

*Overview of NR consultation letter
on the Freight Specific Charge and
other issues (published 8 February
2013)*

*Ben Worley
14 February 2013*

Background

- On 11 January 2013, ORR published its freight charges decision document.
- The document raised a few issues and included requests for us to carry out further work.
- In response to ORR's decision document, we published a consultation letter on 8 February 2013. This letter covered the following:
 - The profile of the Freight Specific Charge in CP5;
 - Our interpretation of the cap on the average freight Variable Usage Charge rate;
 - Updating our freight avoidable cost estimate;
 - Remedying the CP4 spent nuclear fuel charge rate error;
 - Updating our freight only line cost estimates; and
 - Our view of the interaction between the freight only line charge and Freight Specific Charge.

Freight Specific Charge (FSC)

- For CP5, ORR has confirmed the introduction of a FSC on the **ESI coal** (cap of £4.04 per kgtm), **Spent nuclear fuel** (cap of £11.64 per kgtm); and **Iron ore** (cap of £2.96 per kgtm) markets. It is also due to consult on levying the FSC on biomass.
- ORR stated that the FSC should be phased in during the last three years of CP5 and it requested that we consult on the profile of this FSC in CP5.
- We are, therefore, consulting on the profile of the FSC in CP5 based on the profile set out in ORR's conclusion document.
- Based on our SBP traffic forecast and ORR's phasing in profile, the table shows the income that we could receive through the FSC in CP5. These figures are indicative only.

FSC – phasing in profile in CP5					
Market segments	2014-15	2015-16	2016-17	2017-18	2018-19
ORR phasing in profile	0% of FSC	0% of FSC	20% of FSC	60% of FSC	100% of FSC
Total ESI coal, spent nuclear fuel and iron ore forecast traffic (kgtm)	7,244,623	7,244,560	7,244,498	7,244,437	7,244,377
ESI coal	£0	£0	£6.0m	£17m	£29m
Spent nuclear fuel	£0	£0	£0.06m	£0.2m	£0.3m
Iron Ore	£0	£0	£0.09m	£0.3m	£0.5m

Variable Usage Charge (VUC) Cap

- In January 2013 ORR announced an early cap on the average freight VUC rate in CP5 of £1.68 per kgtkm (2011/12 prices, end CP4 efficiency).
- We thought that it would be helpful to set out in our consultation letter our interpretation of how the cap would apply in determining CP5 charges, if required.

Network Rail view on the VUC cap

- We view the cap applying *ex ante* and relating to the average freight VUC rate in the CP5 VUC model, rather than the average outturn freight VUC rate, for example.
- If the average freight VUC rate exceeds the ORR cap, our view is that all freight VUC rates would be reduced by the same percentage (the percentage difference between the average rate and the cap), so that the average charge does not exceed the cap.
- We also consider that any difference between the average charge and the cap would be recovered through passenger FTACs (or any network grant income received in lieu of fixed track access charges), rather than passenger VUCs.
- A key factor which is likely to determine whether the cap will be 'hit' in CP5 is the potential introduction of the new VTISM derived 'equivalent track damage' equation in CP5. We are due to conclude to ORR on this issue by end March 2013. Ultimately, the final decision rests with ORR.

Updating our freight avoidable cost estimate

- In its decision document, ORR also requested that in advance of its draft determination we should update our estimate of freight avoidable costs (developed by L.E.K.), which provide the basis for the FSC.
- We understand that the ORR is considering providing further guidance to us, as part of its consultation on levying the FSC on biomass, on how it wishes the L.E.K. freight avoidable cost estimate to be updated.
- We will, therefore, wait until we receive this guidance before asking L.E.K. to commence its update.
- Given the considerable effort that went into developing the original cost estimate we will be recommending that L.E.K. should be asked to adopt a pragmatic approach to updating its cost estimate.
- For the avoidance of doubt, and mindful of the uncertainty that the update may create, we will only ask L.E.K. to update its analysis once, prior to ORR's draft determination.
- Subject to the early receipt of guidance from ORR, we aim to provide an updated cost estimate to ORR by the end of April 2013.

Remedying the CP4 spent nuclear fuel charge rate error

- In our consultation letter we also highlighted an apparent significant error that has recently come to light in relation to the current freight-only line charge rate for spent nuclear fuel.
- In the first three years of CP4 we received £0.25m, compared to the £1.87m forecast in ORR’s PR08 final determination (nominal prices).

	2014-15	2015-16	2016-17	2017-18	2018-19
Phasing in profile (£/KGTM)	5.76 (existing charge rate)	5.76 (existing charge rate)	8.30 (20% of full rate)	24.91 (60% of full rate)	41.52 (100% of full rate)
Forecast income (£m)	0.15	0.15	0.22	0.67	1.12

- We believe that this under-recovery of income is a result of an error in the calculation of the spent nuclear fuel freight-only line charge rate in PR08, which appears to be 7-8 times too low.
- We propose correcting this error for CP5 but not seeking any adjustments to address the error in CP4. Moreover, mindful that stakeholders are likely to require time to prepare for these changes, we also propose phasing in the new charge rate in CP5.
- We are consulting on adopting the same phasing in profile that ORR has set out in relation to the FSC as shown in the table above (based on IIP cost data).

Updating our freight only line cost estimates

- In November 2011 we consulted on our initial estimates of ESI coal and spent nuclear fuel freight-only line costs before concluding on these estimates to ORR in March 2012. We refined our cost estimates in October 2012 as part of the L.E.K work to estimate freight avoidable costs.
- We will update these cost estimates to take into account more recent SBP cost data when we conclude on this consultation to ORR by the end of March 2013.
- When we conclude to ORR we will include charge rates for the iron ore and, subject to the results of ORR’s consultation, biomass freight market segments. We propose calculating charge rates for iron ore and potentially biomass on the same basis as we have done for ESI coal and spent nuclear fuel.
- We are consulting on the phasing profile of the charge rates for iron ore and potentially biomass during CP5. We propose that profile should be consistent with that for the FSC – see, table, below.
- We are also consulting our proposed methodology for deriving CP5 freight-only line charge rates (dividing the respective cost estimates by forecast average CP5 traffic).

Freight-only line charge – phasing in profile in CP5 for iron ore and potentially biomass					
Market segments	2014-15	2015-16	2016-17	2017-18	2018-19
Iron ore	0% of the full charge rate	0% of the full charge rate	20% of the full charge rate	60% of the full charge rate	100% of the full charge rate
Biomass	0% of the full charge rate	0% of the full charge rate	20% of the full charge rate	60% of the full charge rate	100% of the full charge rate

Interaction between the freight only line charge and FSC

- In our consultation letter, we also thought that it would be helpful to set out our view in relation to the interaction between the freight-only line charge and the FSC in CP5.
- Because freight-only line costs are a subset of freight avoidable costs there could be merit in consolidating these charges in order to simplify the charging structure.
- However, because the freight-only charge and FSC are not due to be introduced at the same time (i.e. the freight-only line charge will be levied in year one of CP5 onwards and the FSC will be levied in year three of CP5 onwards) we consider that it would be better not to consolidate these charges in CP5.
- There could, of course, be merit in reviewing, as part of PR18, whether it is appropriate to consolidate these charges in CP6.

Next steps

- Following the careful consideration of consultation responses, we are aiming to conclude on our consultation letter to ORR by the end of March 2013, as part of our work to propose a set of prices for CP5.
- We will aim to provide ORR with L.E.K's updated estimate of freight avoidable costs by the end of April 2013.
- **The closing date for this consultation is 1 March 2013**
- Consultation responses and any questions should be sent to:
Ben.Worley@networkrail.co.uk