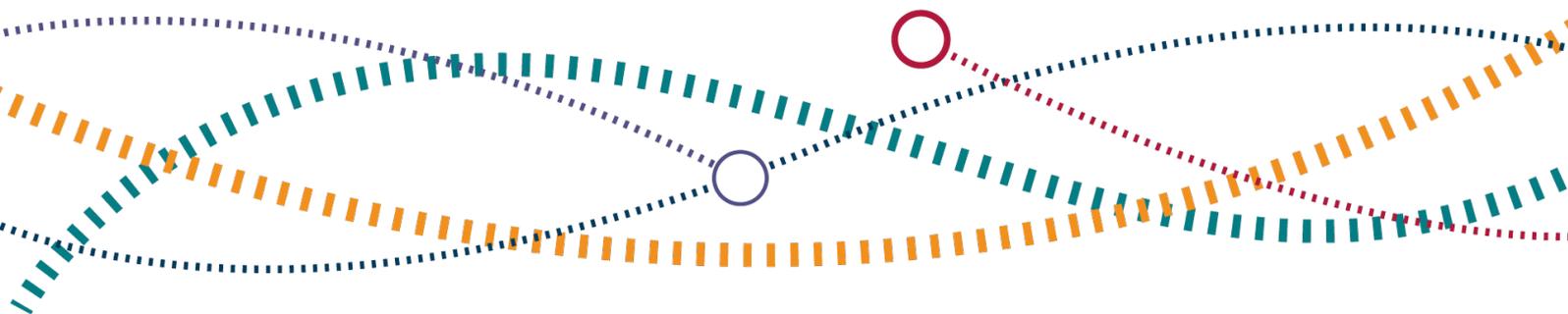




Consultation on Second HS1 Regulatory Statement and Holding HS1 Ltd to Account for Stations in CP3

Conclusions

27 July 2022



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Background

HS1 Ltd has a 30-year [Concession Agreement](#) from the Secretary of State for Transport to operate and manage the HS1 network. It also holds concurrent leases for the operation and management of the four stations on the network.

The Concession Agreement gives ORR a role in regulating HS1 Ltd through periodic reviews and ongoing monitoring of its performance. The Department for Transport (DfT) and HS1 have now amended the Concession Agreement and stations leases to outline a new role for ORR to carry out periodic reviews and subsequent monitoring of HS1 stations, in addition to our existing regulation of the HS1 route infrastructure.

We consulted HS1 stakeholders earlier this year on a regulatory statement setting out this new role, and a holding to account policy for the remainder of the control period (that is, 1 April 2020 – 31 March 2025, “CP3”).

We received responses from the passenger operators on the network, DfT, HS1 Ltd and Network Rail (High Speed) (NR(HS)).

Those responses can be found on our website on the consultation page. This document summarises the views received and our response, including subsequent changes to the regulatory statement and interim holding to account policy for CP3.

Second HS1 regulatory statement

Purpose of document and regulatory framework

Purpose

This statement has been requested by HS1 Limited and sets out our approach to carrying out our duties under the HS1 Leases of land for the permanent way and stations of the railway known as High Speed 1 (“the HS1 Stations Leases”).

Regulatory framework

This statement outlines our functions under:

- the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016;
- the Concession Agreement between HS1 Ltd and the Secretary of State for Transport; and
- the HS1 Stations Leases between HS1 Ltd and the Secretary of State for Transport.

A key function established by these documents is the undertaking of a periodic review of funding for HS1 stations, including setting of the long-term charge for operators.

- 1 In its response to our proposed text, HS1 Ltd proposed additional wording to clarify its asset stewardship requirements using the language of the stations leases (as did Eurostar International Limited (EIL)); our approach to monitoring HS1 Ltd against those requirements; and acknowledging its pre-existing contracts with NR(HS) and Mitie. We accepted this request for clarification, and have accordingly added wording under a new subsection entitled Stations Life Cycle Purposes, and under the Long-term charge section.
- 2 HS1 Ltd also asked that we add wording to refer back to our original Regulatory Statement for HS1, to reflect that we would adopt the approach to regulation set out elsewhere in this statement, and a commitment to consulting on any changes to it. It also asked for wording to acknowledge the difference between the HS1 business model and the rest of the UK rail network. Finally, it asked that we refer specifically to the new functions transferred to us through changes to the Concession Agreement.

Again, we were happy to accept these proposals and have added wording to reflect HS1 Ltd's requests.

Periodic review of HS1 stations funding

Periodic review

The process for periodic review of renewals funding for HS1 stations is set out in Schedule 10 of the stations leases and provides for adequate funding to ensure good and substantial repair and condition of the asset until 1 April 2061. At each periodic review, we would therefore assess HS1 Ltd's life cycle report for each station to ensure that the level of long-term charge is set so that it is able to meet this requirement.

- 3 South East Trains saw us being responsible for carrying out the five-yearly Periodic Review process and associated monitoring for stations aligning HS1 with the rest of the route and industry, and as a positive transition. The expectation was that we would publish associated documents as we do for the rest of the industry, which we intend to do.
- 4 DfT supported our approach to carrying out our duties, agreeing with the expectations set out for HS1 Ltd's life cycle reports, particularly that each station requires a report. It asked that we keep it informed of proposed reductions in the long-term charge, which we would expect to do.
- 5 EIL asked that our Regulatory Statement include provisions for early and timely involvement of industry stakeholders. Throughout the process to enact this transfer, we worked closely with HS1 Ltd and DfT to harmonise the processes for the periodic reviews of HS1 route and stations. This has been achieved through changes to the stations leases that now require the periodic review of stations funding to start 30 months before the start of the control period (mirroring the existing route process, and starting stakeholder engagement much earlier than the previous process for stations which made no provision for a consultation on approach). In addition, NR(HS) asked that roles and responsibilities are clearly defined to ensure clarity for stakeholders.
- 6 We have added wording to our Regulatory Statement to reflect the new periodic review process in the stations leases, in particular our duty to consult on the approach to periodic reviews.

- 7 We note NR(HS)'s response that under its operating contract with HS1 Ltd, it is bound by our determination of route funding, but not by our future determinations of stations funding. While acknowledging varying contractual arrangements, we would expect HS1 Ltd to hold its supply chain to account for outputs agreed at periodic review.
- 8 HS1 Ltd has asked that we state that we do not expect to reopen the DfT determination of stations funding for CP3. We have amended the wording to state that we will not seek to amend or reopen that determination, in our interim policy for holding HS1 Ltd to account in CP3, which covers the remainder of the control period.
- 9 HS1 Ltd also asked that we reflect that it is able to seek interim reviews under the stations leases, the conditions for which we have now included in our Regulatory Statement.

Long-term charge and income from non-railway uses

Long-term charge

HS1 Ltd is required to submit to us a Life Cycle Report for each station no later than 13 months prior to the end of each Review Period.

We would expect each Life Cycle Report to clearly set out the Life Cycle Works Saving, against Deferred Life Cycle Works Saving from the previous cost period. This should enable us to identify reductions in the long-term charge for future control periods (equivalent to 70% of Life Cycle Works Saving achieved by HS1 Ltd).

When setting the long-term charge, we will also consider whether HS1 Ltd's Asset Management Strategy and Life Cycle Reports enable it to meet the Life Cycle Purpose for each station.

Inferior leases

The stations leases list a number of inferior leases held between HS1 Ltd and other parties. Those leases do not fall within the scope of a periodic review of HS1 stations.

- 10 HS1 Ltd asked that we specifically state that periodic review under the stations leases does not include funding for operations and maintenance, or revenue that it receives from non-railway station users. We have accepted these proposals and added text accordingly.

- 11 HS1 Ltd also asked that we clarify that underspend on projects could be driven by a number of reasons, not just deferred life cycle work savings, which we have again achieved by amending our proposed text. More detail of the treatment of life cycle works savings is provided by our interim policy for holding HS1 Ltd to account in CP3.
- 12 We note EIL's view that the stations leases' requirement for adequate funding to ensure good and substantial repair and condition of the asset until 1 April 2061 does not equate to an obligation to fund fully all future potentially required works 40 years in advance. We will be consulting on our approach to the 2024 periodic reviews of HS1 route and stations funding by 1 October 2022, including consideration of the Concession Agreement and lease requirements to fund future renewals.
- 13 HS1 Ltd asked that our regulatory statement acknowledged the interaction between our determined charges and its station access conditions and station access agreements, and clarity that we do not have any role in approving the latter. We have updated the text to provide clarity on the implementation of our periodic review, and reflect that we do not have a role in relation to approving station access agreements on HS1.

Interim policy for holding HS1 Ltd to account for stations in CP3

General

DfT published its PR19 Final Decision in October 2019 with a commitment to working with HS1 to agree on evidence and reporting that will support future reviews.

In taking on responsibility for periodic review of HS1 stations under the stations leases, we will seek to ensure that this work continues and remains aligned with the principles of regulatory best practice. We welcome commitments made by HS1 Ltd and its contractors to providing the required information to enable that to happen.

There are various ways for HS1 Ltd to demonstrate that its plans meet the Life Cycle Purpose for each station, and wherever possible the information that it already produces to operate its business should be used to meet these requirements. However, there may be instances where we may require further analysis, and would expect to be able to agree a method for demonstrating compliance between us, including the use of benchmarks and comparators as necessary. We are committed to continuing to work with stakeholders to ensure that these methods are appropriate and proportionate.

- 15 HS1 Ltd requested that we clarify that we would not be challenging or unpicking DfT's PR19 decision for stations funding in CP3. We have confirmed this in our policy for holding HS1 Ltd to account for stations in CP3.

Aim & objective

We regulate HS1 stations in accordance with the terms of the HS1 Stations Leases dated 30 September 2010 between HS1 Ltd and the Secretary of State (the Stations Leases). In addition to our role under the Stations Leases, we also have responsibilities under the Concession Agreement between the two parties, and under The Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 (the Regulations).

Our approach to holding HS1 Ltd to account in CP3 aims to strengthen or create incentives to:

- identify opportunities for innovation or research and development which support HS1 Ltd's achievement of the Life Cycle Purpose for each of its four stations;
- encourage effective, transparent, inclusive and well-governed stakeholder engagement by HS1 Ltd; and
- if necessary, take direct regulatory action to resolve concerns as early as possible to minimise the impact on operators, passengers and freight customers.

- 16 HS1 Ltd welcomed our aim to drive innovation and research and development, and offered to work with us on fulfilling this objective. We look forward to working with HS1 Ltd and stakeholders on this area through CP3 and at PR24.

Approach

Our approach to holding HS1 Ltd to account is informed by principles of regulatory best practice. In particular, our approach will be:

- Risk-based – this means that we will focus our resources where we consider the risks are greatest.
- Targeted – we will target our detailed monitoring and escalation activities at those areas where an issue, such as a potential non-compliance, has been identified and is material. This is with a view to reinforcing accountability and appropriate incentives on HS1 Ltd.
- Proportionate – so that any actions we take reflect the scale and nature of the problems we are seeking to address and the likely costs and benefits to different parties of taking action
- Transparent – so that we are clear with stakeholders about our view of HS1 Ltd's performance, we will state where we have any concerns and what action we are taking.
- Predictable – we will provide a stable and objective regulatory environment enabling affected stakeholders to understand our approach to making decisions.

We are taking a proportionate approach to monitoring the increased delivery challenge of renewing ageing assets. In particular, we wish to monitor and report on how HS1 Ltd is meeting the incentives set out for it by DfT at PR19 by focussing on:

- asset information;
- financial reporting, including the calculation of efficiency;
- use of risk and contingency provisions;
- the delivery of efficiencies set out in its 5YAMS.

- 17 HS1 Ltd noted that more information on the calculation of efficiencies mentioned here could be found in the Monitoring and Assessment section of our policy, under Financial performance and efficiency.
- 18 HS1 Ltd also noted that in the case of stations leases, efficiencies are set out in the Life Cycle Reports, not the 5YAMS. We have corrected this wording accordingly.
- 19 DfT agreed with our approach and supported our wider document, and hoped that it provided HS1 Ltd with comfort that enforcement is a remote possibility.

Monitoring and assessment

Asset Information

DfT's Final Decision required HS1 Ltd to improve its monitoring of assets and production of asset information with a view to better forecasting future renewals. We intend to continue to monitor HS1 Ltd's progress towards this goal through quarterly and annual reporting on its asset knowledge.

Financial performance and efficiency

We will monitor HS1 Ltd's financial performance using a range of qualitative and quantitative information, from sources including a combined asset management annual statement (AMAS) for route and stations. We expect the AMAS to provide transparent narrative on:

- whether HS1 Ltd has achieved financial outperformance (that is, Life Cycle Works Savings) against the forecast renewals spend, and the resultant payments due to funders under the Stations Leases;
- portfolio efficiency: a comparison of expenditure on renewals activities undertaken by HS1 Ltd against the value of the outputs on a like-for-like basis over time;
- an assessment of how the cost efficiency compares to the targets set in the PR19 Final Decision, as well as contemporary indicators/benchmarks from within (and outside) the industry; and
- a quantitative and qualitative assessment of risks, both what they are and how funding has been used efficiently to meet the risks.

We expect HS1 Ltd to provide the following information for our monitoring of the escrow account:

- timely and transparent information on its investment decisions during the control period for stakeholders; and
- analysis to show the investment decisions made over the year, that is, how it traded-off liquidity (access to funds) and returns.

Risk-based approach

The scope and extent of our routine monitoring may vary over time as different issues become more pressing for HS1 Ltd. We will make decisions on our approach to monitoring based on factors such as performance against commitments, ability of stakeholders to challenge and hold HS1 to account and the strength of HS1 Ltd's own governance and assurance arrangements.

- 20 EIL asked that we consider HS1 Ltd's contractors within the scope of our monitoring. We expect HS1 Ltd to manage its supply chain to ensure that it is able to provide us with the information that we require. We note that NR(HS) had not made resource provision for the monitoring and reporting requirements that we are proposing for CP3, but we welcome its commitment to work with HS1 Ltd to understand the support that it needs.
- 21 We note EIL's request that we ensure that we do not rely solely on information provided voluntarily by HS1 Ltd. We regularly engage stakeholders in our work, and commit to seek operator feedback through open and transparent communication on our monitoring and reporting of HS1 Ltd in relation to stations, in the manner that we currently do for the route.

HS1 Ltd expressed its concerns that the financial reporting that we expect from it was not well-defined. As with our approach to monitoring route performance, our holding to account policies only set out the information that we require. How HS1 Ltd demonstrates efficiencies and outperformance is then set out in its CP3 Governance Handbook, changes to which are made in consultation with us and its stakeholders.

HS1 Ltd requested that we clarify that the stations leases do not anticipate payments to the funders out of the Life Cycle Works Savings, but HS1 Ltd may propose (and we may approve) them. We have updated the wording of our policy accordingly,

- 22 EIL supported our intention to assess HS1's financial and long-term investment performance against DfT's PR19 Decision. We would expect to report on the findings of our first year of assessment of this data, in our annual report on HS1 Ltd for the financial year 1 April 2022 – 31 March 2023. EIL also asked that our assessment of potential savings considers the effects of the Covid-19 pandemic. As with our reporting on HS1 Ltd's performance on the route, we will seek to assess the effect of lower traffic volumes on the renewals workplan.

We note EIL's request that we have access to HS1 Ltd's non-regulated costs and charges, that is, for operation and maintenance of stations, and from non-railway use, in order to assure ourselves that the possibility of double counting has been excluded. This information is regularly published by HS1 Ltd and will be reviewed when compiling our annual reporting on the company.

EIL asked for more detail on penalties or sanctions that we could impose in the case of persistent non-compliance by HS1 with our requirements. The enforcement procedure that would be followed in such instances is set out in Schedule 8 of the

Concession Agreement (available on HS1 Ltd's website). The operator also wished to see a complaints procedure for third parties. Complaints relating to our regulation of HS1 Ltd should be directed to our [Public Correspondence Team](#).



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