective catalytic reduction for NO_x.
- 1.5. It is recognised that these matters are not the direct concern of ORR, but once ORR starts to base judgments on criteria such as "*what the market can bear*" they become highly relevant considerations. The last thing the electricity market needs at present is a further level of complexity and uncertainty created by these proposals.
- 1.6. Modelling a market subject to so many superimposed regulatory pressures, and dependent on so many decision points is also extremely difficult. If, as we believe (and as is set out later in this response), the NERA analysis is flawed in terms of the volumes of coal generation going forward, then the whole analysis is flawed in terms of both the costs attributable to freight, and the revenue that can be generated from freight. The market impacts on generation and freight volumes of the proposals are also clearly flawed – it is like a whole house of cards.
- 1.7. The lack of a clear, long term energy policy for many years, has resulted in a situation where stakeholders have had to take high risk, but long term, investment decisions. Further investment decisions are on hold until there is a clear economic framework that will encourage the delivery of the Government's energy objectives. Track access charges are one of a number of key cost elements that need careful and clear determination. A decision that reduces and/or distorts the rail freight market will hinder future investment decisions.

2. ORR Proposals – General Comments

- 2.1. Whilst recognising that Government is trying to reduce costs across the board, CoalImp is concerned that the proposals contained within this consultation document will have many far reaching effects other than merely reducing Government expenditure on rail freight. A proposal that reverses the previous direction of policy on track access charges, reduces the rail freight market, and distorts that market from the status quo, will put at risk past and future investment decisions, create uncertainty about future track access reviews and put jobs at risk (both in the rail industry and in the supply chain). CoalImp believes that ORR has placed a major emphasis on the funds available from Government at the expense of its duty to promote the use of the railway and to enable companies to plan their business with a degree of reasonable assurance.

- 2.2. Overall, the ORR proposals appear to add a high degree of complexity and uncertainty for the rail operators and its customers. Alternative modes of transport, including road and sea freight, do not suffer this level of complexity. The last thing industry needs in these incredibly challenging times, is increased complexity and risk to its transport decisions. We believe that these proposals would make it more difficult for parties to use rail, and may deter, or impart increased risk to future investment decisions.
- 2.3. CoalImp requests that ORR should review its proposals and revise them so that rail freight operators, customers and supply chain partners can plan their businesses with a degree of security and confidence, building on the positive progress which has been made in the rail freight sector since privatisation.

3. Legality of ORR Proposal

- 3.1. CoalImp believes that should ORR significantly increase track access charges for the ESI rail freight then there is a strong probability that ORR will be in breach of its duties. Section 4.7 sets out the statutory duties of the ORR. Section 4.8 describes how ORR assesses how it determines what the market can bear whilst having regard to its statutory duties.
- 3.2. In Chapter 6, the market analysis undertaken by NERA for ORR concludes that a four-fold increase in TA will result in a reduction of 5% in terms of tonnes lifted (CoalImp believes this analysis refers to tonnes burned, not lifted by rail). Subsequent analysis in the MDST Stage 2 Report associates this level of increase with a potential reduction of 23% in terms of tonne kilometres.
- 3.3. Since the ORR's role is to regulate the rail market, not the energy market, CoalImp believes that a 23% reduction in rail freight puts ORR in breach of its statutory duties.
- 3.4. CoalImp members are already considering the possibility of judicial review, dependent on the outcome of the consultation. Some members may also be responding individually, and in significantly more detail, on the legal aspects.

4. Investment

- 4.1. CoalImp believes that a significant increase in track access charges for CP5 would be inconsistent with, and a dramatic reverse of, past determinations.
- 4.2. In Section 4.7, the duties of ORR include "*to enable persons providing railway services to plan the future of their business with a reasonable degree of assurance*" and "*otherwise to protect the interests of users of railway services*".
- 4.3. Since 1995, whenever track access charges have been reviewed, the result from each Control Period determination has been a reduction

for ESI coal traffic. This has informed and influenced past investment decisions, in turn creating established supply patterns and related contractual structures, many of which are long-term.

- 4.4. These decisions have been made based on a "*reasonable degree of assurance*" and that assurance is put at risk in the consultation document. In this context, the proposals are unreasonable, undermining the investment decisions and contractual commitments already made, and putting at risk future investments. Such investment decisions are not only made by railway operators, but also power stations, mines, suppliers and ports.

5. Assessing what the Market can Bear

- 5.1. CoalImp is fundamentally opposed to ORR's proposed change in policy to a market segment approach, based on an assertion that ESI coal 'can bear the increase'. This unprecedented change will have a negative impact on jobs and investment in coal production, generation and freight as well as a potential negative impact on power security and energy prices at a time when these are already subject to major impacts from energy and environmental policy developments. We are also fundamentally challenging the assertion that a wholly arbitrary and subjective 10% reduction in business activity, in any given market sector, is somehow 'acceptable'. We would argue that no reduction in business activity is justifiable, if its full ramifications are not understood, and where it is based on policy decisions which could not have been reasonably anticipated and planned for.
- 5.2. The proposal is also discriminatory in its application to freight only. For it to be non-discriminatory, the ORR would need to consult that it should also be applied to the passenger rail business i.e. whether a 10% reduction in passenger numbers or revenue would be acceptable as a result of an ORR pricing decision which significantly reduced the burden of providing the passenger railway upon the taxpayer.
- 5.3. The purpose of the NERA modelling exercise was to determine whether the market could bear paying increased track access charges. Given a final conclusion that the market will shrink by 5% if access charges are increased by £10, then clearly the market cannot bear the increase without affecting the market. It is also worth highlighting again the point in 3.3 above that this 5% shrinkage is in the energy market rather than the rail market (where the effect is much greater). The rail market is almost always referred to in terms of tonne kilometres rather than tonnes, which refer to energy market effects.
- 5.4. The NERA analysis looked at the coal-fired electricity market, which at first sight appears appropriate and reasonable. In terms of impact on this market as a whole, it is probably true to say that volatility in international coal and gas prices are more significant than rail track access charges. However, for any set of coal and gas prices the determination of which stations run and which mines, ports and supply routes are used is far more finely balanced and is highly dependent on

the rail charges. This level of analysis is quite explicitly overlooked by NERA, although it is the subject of the subsequent MDST Stage 2 Report.

- 5.5. Any assessment of what the market can bear is extremely subjective. Whilst an overall percentage-based approach may appear to show modest impacts, however the costs were to be recovered would create market distortions and winners/losers. In some circumstances this could lead to significant closures, job losses and stranded assets. Industry margins are already tight, and the notion that these costs can be absorbed is not credible. Also, the proposed 10% test of price elasticity and market impact is exercised at the national i.e. GB level – but that is also arbitrary, and masks the potentially devastating impact at the regional e.g. Scottish or Welsh level. If, for example, the Scottish market, which accounts for some 30% of GB coal production, were considered a sub-sector within its own right, then clearly the implications could be much more serious, as illustrated in the MDST Stage 2 analysis.
- 5.6. We note that the MDST Stage 2 Report concludes that an increase of £10 will result in a national decrease in railfreight of 23%, and that there will be dramatic regional fluctuations. For example Ayrshire mines will lose 24% of their market even if they reduce their gate price of the coal by £2.50/tonne, and Hunterston would see a drop in business of 41% even after reducing its port charges by £2.20/tonne. Should these supply points be unable to absorb any of the proposed increase in charges, then obviously such geographic market impacts would be even greater. All the MDST Stage 2 analysis demonstrates that the market cannot bear the modelled increases of £5, £10 or £15 per thousand net tonne km.
- 5.7. At present there are eighteen coal plants on the system (including those partially or wholly converted/converting to biomass). On this basis a 10% impact is equivalent to almost two stations together with all the associated jobs and investments. Asserting to those workers or holders of stranded assets that this was simply something 'the market can bear' would not seem acceptable. The same considerations apply in terms of marginal ports, opencast sites and rail routes.
- 5.8. The indigenous coal producers¹ are already facing stiff challenges in a market of uncertain future and are vulnerable to major fluctuations in the world coal price which indeed has reduced by some 30% over the last year or so . At least three of the UK's coal producers have recently made announcements concerning their trading and mining difficulties. The idea that UK coal mining companies will be able to absorb increased track access costs would appear highly unlikely.
- 5.9. In terms of quantifiable impacts, for example, the loss of two power stations could lead to around several hundred direct job losses with a similar number of indirect jobs affected. On the mining side, job losses

¹ CoalImp members include some indigenous producers, but doubtless Coalpro will be responding in greater detail on this matter.

could again be several hundred. Stranded assets could run to hundreds of millions of pounds, with further tens of millions in cancelled projects.

5.10. Similarly the three UK rail freight companies that operate in the market of hauling coal for electricity generation are facing difficult times as an analysis of recent published accounts would demonstrate. These trading difficulties persist despite the fact that since privatisation these companies have delivered significant investment whilst dramatically improving efficiencies (a fact acknowledged in the McNulty report). Any alteration in track access charges that leads to a reduction in the size of the market for rail freight will have far-reaching consequences for the rail freight operators and any thought that they can absorb increases in track access charges appears ill conceived.

5.11. Section 4.4.2 of the NERA report states "An indirect but more far-reaching impact on rail industry investment might occur if increases in track access charges lead to changes in the nature of competition between FOC's." This appears to imply the real prospect of a freight operating company (FOC) withdrawing from the market. This would clearly question whether the market can stand such an increase if the result of that increase would cause such a 'far-reaching impact'.

5.12. Coalimp estimates that a 25% decrease in the rail freight market for the movement of ESI coal (as modelled resultant from a £10 increase) will leave stranded investment of around £100m of rail assets.

5.13. A reduced coal/bulk rail freight market, resulting from these proposals, will not be able to meet the challenge of a future, in which existing coal stations are co-firing or converted to run on biomass, with the increased rail capacity will inevitably required (recognising the significantly lower calorific value and lower bulk density of biomass compared to coal). Targeting ESI coal now could mean that the freight market cannot meet Government aspirations on biomass in the future.

6. Geographically Based Charges

6.1. CoalImp does not understand the benefits expected from any introduction of geographically based charging. CoalImp believes such a proposal would increase risk to rail freight decisions and distort the market (recognising there may even be winners as well as losers in any such proposal). Such a proposal would add yet another degree of complexity and uncertainty to the use of rail freight, a complexity that road haulage does not face.

7. Comments on Market Analysis

7.1. CoalImp has major concerns about the conclusions that ORR draws from various works of analysis into the rail freight market, and especially into the market of rail haulage of coal for the electricity supply industry. Comments on the NERA report have already been submitted to ORR, but are included for completeness in the answer to question 6.83 below.

- 7.2. The MDST Stage 2 Report was published after the consultation document, and is referenced several times in this response, as it amply illustrates CoalImp's concerns. Analysis of this nature is necessarily something of a 'blunt instrument' as the modelling can never fully reflect the complexities of the market. In the case of the MDST Stage 2 Report, the quality considerations which can drive supply patterns are not considered (e.g. sulphur and NOx); nor are the influences of long-term contracts for supply, port capacity or haulage taken into account. The constraints as to which size of vessel can be handled at which port are also ignored.
- 7.3. Probably the most significant flaw in the MDST analysis is the assumption that mine outputs are elastic, but the fact that they generally are not, makes the consequences of the modelling output even more draconian. Mines generally have to operate as close to their maximum capacity as they are able, to remain viable. A 24% loss in market for Ayrshire opencast mines could simply not be absorbed; equally it would not be practical for English deep mines to ramp up output to capture market share lost by Scottish mines, as suggested by the report; either the market would shrink or UK output would be replaced by more imports.
- 7.4. Despite these flaws, Coalimp believes that the MDST Stage 2 Report well illustrates CoalImp's concerns. Conclusions that entail a 24% loss in business for one of the UK's principle coal-producing regions, or a major port having to *"drop out of the English power station market as the impact of such a drop (in charges) would exceed its current revenues"* are simply breathtaking.
- 7.5. In both the NERA and MDST reports the almost casual references to biomass (especially about subsidies) and the future investment decisions of generators (and others) appear to be highly subjective, with little demonstrative evidence to support the statements. The implication by NERA that DECC may pay more subsidies to cover increased TACs is naïve, especially when considering that the recent DECC announcement on ROC's has resulted in a reduced level of subsidy to those indicated during the consultation process. The reduced co-firing ROC level makes biomass investment decisions even more marginal, and uncertainty over track access charges for biomass could be final straw. The use of 2011 biomass burn capabilities to justify a statement that *'biomass usually makes up only a small proportion of fuel burned'* is extraordinary, when the study relates to the post April 2014 Track Access regime. The impact of the ROC banding review and the potential major increase in co-firing or full conversion has major implications for port and rail capacities and future investment decisions. Regulatory uncertainty on track access charges for biomass will undermine Government energy and climate change objectives.

8. Conclusions

- 8.1. In 2011 coal generation supplied 30% of the UK's electricity, and in peak times, during last winter, this level rose to well over 50%. However, the energy market is embarking on a period of major change, largely driven by environmental and climate change objectives. Keeping the lights on during this period, and ensuring that ageing assets do not close prematurely, before new low-carbon generation comes on stream, will be particularly challenging. A whole series of complex initiatives is being put in place under the Electricity Market Reform (EMR) programme, now being taken forward in Parliament in the Energy Bill. This adds to other EU and UK regulation, already announced, but still to take effect.
- 8.2. It is recognised that these matters are not the direct concern of ORR, but once ORR starts to base judgments on criteria such as "what the market can bear" they become highly relevant considerations. The last thing the electricity market needs at present is a further level of complexity and uncertainty created by these proposals. Proposals that reverse the previous direction of policy on track access charges, reduce the rail freight market, and distort that market from the status quo, will put at risk past and future investment decisions, create uncertainty about future track access reviews and put jobs at risk, both in the rail industry and in the supply chain. Also, regulatory uncertainty on track access charges for biomass will undermine Government energy and climate change objectives.
- 8.3. CoalImp is fundamentally opposed to ORR's proposed change in policy to a market segment approach, based on an assertion that ESI coal 'can bear the increase'. This unprecedented change will have a negative impact on jobs and investment in coal production, generation and freight as well as a potential negative impact on power security and energy prices at a time when these are already subject to major impacts from energy and environmental policy developments. Any assessment of what the market can bear is extremely subjective. Whilst an overall percentage-based approach may appear to show modest impacts, however the costs were to be recovered would create market distortions and winners/losers. In some circumstances this could lead to significant closures, job losses and stranded assets. Industry margins are already tight, and the notion that these costs can be absorbed is not credible.
- 8.4. CoalImp requests that ORR should review its proposals and revise them so that rail freight operators, customers and supply chain partners can plan their businesses with a degree of security and confidence, building on the positive progress which has been made in the rail freight sector since privatisation.

Yours sincerely

Nigel Yaxley
Managing Director

Responses to Consultation Questions

Chapter 3 – Variable usage charge

3.60 Network Rail has already consulted on its estimates of variable costs. Do you have any further evidence, subsequent to Network Rail's consultation, that you wish to provide in relation to the process for estimating variable costs and average variable usage charges?

CoalImp is not in a position to offer a fully informed response, but notes that many of the cost elements appear to have been estimated from engineering judgement rather than from firm cost evidence. This does not fill CoalImp with confidence that such estimates are correct or valid. CoalImp is also concerned that the cost savings perceived, or targeted in past charging reviews, have been wiped out by the decision to now include costs relating to masonry under bridges.

3.61 Do you agree with our analysis, which leads to a proposed confidence interval of 15% around Network Rail's estimates of variable usage costs?

CoalImp does not understand why a 15% confidence interval is required. Surely track maintenance and renewals costs can be more accurately forecast. CoalImp notes that ORR has instructed Network Rail to undertake further analysis to determine freight avoidable costs and awaits the outcome from that work. CoalImp questions whether such further detailed analysis can be undertaken in the indicated timeframe and presumes this will merely be a top-down analysis rather than a bottom-up approach that would surely be more accurate.

3.62 Do you agree with our approach to estimating an adjustment to variable usage charges for long-run cost efficiency?

If charges are to be more aligned to cost, as proposed, then CoalImp believes it is only correct that long run costs efficiencies are included, otherwise there will be an over-recovery of costs.

Chapter 4 – Framework for a freight-specific charge

4.49 Do you agree with our proposed approach to satisfying the Access and Management Regulations with respect to levying a new freight-specific charge?

Whilst recognising that Government is trying to reduce costs across the board, CoalImp is concerned that the proposals contained within this consultation document will have many far reaching effects other than merely reducing Government expenditure on rail freight. A proposal that reverses the previous direction of policy on track access charges, reduces the rail freight market, and distorts that market from the status quo, will put at risk past and future investment decisions, create uncertainty about future track access reviews and put jobs at risk (both in the rail industry and in the supply chain). CoalImp believes that ORR has placed a major emphasis on the funds available from Government at the expense of its duty to promote the use of the railway, and to enable companies to plan their business with a degree of reasonable assurance.

This would be the first time since rail privatisation that material increases in track access charges have been proposed, increasing risk to customers and supply chain players in relation to their future use of rail freight. A consistent and clearly stated interpretation of policy, and of the basis of future track access charges, is required so that industry can plan for the future with a degree of security and confidence.

4.50 Do you agree that the infrastructure costs allocated to freight operators - either for direct funding by freight operators, or explicitly subsidised by government - should be freight avoidable costs, including fixed costs, but not costs common between passengers and freight?

Coalimp is not in agreement with this principle.

Coalimp draws the attention of ORR to the comparison between road haulage infrastructure charges for freight and those of rail freight, when considering how infrastructure costs should be allocated and/or funded.

Some of the freight avoidable costs are highly subjective and theoretical, based on freight being removed from the network. We do not believe that freight should pay for any costs that are attributable to inefficient historic network infrastructure that already exists. We do not believe it is correct to consider savings that would be achieved by assuming that the network could be remodelled over a 35 year period.

Coalimp agrees that the costs of maintaining and renewing freight-only lines and Network Rail's freight staff, are real costs that are incurred. Costs that could be demonstrated as being directly saved if there was no freight, we believe are valid.

The existing charges for coal spillage and freight-only lines are directly avoidable costs and should be included in the freight avoidable cost calculation. However, we believe the charging structure should be simplified, and that the different elements of charge should be amalgamated into one overall freight specific charge for each commodity. This would aid the transparency and clarity of the charging regime.

4.51 Do you agree that we should retain our current definitions of particular categories of rail freight commodities as separate market segments?

CoalImp has no better suggestion to the ORR's segmentation of the rail freight market. However, CoalImp recognises that biomass is intrinsically linked to ESI coal, when used for co-firing for electricity generation. CoalImp believes that track access charges should not be discriminatory between market segments.

4.52 Do you believe that we have taken into account the appropriate factors in considering the efficiency of the proposed charges? Do you believe there are other factors we should take into account?

Coalimp does not believe proper efficiencies have been considered in calculating the Freight Specific Charge. Historic, inefficient infrastructure on the ground, that permits specific movements to be carried out in a

number of ways, will duplicate some charges that feed into the freight avoidable cost figure. It is not right that this duplication is replicated throughout the UK rail system and, given the short time that LEK Consulting has to produce a credible report, there is a real possibility that the data feeding into it will be incorrect and incomplete, and the output will not be justified.

4.53 Do you agree that our approach (of analysing rail freight traffic) addresses the relevant criteria, when considering to which market segments the charge should apply?

CoalImp considers that the analysis undertaken by NERA is primarily focussed on the effect of any increase on the customers of rail freight, something that is interesting but not of primary concern to ORR. The analysis undertaken by MDST is more focussed on the effect on the rail freight market, the subject of the consultation, and totally aligned to the duties of ORR, but is fundamentally flawed in its understanding of the electricity market. The NERA report, conversely, looks at the Electricity Market but is based on "no switching in coal sourcing and transport decisions as a result of changes to charges" (section 6.21) and therefore overlooks the real impact on the freight market and on individual operators. This is a fundamental flaw in the analysis if this is a base assumption of their model and puts a large question mark against the model outputs. This may explain why the modelled £5, £10 & £15 increases result in such small reductions in coal lifted and coal moved. The question of market elasticity is focused on the electricity market rather than the rail freight market, where elasticity of the market is clearly affected by the length and cost of the haulage.

4.54 Do you agree that certain market segments should be exempt from the new charge?

CoalImp believes that track access charges should not be discriminatory between market sectors. Any increase that leads to a reduction in the rail freight market is clearly more than the market can bear. Therefore any increase must be capable of being absorbed by that market, without reducing the size of that market. Any increase should also be justifiable and demonstrably apportionable to the costs of serving that rail freight market, and be compliant with UK and EU legislation.

4.55 What do you think is the most appropriate methodology for allocating costs, and what is your reasoning?

CoalImp does not support an increase that leads to a reduction in the size of the rail freight market. It believes that this places ORR in breach of its statutory duties. CoalImp equally does not support an increase or change in charging mechanism that creates a distortion in the rail freight market.

4.56 Do you consider it is appropriate to cap the new charge for particular market segments according to its impact on the associated freight traffic (in addition to a constraint relating to relevant avoidable costs)? Do you wish to propose an alternative?

Any assessment of what the market can bear is extremely subjective. Whilst an overall percentage-based approach may appear to show modest impacts, however the costs were to be recovered would create market distortions and winners/losers. In some circumstances this could lead to significant closures, job losses and stranded assets. Industry margins are already tight and the notion that these costs can be absorbed is not credible.

Also, the proposed 10% test of price elasticity and market impact is exercised at the national i.e. GB level – but that is also arbitrary, and masks the potentially devastating impact at the regional e.g. Scottish or Welsh level. If, for example, the Scottish market, which accounts for some 30% of GB coal production, were considered a sub-sector within its own right, then clearly the implications could be much more serious, as illustrated in the MDST Stage 2 analysis.

We note that the MDST Stage 2 Report concludes that an increase of £10 will result in a national decrease in railfreight of 23%, and that there will be dramatic regional fluctuations. For example, Ayrshire mines will lose 24% of their market, even if they reduce their gate price of the coal by £2.50/tonne, and Hunterston would see a drop in business of 41% even after reducing its port charges by 50p/tonne. Should these supply points be unable to absorb any of the proposed increase in charges, then obviously such geographic market impacts would be even greater. All the MDST Stage 2 analysis demonstrates that the market cannot bear the modelled increases of £5, £10 or £15 per thousand net tonne km.

4.57 What should be the unit of the new charge? Please explain your reasoning.

Whilst CoalImp does not propose a specific mechanism for future track access charges, it wishes to comment on the proposed options that ORR appears to be considering, as follows :-

- If track access charges were levied on the basis of tonnes lifted, then it would lead to an increased probability of a modal shift from rail to road. For example, if track access charges increase as proposed, there would be a significant volume of short distance haulage that would switch from rail to road. This methodology could have a more dramatic effect on opencast coals that often have a road leg to move the coal from mine to railhead, before onward transport by rail. For mid-distance rail journeys there is an increased risk that the increased track access charge will tip the balance and make it economical to leave the whole journey on road, especially within Scotland where all the indigenous coal is opencast.
- If the proposed track access charge increases were levied on the basis of tonne/kilometres, then it would significantly alter the competitive position of different players in the rail freight market for ESI coal. This would put at risk jobs and investments associated with longer distance movements, which have been established on the basis of current arrangements, whether at power stations,

mines, ports or on the railways. Investment decisions already sunk could not have reasonably anticipated these costs.

Chapter 5 – Freight avoidable costs

Do you agree with our framework for estimating freight avoidable costs? Please explain any suggested changes to the framework, including your calculations (noting that there will be further opportunities to contribute to this work as the cost estimates are refined during the periodic review, for example in relation to Network Rail’s strategic business plan).

For the reasons already stated in response to 4.52, Coalimp does not agree with the framework for estimating freight avoidable costs. At several levels it appears to be too broad in its accuracy with a real likelihood of taking too much cost into the equation.

Secondly, the inclusion of twenty one new people into Network Rail’s freight planning team should not occur, as these people have been employed to improve current network performance, and not for CP5 planning purposes.

Chapter 6 – Market Analysis

6.83 Do you have comments on our write-up, interpretation and application of the studies carried out by MDST and NERA? Is there any further evidence that you believe should be considered?

The following comments on the NERA Report (slightly amended to take account of recent developments) were submitted earlier to ORR.

Base assumptions – We have serious concerns about the base assumptions upon which the model is based. Section 3.1 shows the base case forecasts before any impact of changes in track access charges. These base case statistics appear implausible to CoalImp members who are closely involved in the market.

- Firstly, 2012 & 2013 show a step change up in coal demand compared to recent years. This has indeed occurred in the first half of 2012, but for next year a number of coal stations have already announced early closure as a result of hours being ‘used up’.
- Secondly, the step change back down, onwards from 2014, presumably reflects the impact of LCPD opt-out plant closures, the start of carbon price support and then the effect of IED legislation, but an increase in demand in years 2015, 2017 & 2019 again appears implausible (compared to previous years and compared to 2014), and does not seem to reflect the ramping up of the carbon price floor and expected increase in gas generation.
- The reference to the IED appears grossly over-simplified. The Transitional National Plan (TNP) option is not mentioned, whereas we would expect this to be the most likely route for the majority of generators.

- A coal demand of circa 40mt in 2020 simply does not look credible (and contrasts to DECC's central case projection of less than 70 TWh including coal with CCS).
- This modelled base case (before any effect of changes in track access charges) appears inconsistent with all other projections, including those of DECC. If the base case is flawed this leads us to have serious concerns about the overall accuracy of the modelling and the robustness of any ORR decisions around it.

Methodology – The “fundamentals” model used to estimate the effects on generation is accepted as probably amongst the best currently available, assuming that the base case inputs are correct (see above). However the subsequent inputs need careful consideration.

- There appears to be no appreciation or recognition of port or shipping costs that affect the delivered price of coal to the power stations. For example, the cost of delivering a cape-sized vessel of coal into Hunterston or Redcar will be significantly different to the cost of a panamax vessel into Immingham or Liverpool, or a handy-sized vessel into Hull. The cost of sea-freight and the cost of port handling (discharge, stocking & re-loading) appears to have been omitted from the analysis.
- There also appears to be no analysis of rail freight capacity (paths) on the key routes. e.g. How much additional traffic is it possible to accommodate on the route out of Immingham? How will this be further impacted by increased biomass traffic with its much lower heat content and bulk density?

Supply Patterns - Any increase in access charges will distort the supply pattern if the increase is linked to distance. So the modelling premise that *“we have assumed that the proportions of coal that each power station sources from and transports via different routes remain unchanged”* is a seriously flawed assumption. This fact is then recognised in later parts with comments about shorter routes being favoured over longer distance routes. It is not clear how these conflicts are dealt with in the model.

Scottish Coal Producers – There is speculation that some of the potential track access charges can be absorbed by coal producers, specifically in Scotland. There does not appear to have been any analysis of the profitability of the various Scottish mining companies (or English coal producers). We believe this is essential before any conclusions can be reached. The *“expectation that the greater part of Scottish opencast production will continue to be sold in Scotland”* appears implausible given the closure of Cockszie and the uncertainty around the future of Longannet with respect to the IED.

Impact of FOC's – There is interesting comment about the potential impact on FOC's. Section 4.4.2 speculates about the possibility of some of the increases being absorbed by FOC's, but (as per the UK mining company comment in point 4) analysis of the profitability of FOC's would

deem this highly unlikely. The report then comments that "*An indirect but more far-reaching impact on rail industry investment might occur if increases in track access charges lead to changes in the nature of competition between FOC's.*" This appears to infer the real prospect of a FOC(s) withdrawing from the market. This would clearly question whether the market can stand such an increase if the result of that increase would cause such a 'far-reaching impact'. The analysis undertaken is purely subjective and, given the conclusions stated, it is clear that further work is needed to fully understand the possible impacts.

Biomass – The almost casual references to biomass (especially about subsidies) and the future investment decisions of generators (and others) appear to be highly subjective, with little demonstrative evidence to support the statements. The implication that DECC may pay more subsidies to cover increased TACs seems naïve, especially when considering that the recent DECC announcement on ROC's has resulted in a reduced level of subsidy to those indicated during the consultation process. The use of 2011 biomass burn capabilities to justify a statement that '*biomass usually makes up only a small proportion of fuel burned*' is extraordinary, when the study relates to the post April 2014 Track Access regime. The impact of the ROC banding review and the potential major increase in co-firing or full conversion has major implications for port and rail capacities and future investment decisions.

6.84 Do you agree with our proposal, on the basis of MDST's analysis, to not levy a mark-up on certain rail freight commodities, including intermodal, construction materials and metals?

It is not for CoalImp to support increased charges for other commodities, whatever the outcome for coal. However, CoalImp is concerned that any variation in the charging of different market segments of rail freight could be deemed discriminatory and potentially in breach of EU legislation.

6.85 Do you agree with our proposal to levy the proposed charge on ESI coal traffic?

CoalImp is fundamentally opposed to ORR's proposed change in policy to a market segment approach, based on an assertion that ESI coal 'can bear the increase'. This unprecedented change will have a negative impact on jobs and investment in coal production, generation and freight as well as a potential negative impact on power security and energy prices at a time when these are already subject to major impacts from energy and environmental policy developments. We are also fundamentally challenging the assertion that a wholly arbitrary and subjective 10% reduction in business activity, in any given market sector, is somehow "acceptable". We would argue that no reduction in business activity is justifiable, if its full ramifications are not understood, and where it is based on policy decisions which could not have been reasonably anticipated and planned for.

The proposal is also discriminatory in its application to freight only. For it to be non-discriminatory, the ORR would need to consult that it should

also be applied to the passenger rail business i.e. whether a 10% reduction in passenger numbers or revenue would be acceptable as a result of an ORR pricing decision which significantly reduced the burden of providing the passenger railway upon the taxpayer.

6.86 Do you agree with our proposal to levy the proposed charge on spent nuclear fuel traffic?

It is not for CoalImp to support increased charges for other commodities, and CoalImp is concerned about the potential discriminatory effect of such charges.

6.87 What views do you have on our analysis of the iron ore market segment? Do you consider that there is also a case for levying the proposed charge on iron ore?

It is not for CoalImp to support increased charges for other commodities, and CoalImp is concerned about the potential discriminatory effect of such charges.

6.88 Do you agree that we should revisit our policy on levying a charge for the biomass market segment to coincide with the recalculation of its credit (subsidy) regime (from 2017 for England and Wales)?

Although biomass traffic is not strictly within CoalImp's purview, CoalImp membership includes many of the key players in this market both now and in the future. Whether at ports, on the railways, or at power stations, biomass traffic for co-firing will be intimately associated with coal traffic. Biomass Investment decisions associated with biomass co-firing will be taken in conjunction with decisions on the future of the coal infrastructure and capacity on which it depends.

Simply deferring the decision on biomass charging adds further uncertainty to the investment case at ports and on the railways as well as at power stations. The reduced co-firing ROC level makes biomass investment decisions even more marginal, and uncertainty over track access charges for biomass could be the final straw. This investment is required to deliver the Government's strategy of supporting co-firing of biomass, as part of the decarbonisation of the electricity market. Regulatory uncertainty on track access charges for biomass will undermine Government energy and climate change objectives.

6.89 Do you consider that the proposed charge should be levied on other (non ESI) coal flows?

CoalImp's opposition to the proposed charge applies equally to other (non ESI) coal flows. Any analysis of these other sectors would doubtless demonstrate that they would be at even greater risk from increased charges than ESI coal.

CoalImp Membership

Associated British Ports

Clydeport

DB Schenker

Drax Power

EDF Energy

E.ON Energy Trading

Fergusson Group

Freightliner Heavy Haul

GB Railfreight

Hargreaves Services

International Power

Network Rail *

Oxbow Coal

Port of Tyne Authority

Rio Tinto Alcan

Rudrum Holdings

Scottish Coal

Scottish Power Energy Management

SSE Energy Supply

* Network Rail has stood aside from participating in the discussions and processes leading to this response, and its views are not represented.