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11th August 2012

RWE response to the Office of Rail Regulation "Consultation on the variable usage charge and a freight specific charge"

Dear Joe

Please find enclosed the RWE response to the "Consultation on the variable usage charge and a freight specific charge" published by the Office of Rail Regulation on 17th May 2012. This response is provided on behalf of the RWE group of companies, including RWE Npower plc, RWE Supply and Trading GmbH and RWE Npower Renewables Limited, a fully owned subsidiary of RWE Innogy GmbH.

We recognise the need to develop charges that better reflect the costs associated with the use of freight transport across the GB rail network. We support the proposals to introduce a variable usage charge with a cap for freight services that would hold for a nationally-based charge at £1.68 per kgtkm (2011-12 prices) for end CP4 efficiency, which is £1.46 per kgtkm plus a 15% confidence band. While there may be greater potential for geographically disaggregated charges, we believe that further work is required to establish the basis for any such change to the charging regime. We look forward to working with you on this.

With regard to freight avoidable costs we note the work that you and your consultants have undertaken to examine the elasticity of certain market segments. However in our view all market segments should be treated equally. Introducing charges that are related to the perceived elasticity of certain market segments cannot be objectively justified and may be considered discriminatory. In addition, your conclusions with regard to the future development of biomass power stations seem flawed. Following the announcement of the RO Banding conclusions recently, we believe that the majority of biomass demand will be from existing large power stations utilising existing port infrastructure. In addition, it is clearly not the case that developments will be small scale, purchasing biomass from local areas. Recent announcements by existing coal generators would seem to support this view, resulting in millions of tonnes per year of biomass being imported and transported by rail.

While we accept that with regard to certain commodities there is limited opportunity for substitution, in the Electricity Supply Industry (ESI) an increase in costs for one form of transport will encourage substitution unless alternatives are also subject to similar charges. Consequently cost reflective charges must be introduced for

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biomass alongside coal. We believe the impact of increased costs for biomass should be considered in the relevant support regime not by the ORR.

In our view ESI freight transport charges for nuclear, coal and biomass must be based on a charge that is levied per kgtm (thousand gross tonne miles) with no cap on mileage as this would not be cost reflective. Such charges must be introduced in the next price control period. We do not believe that such charges should include a maximum charge for any one journey. We do not support the introduction of a charge per tonne lifted since such charges are not cost reflective in as much as this would not reflect the cost of track usage.

We note the conclusions that *"track access charges are likely to make port locations more attractive relative to inland locations. However, increases in track access charges might impact on investment and location decisions for new power plant."* We do not agree that this is a reason to not introduce a Freight Specific Charge to biomass. On the contrary, we believe that the cost reflective freight charges provide the correct economic signal for power station location and investment in biomass capability with respect to costs incurred by Network Rail.

The answers the detailed questions in the consultation document are included as an attachment to this letter.

If you wish to discuss any aspect of our response, please do not hesitate to contact me.

Yours sincerely

Terry Ballard
Policy & Public Affairs

Attachment 1: Answers to the "Consultation on the variable usage charge and a freight specific charge" consultation questions

Chapter 3 – variable usage charge

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?

We have no evidence to provide.

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?

From the information in the consultation document it would appear that a 15% confidence interval would be appropriate. However, we believe that Network Rail should undertake further work to reduce the level of uncertainty in variable charges.

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

We agree with the approach taken by ORR on the basis of the information presented in the Consultation Document.

Chapter 4 – Framework for a freight-specific charge

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?

We agree that cost reflective charges should be introduced for nuclear, coal and biomass.

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?

We agree that the infrastructure costs allocated to freight operators should be freight avoidable costs.

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

We do not agree with the definitions of rail freight commodities as separate market segments. In particular we believe that the supply of fuels by rail to power stations should be considered as a single market segment. This would mean that the impact of freight charges on nuclear fuel, coal and biomass should be considered together.

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?

We believe that ORR has taken into account the appropriate factors in considering the efficiency of the proposed charges.

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

In our view all market segments should be treated equally. Introducing charges that are related to the perceived elasticity of certain market segments cannot be objectively justified and is certainly discriminatory.

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

As noted above, in our view all market segments should be treated equally and subject to cost-reflective charges.

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

We believe that a line charge that is levied per kgtm (thousand gross tonne miles) is the most appropriate methodology. However, this charge should apply to nuclear, coal and biomass to avoid distortions in the markets to supply fuels to power stations.

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?

We do not believe that it is appropriate to introduce an overall cap for freight charges or to cap the new charge for particular market segments. Furthermore, we believe that any cap undermines the principle of cost reflective charging.

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

The unit of charge should per kgtm (thousand gross tonne miles) as this is most cost reflective.

Chapter 5 – Freight avoidable costs

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).

We agree with the framework for estimating freight avoidable costs.

Chapter 6 – Market Analysis

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?

We have the following comments on the MDST report:

- “We do not agree with the conclusion that “m*ost demand will be domestic*”. We believe that the majority of UK demand for biomass will be met from Canada and the US South;

- The statement that “m*ost planned and proposed large dedicated biomass stations are sited in close proximity to deep water ports*” is incorrect. It is likely that there will be a number of inland conversions. Tilbury is the only announced large conversion located on the coast. Consequently it is possible that biomass transported from ports to inland locations by rail will have a material impact on Network Rail costs; and

- The report states that “*It is therefore unclear as to whether in the future there will be significant biomass transported by rail*”. However, it is now clear that significant amounts of biomass will be transported by rail and this should be considered in the analysis. The recent announcement of the levels of support for biomass co firing under the Renewables Obligation will lead to a high number of conversions of old coal stations, the majority of which are supplied by rail. For example, one recently announced inland project alone will result in the burning up to 6-7m tonnes of biomass alone.

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?

We do not have a view on the proposal to not levy a mark-up on certain rail freight commodities, including intermodal, construction materials and metals although generally support cost reflective pricing for all users of the network as far as practicable.

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

We agree with a cost reflective charge on ESI coal traffic.

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

We agree with the proposal to levy a cost reflective charge on spent nuclear fuel traffic.

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?

We have no comment on the analysis of the iron ore market segment.

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)?

We believe that the potential increase in the transport of biomass by rail may be underestimated. The recently announced ROC banding levels may result in a significant percentage of plant currently fired by coal converting partly or wholly to biomass. The majority of this biomass is likely to be imported wood pellets that will be transported by rail particularly to inland stations.

We believe that the ORR should revisit the policy on levying a charge for the biomass market segment. The support regime for renewables is matter for DECC and Government and should not concern the development of cost reflective charging for use of Network Rail assets. To avoid distortions in the ESI a cost reflective charge for biomass must be introduced alongside a similar charge for nuclear and coal.

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

We believe that the ORR should consider the introduction of cost reflective charges on other (non ESI) coal flows but note that a large proportion of these flows may be relatively sensitive to increases in track access charges. The transfer of rail traffic to road is not in the wider societal interest.