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Dear Joe,

28 March 2013

Periodic Review 2013: Consultation on a freight specific charge for biomass.

This letter contains the response by DB Schenker Rail (UK) Limited ("DB Schenker") to the consultation document entitled "Consultation on a freight specific charge for biomass" issued by Office of Rail Regulation ("ORR") on 15 February 2013.

Introductory Remarks

1.1. This response should be read in conjunction with DB Schenker's reply dated 10 August 2012 to ORR's earlier consultation document entitled "Consultation on the variable usage charge and a freight specific charge". Whilst DB Schenker will not repeat all of its earlier representations here, to recap, the key comments relating to biomass were:

"DB Schenker agrees (with ORR's proposal) that it is not appropriate to introduce increased charges for biomass at this point for the following reasons:

- a. this is a nascent market which is very much in a "start-up" phase;*
- b. assuming that the electricity supply market and Government policies develop in way that facilitates the use of biomass, very considerable capital investment in wagons and product handling facilities will be needed; and*
- c. the scale of these investments, and their payback periods, may require ORR to give greater certainty that biomass will not be targeted at the next Periodic Review."*

1.2. Given this, DB Schenker finds it extraordinary that ORR has completely reversed its earlier position and has now decided to subject the market segment to what it calls "planning certainty" by imposing a new freight specific charge and freight-only line charge for biomass - largely on the mistaken notion of the need to give equivalence between biomass and coal. Coal and biomass are simply not linked in the way that the ORR seems to think they are.

General Comments

2.1. DB Schenker strongly opposes ORR's decision to introduce a freight specific charge and freight-only line charge for biomass. The imposition of such charges on an emerging market that barely exists will severely damage expectations that customers will be attracted to using rail for the transportation of significant amounts of this commodity.

2.2. The government has openly encouraged the conversion of existing coal-fired power stations to run on biomass in order to help fulfil its renewable energy and carbon reduction commitments while maintaining security of electricity supply. In support of these commitments, the government has also encouraged multi-million pound investments in low carbon technologies through the establishment of financial support arrangements set out in the Renewables Obligation legislation (RO) and is finalising details of the new Feed-in Tariff with Contracts for Difference (CfDs).

2.3. ORR's 'about turn' in deciding to impose a freight specific charge and a freight-only line charge on biomass has emerged so late in the day that these charges have neither been factored into the recent RO Banding Review nor into the strike price setting for the CfDs. This will, therefore, result in such charges ultimately being funded by power station owners who, given that they already need government support to use biomass, implies that the market cannot afford to bear such charges. ORR's decision, therefore, undermines the lengthy consultation process that the government has already concluded with the power industry on providing financial support for biomass. A single coherent regulatory regime between government departments and agencies is urgently required in relation to biomass.

2.4. In taking this decision, DB Schenker considers that ORR will now effectively disincentivise the full or partial conversion of power stations to take biomass at a time when a number of generators are preparing to submit business cases to their respective Boards to fund the necessary conversions to help meet government objectives in this respect.

2.5. In fact, a number of those customers and suppliers preparing to invest in biomass and the future of the energy industry have already spent significant time and money in choosing their logistics partners and in some cases have already made early investments in plant and equipment. ORR's decision will, therefore, run directly counter to government energy policies and could fundamentally alter long-term investment plans and arrangements as customers will need to reassess their chosen partners. This will also produce similar impacts on rail freight operators and equipment suppliers with the inevitable reduction in supporting investments that would have contributed to the development of transporting biomass by rail. ORR's decision thus also contradicts its duty to allow rail freight operators to plan their businesses with a reasonable degree of assurance.

2.6. DB Schenker considers ORR's decision all the more surprising given that the use of biomass as a fuel source in power generation already receives subsidy from the government, a fact acknowledged by ORR in its consultation document but seemingly

ignored in its decision. It could be strongly argued, therefore, that an emerging market which barely exists and requires subsidy and significant investment to develop and grow cannot be considered to be able to afford increased track access charges in the form of an additional freight specific charge and a freight-only line charge. In requiring significant investment and support from both the government and the private sector to allow the UK achieve its mandatory green targets, biomass is, therefore, in a completely different position to the well established markets of ESI coal, iron ore and spent nuclear fuel that ORR has also decided to impose a freight specific charge and freight-only line charge upon. In addition, given that biomass is a renewable energy source, it is not clear to DB Schenker how, in arriving at its decision, ORR has taken into account its duty to contribute to the achievement of sustainable development.

2.7. Furthermore, owing to the differing calorific value of the products, more biomass will be needed to produce the same amount of electricity as is currently produced by coal. If ORR's decision is implemented, it would actually serve to penalise biomass compared to coal, benefiting the continuance of coal-fired power stations and increasing the differential between the two fuels that other government departments are simultaneously working hard to remove. It appears, therefore, that ORR has made its decision in isolation and by doing so has ignored overall government strategy which must be taken into account when considering whether and how any additional freight specific and freight-only line charges on biomass are implemented.

2.8. It is not clear from the consultation document how ORR will calculate the proposed charges. Without this transparency, the industry cannot be clear that the charge is fair and reasonable. ORR should make its methodology clear in advance of any decision being made (including in respect of the calculation of any freight-only line charge). However, DB Schenker is aware that one power generator has estimated that the ORR's decision to impose a freight specific charge on the rail transportation of biomass could add between £0.50 and £1.50 per tonne to the overall price of biomass. This increase is a material change to ORR's earlier proposal (i.e. that such a charge should not be imposed on this market segment) and, as indicated in paragraph 2.4 above, may have the effect of delaying or even halting a number of biomass projects, potentially endangering thousands of existing and potential jobs at power stations, rail companies, construction businesses and ports.

2.9. Given ORR's acknowledgement in its consultation document that "biomass is an emerging market for which relatively little data are available", it seems that ORR's decision to impose a freight specific charge and freight-only line charge on biomass is based merely on conjecture and supposition, particularly given that the consultants' reports relied upon by ORR were available at the time of ORR's earlier proposal not to implement these charges on biomass. Although ORR indicates in its consultation document that there have been further developments in the market segment since its earlier proposal, it does not say what those further developments are and how they have made ORR completely overturn its previous position. DB Schenker, therefore, cannot understand how ORR can be in any way certain that the transportation of biomass by rail is a market segment that can afford to bear higher track access charges in line with relevant legislation. DB Schenker is aware that ORR can only levy increased charges ...

if the 'market can bear it'. DB Schenker strongly believes that the market segment for biomass cannot 'bear it' particularly given that it already requires private investment and public subsidy through the RO in order to develop and grow.

2.10. In summary, therefore, DB Schenker submits that for the reasons set out above, it rejects ORR's decision to impose a freight-specific charge and a freight-only line charge on biomass as it is:

- contrary to relevant rail legislation (i.e. EU Directive 2001/14/EC as transposed into UK law through the Railways Infrastructure (Access and Management) Regulations 2005 as the market clearly cannot afford to bear such charges;
- runs counter to wider government policy to encourage the conversion of existing coal-fired power stations to run on biomass in order to help fulfil its renewable energy and carbon reduction commitments; and
- may have the effect of delaying or even halting a number of biomass projects, potentially endangering thousands of existing and potential jobs at power stations, freight operators, construction businesses and ports.

ORR's Specific Questions

3.1. It should be noted that the responses to ORR's specific questions should not be taken as an indication that DB Schenker accepts or supports the imposition of either a freight specific charge or freight-only charge on biomass. From its general comments set out above, it is clear that DB Schenker supports neither charge.

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

3.2. Given the likely volumes involved, it could be argued that the imposition of a freight specific charge/freight-only line charge on biomass may not lead to significant modal shift from rail to road. However, DB Schenker considers that a 'road versus rail' test is not appropriate in this case. This is because what is likely to be achieved through the imposition of these additional charges is to encourage power generators not to use biomass at all and instead continue to make use of other fuels, such as coal thereby directly running counter to wider government policy to incentivise the conversion of existing coal-fired power stations to run on biomass in order to help fulfil its renewable energy and carbon reduction commitments.

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?

3.3. As stated earlier in this response, DB Schenker considers that biomass should not be subject to a freight specific charge. However, should a freight specific charge be applied to biomass and the ORR's aim is to promote cost reflectivity, the charge would need to be calculated on the same basis that has been applied to the other commodities ORR has previously deemed should be subject to a freight-specific charge.

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

3.4. Whilst alternative proposals for modifying the freight specific charge based on calorific value or exempting small stations may make the charge fairer in comparison to coal, it appears that fairness is not a consideration for ORR in deciding to impose this charge as it would contradict ORR's mantra of cost reflectivity.

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?

3.5. Again, given the aim of cost reflectivity, there would appear to be little or no alternative to applying the same methodology as that used for other market segments to which a freight specific charge applies. However, in imposing a freight specific charge on biomass, DB Schenker would expect ORR to revisit the levels of the freight specific charges that are to be applied to other commodities to ensure that there is no double-recovery.

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?

3.6. DB Schenker considers that the freight specific charge of £4.04 per kgtm for biomass is not reasonable because contrary to ORR's belief, biomass and coal are not interchangeable. The calorific value of biomass is much lower than that of coal which means that greater volumes of biomass are required to generate the same amount of electricity. Therefore, imposing the same charge for biomass and coal will penalise biomass compared to coal, benefiting the continuance of coal-fired power stations and increasing the differential between the two fuels that other government departments are simultaneously working hard to remove.

Q6. Should a freight 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 coal freight specific charge?

3.7. If the freight specific charge for coal, iron ore and spent nuclear fuel is being phased in then there would be no reason why any freight specific charge for biomass should not be subject to similar phasing subject to any views from the Department of Energy and Climate Change to ensure alignment with wider government regulatory policy on biomass. However, as stated throughout this response, DB Schenker considers that biomass is currently an emerging market that already requires significant government subsidy and private investment if it is to develop and grow. Therefore, DB Schenker believes that this is not the right time to impose a freight specific charge on this market sector and ORR should instead postpone its decision until the market segment becomes more established and actual data can be evaluated rather than the current reliance on subjective views and judgement.

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

3.8. Given the aim of cost reflectivity, there would appear to be little justification in applying a different method to calculate a freight-only charge for biomass. However, in imposing a freight-only line charge on biomass, DB Schenker would expect ORR to revisit the levels of the freight-only line charges that are to be applied to other commodities to ensure that there is no double-recovery.

Please contact me if you would like any clarification or amplification of any of the points in this letter; we would, as usual, be happy to discuss this further and have no objection to the contents becoming public

Yours sincerely,



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