

Mr Tim Griffiths
Senior Economist
Office of Rail Regulation
One Kemble Street
London WC2B 4AN

17th August 2007

Dear Mr Griffiths,

Periodic Review 2008: Charge to recover the costs of freight-only lines

1. I am pleased to respond to your letter of 22nd June 2007 ('Consultation Document') on behalf of CoalImp (the Association of UK Coal Importers).
2. 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 twenty two members (listed in the Appendix) account for the handling, transportation and use of the majority of imported supplies into the country, in turn accounting for over a quarter of electricity produced last year.
3. Members are responsible for the despatch, transportation and receipt of the majority of ESI coal carried on the rail network.
4. 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

The principle of charging for costs of freight-only lines on ESI coal

5. CoalImp is opposed to the principle of charging costs of freight-only lines on ESI¹ coal traffic, set out in the 'Advice to Ministers'² document. This advice has been based on ORR's view that the ESI coal freight market 'can bear this cost', a view which CoalImp believes is flawed.
 - 5.1. The market for electricity generation is extremely sensitive to price signals, especially between the coal and gas sectors. Levels of burn react rapidly to changes in coal, gas and carbon commodity prices combined with transport charges.

¹ Electricity Supply Industry

² <http://www.rail-reg.gov.uk/upload/pdf/316.pdf>

- 5.2. The potential of power station burn switching from coal to gas was illustrated in the first four months of 2007 where coal burn was 24% lower than the same period in 2006, and gas burn was 46% higher.³ ORR's own figures published in the National Rail Trends Yearbook 2006-2007 show coal freight lifted in the first quarter of 2007 to be 11% lower than a year earlier.⁴ There is likely to be a lag in the effect of reduced burn on freight forwarding as stocks are rebalanced.
- 5.3. Whereas proposed changes in track access charges are of a lower order of magnitude than some of the volatilities seen in commodity prices, at the margin they can determine whether a power station burns or is idle, or whether one rail despatch point is chosen over another. An increase in transport costs feeds through to the 'make or buy' decision and inevitably increases the number of half hours in which coal is more expensive than gas.
- 5.4. It would not be in the interests of CoalImp members to see freight-only line charges applied across further market sectors. However, the reasoning which distinguished ESI traffic, in terms of its ability to bear these costs, vis-à-vis other sectors is not clear and transparent. Using the same criteria for other sectors, that have been used to assess ESI coal's ability to pay, would seem to indicate that ESI coal (and spent nuclear fuel) is not unique and indeed on many routes is less able to pay than other freight.
6. Whatever the system for allocation and charging of freight-only line costs, these charges are discriminatory and will distort the market, both between coal and other forms of generation and between individual businesses involved in the ESI coal market.
- 6.1. CoalImp is concerned that ORR's main concern may have been potential effects on railfreight operators and on the overall size of the coal freight market.
- 6.2. Whilst not underestimating the effect on rail companies, not least in assessing business cases for investment, a more immediate effect is likely to be seen by those despatching and receiving rail traffic. Businesses have based investment decisions on the current relativities of freight charges, and any distortion of these relativities could have a significant impact on their competitive position.
- 6.3. The work carried out by NERA for ORR, on the effect of a new charge on ESI demand for coal⁵, shows reductions in the total ESI coal market between 0.3% and 1.6% for different scenarios. However, the potential for distortion is indicated by effects on individual power stations between -13% and +7%. This is broadly consistent with results of modelling carried out by members. The effects on despatch points appear not to have been modelled, but are likely to be greater.

³ http://stats.berr.gov.uk/energystats/et5_3.xls

⁴ <http://www.rail-reg.gov.uk/upload/pdf/330.pdf>

⁵ Revised NERA report - <http://www.rail-reg.gov.uk/upload/pdf/pr08-nera-esicoal-jun07.pdf> ; table of individual power plant impacts - <http://www.rail-reg.gov.uk/upload/pdf/pr08-nera-esicoal-add-040607.pdf>

The range of freight variable usage charges and caps

7. Whilst this consultation is concerned with matters of principle, businesses' views on these matters are inevitably conditioned by the materiality of the charges. Members' concerns about charges for freight-only lines would be mitigated if there was a significant reduction in the overall level of track access charges.
 - 7.1. All of the figures quoted by ORR, both for the freight variable usage charge and the freight-only line charge, are lacking in transparency, and the ranges are so wide (£41 million to £99 million per year for the freight variable usage charge) as to cast further doubt on the reliability of the numbers. There should be scope for significant reductions in costs if best practices were used.
 - 7.2. The combined effect of evidence supplied by EWS Railway would support a reduction of access charges by between 40 and 60% from the current level.⁶ It is of concern that this consultation closes before the release of the Network Rail strategic business plan which will, inter alia, include the company's response to the EWS studies.
8. Network Rail should be pressured to produce more firm costs, and also commit to efficiencies and hence lower costs. This would enable the market to plan business accordingly, in the best interests of ESI coal and freight on rail.

Maximum charges to recover the costs of freight-only lines

9. Similar arguments apply to the range and magnitude of charges for freight only lines. Modelling work carried out by EWS Railway suggests that costs could be less than half of the £13.9 million quoted.
10. When assessing the potential charges, it needs to be taken into account that residual liabilities for closed routes lie with Network Rail (i.e. they have to maintain the structures - embankments, tunnels, bridges, culverts etc - in perpetuity, unless the land is sold.)
11. As freight is supposed only to pay incremental costs, and with such ongoing structure costs not being incremental with freight use, they should, therefore, be excluded from the charges.

⁶ EWS submission to the consultation on caps for freight track access charges - <http://www.rail-reg.gov.uk/upload/pdf/310-EWS-290107.pdf>

Systems for allocating costs for freight-only lines

12. The Consultation Document sets out criteria for assessing systems for allocating costs and setting charges for freight-only lines (paragraph 16). This includes a charging aim '*not to discriminate between users of the network*'. CoalImp believes that the levying of these charges on the ESI coal sector inevitably causes market distortion and discrimination between users when compared to the status quo, and its opposition to the principle is set out above.
- 12.1. Given that these charges are implemented, however, CoalImp wishes to ensure that the charging aim '*to be practical, cost-effective and fair*' is met, through a system which is the 'least of a number of evils' and causes minimum discrimination between users.
- 12.2. This criterion can partly be met by ensuring all charges are as low as possible, and ORR should bear this in mind when deciding on the final level of freight charges. Whilst reserving its position on the principle of charging for freight-only lines, CoalImp has the following comments on the proposed allocation and charging methods.
13. The system for allocating costs of freight-only lines (based on modelled line by line costs spread using train kilometres) proposed by ORR, is considered the fairest method. This mechanism supports the principle that fixed costs are to pay for the provision of the infrastructure, not the damage/wear caused by individual trains (this is the same as the passenger regime).

Charging system for freight-only line costs

14. The commercial interests of individual CoalImp members are differently affected depending on which charging mechanism is adopted. (However, it should be stated that members who are generators do not necessarily have the information to assess whether individually they would suffer more or less from a particular charging mechanism.) Our response on this topic is strongly conditioned by the out-turn level of total charges – an arrangement that causes any individual flows to bear higher track access charges than at present would not be acceptable.
- 14.1. Taking account of the comments above, there is a consensus amongst members that the fairest system or ‘least of a number of evils’ is to spread the charges by adding an amount to the variable charge across the network, as proposed by ORR. This appears to be the least discriminatory method and would avoid the significant distortions that would occur by applying fixed charges on a line-by-line basis. It is also the simplest method to implement.
- 14.2. The above allocation and charging mechanisms coupled with a reduction in standard variable costs (gained from Network Rail efficiency improvements) could lead to a rate similar or less than today.
- 14.3. CoalImp fears that a system of charging which allocates freight only costs to specific despatch points and power stations could have unintended consequences, such as the transfer of traffic to other routes, resulting in congestion and other disbenefits to other users.
15. CoalImp supports the principle set out in paragraph 38 of the Consultation Document that *‘Network Rail takes the risk of under-recovering their costs’* with respect to traffic forecasts. We therefore support the use of the upper end of ESI coal demand predictions, as proposed by ORR.

Review of track access charges during the control period

16. CoalImp has strong concerns about freight-only line charges being fixed for five years. Any substantial change should lead to recalculation of freight-only costs – e.g. if a freight-only line closes or if a passenger service is reinstated on a current freight only line. Resultant savings should be returned to operators through an interim review process, by means of a reduction of the variable charge, not all retained by Network Rail. CoalImp invites ORR to consider how such a review might operate and would be happy to engage in discussions on the subject.
- 16.1. Network Rail should also be required to show that the costs accrued are being utilised on maintenance/renewal of the infrastructure for which they are being charged.

Conclusions

17. CoalImp is opposed to the principle of charging costs of freight-only lines on ESI coal traffic. This has been based on ORR's view that the ESI coal freight market 'can bear this cost', a view which CoalImp believes is flawed.
18. Whatever the system for allocation and charging of freight-only line costs, these charges are discriminatory and will distort the market, both between coal and other forms of generation and between individual businesses involved in the ESI coal market.
19. Whilst this consultation is concerned with matters of principle, businesses' views on these matters are inevitably conditioned by the materiality of the charges. Members' concerns about charges for freight-only lines would be mitigated if there was a significant reduction in the overall level of track access charges.
 - 19.1. The combined effect of evidence supplied by EWS Railway would support a reduction of access charges by between 40 and 60% from the current level. Similar arguments apply to the range and magnitude of charges for freight only lines. Modelling work carried out by EWS Railway on freight-only lines suggests that costs could be less than half of the £13.9 million quoted.
20. Whilst reserving its position on the principle of charging for freight-only lines, CoalImp has the following comments on the proposed allocation and charging methods.
 - 20.1. The system for allocating costs of freight-only lines, based on modelled line by line costs spread using trains per kilometre, proposed by ORR, is considered the fairest method.
 - 20.2. An arrangement that causes any individual flows to bear higher track access charges than at present would not be acceptable. Provided this outcome is avoided, the fairest system or 'least of a number of evils' is to spread the charges by adding an amount the variable charge across the network, as proposed by ORR. This is the least discriminatory method, the simplest method to implement and the least likely to distort the coal supply market.
 - 20.3. CoalImp has strong concerns about freight-only line charges being fixed for five years. Any substantial change should lead to recalculation of freight-only costs. Resultant savings should be returned to operators through an interim review process, by means of a reduction of the variable charge, not all retained by Network Rail. CoalImp invites ORR to consider how such a review might operate and would be happy to engage in discussions on the subject.

Yours sincerely

Nigel Yaxley
Managing Director

CoalImp Membership

[Alcan Smelting and Power UK](#)
[Associated British Ports](#)
[British Energy Power and Energy Trading Limited](#)
[Carron Energy Limited](#)
[Clydeport](#)
[Drax Power Limited](#)
[EDF Energy plc](#)
[E.ON UK](#)
[EWS Energy](#)
[Fergusson Group](#)
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[Forth Ports PLC](#)
[Freightliner Heavy Haul Limited](#)
[Hargreaves Services](#)
[International Power Plc](#)
[Network Rail *](#)
[Port of Tyne Authority](#)
[Rudrum Holdings Limited](#)
[Scottish Power Energy Management Limited](#)
[SSE Energy Supply Ltd](#)
[SSM Coal Ltd](#)
[The Bristol Port Company](#)

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