Response to Office of Rail Regulation Consultation on the variable usage charge and on a freight-specific charge

May 2012

Energy UK has been formed by merging the Association of Electricity Producers, the Energy Retail Association and the UK Business Council for Sustainable Energy. With over 70 members we cover the broad spectrum of the energy industry and include companies of all sizes working in electricity generation, energy networks and gas and electricity supply, as well as a number of businesses that provide equipment and services to the industry. Our members generate more than 90% of UK electricity, supply up to 26 million homes and last year invested £11 billion into the economy.

Energy UK's members use a wide range of power generation technologies and include the companies which own and operate all the coal-fired and nuclear power stations in the UK. We therefore welcome the opportunity to respond to the ORR's consultation on track access charges. We consider that the principles applied in formulating the proposed new freight-specific charge are not equitable and that the charge is likely to have consequences for the energy market which are not properly assessed in the ORR's analysis. We therefore do not support the proposal to levy a new charge solely on the transport of ESI coal and spent nuclear fuel in order to recover freight avoidable costs. Our members may have differing views on some of the specifics of the charging methodology proposed by the ORR and will comment on how these proposals might affect their businesses in their own responses to this consultation, but Energy UK considers that there are a number of issues to which the ORR should give further consideration.

Principle of the charge and its allocation

We are concerned by the principle applied by the ORR in recovering costs only from those market segments which have inelastic demand and lack the potential to switch to road, which we consider to be discriminatory and inequitable. This approach unfairly penalises sectors purely on account of the nature of the materials which they need to transport and factors which are outside of their control. It is unlikely, for example, to be publicly acceptable or in keeping with best practice in terms of safety and security to transport spent nuclear fuel by road. It is crucial that whatever charging arrangements are put in place are fair and reasonable. If the aim of the new charge is to recover freight avoidable costs which are not recovered through other charges, we cannot see why all rail freight market segments should not contribute their share of the costs. It is important that the principle of cost-reflective charging is followed and that charges do not result in some sectors being subsidised while others, which are unable to adopt alternative means of freight transport, have to pay their way. The ORR should aim to avoid perverse outcomes, such as ESI coal paying increasing charges even though its use of the rail network is decreasing.

Analysis of whether the market can 'bear' the charge

The ORR has adopted a very narrow and subjective consideration of whether a sector is able to 'bear' the increase in track access charges, looking only at whether there is a significant risk that use of rail infrastructure will decrease. We do not consider that the ORR is best placed to determine what counts as an acceptable level of impact on electricity generation on this basis. We are unclear how the ORR can accurately assess the impact of its proposals on the power generation sector given the changes that the sector will experience in the next decade. The cumulative impact of an increase in freight charges together with other policies affecting the energy sector has not been properly considered in the analysis.

The ORR proposes to introduce a cap to ensure that the reduction in market activity is not more than 10%, but there is no substantive reason given why 10% is considered a “reasonable” level. We are unclear whether this cap would be an annual figure or across the charging period and how the ORR would regulate the impact of the charges to distinguish between declines in ESI coal freight due to the increased coal freight charge and declines from other market forces, such as commodity or carbon price fluctuations.

Our members consider that there are errors and inconsistencies in some of the assumptions used in the analysis accompanying the consultation, which mean that the assessment of the impact of the changes on the power sector may be invalid. In particular, the data on future ESI coal use and fossil fuel prices does not appear to align with those provided by DECC and the consultation document appears to be inconsistent in its estimate of the proportion of freight movement for which ESI coal is responsible. The ORR should review the underlying data to ensure that it is consistent with industry and government expectations and with the ORR’s own calculations.

Implications for investment decisions and government energy policy

Energy UK is concerned that the consultation does not fully consider the wider impacts of the proposed charge on the energy market and the government’s energy policy ambitions. We do not consider that it would be appropriate for rail freight charges to be a significant driver of outcomes in the energy sector by distorting the relative economics of power generation fuels and technologies. The implications of the proposals do not appear to have been discussed with DECC and Ofgem.

The proposals will have an impact on the investment decisions which the electricity industry will have to make in order to help meet the UK’s energy policy goals. For example, the charge will add additional cost to coal-fired electricity generation at a time when there are already mounting economic pressures on coal-fired plant and significant uncertainties surrounding the future of coal-fired generation and its role in the energy mix. Coal-fired power stations need to make important decisions before 2014 about whether to invest in new technology, reduce production or close. The timing of these proposals adds to the uncertainty that companies face in making these choices.

NERA’s analysis clearly shows that the new charge could have a significant impact on whether coal-fired plant will opt in or out of the Industrial Emissions Directive. Decisions over whether to invest in further equipment to control emissions at coal-fired plant or whether to run for a limited number of hours and then close must be taken by the end of 2013 and the full range of economic drivers will need to be considered by companies. Increased freight charges could be an extra disincentive to the continued operation of coal-fired plant and a further driver of plant closures, possibly putting security of electricity supply at risk or increasing the cost of capacity for electricity consumers. Increased freight charges for spent nuclear fuel could also act as a disincentive for nuclear operators to seek life extensions for their plant, which has not been properly considered in the ORR's analysis.

As stated in the recent decisions on the Renewables Obligation Banding Review, the government considers the use of biomass at coal-fired power stations to be one of the quickest and cheapest ways to decarbonise electricity production. It expects a significant proportion of coal-fired plant to begin using greater levels of biomass in the period up to 2017 and the Banding Review has allowed generators a flexible approach to achieving this. The options of enhanced co-firing and unit-by-unit conversion means that coal will play an important ongoing role alongside the burgeoning use of biomass at existing fossil-fuelled power stations. The ORR should therefore consider how its proposals might alter the economics of biomass co-firing and hence the opportunity to develop this low carbon option in the power sector. Decisions over whether and to what extent to biomass will be used at existing coal-fired plant are likely to be made in the coming years and the possibility of a review of whether to implement the charge for biomass will create additional uncertainty for investors. We therefore consider that clarity is required now as to whether and when the charge might be implemented for biomass.

The charge would also need to be factored into the economics of the development of new nuclear power stations and Carbon Capture and Storage projects, which are a key part of the government's strategy for the long-term decarbonisation of the power sector.

Impact on energy bills

The proposed charge transfers freight avoidable costs from taxpayers (and other rail users) to a similar set of consumers in the form of energy customers. We therefore doubt the extent to which the charge actually increases value for money for the taxpayer. The analysis in the consultation suggests that an increase in access charges of £10 per net tonne kilometre could increase electricity consumers' bills by some 0.2%. Energy UK does not consider this insignificant at a time when there is already upward pressure on energy customers' bills and it will only serve to compound public and business concern about energy costs. The way in which additional costs arising from track access charges will add to cumulative pressure on energy bills, particularly for customers in fuel poverty or for internationally competitive businesses, does not seem to have been properly considered in the ORR's analysis.

Energy UK considers that the ORR should fully assess the implications of its proposals for the power sector and reconsider the approach proposed in the consultation document in the light of the above comments. We would be pleased to elaborate on or discuss further any of the points raised in this response.

14 August 2012

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