
Subject: *HS1 Ltd response to ORR 2014 High Speed 1 Periodic Review – First Consultation*

Date: *16 April 2013*

This note sets out HS1 Ltd's response to the ORR first consultation document. We make some general points, then specific comments against the questions raised in the document. We do not consider any of the material in our response to be confidential.

General comments

We broadly endorse the consultation document, and consider that it captures the key elements of the review and sets out a robust process between now and our eventual submission of the 5 Year Asset Management Statement (5YAMS) by the end of December 2013. In particular we welcome the regular programme of meetings with ORR to identify and resolve issues as they arise, and to achieve clarity around what is expected of our submission so that there are no surprises.

Our goal is to be the world's leading high speed railway, and this applies equally to our approach to regulation. We are committed to continuing the open and transparent approach we have demonstrated to-date, and to take the opportunity to deliver – with industry partners – a regulatory model that provides greater surety with lower regulatory burden. As the consultation document notes, there is a different regime in place than that which ORR applies to NRIL, and these differences are driven by the commercial nature of our concession, and the focussed relationships we have with operators over a specialised piece of infrastructure.

For HS1 Ltd, a successful regulatory model is one that **avoids** the following risks:

- customers take the view that they no longer trust us to give them a fair price and the quality they want and judge that they will be better off objecting to the proposed 5YAMS and relying on the ORR to settle the matter;
- HS1 and NRHS don't actively work together on the right balance between cost and outputs, and instead wait for either customers or ORR to settle the matter; and
- ORR decides that it cannot accept a package even where that is agreed by customers and HS1 – that instead it must be seen to make some changes otherwise it's not adding value.

All of the work we have undertaken to-date, including four key industry stakeholder workshops plus monthly bilateral meetings with the ORR and train operators, is targeted at avoiding these risks by sharing relevant information and identifying any issues / concerns early so that they can be addressed. We agree with the comments in paragraph 3.5 of the consultation document:

A determination which contains either no, or only minor, changes from HS1 Ltd's 5 YAMS submission will demonstrate the efficiency of HS1 Ltd's approach and its overall engagement with stakeholders, including ORR, throughout the PR14 process. Such a determination will also demonstrate the robustness of the work which HS1 Ltd has undertaken, and we encourage all parties to aim for this outcome.

We will continue to engage with stakeholders with the next workshop scheduled for 26 June 2013. The focus will be on costs and efficiency, building on the material presented at the workshop on 13 March 2013.

Specific responses

Length of HS1 Ltd Concession

We would like to correct the statement in paragraph 1.2. Our Concession ends on 31 December 2040, not in 2047.

Do you agree that CP2 outputs should balance HS1 Ltd's vision, contractual requirements and customer views? Are there any other relevant considerations?

We agree that these are the relevant considerations. In practice, our vision is aligned to achieving what our customers want, who will in turn reflect the demands of their own customers – the end-users of the railway. What we have heard from the stakeholder consultation to-date is that customers would welcome the continuation of the current excellent performance being achieved on HS1.

We have committed to providing the underlying analysis that will allow parties to confirm that view. For passenger operators this includes whole-life cost modelling that will provide some insight into the relationship between operational performance and cost / risk. For freight operators, this includes exploring opportunities to organise possessions differently to achieve 6 or 7 day a week operation and outlining the costs of doing so in order that informed decisions can be made.

Do you agree that a wholesale review of the contractual incentives mechanisms is not necessary? In your experience, are the existing performance regime and possessions regimes working well?

We consider that no wholesale review is necessary. The contractual framework was consulted on extensively quite recently in the lead-up to sale of HS1, and appears to be working well. This is reinforced by the nature of the railway where we have a specialised infrastructure with a small number of operators with whom we have deep ongoing engagement.

Our challenge is to extend this coordinated working relationship into adjacent infrastructure managers into Europe.

The focus of our work on the incentive mechanisms is around 'future-proofing' rather than a fundamental change to the structure. For example, how the performance regime will work in the event of a new operator.

Do you have further thoughts and ideas on the ways in which parties can work with HS1 Ltd to improve efficiency, including comments related to the outperformance mechanism?

We welcome the commitment of our key contractor (Network Rail High Speed (NRHS)) to share outperformance with operators and HS1 Ltd in the last three years of CP2. This is over and above the challenging but achievable efficiency target that ORR is obliged to set for CP2, and creates an important incentive to work together to achieve lower costs.

Do you consider that the existing structure of charges is consistent with the Railways Infrastructure (Access and Management) Regulations 2005? Do you consider that the existing structure of charges creates efficiency incentives?

There has been no appetite from industry stakeholders to modify the existing structure of charges. As with the incentive framework more broadly, the charging framework was consulted on widely and establishes a mechanism to share costs fairly between operators in line with cost-causation. For example, international operators pay for the cost of the line between Ashford and the Channel Tunnel.

In conjunction with the Periodic Review process and the resultant ORR determination which embodies efficiency improvements into the charges, the structure of charges creates clear incentives to reduce costs.

We are finalising our review of how the charging framework matches up to the 2005 regulations. We will share this with ORR shortly. Our preliminary view is that there may be some opportunity to better align the structure of our charges with the specific requirements of the regulations, though this would not affect the overall nature of the costs recovered nor the important mechanisms used to allocate costs between operators in a reasonable way. We would of course fully consult on any changes proposed as part of the PR14 process.

Are there other issues that we should take into account as we consider the operation of the escrow arrangements?

The consultation document identifies the key issues, and we agree that further discussion is required around the treatment of risk, any cash short-fall, and how to treat any outcome where actual spend differs from planned. It can be difficult to accurately forecast what work is required in the future, and there needs to be flexibility to ensure that different, more efficient, solutions can be implemented. Naturally this should not undermine the efficiency incentives on HS1.

The whole-life cost modelling analysis being undertaken by NRHS will provide significant and helpful input to discussions.

Do you consider that there are gaps in the benchmarking programme put forward by HS1 Ltd?

We consider that the benchmarking programme is extremely comprehensive. As we have noted publicly before, it is important to note that the benchmarking programme is:

- only one of several inputs into the efficiency story for CP2. Given the focussed nature of our railway it is easy to see our cost structure in a granular way, and to evaluate whether the efficiency initiatives that we and NRHS intend to put in place are reasonable and exhaustive; and
- unlikely to generate a specific and incontrovertible estimate of efficiency. There are inherent limitations on the data available and difficulties in adjusting for the specific factors on HS1 (and other railways) to allow for truly comparable analysis. We are committed to generating as much insight as possible from the benchmarking exercise because we are keen to identify efficiency opportunities. We are also keen to put in place a framework that allows the robustness of the benchmarking outputs to naturally improve over time. The benchmarking outcomes will provide important insight to be taken account of along with other analysis, rather than a definitive answer.

We will be updating stakeholders as to progress and preliminary outcomes of the benchmarking programme on 26 June 2013.

Do you agree that this document comprehensively covers those areas which should be considered as part of PR14? Are there any other areas which you consider we should be exploring?

We consider the document to be comprehensive.

Do you have any comments on the timescales set out in this chapter?

The timescales are clearly tight and there is a significant amount of work to do. A lot of material will become available at similar points in time so we are establishing clear processes internally for how we treat this. The timescales are an important driver of our commitment to regular dialogue with stakeholders so that we eliminate 'surprises' in the final submission. The timescales themselves have been the subject of extensive discussion and consultation.

We would be happy to discuss any element of this response in greater detail should that be helpful. Please contact Geoff Jones, Head of Regulation on email: geoff.jones@highspeed1.co.uk or phone: 020 7014 2724.

We look forward to continuing to engage with ORR and stakeholders to generate a successful outcome for all from this extremely important review.

Geoff Jones
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