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10<sup>th</sup> August 2012

Dear Mr Quill

**Periodic Review 2013: Consultation on the variable usage charge and on a freight-specific charge**

**Tata Steel context**

Tata Steel is one of the world's top ten steel producers. The combined group has an aggregate crude steel capacity of more than 28 million tonnes and approximately 80,000 employees across four continents.

The European operations of Tata Steel (formerly known as Corus) comprise Europe's second largest steel producer. With main steelmaking operations in the UK and the Netherlands, they supply steel and related services to the construction, automotive, energy & power, material handling and other demanding markets worldwide.

Tata Steel's integrated steel producing hubs in the UK are in Port Talbot, south Wales, and in Scunthorpe. Port Talbot produces 'flat products' for automotive, packaging, white goods and some construction products. Scunthorpe produces 'long products' such as construction beams, wire rod and rail as well as producing steel plate for offshore and onshore wind markets and feedstock for special profiles in the lifting and excavating sector. There is little flexibility to swap production between one hub and another due to asset requirements.

Tata Steel's UK operations directly employ 20,000 people and indirectly support more than 100,000 jobs nationally. In many cases it is the largest local private sector employer and the development of its activities have been, and continue to be, integral to surrounding local communities.

**Steel industry context**

**TATA STEEL**

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The dynamics of the steel industry are highly international and deeply competitive. 55% of steel sold in the UK last year was imported. The proportion of steel that's both made and consumed in the UK as a proportion of total UK consumption (i.e. including the import of steel in finished goods) has reduced from 90% in 1970 to 23% in 2011. The UK steel industry has also got to compete on a truly global level for key raw materials and investment funds.

The prolonged poor economic conditions have impacted the steel industry badly with activity levels in the UK reaching the low points of the 1980's in early 2012. Core steel consuming sectors such as the construction sector have continued to decline, although there are stronger niches such as the premium automotive segment. It seems far from clear to many commentators when significant broad based recovery will return and at what pace. TSUK and many other European steel makers are being forced to realign production to demand levels by changing operational patterns and delaying production restarts.

The highly competitive nature of the steel industry and the rigorous focus on operational efficiency across the European industry has resulted in a relatively flat 'cost curve' or 'merit order' as judged by 3<sup>rd</sup> party specialists. Thus seemingly minor increases in national or plant level costs can have significant adverse impacts on a plant's competitiveness. This principle has been recognized by the UK government in relation to the impact of some other unilateral policies such as the Carbon Price Floor.

### **Tata Steel's exposure to the UK rail sector**

We believe that Tata Steel UK ("TSUK") is the largest external rail customer in the UK, covering movement of raw materials (including coal and iron ore), scrap, semi and fully finished steel. TSUK's estimated annual spend on rail freight is around £80m.

The impact of rail charges has a number of 'additive' effects for TSUK, e.g.:

- Around two tonnes of raw material, principally iron ore and metallurgical coal, are required for every one tonne of steel produced
- Semi-finished steel products are frequently moved between sites for different types of further value addition
- A growing proportion of these further value added products are then transported to end customers by rail

TSUK have consciously attempted to follow government policy and guidelines in diverting volume onto the rail. We have made good progress on this shift, with some 75% to 80% of all tonnage now moved by rail at some point in the manufacturing process (vs, we believe, only 5% of UK total freight is moved by rail). This shift is driven by two key criteria:

- *Environmental*
  - Tate expect to consign approx 1,400 kt miles to rail per annum, equivalent to over 740,000 lorries journeys.



- Such additional vehicle movement would escalate road congestion considerably, particularly in the areas around our sites but also more widely (we note that road congestion is already estimated to cost the British economy up to £8bn every year).
- If all the TSUK's freight was converted to road it would require an additional 10 million more gallons of diesel fuel per annum, thereby increasing levels of various undesirable emissions as your consultation document rightly notes.
- *Supply chain efficiency*
  - Rail has the capability move large volumes of material relatively quickly. This is important assist manufacturing continuity and delivery performance for TSUK's customers, the majority of whom are UK manufacturers

### **Common themes of our responses to individual questions and alternative solutions**

Given the priority we have placed on a modal shift to rail, the highly competitive nature of the steel industry and the persisting extremely tough economic environment we are deeply disappointed by a number of aspects of the proposed PR13 approach. In summary, we believe that certain proposals risk producing the following negative effects for TSUK and the UK through increases in cost levels and higher uncertainty:

- Reduce the attractiveness of the UK as an investment location
- Disproportionately impact Tata Steel vs other UK industrial businesses
- Negatively impact the UK's environmental performance by implicitly incentivizing modal shift.

**Although a precise assessment of the net direct impact of TSUK is difficult given uncertainty about some aspects of the proposals, it's possible that we would be facing a £10m (12.5%) increase in our rail freight costs. This impact would be localized around some parts of our business. In addition there would be an indirect impact as power generators pass through their additional costs to customers. And in the longer term we have a fear that pricing transport off rail may reduce the overall efficiency of the rail industry leading to longer term cost creep for remaining users.**

We applaud Networks Rail efficiency drive to date and the actions of the ORR to facilitate and incentivize this. We believe that the best route to continue this admirable trend is through targeting delivery of further efficiency such as increased axle loading on selected heavy freight routes, and increasing access to the network over a full 7 days period rather than trying to recover 1% of the their total revenue through increasing track access charges for rail freight customers. We very hope to contribute to delivering such efficiency improvement initiatives through engagement with key stakeholders, such as the ORR and Network Rail, and cooperation with operating companies.



## Responses to specific consultation document questions

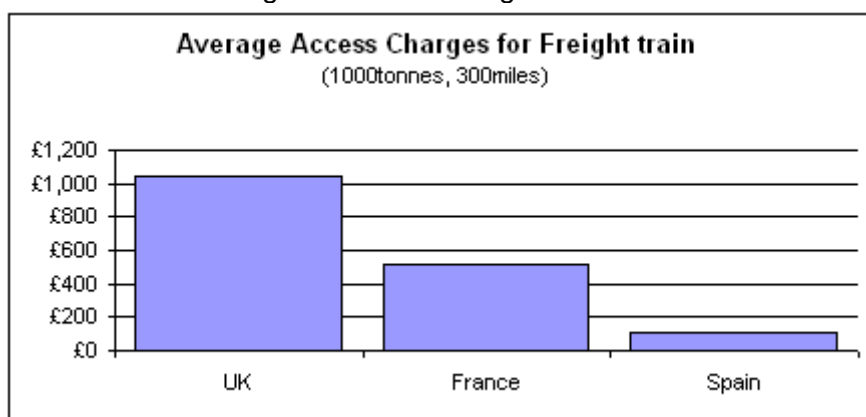
We have focused our response on questions where we feel we can add a distinctive perspective.

*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?*

The proposed changes to the charging mechanism will add uncertainty complexity to an already fragmented charging structure based upon loco type, wagon type, commodity carried. The proposals for an over complicated formula for calculating track access costs are unmanageable and will be severely detrimental to our business and operations.

Road operators can easily provide pricing for new flows at short notice as road VED rates are known, simple to calculate, and short run fuel costs known. The practical implication is that quoting for spot opportunities by rail is already more complex on rail than road and the proposal will diminish the rail industries ability to offer short lead time movement solutions leading to greater road use.

As highlighted previously steel is an internationally traded product. The 'cost curve' of £ / tonne of steel within Europe is increasingly flat as producers strive to greater levels of efficiency. Our own benchmarking of rail charges vs elsewhere in Europe suggests that a competitive gap already exists with our European counterparts – at least between 10 - 20% higher on a like for like basis in the UK than in mainland Europe. A graphic illustration of how large this disadvantage can be is shown below.



Source: DB Schenker

It seems highly likely that the proposed measures will push this competitive gap higher. TSUK would experience this disadvantage at multiple levels – the 'input' transport of raw materials, the 'intermediate' transport of semi finished steel products from one TSUK site to another and the 'finished' transport of products to customers. It is



therefore disappointing to see an international perspective not reflected in the report and consideration given to its impact.

*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?*

Confidence and stability of a regulated pricing regime is, as your consultation document rightly states, very important for long term investors. The time horizons of such investors run over multiple PRs. We would make the point that this is equally true of non-rail industry investors for whom rail represents a substantial cost input.

For the relatively high level of investment TSUK has seen since its acquisition by Tata to continue it is crucially important to have a stable, transparent regulatory and external charging regime. This is obviously a common theme across a range of areas where there is a substantial Government or Regulator input but poor experiences in one area, such as rail, can have disproportionate impact on investment perceptions of Boards who have to take a global perspective.

We are concerned that substantial changes from one PR to another, including the imposition of new, narrowly targeted charges together with increased variability run the risk of reducing the attractiveness of the UK as an investment location.

*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?*

Of the three remaining iron-ore consuming steel plants in the UK only one – TSUK's plant at Scunthorpe – has an inland location and is therefore subject to the external transportation of iron ore. So the proposal to levy a specific iron ore charge is actually a direct tax on one particular operation. Such a charge not only impacts the absolute competitiveness of steel production at Scunthorpe it also negatively impacts its relative attractiveness of the plant as the location for further investment. The pressure that inland plants are under is clear, for example, from the public announcements that our largest competitor Arcelor Mittal has made in its "Asset Optimisation Plan".

TSUK's rail production activities are primarily based at Scunthorpe. Our activities in this sector are a notable export success story for the UK with recent major orders supplied to Singapore and India for example. TSUK rail activities are also delivering important innovations, such as the SilentTrack™ rail supplied into the Blackfriars development. Negatively impacting the competitiveness and viability of this site therefore risks harming the UK rail sector in a much broader sense.

Therefore we would ask in the strongest possible terms for the proposal of iron ore specific freight charge to be withdrawn.



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

TSUK is a large consumer of coking or metallurgical coal. Again, Scunthorpe as an inland site is highly dependent on the rail route for Immingham for its supply. Similar arguments drive our objection therefore to levying an additional charge on coking or metallurgical coal rail freight. In addition, we attempt to source increasingly quantities of coal from UK suppliers. This would clearly become less viable for our Port Talbot steel making plant in South Wales which has a port and therefore a choice of where it receives its coal. Reduced TSUK demand would have a massive negative impact on certain sectors of what remains of the UK coal industry. We would be prepared to discuss this matter further directly with the ORR.

**In summary, Tata Steel is extremely concerned that potential increases to track access charges, and in particular proposals on the movement of essential raw materials such as iron ore and coking coal, could not only impact on the competitiveness of our products in the short term but could also contribute negatively to the long term viability of UK steel producing sites to attract and retain crucial inward investment. This point is particularly relevant to our Scunthorpe site that does not have access to deep sea ports and therefore relies on rail for the delivery of iron ore to the site.**

Yours sincerely,

Tim Morris