Our ref: 6215A/3.4/MN/X607
Your ref:

3 August 2012

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

Dear Mr. Quill,

Consultation on the variable usage charges on rail freight traffic (May 2012)

We are responding, in respect of the above, on behalf of Kier Minerals part of Kier Infrastructure and Overseas, which is part of the Kier Group a leading construction, services and property group specialising in building and civil engineering, support services, public and private house building, property development and structured property finance. The Group employs nearly 11,000 people worldwide and has annual revenue of £2.2bn.

Kier Minerals within Scotland operates the Greenburn surface coal mine in East Ayrshire currently with 122 direct employees, a significant number for the local economy. Kier Minerals has recently secured an additional planning permission for a further 4 million tonnes of coal at Greenburn, extending its life to 2022, and will require a further 43 direct jobs to be created. It is estimated that the new permission will also provide a further 122 indirect jobs. Achieving this position has required considerable time and investment from Kier.

The Greenburn Mine has a dedicated, and purpose built, rail depot and the coal production is primarily supplied to English power stations by rail. The supply of coal to the power generators relies almost exclusively on the rail and the rail freight operators.

Preamble

The consultation has a range of suggested charge increases but it appears that an increase is being forecast of £4.50 /tonne. It has been stated in the consultation that the coal producers could absorb this increase in track charges. There is no evidence base presented in the consultation to support this assertion, and appears to be an arbitrary statement. Furthermore, it is proposed the coal industry and the nuclear industry are to be singled out to be burdened with these increased track charges. The cynical view could be taken that these two industries are seen by the ORR as a captive market without the ability to revert to road transport.

There are concerns that the consultation proposals is contrary to certain Government policies and if implemented could pose a serious threat to not only to the rail freight industry but also to the UK coal industry, and in particular the viability of Scottish coal mines. These concerns are set out in detail below.

Impact on Coal supply in the UK by Track Access Charges

Figures from the Department of Energy and Climate Change (DECC), show that coal production in the UK was 17.9 million tonnes in 2011. Scotland contributed 33% of this total as a contribution to supplying the UK coal fed electricity generation need.

Coal is a significant and essential component to the electricity generation in the UK regularly contributing over 50% of the electricity produced on a winter day, and quite commonly 40% on a summer day.

Contrary to the consultation documentation statements about high international coal prices the reality is that coal prices have dropped by approximately 30% in the last year. This is reflected in the recent trading announcements from a number of the UK coal industry companies, which show an industry under severe financial strain.

Against this background the coal industry is under additional pressure directly from the requirements of the CRC, and indirectly from the requirements imposed on the electricity generators, by Large Plant Combustion Directive (LPCD), Industrial Emissions Directive (IED), and the Electricity Market Reform (EMR). Notwithstanding this the key EMR drivers are security of supply, affordability of electricity, and decarbonisation.

The effect of the proposed increase to track charges will threaten the security of indigenous coal production if one accepts that the result of the track charges will shrink the coal market by 5% to 10% as identified in the consultation. This will damage the secure base of coal generated electricity capacity which stated above has been at a consistent 40-50% of total generation. Due to the much longer haul from the mines in Scotland to the English power stations the adverse consequences of the track charges will be disproportionately felt in Scotland than elsewhere in the UK coal industry.

In terms of affordability of electricity the consultation assumes that the Scottish coal producers will absorb the increased cost. As previously stated there is no evidence base presented for this assumption, and as stated the coal industry is currently under financial pressure, and these additional costs will threaten mine viability with the inevitable switch to gas by generators. This will impact price and security of supply. The ORR consultants, in their conclusion to their report *The Impact of Changes in Access Charges on the demand for Coal (page 42)* acknowledge the threat to Scottish produced coal by the long term impact of increased track charges on the development of future opencast coal mines in Scotland. These concerns do not appear to have made it to conclusions of the main consultation report.

Assuming the above scenario of a 5% to 10% reduction in the UK coal production happens there will be a requirement to increase the amount of coal imported with the increase in the carbon footprint in transport and a likely carbon emissions increase. The transfer of environmental and social impacts overseas is of concern to the UK Government. ''Securing the future – UK Government sustainable development strategy'' states that environmental policy should encompass impacts outside the UK *''there would be little value in reducing environmental impacts within the UK if the result were merely to displace those impacts overseas...''.* Those impacts would include the transport of raw materials into the UK. It is important that the UK make the most of our indigenous coal assets and recognising, that apart from the important security of supply issue, a domestic minerals industry is the most sustainable way to supply the market.

In the market analysis section of the consultation it acknowledges that there could be a substantial reduction (up to 25%) in the demand for rail hauled coal because ''*there is scope for reductions in length of haul''.* As coal can only be mined where it exists this appears to be a clear policy by ORR to direct electricity generators to import coal via ports to achieve the shorter haul on rail that it alludes to in its analysis, rather than take indigenous UK coal. Due to the substantially longer haul distances for Scottish mined coal to the English power stations the track charge proposal can only be seen as a direct attack on the Scottish coal mines. Furthermore generators sourcing their coal from overseas will not be able to pass any increased track charges to international coal producers. The only way these extra costs can be recovered is through increasing the price of electricity to the consumer.

There is also concern if there is a need to substantially increase coal imports whether there is enough rail served deep port capacity to cope with the increase.

At the suggested track charge increase of £4.50/tonne for coal from Scotland we believe that this could double the cost of coal transport from Greenburn Mine to Kier customers in England. There is no prospect of transferring this supply to the roads for cost and environmental reasons. This level of cost increase will impact heavily on the viability of coal operations in Scotland, with the real possibility of mine closure. If operations were to close this would have a significant impact on employment, both direct and indirect, in East Ayrshire where the Greenburn mine is located. This area of Scotland, which suffers from high levels of unemployment, relies heavily on the well paid jobs provided by the coal industry. Any reduction in these jobs would be very noticeable in the local economy.

If, and in the unlikely event, the cost increases proposed were absorbed by coal operators then the average working ratio for coal extraction would be lowered effectively sterilising higher ratio coal that would otherwise be economically viable. This would clearly be against the sustainable objectives of the Government.

It is also important to note that Carbon Capture and Storage projects are due to start in 2014. The proposed increase in track charges could seriously damage the prospects of these projects before they start. This would threaten the ability of the UK to build up its indigenous capacity to be self sufficient with respect to energy supply.

Impact on the Rail Freight Industry

The coal industry is heavily dependant on a healthy rail freight sector and any potential threat to it is also a direct threat to the coal industry. Consequently it was of concern to read the various comments made by the Rail Freight Group (RFG) to the Chief Executive of the ORR in their letter dated 28 May 2012 as an initial response to the consultation.

First we note the comment of the RFG about how the ORR has chosen to balance its duties and whether undue weight has been given to the duty to have regard to the funds available to the Secretary of State perhaps at the expense of the duty to promote the use of the railway for rail traffic, and the duty to enable companies to plan their businesses with a reasonable degree of assurance. This concern seems to be backed up with the apparent acceptance by the ORR within the consultation document that a 10% drop in coal rail traffic as a result of increased track charges is acceptable, without any analysis on the potential impact this could have either on the rail freight industry or on the coal industry as an end user.

Furthermore in the RFG letter it is noted that the size of the specific freight charge expected to be levied ''*will be a considerable financial risk for the rail freight operators*'', and it also identifies that in effect they are making an operational loss based on latest figures. Consequently the impact of a £50-60m risk, as suggested in your consultation analysis, on the rail freight industry is substantial. From a coal industry point of view the concern is, as expressed by RFG in their letter that the option for the rail freight operators to exit the market or consolidate cannot be ruled out. Such a scenario would likely to be terminal for the coal industry especially in Scotland.

This concern, stated above, appears to be acknowledged by the ORR consultants, in their conclusion to their report *The Impact of Changes in Access Charges on the demand for Coal (page 42)* where they acknowledge *further important uncertainty* on how Rail Freight operators will react and whether one company may try and absorb some or all of the increased track charges. The report further adds that '*the longer term implications will depend on whether such a move leads to any change in the level of competition between freight operating companies. If competition was reduced because of a market exit decision, consolidation or bankruptcy, this could have wide-ranging implications for both rail freight customers and also infrastructure maintenance costs.*'

Kier Minerals support the RFG concerns expressed above.

Conclusion

All the above comments show that the consultation has been blinkered and not considered the wider strategic impacts if the suggested track charges are implemented.

The proposed track charge increase proposed appears arbitrary, and not supported by any evidence base, as are the comments that the coal industry would be able absorb such costs. This leads on to the unacceptable conclusion that there will be a reduction of 5-10% in

coal transport by rail which is an odd position for the ORR to be supporting bearing in mind their duty to promote rail use.
The consequence of these charges if implemented will impact the viability of the UK coal industry, particularly in Scotland, with the resultant increase in imports, carbon footprint and loss of employment. The practical effect of these proposals is a direct attack on the coal industry in Scotland, and the likely withholding of further investment in the industry.

The proposal would also seem to be contrary to other Government policies of indigenous energy generation, security and affordability of supply, employment, and sustainable development.

It is the view of Kier Minerals that the most appropriate way forward is the maintenance of the status quo in respect of the current charging regime.

I would be grateful if you could acknowledge receipt of this letter

Yours sincerely,

Mark Harrington
Mining Director