



15-25 Artillery Lane,  
London E1 7HA.

**Telephone:** 020 7983 5174

**Facsimile:** 020 7983 5171

**Mobile:** 07818 421220

**E-mail:** ian.kapur@gbraillfreight.com

Joe Quill.  
Office of Rail Regulation,  
One Kemble Street,  
London,  
WC2B 4AN.

28<sup>th</sup> March 2013

Dear Joe,

**GB Railfreight Ltd. response to the ORR Periodic Review 2013 Consultation**  
**On a Freight Specific Charge for Biomass:**

Thank you for the opportunity to respond to the above consultation (the Consultation).

**Current Position**

There is currently no freight specific charge relating to the transport of biomass by rail. The ORR is consulting on introducing such a charge, having decided in January 2013 to introduce freight specific charges for coal, spent nuclear fuel and iron ore.

Consulting on the introduction of a charge relating to biomass represents a change in position from that set out in the ORR's May 2012 "Consultation on the variable usage charge and the freight specific charge" (the **May Consultation**), where the ORR indicated that it would not make a decision regarding the potential to levy a freight specific charge in relation to biomass until after the 2013 periodic review (**PR13**). The key reason given in the May Consultation for this approach was that it was not appropriate to impose a freight specific charge on biomass during PR13 because of numerous uncertainties surrounding the biomass market. The ORR identified that these uncertainties arise predominantly from the fact that the biomass market is a developing market, dependent in part on subsidies for renewable energy<sup>1</sup>.

GB Railfreight's (**GBRf**) view is that the ORR's position in the May 2012 Consultation was correct. A freight specific charge relating to biomass should not be introduced in PR13 as the biomass market, and the likely impact of the charge upon it and the rail freight market serving it, is too uncertain for adequate assessment of the position at present. It is judged intervention now in an emerging market could prove very detrimental.

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<sup>1</sup> For example, the ORR stated at paragraph 6.50 of the May Consultation: "The impact on the biomass market [of introducing a freight specific charge] is hard to predict because it depends upon whether and how subsidies are adjusted in order to ensure renewable targets are still met. In addition, as it is not clear how biomass generating capacity might be provided or located, it is difficult to assess its sensitivity to charges."

## **General Comments:**

### **1. Impact on Investment**

The success of the UK Railfreight industry is well documented. The post-privatisation period has seen significant investment which has driven efficiency resulting in lower prices to end customers. Trains are now more efficient and better utilised than ever before. Freight operating costs reflect the years of hard work in driving efficiencies while service standards reflect the fact that customers now have a choice of supplier. Freight Operating Companies (FOCs) have driven performance improvements through investment in more reliable rolling stock. The industry has innovated and invested heavily in the post privatisation period.

Network Rail has also been a significant beneficiary of post-privatisation efficiencies in the rail freight industry. Network Rail (NR) is benefitting from a reduction in its costs of conducting maintenance activities by virtue of the competitive rail haulage market for NR's own maintenance trains.

This industry's success flows in large part from an effective open access regime which allows for incumbents and new entrants to enter markets and grow within a stable regulatory structure. These factors are critical to the creation of a market in which investment in long life assets is viable.

GB Railfreight (GBRf) is a product of this open access and competitive rail freight market. It entered the market in 2001 and has grown its business every year since. Central to our growth has been the ability to invest in rolling stock, either with our own funds or via the rolling stock lessors (ROSCOs). Rolling stock that we or the ROSCOs have invested in on our behalf now totals some £200 million in value.

Over the past three years, GBRf has worked hard to investigate the potential of carrying biomass by rail and has secured two contracts for the carriage of biomass to supply Drax and Ironbridge power stations. As far as we are aware, GBRf is the only FOC currently carrying significant biomass loads by rail.

The proposal for a biomass freight specific charge will, in GBRf's view, materially and adversely affect the full start-up of this fledgling UK biomass carriage market. If adopted the proposals would:

- Materially affect the viability of future investment in the important biomass market, a market that requires innovation, investment and is a key component in the replacement of coal within the Freight Operating Companies' portfolios;
- Discourage the ROSCOs from investing in rolling stock to support growth;
- Reduce our return on capital; and
- Reduce the value of our business.

### **2. Transparency of Proposed Charges**

This proposed extra charge for biomass appears to be about recovering additional revenue, at any cost, from a sector that, by ORR's own words, is an emerging market for which relatively little data is available. The Consultation also states that it is not yet clear what the average length of train will be or the associated net tonne miles of biomass transported.

Without clarity of the above and also the clear methodology, in advance, informing how the proposed biomass Freight Specific Charge is calculated, GBRf cannot be clear whether or not any proposed charges are fair and reasonable. On this basis, there can, currently, be no clear answer to what a non-discriminatory biomass freight specific charge should be if, indeed, it is appropriate to impose one at all.

GBRf also notes that the prospect of freight specific charges is a new development for the rail freight industry. As set out above, the ORR has recently taken decisions to impose freight specific charges on the transport of coal, iron ore and spent nuclear fuel, and those charges are to be introduced during CP5. These market segments are far more developed than the emerging biomass market. In any event, the full impact of these charges remains unclear. In addition to a lack of evidence regarding the emerging biomass market, the ORR therefore currently also has no evidence of how such freight specific charges impact on the rail freight market and the markets for associated commodities.

### **3. Complexity and Transaction Costs**

In addition to this consultation, several other proposed changes to CP5 access charges have been or are still being consulted upon. In this whole process, the ORR needs to have regard to the total level of impact on the FOCs from the aggregation of all of these proposed changes and should evaluate the total direct financial impact on the FOCs, the increasing complexity and compliance burden and the secondary impacts on the market (customers, suppliers, investors).

There is a very real danger for individual consultations to be concluded in isolation when, in totality, after all changes are aggregated, a significant level of uncertainty, complexity and financial burden is being added to the industry.

### **4. Statutory Duties of the Office of Rail Regulation**

In our view the statutory duties that seem most relevant to the issues under consideration are the duties to act in the manner best calculated "*to promote the use of the railway network in Great Britain for the carriage of passengers or goods, and the development of that railway network to the greatest extent that it considers economically practicable*", the duty to act in the manner best calculated "*to promote efficiency and economy on the part of persons providing railway services*" and the duty to "*enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance*". It is not clear from the Consultation how the ORR has sought to balance these duties and ensure that its emerging policy is consistent with these duties and rational in all the circumstances.

In our view the ORR's change in position from the May Consultation, and the clear intention not to levy charges relating to biomass, to the position in the current Consultation is inconsistent with the ORR's duty to enable the railway industry to plan the future of their businesses with a reasonable degree of assurance. The industry has developed in the period between the May Consultation and the current consultation on the basis that no charges would be levied, and decisions taken during that period will be impacted by this change in position.

GBRf would like sight of how the ORR has considered and balanced its duties as, without this evidence, GBRf and other bodies cannot be clear whether or not the ORR has properly carried out its statutory duties. Clarity and transparency are key here.

### **5. Biomass Funding**

The levying of an additional freight specific charge for biomass would, in GBRf's view, be counter to the government's current energy policy. Government has encouraged the conversion of existing coal-fired power stations for use by co-firing with coal (e.g. Drax Power Station) or purely biomass use, as has recently commenced at Ironbridge Power Station with close working by GBRf and E.ON UK. We understand that several other existing power stations are considering whether or not to make the change from coal-fired to biomass.

In our view, the prospect of the introduction of a new freight specific charge relating to biomass will mean that the Government is sending mixed signals to such power stations about whether it should do so.

This consultation proposal could add between £1.00 and £1.50 per tonne to the price of biomass, a very material change that is being proposed very late in the day and which is likely to halt investment in a number of fledgling and potential biomass projects.

The Government, in the form of the Department of Energy and Climate Change (DECC), has already established financial support arrangements, through Renewables Obligation Certificates (ROCs), to encourage multi-million pound investments in low carbon technologies such as biomass-fed power stations. The extent to which the ORR has consulted DECC about an additional charge for biomass is unclear from the Consultation and is inconsistent with the lengthy consultation process that the government has already concluded with the power industry on financial support for biomass.

Baroness Verma confirmed in a written answer in the House of Lords on behalf of DECC, on 25<sup>th</sup> March 2013, that the Renewables Obligation biomass subsidy levels that will take effect on 1 April 2013 do not take account of the ORR's proposed freight specific charge for biomass. Indeed, Baroness Verma confirmed that the support levels reflect the May 2012 Consultation and the ORR's decision not to propose a charge at that time

The subsidy regime has been set by DECC so that the taxpayer does not over-fund the desired market outcome nor does it result in any economic rents accruing to the generators. How then is it possible to apply a freight specific charge to biomass on the basis that the market can bear such a charge? For this to occur, unless the rail freight sector absorbs the charge itself and does not pass it on to biomass customers, the biomass sector would need to be subsidy free and profitable at the start date of the introduction of any freight specific charge. GB Railfreight considers this highly unlikely. GB Railfreight cannot, therefore, comprehend how it is possible to apply a freight specific charge to biomass on the basis that the market can bear such a charge.

GBRf considers that the rational approach in relation to this issue would be to allow time for the biomass market to develop, and during that time to co-ordinate policy with DECC and ensure that any inter-relationship between the biomass subsidies and any potential rail freight charge is explored in detail in advance of any decision being taken..

### **Answers to Specific Consultation Questions:**

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

GBRf believes that it is extremely likely that some biomass would transfer to road if higher access charges are introduced for rail freight.

The % of modal shift, from rail to road, is as yet unknown, as the biomass industry is still emerging but what is clear is that continuity of supply is paramount. This is especially true now, as it's clear that desired volumes of gas supplies to the UK are not guaranteed, the price of gas is likely to stay far higher than previously thought over the next 5-8 years, and that, from ORR's own published views, the use of coal for electricity supply will drop dramatically over the next three years.

In GBRf's view increasing biomass road transport is not the only likely effect of higher access charges. It is also likely to lead to some potential biomass projects being abandoned. The ORR does not appear to have considered this likely impact on a nascent industry in detail in the Consultation.

*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?*

For the reasons set out above, GBRf does not believe that a freight specific charge should be introduced at present, so the question of how to calculate such a charge is not relevant.

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

If a Freight Specific Charge were to be imposed for biomass, GB Railfreight does not think various modifications should be made for calorific value and different sizes of power station. Simplicity of charging regimes is what is required by both freight operating companies and its customers.

*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?*

As written in previous consultation responses, GBRf does not agree with the methodology used by LEK for estimating freight avoidable costs. There were items of principle and items of detail that led GBRf to conclude that, taken together, the contents of this report should not have been used in the determination of freight avoidable costs as the quality of the data was flawed to such an unacceptable level, and the outputs of too wide a range to be credible.

GBRf's response to the LEK Consulting Draft Final Report (sent on 7/9/2012) raises serious issues with estimated total freight avoidable costs, one-off enhancement costs, cost of freight-only lines, redundant fixed costs, Network Rail NDS operations if taking in-house, signalling costs, coal spillage costs and Network Rail staff costs.

In summary, GBRf had concerns about this report and stated it must not be used going forward to determine freight avoidable costs, as the quality of the input data was questionable and untested in places.

For this reason alone, freight avoidable costs should not be allocated to biomass, let alone any market segment. For the many reasons described in this response, principally as biomass subsidies have already been set and investments made, freight avoidable costs should not be allocated to biomass.

*Q5: Is the resulting cap on the freight specific charge, of £4.04 per kgtm, for biomass reasonable? How would such a charge affect existing biomass flows and development of future flows?*

The Consultation states that biomass is an emerging market and relatively little data is available (GBRf agrees) but then goes on to propose a similar figure to coal for the freight specific charge cap for biomass. In GBRf's view this is not a rational step to take, as currently the only thing that is clear is that the coal market and the biomass market are very different at present.

The ORR's simple methodology gives no transparency and actual evidence or reasoning for why ORR has arrived at this cap rate and GBRf cannot be clear whether or not this cap rate would be reasonable and non-discriminatory.

The £4.04/kgtm cap will lead to a greater actual cost being applied to biomass over coal. As biomass has a lower calorific value than coal, more biomass will need to be transported, for the same output, and this level of cap will lead to a higher rate of £0.15/tonne of biomass moved over coal.

This penalises the movement of biomass by rail, over coal, just at the point when large scale biomass use is being encouraged by government. It also increases the differential between coal and biomass just when Government has worked hard to close that gap.

Coupled with a biomass freight-only line charge and many other increased charges being discussed, the new biomass freight specific charge would, in GBRf's view, lead to reduced tonnages of existing rail-transported biomass along with less private sector investment in low-carbon technologies..

For the many ports and power stations about to "press the button" on biomass investment, based on the government's recent decisions on biomass subsidies, the increased access charges could be very serious. Some companies will not push forward with upgrade and investment and a number of fledgling and future biomass projects will not be realised. This potential impact does not appear to fit with wider Government policy as set out above.

*Q6: Should a 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 freight specific charge?*

GBRf is strongly of the view that a specific charge for biomass should not, at present, be introduced for the reasons already discussed in this response. Once the biomass market has developed then it may be appropriate, in time, to consider the imposition of a freight specific charge again, and to look at potential phasing as part of this.

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

The freight-only line charge is designed to recover a proportion of the fixed costs that Network Rail incurs in respect of freight-only lines and is, currently, only levied on segments of the market that are able to bear the fixed costs of freight-only lines.

By ORR's own admission, biomass is an emerging, fledgling market for which relatively little data is available. It is unclear what the average length of train will be, the associated net tonne miles of biomass transported, and, importantly, which origins and destinations biomass trains will serve. In any event, it is very likely that these points are already served by other freight services that will be subject to the freight-only line charge in CP5, so none should be made for biomass.

Yours sincerely,

**Ian Kapur.**  
**National Access Manager.**