Freightliner

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Dear Joe

Consultation on a freight-specific charge for biomass

Thank you for providing the opportunity to respond to this consultation. Without prejudice this is the formal response of Freightliner Group Ltd (Freightliner), incorporating Freightliner Limited and Freightliner Heavy Haul Limited.

Executive Summary

Freightliner does not support the introduction of a Freight Specific Charge (FSC) for biomass.

Freightliner urges the ORR to reconsider its position and set no Freight Specific Charge for biomass for at least two Control Periods to enable investment to take place at power stations for co-firing of biomass. Setting charges for one Control Period only generating uncertainty and endangers the case for making the investment. The biomass market is fundamentally different to the electricity coal market: a step change in investment is required.

As power stations will be receiving subsidies from the government to enable them to burn biomass it is clearly a market that is unable to bear its own costs and therefore logically cannot bear a mark-up on freight access charges.

The introduction of a Freight Specific Charge has not been assessed in the setting of the subsidies and therefore if introduced is likely to have a disruptive impact on investment and the future market.

The biomass market is more complicated than the electricity coal market and if the ORR try and split the biomass market into co-firing in coal power stations and others it may face challenges on the basis that it is discriminating in what is essentially the same market: biomass power generation

We contend that the reports commissioned by the ORR from NERA and MDS are inadequate to assess the impact of a Freight Specific Charge on the biomass market.

The LEK work on freight avoidable costs did not assess the avoidable costs that could be allocated to the biomass market. As the biomass market is in its infancy we do not understand how a level of cost can be allocated to this market.

It is unclear whether any meetings have taken place between the ORR and the Department of Energy and Climate Change (DECC) to discuss the potential introduction of a Freight Specific Charge for biomass and whether this is in line with government policy.

This consultation appears to be proposing a fundamental change in policy in setting the level of Freight Specific Charge for all commodities. We do not support this apparent change in policy and do not believe that has been clearly and adequately consulted on.

1. Introduction

Freightliner welcomes a review now rather than part-way through CP5 or for the start of CP6, as the biomass market requires long term investment and certainty is required if investment decisions are not to be put at risk. However, in the ORR consultation there appears to be no mention of setting now the level of charges to apply in the biomass beyond CP5. Given the considerable investment in new equipment that is required power station owners need certainty of charges beyond a 5 year period. The new equipment will have a pay-back period of 15-20 years and setting charges for a period of 5 years only will risk this investment taking place. We understood the whole reason why the ORR is re-opening the consultation on a freight specific charge on biomass was to create certainty; however, the proposals do not address this very issue, which is disappointing. The fact that very considerable investment is needed to enable an emerging biomass market makes it a completely different scenario to the electricity coal market, where the majority of investment has already been made.

We note the timescales indicated by ORR but it should be recognised that DECC's decision on the level of ROC support for conversion of generating capacity from coal to biomass, has already been announced. Therefore there needs to be joined up policy-making between the ORR, the DfT and DECC. The DECC Renewable Obligation Certificates (ROCs) will be in place until 2022, this recognises the need for investment. The ORR decision on a Freight Specific Charge for biomass should also span this period for the same reason.

ORR proposals on track access charges for the haulage of biomass should be aligned to the detailed subsidy of low carbon generation which DECC and the Scottish Government is in the process of carefully determining. ORR must as a matter of urgency discuss with DECC and the Scottish Government their proposals and ask if they have considered the proposed FSC in setting the level of subsidy to support the level of conversion that is desired and to meet DECC targets.

We note that ORR states that it is seeking to design charging mechanisms that encourage efficiencies, with passenger operators more exposed to costs to improve their incentives to deliver efficiencies. However as the ORR now appears to be proposing that the level of Freight Specific Charge could be set anywhere between the low and average level of estimated freight avoidable costs there will be no incentive on freight operators to work with Network Rail to reduce costs.
In order to enable any incentives to work freight operators must have certainty of the policy on charges that will apply in CP6, otherwise we will have no confidence that even if efficiencies are achieved there will be any actual reduction in charges.

2. Background

We note the ORR's desire to reduce the subsidy of Network Rail's costs by the government. The ORR state that passenger train operators paid £887 million to Network Rail in fixed charges in 2011/12, we do note however that the majority of passenger operators are also subsidised and that paying the subsidy via the passenger operator appears to be simply moving it around rather than reducing it.

We have noted that the ORR has recently published press releases stating that freight operations are subsidised by passengers. We do not believe that this is factually correct and suggest that this is not included in future public statements.

We also remind the ORR that the road freight infrastructure is not charged in or considered in the same way. The impact of the budget announcement on 20th March 2013 to cancel the 1.89 pence per litre rise in fuel duty due to be implemented on 1 September 2013 is a saving to the road freight industry of £218 million a year (source FTA). There has been no increase in fuel duty March 2011 and no increase planned until at least September 2014, in this time rail freight charges have increased by 13.6% due to RPI increases. There is no assessment by government on the road freight industry's ability to pay increased charges in certain markets.

Freightliner is pleased to see the ORR recognises the economic, social and environmental benefits of moving freight by rail rather than road but these benefits should not be put at risk by any changes of the track access charging regime. The current periodic review is creating great uncertainty in the rail freight industry and is potentially highly damaging, not just for future investment decisions (by operators and customers) but the growth prospects of the rail freight industry as a whole. There is still a high level of uncertainty about the overall level of freight access charges that will have to be paid.

The review process has used highly abstract theoretical concepts, for example 'freight avoidable costs', in determining the future levels of charge as well as using models whose outputs are determined by questionable engineering judgement and flawed assumptions for inputs which are opaque.

Freightliner is very concerned with the process used by the ORR in reaching conclusions on the level of freight avoidable costs. The LEK report, which was constructed following consultation with the industry estimated 'freight avoidable costs' at £154m low scenario to £377m high scenario. On the basis of the following 2 paragraphs in the Arup report the ORR appear to have adjusted the range to £229m low scenario to £408 million high scenario. As the ORR decided to use the low scenario to set charges the impact of this is to increase the baseline by £75 million. Freightliner is of the view that the following paragraphs are not an adequate basis and do not constitute sufficient evidence to make such a decision.

"Network Rail has necessarily had to use judgement to apply revised intervention intervals and renewal types to produce the required performance level for a passenger only railway. These have been based on current track policies because amending the policies for such a railway would require significant effort. As an example, with the removal of all heavy axle load traffic, the track renewal policy for routes in Criticality Bands 3 and 4 could be changed to refurbishment only and the continuation of maintenance of jointed track. This simplification is likely to result in an under-estimate of freight avoidable cost.

Using the track policy material specification for renewals might be more than is necessary with freight removed. Instead, the policy is likely to be refined to focus on the particular wear and tear characteristics of passenger traffic. Again, this simplification is likely to result in an under-estimate of freight avoidable cost."

It is our belief that there is considerable doubt about the true cost that freight imposes on the network (between Arup and LEK) and that further work should be undertaken. Until there is greater clarity on these abstract theoretical additional costs, then the use of this data for reviewing track access charges must be considered as materially unreliable.

3. A freight specific charge for biomass

We note that the ORR is relying on the analysis produced by NERA and MDST last summer with regard to the elasticity of the biomass by rail market. The reports' authors themselves acknowledge that their analysis of the biomass market is flawed. Freightliner is strongly of the view that ORR does not yet have sufficient evidence of the economics of a potential biomass market to conclude that it can afford to pay its avoidable costs.

Additionally there is no evidence what the freight avoidable costs for biomass would actually be. It is an over-simplification to assume the costs are the same as for coal traffic; for example, the loaded wagons will be lighter than coal wagons, it is not known how this will impact on the VTISM modelling which forms a substantial part of the freight avoidable costs.

Competition with road transport

We note that the ORR consider the biomass market in two segments which distinguish between biomass used in co-firing with coal at large power stations with biomass used in smaller plants. We agree that the economics of rail movements between these categories do differ and Freight Specific Charge if applied to smaller power stations would have the effect of preventing rail movements being competitive with road movements.

The ORR is however potentially leaving itself open to challenge if it discriminates between different users of biomass, all of which is being used to generate power, and therefore competing. In reality it may be difficult to discriminate between the two types of power stations. This is another reason why the best resolution would be not to raise a Freight Specific Charge against any part of the biomass market.

The following paragraph in *italics* must be redacted when published on the website as it is commercially confidential.

We have been contacted by companies who wish to explore the rail haulage of smaller volumes of biomass using containers, for onward delivery to small biomass plants. As the onward delivery will be by road, it is likely that an additional rail charge would price these potential small volumes off rail and onto road for the whole domestic journey leg.

The level of subsidy announced by DECC is specifically pitched at a level so as to deter a longer term commitment to new biomass stations and to promote conversion of existing coal fired power stations.

Electricity Generation Market

There appear to have been 45 responses to the Office of Rail Regulator's (ORR) May 2012 consultation on freight track access charges. Not one of these responses agreed with the ORR's proposals for a new freight specific charge. Four of these responses only suggested that biomass should be charged on the same basis as ESI (Electricity Supply Industry) coal. Many more respondents stated that more certainty was needed to enable investment decisions to be made with regard to biomass. We request that ORR take this into account when making their decision.

Care is needed when considering the level of any Freight Specific Charge for biomass, as it cannot be considered as a direct replacement for coal. It is lighter – with less downward/vertical force on the rail infrastructure and it is conveyed in covered wagons so there will be no spillage. A fundamental difference is that the market will only be there if considerable investment is made, unlike coal where the majority of investment is already sunk.

The NERA analysis on generation costs and elasticity's is interesting but it is ORR's duty to regulate the rail industry; OfGen regulates the energy sector. In respect of your comments made in para 3.18 we would ask if MDS Transmodal is undertaking work for OfGen, if not their views on generation costs and calorific value are irrelevant. The calorific content of a commodity is irrelevant to ORR's duty as the rail regulator.

Freight avoidable costs and their allocation to biomass

We do not understand how ORR can calculate a biomass avoidable cost on the same basis as that for other commodities when there are only a handful of trains running each day currently.

Freight avoidable costs - wider implications

We note that the ORR states in paragraph 3.26 “Network Rail’s work will only result in freight specific charges being set below the cap, if the revised estimates based on best available evidence - which in practice may mean the average of the low and high estimate – are below the cap”.
This paragraph seems to indicate a fundamental change of policy by the ORR, which would apply to ESI coal, iron ore and nuclear services as well as biomass. This seems rather inadequately flagged in this consultation given the major implications of this statement. Such a change in policy should be adequately and clearly consulted upon.

In its conclusions document published on 11th January 2013 the ORR stated on page 54 “taking a conservative approach to the level of FACs we seek to recover from the charge by setting the cap on the charge at the lower end of the range of our estimates for FACs”

Freightliner does not support this apparent change of policy on the level of the Freight Specific Charge. It is a fundamental change on the basis on which the Freight specific Charge is calculated. The actual level of charge will have very considerable impacts on the transport of electricity coal by rail and in particular the future of the Scottish mining industry which is unable to afford any increase in track access charges.

It seems to undermine any incentive on freight operators to work with Network Rail to reduce their cost base and this seems contrary to the direction of travel on creating industry incentives.
We are content for the contents of this response to be published in full on your website, except where redaction has been indicated and are happy to meet with ORR to discuss any of the points raised in this document.

Yours sincerely

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p.p.
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Freightliner Group Limited