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

Dear Mr Quill

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

General Remarks

The Confederation of UK Coal Producers (CoalPro) represents member companies who produce over 90% of UK coal output. Coal production in the UK is a growth industry. Output has increased every year since 2006 with a corresponding increase in employment, representing high-skilled, high-wage jobs, often in depressed areas. UK coal production is a £1 billion a year industry employing some 7,000 people directly and a total of some 20,000 direct and indirect jobs, including in the rail freight industry.

CoalPro is pleased to be able to respond to this consultation but is extremely concerned at the impact of the proposed increases in charges for the transport of ESI coal on the overall market for coal, on the resultant impact on UK coal production, and particularly on the impact on coal production in Scotland from which approximately one third of UK coal production is sourced.

Whatever the size of the impact, it WILL result in the displacement of UK output and jobs by either imported gas or imported coal, or a combination of both.

It does not appear that these proposals have been discussed with other Government Departments with a major interest in the continuation of a successful UK industry such as DECC and HM Treasury, nor with the devolved administrations, in particular the Scottish Government.

CoalPro does not accept ORR's view that a reduction in business activity of up to 10% can be reconciled with the requirement that freight charges should only be increased where the market can bear it. ANY reduction in business activity as a result of increased charges in current economic circumstances should be regarded as clearly demonstrating that the market CANNOT bear such increases, particularly when the result will be its replacement by imported products.

Furthermore, it appears that a reduction of up to 23% in tonne/kilometres is envisaged with the recognition that this may cause a withdrawal from the sector of one or more freight operating companies, with all the implications for competition, jobs, investment and stranded assets that this would entail. Surely this represents an indisputable conclusion that the market cannot bear the increases proposed. It is CoalPro's view that such an increase would put ORR in breach of its statutory duties under the European legislation.

Indeed, a reduction of up to 23% in tonne/kilometres clearly indicates a disproportionate effect on UK indigenous coal production. The consultation document recognises that there is scope to reduce the average length of haul for ESI coal. **This can only occur at the expense of a reduction in Scottish coal production.** Such a reduction cannot be replaced by an equivalent increase in production from England. The economics of deep mining is such that output has to be maximised in any set of circumstances. Output is thus already maximised (within the operating exigencies of geology, etc) and cannot therefore be further increased. The constraint on English surface mine production is the number of sites with planning permission. There will be no increase in production capacity to replace lost Scottish production. **The inevitable and unavoidable consequence will be a replacement of UK production capacity by imported coal or gas.**

The consultants suggest that, in view of high coal prices, Scottish producers may absorb some of the increase. **They CANNOT and WILL NOT do so.** Coal prices have fallen by some 30% so far this year and new contracts for the supply of coal are now reflecting this reduction. Margins are wafer thin and there have already been some redundancies in the industry in Scotland. An increase of £4.50/te in freight charges for supplies to England will result in an immediate reduction in output as higher ratio coals within existing sites are abandoned, with the possibility of some sites closing altogether. The output reduction will get worse as it becomes clear that some or all new replacement sites are no longer economic propositions. The average date at which existing sites have to be replaced is 2014 – the impact will be felt rapidly. **Up to 3mtpa of Scottish production will be at risk with the consequent loss of some 2000 direct and indirect skilled and high paid jobs in areas which are already economically depressed.** This can only be replaced by imports of coal or gas and a corresponding export of jobs.

CoalPro does not accept Network Rail's assessment of freight avoidable costs and ORR's apparent acceptance of this. A large proportion of these costs are related to the separation of freight and passenger transport on a mixed traffic network with the clear objective of keeping paths clear for passenger traffic, e.g. loops, 4-track sections, related signalling, etc. Whilst this infrastructure and the related costs would not exist on a passenger only railway, they would equally not exist on a freight only railway. **They are no more freight avoidable costs than they are passenger avoidable costs.**

<u>Consultation Questions</u>

I now turn to the individual questions in the consultation document before making some concluding remarks. In doing so, some repetition of the points made above is unavoidable.

Chapter 3 – variable usage charge

7.14 CoalPro has no comment.

7.15 CoalPro cannot accept that costs cannot be estimated with a greater degree of accuracy than a 15% confidence interval. If this is the level of uncertainty involved, it must know throw the whole exercise into doubt.

7.16 Yes.

Chapter 4 – Framework for a freight-specific charge

7.17 No. CoalPro believes that ORR does not satisfy the Access and Management Regulations in a number of respects by ORR's own proposed tests for PR13. The proposals will result in an overall fall in the demand for coal and its replacement by gas or biomass. This is discriminatory. The proposals will result in a further, incremental fall in the production of indigenous coal and its replacement by imports. This is discriminatory. The proposals will have a disproportionate effect on Scottish coal production. This is discriminatory. If ORR's response to this is that they are only concerned to avoid discrimination between freight operators and not by discriminatory effects in the wider economy, this is an unacceptably myopic view.

CoalPro also believes that the costs attributed to freight only operations are wrongly attributed to a significant degree (see below) and that there is consequent over-recovery.

It is CoalPro's view that the potential transfer to road is greater than that envisaged and that the proposals do not therefore follow efficient principles. A number of opencast sites are not directly rail connected and road transport to a railhead is required. A large increase in rail charges may result in road transport becoming cheaper for the entire haul, taking into account modal transfer costs etc.

7.18 Yes but CoalPro's view is that the separately identified freight avoidable costs are excessive (see 7.26 below).

7.19 Yes, but no distinction should be made between coal and biomass for the ESI market to avoid discrimination and distortion of competition.

7.20 and 7.21

No, in each case. CoalPro believes that other factors should be taken into account and in particular the overall effect on the electricity generation market for coal if all relevant criteria are to be considered. CoalPro cannot accept that a reduction in an overall market segment of up to 10% is considered to be within the parameter of what the market can bear. Wider energy and economic policy considerations should be taken into account. On energy policy issues, DECC should be consulted. On overall economic effects, particularly the replacement of indigenous coal by imported gas or coal, HM Treasury should be consulted. On regional policy issues, the Scottish Government should be consulted. Beyond this, CoalPro questions whether ORR has the power to determine charges in Scotland and considers that the matter of whether the Scottish Government has jurisdiction here should be considered.

CoalPro also questions whether ORR's consultants have correctly assessed the effect on the ESI market for coal. The existing coal-fired power stations are ageing and need to make major investment decisions as to whether to meet the requirements of the IED or close. In each case, there will be a tipping point. These decisions will be difficult enough given the Government's introduction of carbon price support. Further increases in rail freight charges may be the tipping point and there can be no guarantee that the impact will be limited to 2GW of plant opting in, or opting out of the IED.

7.21 See response to 7.20 above.

7.22 No. There should be no discrimination between market segments. An increase which results in ANY reduction in a market segment must be considered, in current economic circumstances, as going beyond what the market can bear.

7.23 CoalPro considers it wholly inappropriate to allocate all common freight costs to one market segment that is deemed capable of bearing the charge. This is clearly discriminatory and in CoalPro's view infringes ORR's statutory responsibilities. The analogy with a business allocating common costs to more profitable activities is simply wrong. First, for a business to do this offends against basic management accounting principles. Second ORR is not running a business – it is a regulatory body.

7.24 No. Apart from being discriminatory in itself, and apart from the argument as to whether a reduction in the overall market of up to 10% falls within what the market can bear, the proposed approach ignores the severe market distortions that will arise within the ESI coal segment. There will be a fundamentally disproportionate effect on Scottish coal production with all the consequences that follow from that which are set out elsewhere in this response.

Beyond that, the anticipated reduction of 23% in tonne/kilometres demonstrates these disproportionate effects and surely represents an impact which goes beyond what a market segment can bear. All market segments should be treated equally and the effect on the railfreight market as a whole should be the determining factor.

7.25 Each proposal has disadvantages. A charge per tonne lifted would be likely to lead to a greater shift to road for short hauls and where opencast sites are not rail connected so that road transport has to be used from the site to a railhead. In such cases the additional costs associated with modal transfers may significantly change overall economics in favour of road.

A charge based on tonne/kilometres would severely discriminate against long distance flows and would particularly disadvantage Scottish producers.

The fact that there is 'no right answer' demonstrates that the proposals as a whole are fundamentally flawed.

Chapter 5 – Freight avoidable costs

7.26 No. Whilst certain costs may be avoided if there were no freight on the railway (e.g. loops, 4 – track sections related signalling), their primary purpose is to separate freight from passenger traffic on a mixed use network, thus permitting clear passenger paths. They would equally not exist if there were no passenger traffic. They are no more freight avoidable costs than passenger avoidable costs. Freight avoidable costs should be restricted to those costs solely attributable to freight, e.g. bridge strengthening, etc.

Chapter 6 – Market analysis

7.27 CoalPro considers that the base case assumptions are completely unreliable to the point that they are simply incredible. We can see no justification following the LCPD closures and the increasing impact of carbon price support for any increase in demand post 2012/2013 at any time until coal-fired plants equipped with carbon capture and storage come on line to a significant degree – the early 2020s at the earliest. The impact of the IED and the various options permitted under it seem to be imperfectly understood, in particular the availability of the Transitional National Plan for the 2016 – 2020 period. The TNP is important as we expect most generators to opt for this derogation. The TNP implies reducing overall national emissions. This, together with the impact of carbon price support makes a demand of 40mt in 2020 incredible. These serious flaws in the base case cast severe doubt on the robustness of the subsequent modelling of possible ORR decisions on freight charges.

The modelling premise 'that the proportion of coal that each power station sources from and transports via different routes remain unchanged' is simply wrong. Throughout this response we have referred to the differential impact on Scottish production and that Scottish producers cannot absorb any increase in track charges. This fact alone will dramatically change sources and routes and is actually recognised by the later comments about shorter routes being favoured.

The contention by the consultants that some of the increase in charges can be absorbed by Scottish coal producers is wrong, as repeatedly asserted above, given present coal prices. Nor will the greater part of Scottish production be sold in Scotland given the imminent closure of Cockenzie and the uncertainty over the future of Longannet. In fact, the opposite may well be the case.

As a comment, the speculation about the impact on the freight operating companies surely demonstrates that the market cannot, in fact, bear the proposed increases.

Finally, on biomass, the consultants' comments seem to be purely speculative. Future biomass burn may be much higher than anticipated, not least because it may facilitate a lower cost route to IED compliance. Any implication that greater subsidies may be available to compensate biomass for higher track access charges is unwarranted by the evidence.

7.28 Yes, but to avoid discriminatory effects and to avoid potential breaches of EU legislation, there should be no mark up on ESI coal.

7.29 Absolutely not. The proposal fails to take into account wider policy considerations and is thoroughly discriminatory. It will introduce widescale market distortion both between market segments and within the ESI coal segment. The potential impacts on UK coal production and the effects of replacing this by imported gas or coal are simply ignored. This myopic in the extreme and unacceptable.

CoalPro challenges the assumption that ANY reduction in the market, let alone one of up to 10%, can be regarded as falling within what the market can bear.

7.30 It is CoalPro's view that there should be no new freight-specific charge for ESI coal and that the same should apply to spent nuclear fuel.

7.31 The same applies to the iron ore market segment.

7.32 Because of the inter-relationship between coal and biomass, the two should be considered together. Whatever the outcome for ESI coal, the same should apply to biomass to avoid market distortion and a decision should not be delayed.

7.33 No.

Conclusions

CoalPro considers ORR's proposals to be fundamentally flawed. First and foremost, they will introduce severe market distortions between segments of the railfreight market and within the ESI coal market. These market distortions will apply to electricity generation as a whole, leading to a further switch from coal to gas, and to the sourcing of coal by the electricity generators, leading to a switch from UK produced to imported coal.

It cannot be right that a new charge introduced by ORR will result in such widespread and large scale market distortion.

Apart from the market distortion effects, ORR's proposals will be thoroughly discriminatory against coal compared to other railfreight segments, against coal compared to gas, and against indigenous compared to imported coal.

Major changes will take place in the electricity generating market because of the impact of the IED and because of the UK Government's EMR package of measures. Introducing a major new railfreight charge into this rapidly changing and uncertain environment risks further clouding investment decisions, will add to regulatory uncertainty, and may lead to severe unintended consequences.

Finally, CoalPro cannot accept that the ESI coal market can bear the proposed new freight-specific charge and believe that ORR, should it choose to pursue it, may be in breach of European legislation.

CoalPro proposes to ORR that it fundamentally reconsiders its proposals and, in so doing, takes into account a range of wider policy issues. It should, in particular, discuss its proposals with other Government departments and with the Scottish Government.

Yours sincerely

David Brewer
Director General

Confederation of UK Coal Producers (CoalPro)
9 August 2012