

**THE OFFICE OF RAIL AND ROAD
166th BOARD MEETING**

10 December 2019, 09:00 – 13:45

ORR London Office, 10th floor, 25 Cabot Square, London E14 4QZ

Non-executive members: Declan Collier (Chair), Stephen Glaister, Anne Heal, Bob Holland, Michael Luger, Justin McCracken

Executive members: John Larkinson (Chief Executive), Graham Richards (Director Railway Planning and Performance); Ian Prosser (Director Railway Safety).

In attendance: Russell Grossman (Director of Communications), Freya Guinness (Director Corporate Operations), Dan Brown (Director, RME and Strategy), Tess Sanford (Board Secretary).

Other ORR staff in attendance are shown in the text.

Item 1 WELCOME AND APOLOGIES FOR ABSENCE

1. The chair welcomed everyone to the meeting.
2. Graham Mather had sent apologies for the meeting.

Item 2 DECLARATIONS OF INTEREST

3. No new relevant interests were declared.

Item 3 APPROVAL OF PREVIOUS MINUTES AND MATTERS ARISING

4. The minutes were agreed and the chair would sign them¹.
5. The chair reported on two meetings the previous day which closed matters arising.
 - The meeting with the Chair and CEO of Network Rail (NR) to discuss the notices on track worker safety had gone well. The FOI request in relation to Margam had been mentioned: documents to be released would be shared in advance as a courtesy for information only. The board asked to see the legal advice in relation to disclosure [Action].
 - Declan Collier had observed the meeting of Route Supervisory Board chairs (including the system operator) with the chair of NR. He reported on shared areas of concern which emerged. The board noted the variety of approach between the route boards and the way the nature of the RSBs had changed since the original concept had been included in NR's plans for route based devolution. These changes meant that they would be of inconsistent value to ORR as an indicator of the quality of stakeholder engagement at a route level in terms of providing input to ORR holding NR to account. There was a new performance architecture emerging within NR and it was important that ORR

¹ Post meeting note: during the meeting, a board member had suggested that there was an action missing on additional environmental information in the board information pack. After the meeting it was clarified that this related to the strategy discussion on 26 November and the action would be captured in the January paper reporting on the outcome of that discussion. No other comments on the minutes were raised, so they have been recorded as approved.

found sources of the necessary information to hold NR to account. Staff were asked to circulate the background briefing given to the chair to other board members [action].

Item 4 EXECUTIVE DIRECTOR UPDATES²

6. **John Larkinson** reported on an approach by BEIS to explore whether ORR wished to take on additional enforcement powers on consumer matters in Europe. The exact proposition was still unclear and the obligations that would go with the powers needed to be understood before any advice could be prepared for the board (to whom the response on changes to powers is reserved). The board noted the report.
7. John reported on a conversation with the Rail Minister on the delay to opening of Worcestershire Parkway. John had been able to assure the Minister that the delay was not in relation to ORR processes. The board asked to see the current authorisations tracker to help them understand how the executive tracked and reported on this important work. [Action – include all parts including rolling stock]
8. John also reported on a recent meeting with the Minister in Scotland, which he would be following up in correspondence with evidence to counter some of the claims made by Transport Scotland officials in the meeting.
9. **Ian Prosser** reminded the board of the policy position on DCO and said that the last trap and drag incident involving DCO had been in 2015. He would write to RMT to counter the recent misrepresentation of the safety record in the media [action]. The board discussed the desirability of challenging untrue statements made in the media both with the individual making the claim and with the broadcaster/publisher. The current approach of pragmatic intervention on claims that were repeated was a balance between stopping false stories and the available resources. Strong relationships with media outlets and a reputation for helpfulness and objectivity were key in maintaining this balance.
10. Ian reported on a near miss on a level crossing in East Anglia: a further report on the technical issues (track geometry and wheel profile) which this had highlighted would be included in the January report [Action]. Some mitigation measures have been put in place by operators, including manning some high-risk crossings.
11. **Graham Richards** reported that NR were reviewing how scorecards were built and agreed, noting that the Secretary of State approved them each year. The board discussed risks around the forthcoming December timetable change, particularly train crew availability and the openness with which operators communicated with the PMO as well as the PMO's ability to challenge. ORR would include these concerns in the forthcoming letter to NR on the system operator. [Action] This issue

² As the last meeting was only two weeks previously, there were no data-based reports circulated. Directors updated the board on live issues.

would be covered in the January reports: it was anticipated that the new System Operator managing director would drive improvements in behaviours over time.

12. **Dan Brown** reported that Ministers had signed derogations for rolling stock, but not replacement bus services, although these were understood to be pending. ORR would write to TOCs after purdah asking TOCs to demonstrate their position on providing information to passengers on derogations.
13. **Russell Grossman** reported on recent activity and the imminent launch of the stakeholder survey. The board asked to see the proposed question list for information [Action].
14. **Freya Guinness** updated the board on remaining snagging at 25CS and work to hand back OKS to the landlord by the end of the week. New printers and other IT kit were being rolled out in the regions
15. Freya also reported on the headline results of the staff survey which had just been received by directors. The headline figures had improved, particularly on areas that had been subject to focus in-year. Renco would see and discuss the full results in January. [forward prog]

Item 5 MEMORANDUM OF UNDERSTANDING: BTP/RAIB/ORR

16. Ian Prosser explained that this was an update on an existing MOU which reflected the improvement in relationships and was now principle-rather than process-based.
17. Justin McCracken confirmed that Health and Safety Regulatory Committee had also discussed the MOU at its meeting the day before. The board agreed to adopt the MOU and delegated [Ian Prosser] to sign it.

Item 6 HS1 – PR19 FINAL DETERMINATION

Steve Fletcher, Carl Hetherington, Feras Alshaker, Joe Quill, Debbie Daniels, Laura Majithia, Steven Dennis joined the meeting for this item.

18. Graham Richards introduced the item. HS1 had produced an updated 5YAMS (the November 5YAMS) in response to the draft determination issued by the board in September. HS1 had not adjusted it to reflect all of the provisions in the draft determination and this meant that the board was required to determine whether to impose some of the detail of the determination. This was a novel intervention for ORR, leading it to direct a limited company to change its five year plan. Such direction would also introduce a further consultation stage, as a consequence of the contractual requirements for implementing the periodic review, which had not been envisaged at the time of the original plan. This consultation would require the board to meet and review any responses to the consultation very early in the New Year in order to meet the timetable required by the concession agreement for issuing the final determination. The decisions made today would be consulted on with key stakeholders before

Christmas and the board would be asked to consider any new evidence and representations made before confirming the final determination.

19. The November 5YAMS had been received on 29 November. ORR's due diligence had identified some errors in HS1's financial model and HS1 had now agreed to get third party assurance of the model. The board asked that the team consider the quality of this assurance, when issued. The quantum of errors in the model included a £4m wrongside cost shift in O&M. The team explained that the percentage changes in charges shown in the paper remained a broadly applicable guide to the impact on operators.
20. The board reminded itself of its role and duties in regard to the PR19 determination, including those areas it could not take into account. It discussed the importance of weighing up the different interests and of understanding fully the commercial and operational impact of any decision – particularly on the level of charges to be levied and affordability for operators. The board also noted that the current set of decisions were for the next five year period and could be reviewed and re-set at the next review if events delivered different outcomes from those currently projected.
21. The decisions before the board now comprised three sets: ten issues to be confirmed as set out in the draft determination, five issues where HS1 had not accepted or adjusted their November 5YAMS to reflect ORR's draft determination and three issues where staff advice had changed since the draft determination as a result of further information received.

Matters to be approved because there is alignment between the draft determination and the November 5YAMS.

22. No new evidence had been offered by stakeholders on the treatment of the new signalling system. **The board approved** its earlier decision that the new ETCS signalling system should be treated as a Specified Upgrade. It noted that this required a decision by DfT.
23. Staff had reviewed HS1's evidence underpinning the 4.33% risk premium figure, which was reduced from 5% in CP2. No evidence of double counting of risk had been identified. **The board approved** a level of 4.33% contract risk allowance between HS1 and NR(HS).
24. Eurostar had argued that the efficiency target of 6.7% was less challenging than it should be, but not provided any evidence to support this argument. No benchmarks could be identified to assess this claim. **The board approved** HS1's proposals for operations and maintenance efficiency as set out in the 5YAMS at 6.7%.
25. The board noted that no response was received on funding for preparations for future control periods **and approved** a figure of £5.6m.
26. The board noted that HS1 would be required to develop business cases for future projects to ensure best value for money from its budget. No new evidence had been offered in relation to this decision. **The board approved** delivery integrator costs as 10% management fee and 10% risk funding.
27. The board discussed again the proposal to adopt a 40 year approach to renewals funding for the HS1 network. This is consistent with the concession agreement and also aligns with the government's treatment of stations. The board noted that no comparable concession agreements internationally had been identified for use as benchmarks. Counsel's advice had been sought

and no further challenge had been presented to this interpretation of the Concession Agreement. This was an important issue in securing the best interests of future users as funding over 40 years better achieves sustainable asset stewardship. **The board approved** a 40 year approach to renewals funding for the HS1 Network.

28. **The board approved** an increase of £1.2m to the renewals annuity to address underfunding of the escrow account in CP1 and CP2, as built into the November 5YAMS by HS1.
29. The board noted that there had been no further evidence offered by EIL on the issue of the renewals fund adjustment to avoid an ‘overdrawn’ escrow account. EIL had previously offered to fund spending directly as it became necessary. This offer was rejected on principle as it was not securing the funding needed in advance. Although it was tempting to ease-in operators in relation to the increase in annuity, it is in the public interest to ensure sufficient funding. The board discussed the importance of efficient management of the escrow account and noted that the highest future balance in the current model was about £140m. Future thinking on funding would be able to further reflect this issue. **The board approved** an increase of £0.4m to the renewals annuity to remove a predicted ‘overdrawn’ escrow account in the future.
30. The November 5YAMS included a frontier shift of 0.5% from CP4-CP10 – to reflect the expectation that an efficient company today would be more efficient in future. The board noted other regulators’ approaches and the broad basis of the figure. This was a ‘best judgement’ figure and there was no evidence to support an alternative. **The board approved** a 0.5% annual efficiency overlay for frontier shift from CP4 onwards.
31. The November 5YAMS had adopted the charging model for directly incurred costs on a per train km basis³. This change did not include non-direct costs, which continue to be charged on a per train-minute basis and HS1 intends to conduct a structure of charges review in CP3. **The board approved** HS1’s revised charging model in accordance with Commission Implementing Regulation 2015/909.

Matters to be determined because the draft determination and the November 5YAMS do not align and there is inconsistency with the General Duty as a result

32. The board heard about work done by staff to assess the underlying asset life modelling undertaken by HS1 and the application of best practice in terms of rates and volumes of renewals which would be necessary to maintain asset quality. It is too early in the life of the system to make definitive judgements about future asset life and this was one area open for discussion at the next control period. There is the opportunity to revisit in the 5YAMS for PR24. For now, **the board agreed to determine** a less conservative approach to asset life modelling over 40 years.
33. The board noted the parallel with its earlier decision on delivery integrator costs for CP4-10, the availability of relevant benchmarking data, and the potential for portfolio management to reduce costs overall. The board also noted that the projects planned for CP3 are straightforward, non-complex

³ There was a correction to slide 15 (direct costs). The slide incorrectly stated that the change to charging per train-km reduced Southeastern’s costs but increased EIL’s. The board was informed that the change to charging per train-km is neutral for both operators.

- projects. **The board determined** an allowance of 10% for project management costs in CP3.
34. The board discussed again the commitment required in the draft determination for HS1 to maintain adequate levels of research and development in CP3, in line with industry best practice and, over time, to deliver technical innovation and improvements leading to overall efficiencies for its customers. HS1's proposal in the November 5YAMS included £2m for CP3 only in O&M, ORR staff proposed that the funds should be managed through the escrow account to provide additional governance and transparency to the spending on research projects. The board noted this was a direct imposition of additional costs on operators, and that it was part of an overall package designed to deliver a package of benefits to future users and operators. **The board determined** that HS1 should be funded for £2m of research and development in CP3.
35. Staff reported on discussions with HS1 around the allowance for risk in CP4-10 renewals costs. **The board determined** a 13% risk allowance for CP4-10 and approved a rate of 12.6% in CP3 to reflect the different inputs.
36. The board discussed the interest rate assumptions made by HS1 and the basis of any recommendation to use different rates. Better evidence had been offered to support the rates for CP3 investments on the basis of an agreed investment strategy between HS1 and operators. Carl Hetherington tabled a new slide setting out the evidence to change the assumptions for CP3. **The board approved** that average interest rate assumption for deposits and bonds to be 1.22% for CP3, as set out in the November 5YAMS instead of the 2.5% from the draft determination but determined the allocation of 80%-20% between deposits and bonds and the current account from the draft determination.
37. The board discussed the process leading to the proposed rate of 2.5% for CP4-10 and asked that it be clearly set out in the final determination. The governance of investment is set out in the concession agreement. **The board determined that** an average interest rate assumption of 2.5% should be used for 'deposits and bonds' for CP4-10.

Matters to be determined because further evidence provided since publication of the draft determination means ORR had changed its position as expressed to achieve consistency with the General Duty.

38. In the draft determination deferrals had been proposed from CP3 to CP4 workbank to address issues around deliverability. **The board approved** HS1's revised CP3 plans as acceptable.
39. The board noted the proposed adjustment from 26% in CP3 to 12.6% to reflect current modelling. This reflected some double counting in the original figures. **The board approved** a 12.6% risk allowance for CP3 renewals as consistent with the General Duty.
40. The board noted that the November 5YAMS included additional un-evidenced costs. **The board determined** that HS1's internal costs remain as set out in the draft determination save the reduction in pass-through costs.

Discussion of the overall impact on charges

41. The board noted that the exact charges levied on operators would be levied by HS1 following the implementation of the final determination. The impact of the

changes on the overall annuity figure gave a final annuity of £26.3m. The likely impact of this was increases in charges in the order of 18% for international passenger operators, 15% for domestic passenger operators and 13% for freight operators.

42. The board noted that the determination was commercially sensitive but that all stakeholders would be consulted before the board was asked to approve the final determination on 2 January 2020. This very short timetable was required by the terms of the track access agreements.

Item 7 WILLIAMS WHITE PAPER

43. The board received an update on progress with the draft white paper from Dan Brown and John Larkinson. There had been little further detail on the implementation phase yet. It looked as if a number of policy issues would only be covered at a high level with further consultations on the detail.
44. The chair also updated the board on his discussions with senior DfT officials on the emerging picture for ORR.
45. ORR needed to be ready to brief its own people on what the published document might mean for them. It would also be essential to mobilise a team quickly to respond to the emerging policy implementation challenges.
46. The main focus of activity for ORR should be around how assurance and scrutiny of the new rail body could be carried out to safeguard the long term public interest.
47. At this stage, best estimates were that it would take at least 18 months to deliver primary legislation and a further minimum 18 months on implementation.
48. The board noted the report. The amount of resource dedicated to next steps would depend on the outcome of the election on 12 December.

Item 8 FEEDBACK FROM COMMITTEES AND PANELS

49. **The board deferred feedback from the committee meetings to their meeting on 26 January 2020.**

Item 16 ANY OTHER BUSINESS

50. There was no other business and the meeting closed.