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Dear Tim

Charge to Recover the Costs of Freight-only Lines

I refer to the letter from Paul McMahon dated 22 June seeking views on proposals for allocating costs and setting charges to recover freight-only line costs, and set out our comments below. We do not wish any of this response to be kept confidential.

Your paper set out alternative ways for allocating costs of freight-only lines to ESI coal and spent nuclear fuel and concluded that your preferred option was to base the allocation on modelled line-by-line costs. We agree with this conclusion. However, the Infrastructure Cost Model (ICM) is not currently configured to give the required line-by-line cost as it was developed before that level of detail was identified as a requirement and so further development is needed before we can produce the required cost disaggregation. We are aiming to have a first version of this available in time for the Strategic Business Plan in October, but expect that further work will be needed to refine the approach later in the year.

Once the total cost of each freight-only line is estimated the cost of those lines carrying more than one commodity type will need to be split to assess the cost relevant for ESI coal and spent nuclear fuel – the two commodities that you determined should pay the new charge. We recommend that gross tonne kms is the most appropriate metric to do this split as it reflects the best overall measure of use by commodity and hence the best means of apportioning each line-by-line cost carrying more than one commodity. We propose using the split of traffic in 2006/07 and apply that to our CP4 assessment of the line-by-line costs.

Your paper sets out three possible alternatives for charging the costs of freight-only lines carrying ESI coal and spent nuclear fuel, namely:

1. A new fixed charge on freight only lines;
2. A new variable charge on freight-only lines applied only to ESI coal and spent nuclear fuel traffic; or
3. A mark-up on the variable charge applied to all ESI coal and spent nuclear fuel traffic across the entire network.

We have discussed our views with you at various meetings and in summary our position on each option is as follows:

Option 1 The option of a fixed charge (probably split amongst Freight Operating Companies on gross tonne kms) would require an appropriate change mechanism to allow for significant changes in the tonnage of coal carried by different operators. For example, if the contract to supply a big power station was lost by FOCa and transferred to FOCb then FOCa would expect to pay a reduced fixed charge. This could lead to significant disputes and would be difficult to implement. We also believe that this option would not be as straightforward as option 3 for FOCs to include in the charges they make to their customers given that it is essentially a lump sum to be paid irrespective of traffic.

Option 2 The option for a separate variable charge on freight-only lines is our least favoured option because of its complexity and lack of incentive benefits. This option would mean that FOCs would face a higher charge on freight-only lines than on the mixed network and would thus lead to more complex bills as there would be different unit rates depending on when a train ran on sections of freight-only line and when it ran on the mixed network. This seems to be unduly complex in terms of monitoring traffic flows and billing, and does not provide any significant advantages in terms of cost reflectivity or incentives for optimal use of the network.

Option 3 Given that the purpose of the new charge is to recover costs from the two market segments that you determined had the ability to bear those costs, it is important that charging options consider the relative incentive benefits and ease of recovery. We therefore agree with your view that a network-wide mark-up on the variable charge is preferable. This is primarily because it avoids the need for a wash-up if traffic volumes change and because of the incentive properties it would give; namely that a network-wide mark-up would encourage ESI coal traffic to make more optimal use of the network.

If you wish to discuss this in further detail, please let us know.

Yours sincerely

Bill Davidson
Regulatory Policy Manager