Paul McMahon
Deputy Director, Railway Markets & Economics
Telephone 020 7282 2095
Email: paul.mcmahon@orr.gsi.gov.uk

OFFICE OF RAIL REGULATION

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Paul Chapman
Managing Director
HS1 Ltd
73 Collier Street
London N1 9BE

By email to paul.chapman@highspeed1.co.uk

Dear Paul

Schedule 10 'logging up'

1. You have asked me to explain in more detail how we would apply 'logging up' as part of the provision set out in paragraph 10 of schedule 10 of the High Speed 1 concession that provides for the possibility of an interim review of HS1 Ltd's operations, maintenance and renewal charge (OMRC).

2. HS1 Ltd is able to submit a 'notice of material change' if it considers that, due to circumstances out of its control, there has been a material and significant change in the circumstances in which OMRC was set, or where there has been a 'change of circumstances' that has satisfied certain conditions such that the level of OMRC is materially insufficient. If we accept HS1 Ltd's case, following our review (where we might accept HS1 Ltd's proposed new level of OMRC in whole or part), we would either:

(a) allow the new level of OMRC to take effect within the control period. The new level of OMRC would apply until the end of the control period when it would be reviewed again as part of the normal periodic review process;

(b) 'reset' the control period, i.e. to commence a new five-year control period with a new level of OMRC; or

(c) recognise that the additional costs (OMRC) should be taken into account in the next control period but determine that it is not appropriate to increase the level of OMRC in the current control period (as set out in paragraph 10.4 of schedule 10).

3. Our general assumption is that if we agreed to new levels of OMRC then these would be applied during the current control period, i.e. OMRC would be revised. The revised level of OMRC would take account of any difference in the time between when the costs were first incurred and the time when changes to OMRC become effective.[1]

4. If we decided on option c in paragraph 2, we would 'log up' the costs/OMRC during the current control period. This means that we would expect HS1 Ltd to maintain a record of the 'lost' revenue (i.e. based on the difference between the ‘old’ and ‘new’ levels of OMRC) and, as appropriate, a projection of the 'lost' revenue for the final year(s) of the control period in its periodic review submission(s). The record of the 'lost' revenue would need to be included in its financial reporting and we may want to audit it.

5. The provision to log up the revenue shortfall has been included in schedule 10 to cover instances when the timing of the introduction of any new level of OMRC in the control period, possibly combined with a comparatively small change in the level of OMRC, make it impractical or inefficient to make changes. This could be the case if a decision was reached on an interim review during the last year of the control period and possibly the last two years, once the periodic review is underway. The decision would depend on the timing and the magnitude of change and any other relevant factors. But in any event we would not want to unduly or materially adversely affect the financial position of HS1 Ltd in making this decision. We would expect to consult HS1 Ltd and any other interested parties fully and take into account any views before making such a decision.

6. As part of its proposals for OMRC for the next control period, made as part of its periodic review submission we would expect HS1 Ltd to include the logged up revenue in its proposed OMRC (clearly identified). The logged up revenue could be recovered over the whole or part of the control period and, depending on the specific costs logged up and HS1 Ltd's access charging policies, would be factored into access charges for all or just some classes of train operator.

7. In logging up we would factor in reasonable financing costs, i.e. under the assumption that HS1 Ltd would finance any revenue shortfall due to logging up at its cost of capital. As part of its submission for future OMRC and the treatment of the logged up costs HS1 Ltd would need to clearly identify and justify the financing costs it has assumed.

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[1] It is ultimately HS1 Ltd’s decision to decide the extent to which it reflects the outcome of our decision in its OMRC according to its own commercial considerations, i.e. it could choose not to implement any allowed increase in OMRC in full.

8. I trust this explanation is clear. If there are areas you would like to discuss further please do not hesitate to contact me. I am copying the letter to Graham Gunn and also publishing it on our website.

Yours sincerely

Paul McMahon