

Office of Rail Regulation
1 Kemble Street
London
WC2B 4AN

For the attention of: Joe Quill

28th March 2013

Dear Mr Quill,

Periodic Review 2013 – Consultation on a freight specific charge for biomass

We are responding to the consultation, published on 15th February, 2013, on the possible introduction of freight specific charges paid to Network Rail for use of the network to transport biomass as part of the 2013 periodic review (PR13).

Drax Power Limited (“Drax”) is the operating subsidiary of Drax Group plc and the owner and operator of Drax Power Station in North Yorkshire. Drax also owns an electricity supply business, Haven Power Limited (“Haven”), which supplies electricity to a range of business customers and provides an alternative route to market for some of Drax’s power output.

Over recent years, the Department for Transport (DfT) and Office of Rail Regulation (ORR) have successfully implemented policies and a regulatory regime that has enabled freight users to plan their business with a reasonable degree of assurance. This has resulted in a substantial rise in rail freight over a number of years. We are therefore dismayed that ORR is proposing to completely reverse their position on biomass set out in May 2012 (as shown below) and maintained throughout the freight specific charge consultation until the decision was announced in January 2013.

“We are not proposing to levy such a charge for biomass as part of this periodic review because the market is in an early stage of development. Instead, we propose to revisit this policy to coincide with the recalculation of its associated credit (subsidy) regimes (from 2017 for England and Wales). We are considering whether we would then implement any charge for biomass at the point that the new credit levels are introduced or for the subsequent control period (CP6).”

The main reason given by ORR for this *volte-face* is that at the time of the original proposal the market for biomass was emerging and it was unclear how it would develop. However, in this consultation ORR are still of the view that “...biomass is an emerging market for which relatively little data are available.” There is no new evidence presented in this consultation and the main report quoted pre-dates the original consultation (Mott MacDonald for the Committee on Climate Change in October 2011). Also, the Department of Energy & Climate Change (DECC) published its response to the Renewables Obligation (RO) Consultation in

July 2012, but we don't recall any indication from ORR throughout the original consultation that their stated position on biomass could change.

Furthermore, while it is undoubtedly true that a number of existing coal generators are currently considering moves to convert some of their capacity to biomass, there is as yet very little certainty about how many of these projects will actually proceed and on what timescales. In other words, the position is still very uncertain, and very much as stated in the original consultation.

Creating an unpredictable regulatory regime in the UK like this creates uncertainty and increases risk for investors. This could dissuade investment at just the time when there are enhanced concerns over security of electricity supply and just when the Government is putting in place measures to attract investment in low carbon generating technologies to meet its legally binding targets.

The proposal to consider implementing a freight specific charge on biomass highlights a significant, very unhelpful and counter-productive lack of cross-departmental alignment between energy and transport policy.

The Government has confirmed that coal to biomass conversions are one of the key technologies needed to deliver its energy policy objectives of affordability, security and decarbonisation of electricity generation. They can also make a significant contribution to the UK's target of 15% of energy supplied from renewable sources by 2020 to comply with the EU Renewables Directive target. In principle, we believe biomass should therefore be excluded from any freight specific charge. Or, at the very least, any such charge should be considered properly in the next periodic review for CP6. By then, much more will be known about the capacity of biomass generation and hence the volumes of biomass freight being transported by rail. Such a delay, would also allow for a much more coherent consideration of the wider energy policy issues than is possible in this consultation. If a freight specific charge for biomass is introduced at some point in the future it should not be applied to projects supported under the RO.

Following a comprehensive review, DECC determined the minimum level of support that is required to bring forward investment in biomass conversion and co-firing. DECC has confirmed that the RO subsidy levels do not reflect the track access charges proposed in this consultation. The new RO support levels will take effect from 1st April 2013, which means the opportunity to increase the level of support to cover increased rail charges has passed.

Drax has started to invest in biomass conversion, including supporting infrastructure and contracts for fuel supply. If biomass freight specific charges are to be considered it should only be to the extent that the cost can be recovered to maintain the level of support determined by the DECC. There is insufficient evidence in the consultation document to conclude that the same level of support will be maintained if the charge is introduced. So, we believe any projects supported under the RO should be excluded from any new rail freight charges now and in the future. Only projects that are implemented under the proposed Electricity Market Reform (EMR) can be considered as potentially eligible if new a charge is introduced. But only on the proviso that it can be factored into the CfD strike price calculations now and in the future, so the same level of support is maintained. As you may

be aware, DECC is currently working on the development of the CfD contracts so time is of the essence for ORR to liaise with DECC.

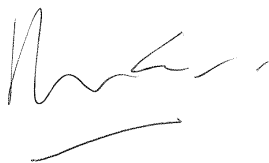
We should also highlight that the prospect of importing biomass has stimulated an interest in upgrading works at a number of Ports. This aligns with the DfT policy objective to improve the Port infrastructure in the UK. However, the potential introduction of a freight specific charge on biomass could jeopardise such investments.

For the reasons highlighted above, and those described in the response to the questionnaire below, we believe that this consultation document has not provided sufficient evidence or rigorous analysis to assess the impact on the biomass market and whether it can bear the proposed charges. We believe ORR can restore regulatory predictability as soon as possible by confirming that:

1. Consideration of a biomass freight specific charge will be delayed until the next periodic review for CP6 as proposed in the original consultation.
2. Biomass that is transported by rail to a power station that has converted or co-firing units with support under the RO will not be subject to a biomass freight specific charge.
3. Biomass that is transported by rail to a power station that has converted or co-firing units with support under the EMR proposals will only be required to pay any biomass freight specific charge if the CfD contract allows for adjustment of the strike price to provide or maintain the same level of support.

If you would like to discuss any of the views expressed in this representation, please feel free to contact me

Yours sincerely,
by e-mail



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Q1. To what extent might higher access charges increase biomass road transport?

Higher track access charges could increase biomass road transport. However, we would have expected that ORR would have carried out this analysis as part of their assessment whether the biomass market could bear the cost of freight specific charges. There is no new evidence in the consultation of ORR's view of the biomass market.

In this section of the consultation document ORR express a view that:

“There is reason to think that there may be serious constraints on the expansion of biomass imposed by the ability to import through the UK's ports and transport it by rail to power stations. The costs of addressing these constraints, some of which are likely to involve incurring further freight avoidable costs, may be large compared with the charge being considered.”

Please could ORR present their evidence on the expected volume of biomass that will be imported which leads them to a view that this could become an issue? Our understanding is that much of the investment in the railway around the ports was sanctioned under previous Periodic Reviews.

Q2. Should a biomass freight specific charge be calculated on the basis of avoidable costs as was done for the commodities on which caps have already been set?

The Consultation document highlights that:

“NERA argued that the potential variable cost of biomass generation may be less than zero when subsidy is taken into account. This means that there are very substantial differences in the variable costs (net of ROC subsidy) of coal and biomass, in the absence of a freight specific charge”.

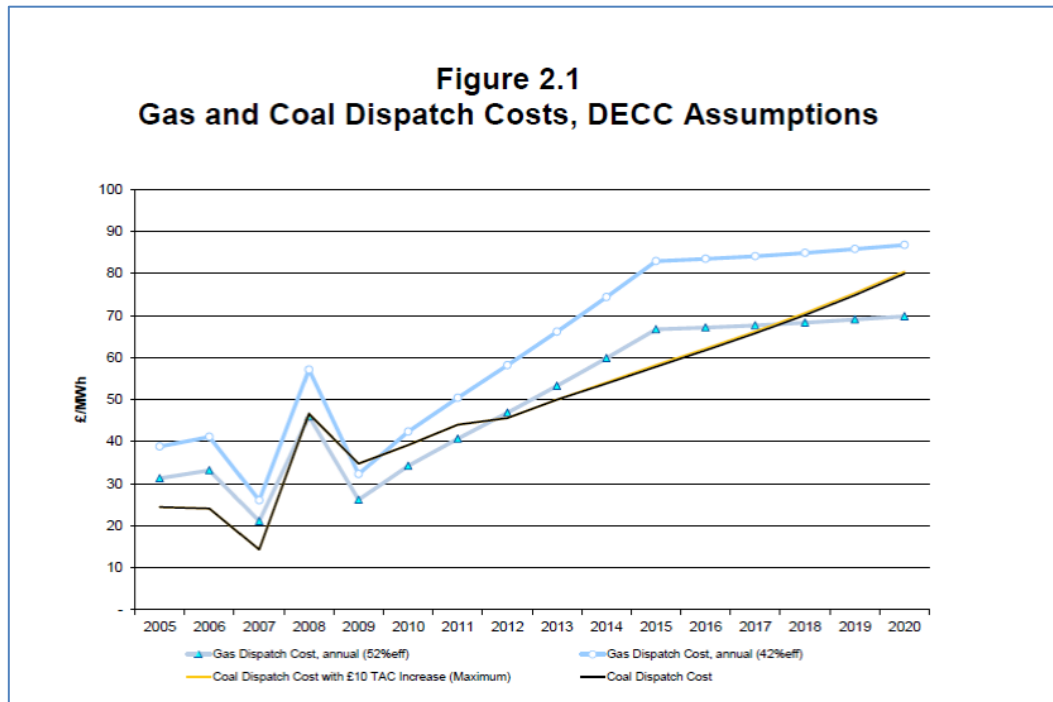
Please could ORR provide the information to support this view, as it appears not to be consistent with the information published by DECC on conclusion of the RO Banding Review. As this forms part of the consultation document is it considered a material factor in the justification for applying freight specific charges to biomass?

Following a comprehensive review of RO subsidies, DECC determined the minimum level of support that would be required to bring forward investment in biomass conversion and co-firing. DECC has confirmed that the RO subsidy levels do not reflect the track access charges proposed in this consultation.

Drax has started to invest in biomass conversion, including supporting infrastructure and contracts for fuel supply. There is insufficient evidence in the consultation document of rigorous analysis to demonstrate that the investment made by Drax would be unaffected by the imposition of a new biomass freight specific rail charge.

It is suggested in the consultation document that biomass generators would benefit from an increase in wholesale electricity prices if a freight specific charge is applied to coal. However, the NERA analysis shows that gas has a higher dispatch cost throughout their period of analysis. Please could

you clarify how biomass generators will benefit from a rise in the wholesale price due to a coal freight specific charge?



The consultation indicates that biomass competes with other fuels [in addition to coal] in electricity generation, including other renewables, and a biomass freight specific charge would raise its cost of generation slightly compared to them, better reflecting the transport cost of each fuel. It is unclear which renewable technologies ORR are considering in this analysis, as the most significant amount of electricity from renewable sources is expected from Offshore and Onshore Wind, which has no operational fuel transportation cost. It is also unclear why the ORR is concerned with the relative costs of different forms of renewable generation, particularly after a comprehensive review of support levels by DECC.

Q3. Should the charge be modified, for example to reflect calorific value or exempt small stations?

As the consultation highlights, if, a tonne of biomass has a lower CV it produces less electricity than a tonne of coal. So, even if the freight specific charge on coal was reflected in higher wholesale prices (which may not be the case for the reasons shown above) it is unclear how it would fully compensate the additional cost of a freight specific charge on biomass.

If the ORR are to demonstrate that investments in biomass conversions under the RO are neutral to a biomass freight specific charge, we believe the analysis should take account of the differing CVs. Also, the effect of conversion or co-firing on the thermal efficiency of the generating unit should be taken into account.

The reasoning behind MDST’s view that for purposes of ‘practicality’ a high biomass freight specific charge should be levied on power stations engaged in co-firing is unclear. Please could you explain the rationale for this proposal?

Q4. Should freight avoidable costs be allocated to biomass using the same methodology as that used for the other market segments to which a freight specific charge applies?

No. Applying any charges should be consistent with Government policy. The Government has confirmed that coal to biomass conversions are one of the key technologies needed to deliver its energy policy objectives of affordability, security and decarbonisation of electricity generation. They will also potentially make a significant contribution to the UK's target of 15% of energy supplied from renewable sources by 2020 to comply with the EU Renewables Directive target. In principle, we believe biomass should therefore be excluded from any freight specific charge.

Following a comprehensive review of RO subsidies, DECC determined the minimum level of support that would be required to bring forward investment in biomass conversion and co-firing. DECC has confirmed that the RO subsidy levels do not reflect the track access charges proposed in this consultation.

Biomass is being supported as a source of renewable energy and should not be considered as close substitute for ESI coal.

Q5. Is the resulting cap on the freight specific charge, of £4.04 per kg_{tm}, for biomass reasonable? How would such a charge affect existing biomass flows and development of future flows?

No. The Government has a policy to encourage investment in renewable energy, as described above, and it is unreasonable to introduce new costs through unforeseeable regulatory change after funds has been committed.

The market for biomass is still emerging and there is as yet very little certainty about how many of the potential projects will actually proceed and on what timescales. In other words, the position is still very uncertain, and very much as stated in the original consultation.

There is insufficient evidence provided in the consultation document to comment whether the proposed charge is reasonable or the consequences for biomass flows. As the proposal is to levy the charge on a tonne-mile basis it will disadvantage ports that are more distant from the power stations.

Q6. Should a freight specific charge for biomass be phased in? Would it be appropriate to apply the same phasing to a biomass freight specific charge as to the ESI coal freight specific charge?

The consultation on freight specific charges started in May 2012 and throughout the period until a decision was published in January 2013, it was understood that biomass would be considered at the next periodic review. With this consultation that position has been completely reversed. It appears that the proposal to include biomass has been rushed and no new analysis has been presented. The ability of the biomass market to bear the cost of a new freight specific charge has not been demonstrated in the evidence provided in the consultation.

In principle, we believe biomass should be excluded from any freight specific charge. Or, at the very least, any such charge should be considered properly in the next periodic review for CP6. By then, much more will be known about the capacity of biomass generation and hence the volumes of biomass freight being transported by rail. If a freight specific charge for biomass introduced at some point in the future it should not be applied to projects supported under the Renewables Obligation for the reasons stated above.

If ORR decides to persist with the consideration of a biomass freight specific charge, we believe there needs to be a more thorough analysis of the potential impact on the market to inform a consultation. As ORR highlight in this consultation document the biomass market is an emerging market. For these reasons, we believe a decision on applying a biomass freight specific charge should be delayed until a more rigorous analysis can be completed.

Q7. Should biomass be subject to a freight-only line charge, calculated on the same basis as for other market segments?

Following a comprehensive review of RO subsidies, DECC determined the minimum level of support that would be required to bring forward investment in biomass conversion and co-firing. DECC has confirmed that the RO subsidy levels do not reflect the track access charges proposed in this consultation.