ORR Periodic Review 2013
Consultation on the Variable Usage Charge and on a Freight-Specific Charge

Submission by International Power Plc

(I) About International Power Plc

IPR welcomes the opportunity to respond to the ORR's consultation on proposals for a variable usage charge and freight-specific charge.

IPR is a leading independent power generation company with active interests in closely linked businesses such as LNG terminals and water desalination. Following the combination with GDF SUEZ Energy Europe and International, International Power plc has strong positions in all of its major regional markets (Latin America, North America, the Middle East, Turkey and Africa, UK-Europe, Asia and Australia). In total, it has 76 GW gross capacity in operation and committed projects for a further 13 GW gross new capacity.

IPR has significant experience in operating coal-fired power generation, both in the UK and in overseas markets. Of IPR's total installed capacity, 11% (8.0 GW) is coal-fired generation. In the UK, IPR owns 75% of the Rugeley 1,000 MW coal-fired station in Staffordshire, and 10% of the Eggborough 2,000MW coal-fired station in Yorkshire.

At Rugeley, approximately 2 million tonnes of coal is burned per year across two units. Coal is imported mainly from Russia and South Africa, with a small amount from Scotland. Over 98% of the deliveries to the station are made by rail, and this has been the situation for some period of time. Presently, IPR uses both EWS Railways and Freightliner Heavy Haul to move its coal requirements, with EWS serving Portbury / Avonmouth / Scottish Coal Sites and FLHH serving Hull / Immingham.

IPR is currently considering the possible conversion of Rugeley to biomass. Should IPR proceed with this conversion, it is anticipated that Rugeley could generate power from biomass from 2014.

(II) Summary key points

- **IPR recognises Government aims to protect taxpayers, and reduce costs across the rail network. However, IPR believes ORR's proposals are discriminatory against particular market segments, such as coal for the Electricity Supply Industry (ESI). IPR believes the proposals are not structured on a fair and equitable basis.**

- **IPR believes that track access charges should be applicable to all rail users, and across all market/industrial segments that make use of the network.**

- **The proposed approach assumes that additional costs on coal can be passed through to the wholesale electricity price. This is only the case if coal is operating at the margin - if coal is not at the margin the additional costs may act to reduce output and impact future overall freight revenues.**

- **Any charges should be apportioned on the basis of volumes transported, not on a distance related mechanism.**

- **IPR believes that the potential introduction of track access charges to biomass from 2017 could create uncertainty amongst developers of dedicated, conversion or co-firing projects before this date. To mitigate this risk, IPR believes it is necessary to 'grandfather' track access charge arrangements for projects that exist or are due to commission before 2017.**

(III) Answers to ORR Questions

Chapter 3 – Variable Usage Charge

Question 7.14 – Network Rail has already consulted on its estimates of variable costs. Do you have any further evidence, subsequent to Network Rail's consultation, that you wish to provide in relation to the process for estimating variable costs and average variable usage charges?

1. IPR is unable to comment on this issue.

Question 7.15 – Do you agree with our analysis, which leads to a proposed confidence interval of 15% around Network Rail's estimates of variable usage costs?

2. IPR is unable to comment on this issue.

Question 7.16 – Do you agree with our approach to estimating an adjustment to variable usage charges for long-run cost efficiency?

3. IPR is unable to comment on this issue.

Chapter 4 – Framework for a freight-specific charge

Question 7.17 – Do you agree with our proposed approach to satisfying the Access and Management Regulations with respect to levying a new freight-specific charge?

4. IPR recognises that Government is seeking to reduce costs across the rail sector, whilst protecting the taxpayer, but it does not agree with the proposals for levying a new freight specific charge.

5. IPR is concerned that the proposed approach is unfair and inequitable, particularly as coal for the Electricity Supply Industry (ESI) is being specifically targeted for increases in freight charges. To this end, IPR does not believe that the Access and Management Regulations have been met, such as the requirement for mark-ups to be allowed if the market segment can 'bear the increase.' The market analysis illustrates a 5% fall in coal consumed if access charges are increased by £10, which raises questions as to whether ESI coal can bear the charge, particularly from a coal margin point of view (please see commentary on market analysis below under question 7.27).

Question 7.18 - Do you agree that the infrastructure costs allocated to freight operators - either for direct funding by freight operators, or explicitly subsidised by government - should be freight avoidable costs, including fixed costs, but not costs common between passengers and freight?

6. IPR believes that all costs should be included in freight avoidable costs. IPR believes that costs should apply across all industry that makes use of the rail network, based upon volumes transported.

Question 7.19 - Do you agree that we should retain our current definitions of particular categories of rail freight commodities as separate market segments?

7. IPR believes that track access charges should not be discriminatory between market segments and, to this end, supports an approach whereby all industrial/market segments using the rail network pay track access charges based upon tonnage transported.

Question 7.20 - Do you believe that we have taken into account the appropriate factors in considering the efficiency of the proposed charges? Do you believe there are other factors we should take into account?

8. IPR is unable to comment on this issue.

Question 7.21 - Do you agree that our approach (of analysing rail freight traffic) addresses the relevant criteria, when considering to which market segments the charge should apply?

9. IPR believes that analysis of rail freight traffic should take into account the potential for switching sources of coal that could be caused by proposed track access charges. This should be considered in NERA's analysis of the impact of changes to charges on the electricity sector, particularly as this could impact the underlying cost assumptions.

Question 7.22 - Do you agree that certain market segments should be exempt from the new charge?

10. IPR believes that the structure of track access charges should not be discriminatory between sectors or users of the rail network, as recognised in the ORR consultation document[1]. To this end, all market segments should be included in any charging framework, and should pay according to the amount of volume transported on the rail network. This should apply to both passenger and freight services.

Question 7.23 - What do you think is the most appropriate methodology for allocating costs, and what is your reasoning?

11. As indicated in our response to Question 7.22, IPR believes that the structure of track access charges should not be discriminatory between sectors. To this end, all market segments should be included in any charging framework, and should pay according to the amount of volume transported on the rail network. This should apply to both passenger and freight services.

12. To this end, IPR does not believe that the current proposals, particularly those based upon distance related charges, are fair and equitable. This could geographically disadvantage players located away from ports, such as Rugeley, from a cost perspective; historic locational decisions cannot now be undone. IPR believes it would be fairer to employ a methodology based upon total volume/tonnage transported on the rail network by operators, which would reflect usage more appropriately.

Question 7.24 - Do you consider it is appropriate to cap the new charge for particular market segments according to its impact on the associated freight traffic (in addition to a constraint relating to relevant avoidable costs)? Do you wish to propose an alternative?

13. IPR does not support proposals to apply track access charges to selected market segments, and thus is opposed to capping the new charge for particular sectors. Any track access charge regime should be applied on a proportional basis across all segments that use rail services.

Question 7.25 - What should be the unit of the new charge? Please explain your reasoning.

14. IPR believes that charges should be based upon the amount/volume of tonnage moved on the rail network rather than distance related. The charge should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably.

[1] Office of Rail Regulation, May 2012, Consultation on the variable usage charge and on a freight-specific charge, page 23.

Chapter 5 – Freight avoidable costs

Question 7.26 - Do you agree with our framework for estimating freight avoidable costs? Please explain any suggested changes to the framework, including your calculations (noting that there will be further opportunities to contribute to this work as the cost estimates are refined during the periodic review, for example in relation to Network Rail's strategic business plan).

15. IPR is unable to comment on this issue.

Chapter 6 – Market Analysis

Question 7.27 - Do you have comments on our write-up, interpretation and application of the studies carried out by MDST and NERA? Is there any further evidence that you believe should be considered?

16. IPR has several comments to make on the MDST and NERA analyses. NERA's analysis seeks to determine the impact on ESI coal through changes in demand for the commodity and freight moved. Movement in commodity prices is recognised as a determinant in demand for coal, as are relative trends in coal and gas prices, and CO_2 prices.

17. However, further analysis should be made to investigate the likely impact on coal generator margins should the additional freight charges not be fully passed through to the power sector. In periods where gas plant sets the electricity price, coal margins are likely to be squeezed due to increased track charges. Although the impact on margins is referred to in NERA's report, this should be used as part of any assessment to determine whether the ESI coal sector can bear the track access charge proposals.

18. The NERA analysis refers to a low gas price scenario in which coal transported falls to approximately 10 million tonnes by 2020. This is based upon the view that, amongst other reasons, gas and oil prices may decouple in the future. This may not occur and if so the impact of this outcome should be considered,

19. NERA makes reference to future developments of both *"dedicated biomass plants and coal plants that use biomass for co-firing."* [2] However, the central case market analysis suggests that coal consumption will remain steady between 2014 and 2020, with some annual fluctuations through interaction with gas prices. In turn, the level of generation from coal is assumed steady for the same period at approximately 90TWh. IPR would question whether conversions have been included in the market particularly as the recent ROC Banding announcement by DECC provides a ROC value for biomass conversion (1ROC/MWh) which could lead to some existing coal plant converting, rather than co-firing (IPR is actively considering the conversion of its Rugeley coal fired plant to biomass in the future).

[2] The Impact of Changes in Access Charges on the Demand for Coal, NERA, Page 28

20. Furthermore, IPR would question the premise that, *"the difference between the change in costs and revenues [for biomass]…will manifest itself as either lower margins for biomass generators, or as a requirement for additional subsidies to maintain the profitability of new biomass plants."* IPR questions whether the proposed support levels for biomass, once agreed, could be amended to account for changes or increases to costs associated with track access charges.

Question 7.28 - Do you agree with our proposal, on the basis of MDST's analysis, to not levy a mark-up on certain rail freight commodities, including intermodal, construction materials and metals?

21. IPR does not agree with this proposal. IPR believes that any charging structure should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably.

Question 7.29 - Do you agree with our proposal to levy the proposed charge on ESI coal traffic?

22. IPR does not believe the charge should be levied on ESI coal traffic whilst other market segments are exempt. IPR believes that charges should be based upon the amount/volume of tonnage moved on the rail network rather than distance related. The charge should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably.

23. The ESI coal sector is already faced with a number of regulatory and environmental measures aimed to restrict power generation by coal, including (a) the Carbon Price Support mechanism, (b) Large Combustion Plant Directive (LCPD) legislation, and (c) Transitional National Plan (TNP) requirements. To target ESI coal through the proposed track access charges would be to further impact the ESI coal sector. In addition, the above measures may act to reduce output from coal generation, and coal consumed, before 2020, which could result in revenue implications for levels sought to be raised from ESI coal track access charges.

Question 7.30 - Do you agree with our proposal to levy the proposed charge on spent nuclear fuel traffic?

24. IPR believes that charges should be based upon the amount/volume of tonnage moved on the rail network and should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably. This would include nuclear fuel traffic.

Question 7.31 - What views do you have on our analysis of the iron ore market segment? Do you consider that there is also a case for levying the proposed charge on iron ore?

25. IPR believes that charges should be based upon the amount/volume of tonnage moved on the rail network and should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably. This would include the iron ore market segment.

Question 7.32 - Do you agree that we should revisit our policy on levying a charge for the biomass market segment to coincide with the recalculation of its credit (subsidy) regime (from 2017 for England and Wales)?

26. In order to facilitate the development of power generation from biomass, IPR agrees that it would be inappropriate to levy a further charge on the biomass market segment before 2017.

27. However, the possibility of further track access charges being applied to biomass after 2017 will create uncertainty amongst operators/developers of biomass projects seeking to begin operations before this date. This is particularly the case as charges, or the implementation date, have not been set for future transportation of biomass.

28. In addition, biomass developers will be seeking to secure fuel supply contracts for at least 6 years, so the lack of any certainty in terms of track access charges for biomass could undermine future investment in biomass in the UK market, particularly large conversions of existing coal plant. To mitigate this risk, it would be sensible for dedicated, converted or co-firing plant existing or commissioning before 2017 to have track access charges ‘grandfathered’ beyond 2017. That is, any existing/known current transport charge remains, and any changes to charging structure in 2017 does not apply to these particular plant.

Question 7.33 - Do you consider that the proposed charge should be levied on other (non ESI) coal flows?

29. IPR believes that charges should be based upon the amount/volume of tonnage moved on the rail network rather than distance related. The charge should be applicable to all users of the rail network to ensure all market segments are treated fairly and equitably. To this end, IPR does not agree that the proposed charge should be levied on other non ESI coal flows as it does not agree with the proposed methodology for future track access charges.

For further information please contact:

James Flanagan
Government Affairs Advisor, UK-Europe
International Power Plc
Senator House
85 Victoria Street
London EC4V 4DP
Telephone: 0207 320 8702
Email address: james.flanagan@iprplc-gdfsuez-ukeu.com

Or

Dr Chris Anastasi
Head of Government Affairs, Policy and Regulation, UK-Europe
International Power Plc
Senator House
85 Queen Victoria Street
London, EC4V 4DP
Telephone: 0207 320 8995
Email address: chris.anastasi@iprplc-gdfsuez-ukeu.com