

Charge To Recover The Cost of Freight Only Lines

Principles and Discrimination

EWS considers that it is essential that ORR's proposals concerning the introduction of a new charge to recover the cost of freight-only lines are consistent with relevant legislation and in particular the charging principles set out in EU Directive 2001/14EC as transposed into UK Law through the Railways Infrastructure (Access and Management Regulations 2005 ('the Regulations')). EWS believes, therefore, that this consideration should be more than just one of a list of charging aims that are set out in paragraph 16 of the consultation document, particularly as ORR's preferred option appears to sacrifice consistency with the Regulations to enable a simple low cost approach to be introduced instead.

Whilst paragraph 2 of Schedule 3 to the Regulations states that mark-ups can be levied on the basis of efficient, transparent and non-discriminatory principles, their effect must not be to exclude the use of infrastructure by market segments which can pay at least the cost that is directly incurred as a result of operating the railway service plus a rate of return that the market can bear. If ORR introduces its preferred option (i.e. adding an amount on the variable charge across the whole network) then the costs directly incurred by each railway service would not be transparent. Therefore, if any new or existing esi coal or nuclear fuel railway service was discouraged from operating by reason of the higher charges the calculation of the direct costs imposed by that railway service would not be able to be readily identified.

In addition, ORR's preferred option would provide that all flows of traffic would pay the additional costs regardless of whether they use freight only lines or not thereby leading to cross-subsidy. EWS submits that this does not promote the creation of a non-discriminatory charging system as required by the Regulations and, therefore, disagrees with the comments made in paragraph 35 of the consultation document. The charging system not only needs to reflect costs at a customer level it should also reflect costs at a flow level because as mentioned above, paragraph 2(2) of Schedule 3 to the Regulations specifically considers 'railway services' within 'market segments'.

We are surprised that ORR has not addressed any of these concerns in detail in this document. All we have is a brief statement in 35 on one aspect ;

"Freight operators have suggested that adding an amount to the variable charge might be discriminating against some customers, but we are satisfied that this is not the case"

Therefore we ask ORR to respond to the points above. We will also address in this response the academic issues which ORR has raised (rather than the other, probably more important, ones which it has not) but retain fundamental concerns over the principle of this charge.

Ability to Bear The Cost of Freight Only Lines

EWS does not accept fully the conclusions which ORR has drawn from its advisers report¹ on the impact of new charges upon the rail carried esi coal market.

We wrote to ORR on this on 14th March 2007 and were disappointed to have received no response. A copy of this letter is attached and the main points summarised as follows :

- Much of the conclusion was drawn from a simple elasticity approach from a non expert source and was not, apparently, subject to the level of scrutiny expected from ORR by the industry
- Additional cost was applied simply, and not in a manner consistent with the basis of the charge itself²
- Around 40% of coal moved does not use these terminal freight only lines. By ignoring this ORR's approach will likely underestimate the impact on particular power stations, loading points or ports

Therefore EWS and the coal industry has been left with the impression that the justification for this charge was never offered for discussion.

Systems for Allocating Costs for Freight Only Lines

1. Aggregate gross tonnage based allocation

We agree with ORR's position that this is a wholly unsuitable method. Usage charges are designed to recover usage costs.

2. Track length based allocation

Track length does not capture accurately the complexity or asset mix on freight only lines (some, for example, are straight forward single lines, others have tunnels, bridges, level crossings-one even for aeroplanes).

However the method does capture roughly many less dramatic but equally substantial costs such as

- The length of time taken to inspect lines
- The likely density of assets requiring time based maintenance
- The likely length of fencing and boundaries with the external environment
- The likely number of signalling sections and therefore asset complexity and maintenance requirement

3. Bespoke allocation system

As we understand it, this is a sort of weighted mileage approach and would work best were several key weightings made to reflect :

- Density of structures
- Number of level crossings

¹ Impact of Proposed New Charge for Freight Only Lines on Demand for Esi Coal". NERA report Feb 2007.

² The charge was designed to operate in a line specific way yet the additional cost was merely applied as an add on to the total cost of generating electricity from coal in the UK

- Track complexity accounting for, for example, density of s&c
- Signalling complexity (captured best by SEU)

The weakness is that this would require considerable subjective judgement to be applied.

4. Modelled line by line costs

It offers :

- Transparency for the costs this charge is designed to recover
- Facility to monitor these costs over time
- Ability to assess how “fixed” costs vary with usage
- Accuracy in reflecting local unit costs

However it has several serious draw backs :

- A reliance upon the ICM which has, thus far, proved itself generally unreliable in understanding the policies applied on this type of line
- A reliance upon the ICM which has, thus far, proved itself generally unreliable by using broad average unit costs
- Such a detailed, line specific and accurate approach would prove inconsistent with the method used thus far to establish charge caps

Majority use of Freight Only Lines

In all cases we do not accept ORR’s view that Esi coal is allocated the total cost (or a proportion of the total cost) for every line over which it operates. The fixed cost of railways should not depend upon usage but more upon design and environment. Moreover lines with mixed traffic would not see their fixed cost change were the Esi coal element to be removed.

Therefore in order to capture more accurately the spirit of the government’s policy³, it would make more sense to allocate to Esi coal costs only for the lines which it accounts for **more than 50%** of the train kms. The following position should apply :

Proportion of total train kms over terminal freight only lines run by Esi coal and nuclear	Proportion of the total “fixed charge” for terminal freight only lines to be recovered from Esi coal and nuclear
0%	0%
25%	0%
50%	50%
75%	100%
100%	100%

When considering this proposal, it is important to remember that the proposed charge is not a means tested contribution to fixed and common costs.

Conclusion

³ That freight pays the full cost of the lines which it uses exclusively

There is little doubt that line by line costs is the optimum approach. However experience from the Periodic Review thus far is that line by line costs can be significantly different from modelled line by line costs.

EWS has not been included in the ICM process and, considering its expertise and experience in these areas, remains extremely suspicious of the model's out-puts. It is important that accurate and efficient freight only line asset policies are included.

ORR should satisfy itself and the industry that freight only lines are not mishandled merely because they are "difficult to model". If doubt remains this method must be scrapped and ORR should chair a panel of both independent and interested experts in order to arrive at the weighting of track or route miles in line with the bespoke allocation system.

Freight fixed costs for specific lines should only be recovered from Esi coal and nuclear businesses when Esi coal and nuclear traffic accounts for at least half the train kms run over those lines.

Charging System for Freight Only Line Costs

1. Preferred Option

We believe that freight only line costs used in this assessment remain far too high. This is due to :

- Network Rail's poor incentive and/or ability to control its excessive unit costs
- The use of deeply flawed engineering policies used to estimate the cost of these lines in the ICM
- Network Rail's excessive indirect and overhead cost being allocated by whatever means

Therefore EWS will continue to argue for a transfer in the ownership of these lines until Network Rail can manage them efficiently.

In terms of ORR's options we would prioritise them as follows.

2. Second Option : Variable charge applied on freight only lines

The strengths of this approach are ;

- It meets the objective of the new charge being a charge levied to recover a specific cost
- It maintains transparency and allows constant monitoring of the costs it is designed to recover
- It gives the industry a clear view that this is a charge not a tax
- It does not discriminate between customers since only those using the lines in question will pay.

Weaknesses include ;

- Recovering a fixed cost through variable means requires regular reviews and adjustments. It could lead to instability in the price charged to customers and the requirement for back dated adjustments being clawed back
- Could prove difficult to administer although operators and Network Rail could work together to simplify this

In summary this option remains the most faithful to the principle of the charge and to the line by line modelled cost allocation method.

3. Third Option : Fixed Charge

The strength of this approach is that it is best able to cope with changes in coal volume or train kms by removing the need for reviews and adjustments.

Weaknesses include ;

- It could discriminate between customers as a different mix in Esi volumes may not be reflected in the charge each pays
- It reduces transparency and therefore shifts emphasis away from the costs which the charge is designed to recover
- It could leave operators as bankers accounting for any shortfall should Esi volume and flow mix change

This remains the most workable option but could store up problems over the course of a control period.

4. Least Favoured Option : Variable charge on all lines

The strength of this approach is that it is straightforward to apply.

Weaknesses include ;

- It breaks the link entirely between the charge and the costs it is designed to recover quickly becoming a tax
- Recovering a fixed cost through variable means requires regular reviews and adjustments. It could lead to instability in the price charged to customers and the requirement for back dated adjustments being clawed back
- It discriminates between customers, power stations, ports and pits as some use terminal freight only lines and others do not
- It could price some business from the network

It is disappointing that ORR appears to favour this method. It is more disappointing that ORR offers no detailed explanation for its choice.

Conclusion

If the charge is to be levied at all, it must be upon a sound, reliable and transparent basis. It must remain honest to the justification put forward for it; to recover all the cost of lines used exclusively by freight. The industry retains greater confidence in charges when they reflect or recover efficient

and transparent infrastructure costs. Transparent costs are the first step towards lower costs.

Freight operators require a) charges which do not discriminate between their customers, b) charges which their customers can see are cost reflective, c) charges which are easy and inexpensive to monitor and collect but above all d) charges which allow them to compete with other modes and deliver a return upon their investments.

Appendix 1 : Ability to Bear The Cost of Freight Only Lines

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14 March 2007

Re : "Impact of Proposed New Charge for Freight Only Lines on Demand for Esi Coal". NERA report Feb 2007.

Dear Tim,

Please will you accept this letter as a submission by EWS to the Freight Charging Review. Please publicise as you see fit.

As I understand it the report above adds the additional track access charge to the price of coal and carries out some sort of simple demand elasticity analysis. The additional charge is calculated by adding a mark up to the existing variable rate. While useful for a general academic study, I worry whether such an approach is too high level to inform this debate in a meaningful way.

Purpose of the Freight Only Line Charge

Firstly the principle of recovering fixed costs through a variable charging mechanism is highly dubious in a market where flows change constantly. I am sure that this is not ORR's intention.

Secondly the purpose of the charge is to recover the elements of Network Rail's perceived freight only line costs which are not accounted for by variable charges; it is not designed as a further tax upon operation. Therefore the charge must target specific lines used by the esi industry.

Moreover it seems reasonable to assume that the charge :

- ❖ should be levied only upon a) Network Rail owned terminal branches connecting power stations with running lines and b) Network Rail owned terminal branches with a dominant esi coal volume connecting ports and loading points to running lines.

- ❖ should take more the form of a fixed charge which is broadly consistent with the costs it is designed to recover

Use of Network Rail's Esi terminal lines

Many power stations (such as Ratcliffe, Rugeley, Ferrybridge, Aberthaw, Cockenzie, Didcot and West Burton) are not joined to the network by Network Rail owned freight only terminal lines. Most use private sidings connected directly to the mixed network.

Additionally, following the proposed re-opening of Stirling- Alloa line, Longannet power station will also disappear from the list of lines which this charge targets. As a rough estimate I would say that 17-20 mt per year, or 40% of rail's esi business, does not make use of these lines.

A similar picture is apparent in the origin points of esi coal. Some key ports (such as Hunterston, Avonmouth, Newport and Redcar) and a few key loading points (such as Daw Mill, Harworth, Kellingley and Ravenstruther) are connected by private sidings. Together these locations account for 10-15mt per year.

Local effects

Although we cannot simply add up these tonnages, it does appear that the charge will effect some facilities and customers more than others. Therefore the impact of the new charge might better be thought of as being localised rather than spread across all coal burned nationally. This could :

- ❖ Impact upon the sustainability of particular power stations
- ❖ Cause closure of some power stations and eliminate volume which could not be met by increasing demand at stations already operating close to capacity
- ❖ Bring about the closure of smaller origin branches such as those connecting small ports and pits
- ❖ Alter the distribution of flows perhaps increasing average length of haul

Therefore please will you reconsider the conclusions you have drawn from this report and perhaps extend your study to take local impacts into account.

Thanks

Ian Smith