Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Joe Quill
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN

Telephone: 01738 456196
Email: victoria.hunter@SSE.com

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Dear Joe

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

SSE welcomes the opportunity to respond to the above consultation. By way of background, SSE is a leading electricity and gas company, operating mainly in the UK and Ireland. We are involved in the generation, transmission, distribution and supply of electricity, in the production, storage, distribution and supply of gas and in other energy services. We are the UK's second largest generation business, with a total capacity of just over 11,300MW, of which 4,370MW is coal-fired capacity (with biomass co-firing capability).

Our significant interest in the ownership and operation of three coal-fired power stations in England and Wales, and hence a user of rail freight for coal transportation purposes, prompts our response to this consultation. Our interest, in particular, is focussed around ORR's proposal to replace the current freight-only line charge with a charge for freight avoidable costs. Our specific concerns being the discriminatory issues associated with the sectors to which it would apply; the proposed cap; the creation of additional market uncertainty; and, that the proposed new charge is significantly higher than the freight only charge that it is proposed to replace.

Application of the proposed charge and market analysis

SSE does not support an approach that would result in the proposed new freight avoidable costs being recovered from only some market segments. Irrespective of whether ORR believe that some segments of the market are able to bear the additional costs or not, the proposed approach is, in our view, discriminatory and, therefore, potentially in breach of the cited EU Legislation. Regardless of whether the charge is based on sector specific costs or not (as discussed in paragraph 4.38) we believe the proposal to charge only certain sectors would also represent a cross subsidy in that irrespective of how the charge is constructed, those that do not pay will necessarily benefit from the services/investment that is funded by those that do.

Even if ORR were able to demonstrate that the ESI market could bear an increase in access charges without any significant adverse effect, we consider it unacceptable that the ORR can openly choose to charge one market more for the same service because, in its view, that market is making better returns.

ORR has stated quite clearly that its proposed approach is consistent with that adopted in PR08 with respect to freight-only lines i.e. to only apply the charge to markets that are the most inelastic and face little competition. We opposed the approach at that time on grounds of discrimination and the impact it would have on the generation market. It is therefore a great concern that ORR intends to continue taking inappropriate advantage of ESI coal's market share and its position as a largely captive market in terms of rail haulage. The considerable economic and environmental uncertainties facing the coal fired generation market since PR08 make this continued approach both opportunistic and naïve.

Notwithstanding the above, in our view, ORR's analysis of the ESI market and its ability to bear the proposed increased costs is incomplete and based on unrealistic assumptions. For example:

- We believe the appraisal of the Industrial Emissions Directive (IED) has been over simplified, not least because it would appear that the Transitional National Plan (TNP) has been omitted from the analysis.

- It is hard to reconcile the 2012 and 2013 coal burn projections given that opted out plant will be closing from 2013 due to the Large Combustion Plant Directive. Also, given the increasing effect of the Carbon Floor Price and the associated likelihood of "front loading" generation, it seems highly improbable that coal burn for 2015, 2017 and 2019 is likely to increase when compared to the previous year.

- No consideration has been given to potential increased biomass co-firing or conversion resulting from the ROC banding review.

- We question why it has been assumed that the proportions of coal that each power station sources from and transports via different routes remain unchanged regardless of freight charges. Generators will undoubtedly endeavour to source coal through the most cost effective option e.g. via more local ports and production sites. In some cases increased charges may mean it is more cost effective to run some local coal flows using road transport as opposed to running rail movements out of remote coal loading sites. It is therefore disingenuous to conclude that the ESI market is highly inelastic - particularly since the analysis presented in table 6.3 of this paper acknowledges that there will be a fall in coal lifted and moved as a result of increases in charges; and that the fall may be even greater (25%, based on a £10 per thousand net tonne kms increase) due to potential reductions in length of haul.

It is also concerning to note that NERA's analysis looked at a range of increases from £5 to £25 per thousand net tonne kms. This implies that the underlying driver is to see how much of an increase can be forced on to the market rather than a fully justified and reasoned increase. Any increase in charges feed through to generation trigger prices and will influence when coal generated power comes onto the system and the price at which it does so, particularly in marginal times.

Ultimately, increased rail freight costs add significant and additional complexity to an already complex environment at a time when generators are required to make major decisions on IED opt in/opt out, enhanced biomass co-firing and managing the impact of the Government's Carbon Price Floor from April 2013. As indicated above, any increase in costs will influence the economic decision to run coal-fired generation, especially when looking at the marginal period of the year, certain power stations and/or freight routes. In other words, we do not believe that it is a realistic proposition for the ORR to conclude that the ESI market can simply absorb this new, higher charge. Rather, it is highly likely to have an impact on the decisions being made, the future mix of generation and therefore the UK Government's long term energy strategy to decarbonise electricity generation. In short, we believe that the impacts of ORR's decisions are not limited to the rail sector, they will have a potential impact on the UK's energy policy and, as such, we question whether this has been adequately appraised in this assessment.

Proposed cap

Not withstanding our opposition to the new and increased charge, should it be introduced we welcome the inclusion of a cap that would place a ceiling on the charge that could be applied. However, we have concerns on the implementation of the proposed cap The purpose of a cap being to give the market confidence of the maximum charge that it could be exposed to.

As we understand it, the cap would be the lower of the following two amounts:

- The allocation of freight avoidable costs; and
- A charge such that the forecast level of traffic does not fall by more than a certain defined percentage as a result of the charge.

It goes without saying that the charge should be based upon actual costs. Depending on which market sector is required to pay such costs, further clarity is needed on what these costs are and whether they are disaggregated and collected from each chargeable market sector or, for example, whether all costs are recovered on a set price basis from the chargeable sectors. These two options are discussed in paragraph 4.38 and, as we have already indicated, in our view would both result in an unfair cross-subsidy from those that pay to those that do not.

We do not believe that it is acceptable to set a cap on the basis of what a market can bear. This provides no assurance on the level of charge that could be imposed, is not transparent and is discriminatory in that it knowingly, and indeed purposefully, seeks to "weed out" a certain proportion of the market. As we have already discussed, in our view it would also appear to directly contravene EU legislation.

In the absence of what these figures may mean in real monetary terms it is difficult to comment further on this issue at this point,

Market Uncertainty

ORR, being a sector regulator, will be aware of the impact that economic uncertainty has on future investment plans. We are therefore very concerned that the proposals being consulted upon create significant cost uncertainty for the ESI coal fired power stations in the UK. This comes at a time when critical investment decisions are required in response to environmental drivers such as the IED, and where additional, substantial costs in respect of freight charges could delay or even prevent investment decisions being made.

A particular concern relates to the suggestion that the charge may, at a future date, be applied to biomass. The discussion in chapter six concludes that "increases in track access charges might impact on investment and location decisions for new biomass plant". This is undoubtedly true. However, there seems to be a lack of realisation in the consultation document that these investment decisions are being made now. In our view, it is unrealistic to suggest that any revised support associated with biomass related ROCs will compensate for increased freight access charges. Therefore, to add a further layer of uncertainty and complexity in respect of track charges at this point runs the risk of, at best, deferring biomass related investment decisions and worst, risks premature closure of existing coal plant that has the potential for enhanced biomass co-firing. In other words, this could have a real impact on the future mix of generation plant within the UK.

Based on the above, we question how the consequential impact on, and uncertainty for, the ESI market and associated power generation sector is consistent with ORR's statutory duty that requires its proposals to allow the rail market to plan ahead with reasonable certainty. That is, these proposals have placed considerable uncertainty on the ESI market and therefore by association, the rail market.

Proposed charge

Not withstanding the issues outlined above, we are concerned that the level of the proposed charge and the costs from which it would be derived are both unclear. The analysis that is presented in chapter 5 of the consultation document is, at best, vague and seems to be based upon best estimates of indicative costs. Indeed, it would suggest that at the time this proposal is being made, the data required to attribute costs fairly and accurately is not readily available. As a result, affected parties are unable to determine the impact of, and comment on, the proposal in full.

Nevertheless, we understand that based upon these rough estimates, ESI coal would be faced with a cumulative additional bill of £60m to £75m a year (this being the estimated ESI-attributable freight avoidable costs that are not currently recovered by existing charges). Based on these figures, ESI freight operators have already indicated (via recent trading statements) that they would be highly unlikely to bear the cost of increased rail charges and that they would, therefore, be passed through to customers such as ourselves. For SSE, based on the numbers provided, initial indications show that our rail freight charges could markedly increase by tens of millions of pounds.

This potential charge increase is a significant issue for us and comes at a time when the coal-fired generation sector faces considerable financial pressures and investment decisions such that unforeseen, additional costs like these are likely to have a significant impact on their future and continued operation. Indeed, if, as a consequence, the future on-going operation of these stations is curtailed (for example by accelerating plant closure dates) there would be a corresponding reduction in the volume of ESI freight traffic. Accordingly, we question how the proposals in this respect are aligned with ORR's statutory duties to encourage and grow the use of the rail network. Indeed ORR's proposals arguably go beyond the scope of its remit given the profound effect a Freight Avoidable Charge could have on the future UK power generation landscape.

Conclusion

To conclude, our concerns can be summarised as follows:

- Increased and new charges are being inappropriately targeted on ESI coal in a way that is contrary to ORR's own charging aims and, arguably, the EU legislation in respect of non-discrimination;
- The analysis provided to support the proposed approach to apply the charge to certain sectors only is, in our view, flawed and the conclusion that the ESI market is able to bear a significant increase in charges is incorrect;
- The proposals are at odds with a number of ORRs statutory duties such as to encourage and grow the use of the rail network and to allow the rail market to plan ahead with reasonable certainty;
- The proposed cap should not be dependent upon the demise of a certain proportion of the market, it should be a prescribed and transparent monetary value;
- The proposals create considerable uncertainty for ESI coal and associated generation market sector at a time when key investment decisions are being made as to the continuation and/or conversion of coal fired generation. The impact of which could have a real impact on the future mix of generation plant within the UK;
- The data required to attribute costs fairly and accurately is not readily available and, therefore, affected parties are unable to determine the impact and comment in full.

We trust that you will find this response useful. Please do not hesitate to get in touch if you would like to discuss any of the points we raise in more detail.

Yours sincerely

Victoria Hunter
Regulation Manager