PR19 first stakeholder workshop

9:30am, Monday 10 June, ORR Offices, One Kemble Street, London WC2B 4AN

Organisations
Office of Rail and Road (“ORR”)
HS1 Ltd (“HS1”)
Network Rail (High Speed) Ltd (“NR(HS)”)
Eurostar International Limited (“EIL”)
London and Southeastern Railway (“Southeastern”)
Deutsche Bahn Cargo UK (DB Cargo (UK))
Rail Freight Group (“RFG”)
Department for Transport (“DfT”)

Minutes

ORR welcomed attendees to the first of a series of workshops, aimed at hearing stakeholder views as the regulator moved into the scrutiny period of its review.

HS1 proposals & discussion
HS1 presented its latest proposals, submitted to ORR on 31 May and published. All responses to its draft 5 Year Asset Management Statement (“5YAMS”) had now also been published on its website.

HS1 had noted EIL’s “Ratchet” model for a 15-year lookahead at renewal costs and would be considering its implications.

It was noted that the costs for Control Period 3 ("CP3") had also changed between the draft, and final, 5YAMS. This was due to HS1 not being satisfied with NR(HS)'s initial approach to risk (that is, on a project-by-project basis); the final proposals narrowed the portfolio resulting in reduced base costs, and had then factored in portfolio-level risk. For long-run renewals, HS1 considered that its efficiency assumption was sufficiently challenging that it had not overlayed a long-term frontier shift.

The final 5YAMS also proposed treating implementation of the ERTMS signalling system as a renewal. A participant stated that the investment recovery charge ("IRC") was not a fixed figure, but instead a commercial maximum. Therefore treatment of ERTMS as a Specified Upgrade and recovery of costs through an additional IRC should take commercial risk into account.

RFG noted that the freight and domestic passenger operator costs of the new signalling system would be effectively undertaken by Government. As with the Network Rail portfolio, it was expected that replacing the system like-for-like was not relevant as the market would only supply interoperable components.

NR(HS)'s plans for CP3 were noted, including areas of optimisation. An attendee reflected that one issue was the scale of ambition: a series of benchmarking reports, including the latest undertaken by Rebel Group, identified scope for efficiencies which were never targeted. The operator did not consider what NR(HS) described as stretch as such. In addition, no unit cost comparison had been undertaken. NR(HS) reported that it had responded to areas of opportunity identified in the Rebel Group report.

HS1 added that factors such as assuring current performance, asset condition at handback, and interface issues, had impacted how far efficiency proposals could be implemented. A participant noted that performance risk was taken into account in the benchmarking work, and without undertaking unit cost analysis, could not foresee how HS1 could respond to the stakeholder responses to the proposals.

It was noted that proposals for network optimisation included the transfer of Ripple Lane to Network Rail Infrastructure Limited ("NRIL").

An attendee reiterated its concern that HS1 was transferring costs and risks in several ways: it suggested examples including, not taking the current control period outturn as the starting cost point, not looking for efficiency savings and not proposing to test the market for operator support.

In particular, it was not evident that HS1 had any incentive to tackle issues in relation to its energy strategy. HS1 responded that the benefits of changing its approach had so far not been considered to outweigh the risk of system failure; it had however restructured the purchasing framework so that operators now had the ability to directly influence the power network price.

It was noted that work remained to be done on recalibrating HS1's performance regime; HS1 wanted to assure that payment rates reflected the real costs of poor performance so asked operators to work with it to achieve a framework that would do this.

ORR's PR19 workstreams

It was noted that HS1 had posited a mechanism, to be developed in conjunction with ORR, for bringing forward currently "provisional" renewals in CP3. In its work with HS1, ORR hoped to understand what such a mechanism would entail, and what the alternative would be if one could not be agreed upon.

ORR could make use of data from elsewhere in the rail industry, as well as that obtained from its monitoring of Highways England, to undertake further benchmarking analysis. One attendee noted that the difference for HS1 is that no other comparator planned work over such a long (40-year) period.

ORR would also be seeking to understand the sophistication of HS1's procurement strategy; the purpose of the periodic review was, after all, to ensure consistency with HS1's General Duty, that is, best practice asset management.

It was also noted that ORR would be examining the justification for the increase in operation and maintenance costs, and how the proposed increase should be borne. As with efficiency, an attendee expressed its concerns that HS1's submission was not ambitious enough at controlling costs; and that ORR should not simply be looking at marginal changes. ORR responded that if it did not find satisfactory justification of HS1's proposed costs, it would of course determine what it would expect to see.

HS1 explained that the NR(HS) Specific Asset Strategies had formed the basis of Bechtel's cost planning for cost periods 4-10. ORR responded that it would wish to take its own view on whether the design lives were appropriate to be used in the calculation, or whether a risk based approach is more realistic.

ORR presented the development of HS1's proposed annuity payment since the initial 5YAMS consultation. It was recognised that HS1 had explored alternative options, in light of some comments from stakeholders, but as a result it was not clear now what the main HS1 proposal was. ORR asked HS1 to make that clear.

ORR set out in its presentation the key factors affecting the calculation of the annuity over a 40-year period and its interpretation that is what the concession requires. It also showed why using a 20-year period was problematic.

ORR recognised that the affordability of the charges was an issue and asked operators to set out the effect on their businesses of the proposed charges, recognising the other costs that operators pay.

ORR outlined next steps for the renewals annuity work stream. These include additional analysis of annuity payment inputs (cost, volume, efficiency, profile, contingency, risk and interest rates) to ensure they are appropriate. As well as considering how the historical underfunding can be addressed, whilst considering the effect on affordability (both short-run and long-run).

EIL noted the upward step change in annuity payments in relation to what was forecast in PR14 for CP3 and questioned the confidence that could be placed in the latest estimates. It also pointed out that careful consideration needs to be taken of the profile and timing of payments in relation to now and in the future. Attendees agreed that further exploration of how the escrow account can be invested should take place.

ORR noted that operators had questioned the efficiency of the escrow balance and we could consider alternative ways of, for example dealing with financial risk, if the operators submitted details of an alternative proposal for funding risk. But noted that this would be done in conjunction with DfT and HS1 as ultimately these matters are governed by the concession.

In relation to HS1’s proposed charging framework, it was noted that HS1 posited recovering non-direct costs through a long-term cost charge, rather than a mark-up on rail segments that could bear such a charge – neighbouring infrastructure manager Eurotunnel recovered them through a long-term cost charge.

ORR would also have regard to its recent periodic review of NRIL when deciding whether to approve or determine HS1’s charges.

Next steps
The next event would be held on Monday 1 July.