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Dear Colleague

Regulation of High Speed 1: Statement by the Office of Rail Regulation

1. The Office of Rail Regulation (ORR) has today published a statement setting out our approach to the regulation of High Speed 1, the rail line between London St. Pancras and the Channel Tunnel. The purpose of the statement is to set out key elements of the regulatory arrangements for the line, and our approach to carrying out our functions.
2. We consulted on a draft of the statement on 19 August 2009, with responses sought by 23 September 2009.
3. Annex A to this letter is a copy of the statement. Annex B is a summary of the consultation responses, and our response to them, including the changes we have made to the statement in the light of them. Annex C shows the changes between the consultation draft and the final version. These documents, and a full set of consultation responses, can also be found on the ORR website.

Yours sincerely



Michael Beswick

Annex A

Regulation of High Speed 1

Statement by the Office of Rail Regulation

Introduction

1. This statement outlines the Office of Rail Regulation's approach to carrying out our functions concerning High Speed 1, the railway from London St Pancras to the Channel Tunnel, under:

- the Railways (Access and Management) Regulations 2005 as amended in 2009 ('the regulations')¹; and
- the amended and restated development agreement between the Secretary of State and HS1 Limited dated 14 August 2009 under which HS1 Limited holds until 2047 the concession to operate the High Speed 1 infrastructure between St. Pancras station in London and the Channel Tunnel portal (the 'concession agreement').

It only addresses our economic regulation functions in respect of High Speed 1 and does not address our safety and competition functions for High Speed 1 which are broadly the same as for the national network. The statement reflects the specific circumstances of High Speed 1, and is not intended to create any expectation about our approach to regulation of the Great Britain national network or other networks, including future high speed lines.

2. In making this statement we recognise that it may be relied upon by HS1 Limited, the Secretary of State, prospective purchasers of HS1 Limited and any new future owner and its equity and debt providers, train operators using or intending to use High Speed 1, and their customers, and the infrastructure managers of networks adjacent to High Speed 1. HS1 Limited has written to tell us that it will rely on this statement.

3. The statement sets out our current intentions as to our approach to the regulation of High Speed 1. Should we intend to change our approach from what is set out here we would consult as appropriate with those affected, consider fully any representations made and provide reasons for the change. Nevertheless, this statement cannot fetter our discretion in relation to the future exercise of our functions; any individual decision, for instance on an appeal under the regulations, will have to be made in the light of all the relevant facts and circumstances at the time and our duties under the regulations

¹ <http://www.opsi.gov.uk/si/si2005/20053049.htm> and http://www.opsi.gov.uk/si/si2009/uksi_20091122_en_1

(including, by virtue of regulation 28(1), our duties under section 4 of the Railways Act 1993).

4. The structure of the statement is as follows

- paragraphs 5 to 8 outline the background to the statement
- paragraphs 9 to 13 outline our general approach to the exercise of our functions
- subsequent paragraphs set out in more detail how we expect to apply this approach to access charges (including periodic reviews of the operations, maintenance and renewal charges), HS1 Limited's stewardship duty, track access and stations.

Background

5. The statement reflects close working between the Department for Transport and ourselves to establish a regulatory framework for High Speed 1 consistent with the commitment by ministers that, 'as far as possible, the operation of this line should be subject to the normal regulatory supervision'², while recognising there are differences between High Speed 1 and the national network, and between the respective infrastructure managers, HS1 Limited and Network Rail Infrastructure Limited ('Network Rail').

6. The key elements of this regulatory framework are:

- a new function for us from 1 October 2009 in the pre-approval of all new framework agreements and of revisions to any existing framework agreements (i.e. track access contracts covering the reservation of capacity for more than one timetable period) for use of High Speed 1 following the recent changes to the regulations. This is in addition to the appeal role we have in respect of the terms of track access and more widely under the regulations;
- a new responsibility for us from 1 October 2009 under regulation 13 to ensure that HS1 Limited, with due regard to safety and maintaining and improving the quality of infrastructure service, is provided with incentives to reduce the cost of provision of infrastructure and the level of access charges. This will be achieved through the company's obligations under the concession agreement and the rights and responsibilities conferred on us as a result of that agreement which include:
 - provision for periodic reviews by ORR of the operation, maintenance and renewal charges;
 - a general duty in respect of asset stewardship in the agreement, requiring the company to secure the operation, maintenance, renewal and replacement of the railway

² <http://www.publications.parliament.uk/pa/ld200708/ldhansrd/text/80513-0003.htm>

infrastructure in accordance with best practice³ and in a timely, efficient and economic manner, and with a long-term (40 year) view. This is similar to that in Network Rail's network licence, but reflects the specific circumstances of High Speed 1;

- enforcement powers for our functions based on those in the Railways Act 1993; and
- an extension of our statutory information gathering powers to our new responsibilities by means of a change to the regulations.

7. Our duties under section 4 of the Railways Act 1993 apply to these functions in accordance with regulation 28(1) of the regulations. We do not have an statutory duty concerning the ability of HS1 Limited to finance its activities (as we do for Network Rail on the national network) because HS1 Limited does not hold a network licence and section 4(5)(b) therefore does not apply to it. In addition, the overriding duty given to us by section 21(1) of the Channel Tunnel Rail Link Act 1996 not to impede the performance of a development agreement⁴ does not apply to the exercise of these functions because this duty is limited to our economic regulation functions for the rest of the Great Britain rail network, under or by virtue of part 1 of the Railways Act 1993.

8. In developing this regulatory statement we have had regard to:

- our section 4 duties in particular our duty under section 4(1)(g) (to enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance);
- our relevant functions under the regulations and in particular our new role in the pre-approval of framework agreements and our appeal role;
- our rights and responsibilities under the concession agreement.

General approach

9. We expect to regulate High Speed 1 so far as possible in the way in which we regulate the national network whilst recognising there are differences between High Speed 1 and the national network, and

³ The concession agreement defines “**best practice**” as meaning in respect of HS1 Co the exercise of that degree of skill, diligence, prudence, foresight and practice which would reasonably be expected from a skilled and experienced infrastructure manager engaged in the provision of high speed railway infrastructure.

⁴ Under the Channel Tunnel Rail Link Act 1996, a development agreement means an agreement to which the Secretary of State is a party and under which another party has responsibilities in relation to the design, construction, financing or maintenance of what is now High Speed 1. The Channel Tunnel Rail Link (Supplementary Provisions) Act 2008 extended the definition of a development agreement to cover the operation of the line. The concession agreement is a development agreement.

differences between HS1 Limited and Network Rail. In general we would therefore expect to apply our general published policies and principles of regulation having regard to these differences to the extent relevant.

10. We recognise, however, that the government has established the concession agreement, and intends to sell HS1 Limited, so as to help achieve the government's objective of recovering over the term of the concession a proportion of the very significant investment it has made in High Speed 1. In the light of this, the company's business model is different from that of Network Rail. The success of HS1 Limited is likely to depend in a large part on its ability to raise revenue through increased usage of High Speed 1, including by new operators, on a long term profitable basis. HS1 Limited will be seeking to finance its activities through the track access charging regime referred to in this regulatory statement. We expect to have regard to the different characteristics and economics of High Speed 1 and the differences in HS1 Limited's business model, where relevant, in our approach to the regulation of High Speed 1.

11. We support the objective of making best use of the capacity on High Speed 1 for international and domestic passenger services, and potentially for freight services. We also support making best use of capacity on the Channel Tunnel corridor as a whole, and through our role in regulating the national network and High Speed 1 and in the Intergovernmental Commission for the Channel Tunnel, we expect to seek to further it. We consider that it is likely to be facilitated by development of a more competitive market for international rail services

12. Consistent with good regulatory practice, we are in the process of reviewing relevant policies to consider whether any of them should be tailored to take account of our new functions in respect of High Speed 1, and the approach outlined in this statement. If we conclude that any of our policies should be adjusted in this way, or that new policies are required, we expect to carry out a full consultation with interested parties before deciding what, if any, changes should be made.

Network Rail (CTRL) Limited

13. We recognise that Network Rail (CTRL) Limited is currently responsible for operating, maintaining and renewing High Speed 1 under a contract with HS1 Limited that is presently under review with a view to restructuring certain aspects. We support restructuring of the existing Network Rail (CTRL) Limited operator agreement to provide for the opportunity to market test the agreement in the future after any future sale of HS1 Limited, and the flow-through of the relevant provisions of the concession agreement to the operator agreement, including those relating to periodic and interim reviews of the operations, maintenance and renewal charge. We expect the revised operator agreement to incentivise Network Rail (CTRL) Limited to deliver and, if possible, outperform its obligations to HS1 Limited. We expect that for as long as it holds the operator agreement that Network

Rail (CTRL) Limited would be closely involved in the processes for periodic reviews, or any interim reviews, set out below.

Track access charging

Charging framework

14. The government has established a charging framework for High Speed 1 through the concession agreement pursuant to regulation 12(4) of the regulations. This charging framework has been established by the Secretary of State following consultation⁵ and is intended to operate in a manner that is consistent with the regulations.

15. In particular this framework provides that track access charges may include:

- an investment recovery charge to recover the capital costs of the High Speed 1 project;
- charges relating to the operation, maintenance and renewal of High Speed 1, including long-term costs of providing for railway services on High Speed 1 (that is, of the operational phase of the High Speed 1 project) including meeting the performance standards, asset stewardship requirements and handback condition required by the concession agreement; and
- discounts in accordance with paragraph 6 of schedule 3 of the regulations.

Investment recovery charge

16. The charging framework provides that access charges levied by HS1 Limited may include an investment recovery charge for the use of High Speed 1 up to a maximum level set by the Secretary of State as a maximum value per minute of train service. We understand that the intention is that HS1 Limited should recover a significant part of the long term capital costs of the project over the life of its concession expiring in 2047 through this charge. We further understand that HS1 Limited intends to levy this charge at the maximum level on all passenger train operators except when it elects to apply a discount in accordance with the regulations. The effect of the cap on the investment recovery charge in the charging framework is that HS1 Limited is likely to recover only a part of the amount of the long term capital cost (after deducting amounts already recovered in the form of domestic capacity charge under the original development agreement and investment recovery charges paid by Eurostar under its original track access agreement) at current values over the life of its concession. Government has advised us that it envisages that any long term capital costs which have not been recovered by the end of the

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<http://www.highspeed1.com/information/?page=1&id=108&category=&pagecategory=>

concession in 2047 will be recovered under a second concession which it currently intends will run from 2047 to 2086.

17. Given the principle that this investment recovery charge is set at a level to recover the capital costs of the project over the longer term, we would not expect, in considering any appeals concerning this charge, to change the arrangements for it, as set out in the charging framework.

Operations, maintenance and renewal charge

18. Under the concession agreement, the element of track access charges levied for operation, maintenance, and renewal of High Speed 1 Railway Infrastructure⁶ ('OMR charges') is subject to periodic review by ORR. During the course of such reviews we would expect to either approve or determine the level of operation, maintenance, and renewal cost that would be incurred by an efficient operator, and set a level of OMR charges consistent with that. For passenger operators we expect that the OMR charges will, in particular, continue to comprise:

- charges for costs directly incurred as a result of operating train services; and
- charges for fixed and common costs, recovered as long-term costs of providing for railway services on HS1 (that is, of the operational phase of the High Speed 1 project). Charges relating to renewal will be calculated as an annuity based on the long term cost, with a fund, held in escrow, being built up to cover the cost of future renewals.

19. We expect to determine OMR charges by reference to the efficient level of operation, maintenance and renewal costs, and consistent with the concession agreement will not take into account the actual or expected income that HS1 Limited receives from property (including station and depot lease charges and station access charges), retail, car parking or other activities, or from the investment recovery charge. Thus the level of OMR charges is not established using the "single till" model adopted for Network Rail. This is because the concession agreement specifies the specific sources of funding that we can take into account when we approve or determine the level of OMR charges.

Freight charges

20. HS1 Limited plans to levy freight charges based on the efficient costs directly incurred as a result of operating freight train services, in accordance with the regulations. The freight charges that will be levied

⁶ This is defined in the concession by reference to the definition of railway infrastructure in Regulation 3 of the regulations. It includes network, track and the EdF Assets (being the assets which are subject to the EdF Agreements) but does not include any estate or interest over any light maintenance depot, the London St Pancras Station, Stratford Station, Ebbsfleet Station or Ashford International Station.

by HS1 Limited for the costs directly incurred comprise a 'variable' element to recover wear and tear costs and an element to cover the additional 'avoidable' costs of operating freight train services. In accordance with the regulations, HS1 Limited has applied a significant but time-limited discount to the 'avoidable cost' element of the OMR charges for freight operators. We understand this is to aid the development of new freight services when capacity is under-utilised. We would be prepared to approve charges based on these cost-reflective principles, though as noted in paragraph 25 below there is further work to be carried out in respect of freight avoidable costs.

21. Whilst mark-ups are permitted by the regulations (for example, to enable infrastructure managers to recover costs which are common to different types of train operation) we understand that there are currently no plans by HS1 Limited to charge freight operators any such mark-up. Depending on the ability of freight operators to pay higher charges in the future, in accordance with the regulations, HS1 Limited may seek to recover higher charges from specific freight market segments. Any such mark-up would need to be reflected in an access contract and would be subject to our approval.

Initial review of the structure and level of access charges

22. HS1 Limited has outlined to us how it has established the initial structure and level of the track access charges (excluding the investment recovery charge referred to in paragraphs 16 and 17) that it proposes to implement for the period to 2015 (the first control period). We have also reviewed benchmarking analysis undertaken by HS1 Limited comparing itself against international comparators.

23. HS1 Limited's proposed OMR charges reflect its anticipated efficiency improvement over the course of the first control period, through specific cost savings resulting from restructuring and ongoing improvements in efficiency. We have reviewed HS1's costs and charges, including its international benchmarking analysis. We consider that HS1's international benchmarking analysis is not at a level of robustness that allows unambiguous conclusions to be drawn on the relative efficiency of HS1 Limited to relevant comparator railways, although our analysis does indicate that there may be opportunities for further efficiency improvement beyond the first control period. Before firm conclusions can be drawn on the relative efficiency of High Speed 1 more work, in which we expect to be involved, needs to be done including to understand and potentially adjust for the particular circumstances of HS1 Limited.

24. Based on the work we have undertaken to date to assess HS1 Limited's proposed costs and charges we have no evidence to suggest they are unreasonable for the first control period.

25. However, as part of our review of the level of access charges we did not examine in detail HS1 Limited's estimates of the freight avoidable costs that underpin the charges that will be incurred by freight. We understand that HS1 Limited is working with freight

operators to establish freight operations on High Speed 1. Until there is more clarity on the extent of freight services that will operate on High Speed 1 there will remain uncertainty around the costs of freight, in particular the avoidable costs of freight and the impact of these on freight access charges. We recognise the significant discount that HS1 Limited has offered to freight operators for the first control period and consider this would be likely to offset any inefficiencies in the level of the freight avoidable costs. However, we have agreed with HS1 Limited that the company will review the level of freight avoidable costs during the next twelve months and, if appropriate, review the level of freight access charges.

Periodic reviews

26. The concession agreement sets out the purpose, and, in general terms, the process, for periodic reviews, the first of which is expected to take effect in April 2015. As far as possible the periodic review process has been designed to be consistent with the broad approach that we adopt for periodic reviews on the national network, with charges being determined for each control period lasting five years. The concession agreement requires that a long term (40 year) view of renewal and replacement costs is taken and we will need to ensure that the annuity payments are adequate in the light of this.

27. Establishing OMR charges that are fixed in real terms for the duration of the control period provides certainty to train operators and also provides incentives on HS1 Limited to outperform the decisions made at a periodic review. Any benefits of outperformance in efficiency of renewal and replacement will be available for sharing between HS1 Limited and train operators by way of allocating a percentage (set at 70% for train operators and 30% for HS1 Limited in the concession agreement but subject to possible change by ORR at periodic reviews) to a reduction of the renewal and replacement elements of future OMR charges payable by train operators on High Speed 1. Any benefits of outperformance in efficiency in respect of the operations and maintenance elements would be retained by HS1 Limited for the relevant control period.

28. Before each periodic review for High Speed 1 is started we would expect to consult on the detailed process to be followed for the review, and this is reflected in the concession agreement. We recognise that as part of this, HS1 Limited is likely to want to do its own consultations on the level of OMR charges, the performance regime, possessions regime and proposed performance levels before it submits its five year asset management statement which will, as set out in detail in the concession agreement, address all these issues. We expect to issue any appropriate guidance to assist this process.

29. Consistent with regulation 13, achieving high levels of operating, maintenance and renewals efficiency on High Speed 1 is important, in order to minimise the track access charges paid for use of the railway by passenger and freight train operators, and ultimately reduce the cost to users and encourage best use of this important

national asset. We therefore expect that a key part of a periodic review for High Speed 1 will be an assessment of the efficiency of HS1 Limited.

30. We expect HS1 Limited to establish an ongoing and robust programme of benchmarking work to compare itself to other high speed railways. We would expect to approve or determine OMR charges that assume HS1 Limited is as efficient as other high performing high speed rail companies, taking into account the specific characteristics of High Speed 1, such as the extent of scale economies achievable by HS1 Limited.

31. In particular, following the start of our role under the concession we expect to discuss with HS1 Limited its programme of benchmarking work that will lead up to its submission to us at the first periodic review. We consider that the type of approach to benchmarking which we undertook as part of the 2008 periodic review of Network Rail's access charges (top-down statistical analysis complemented by bottom-up engineering and process benchmarking) represents a sound model for HS1 Limited to follow. We expect its periodic review submissions to us to be supported by this benchmarking. As part of a periodic review we expect to review HS1 Limited's benchmarking and, as appropriate, supplement it with our own work.

32. HS1 Limited has certain long term contracts in place with Network Rail (CTRL) Limited, and also with EdF Energy (Services) Limited and EdF Energy plc (together, EdF), which pre-date our regulatory role. In setting OMR charges, we expect to have regard to the terms of the Network Rail (CTRL) Limited operator contract and the arrangements concerning power supplies with EdF. But we expect HS1 Limited to use such rights that it has under these and other contracts to secure efficiency improvement.

Interim reviews

33. The concession agreement makes provision for interim reviews of OMR charges in the event of material changes between periodic reviews. If HS1 Limited seeks such a review (the concession agreement does not enable ORR to seek an interim review), we would expect it to be supported by strong evidence as to why such a review is required, and why the issue cannot wait until the next periodic review. The concession agreement also provides that we have discretion to decide that it is not appropriate to increase OMR charges as a consequence of a relevant change and that the costs resulting from such a change may be taken into account when setting OMR charges for future control periods.

Changes to track access charges

34. Given the arrangements described above for setting and amending track access charges and subject to what is said in paragraphs 16 and 17 in respect of the investment recovery charge, it should be clear that any changes made to either the level or structure of track access charges for HS1 in a framework agreement will be

subject to the approval of ORR. This would not be the case where the framework agreement includes a self-modifying provision; for example the review event mechanism⁷. In particular, HS1 is not able to make changes to charges payable under a framework agreement by amending the tariffs published in the network statement, although we would expect HS1 to update the network statement to reflect any changes which we have approved.

HS1 Limited's stewardship duty

35. The concession agreement gives ORR responsibility for monitoring HS1's compliance with certain obligations and taking appropriate enforcement action, including preventative action in respect of likely future breaches. Our enforcement powers under the concession have been modelled on our enforcement powers under the Railways Act 1993 with powers to make enforcement orders and require compliance with an order through seeking an injunction or other relief or remedy, though without the ability to levy penalties. HS1 Limited's failure to comply with an enforcement order which has not been appealed is an event of default under the concession agreement, which may lead to termination of the concession agreement by the Secretary of State.

36. A key obligation in the concession agreement is the general duty concerning stewardship of the High Speed 1 railway infrastructure. The asset stewardship purpose is to secure operation, maintenance, renewal and replacement, and planning and carrying out of upgrades in accordance with best practice⁸, in a timely, efficient and economic manner, and for assets other than those covered by the EdF agreements, taking a 40 year perspective. This is subject to the safety authorisation for High Speed 1 and the minimum capability requirements set out in the concession agreement.

37. The concession agreement contains other specific obligations related to asset stewardship but these are without prejudice to the generality of HS1 Limited's general duty to achieve, to the greatest extent reasonably practicable having regard to all relevant circumstances, the asset stewardship purpose which is summarised in paragraph 36⁹ above.

38. We expect to take a proportionate and timely approach to monitoring and enforcement consistent with our approach for the national network, and recognising the processes set out in the concession agreement.

⁷ See definition of Review Event in Section 7 of HS1 Passenger Access Terms <http://www.highspeed1.com/information/?page=1&id=117&category=64&pagecategory=1>

⁸ See definition at footnote 3.

⁹ Correction made to cross-reference on 9th November 2009.

39. We expect to have regard to the terms of the Network Rail (CTRL) operator agreement and the EdF agreements in relevant cases as "relevant circumstances" for the purposes of the general duty. We would also have regard to whether HS1 Limited has taken the actions that would be expected of an efficient infrastructure manager complying with the general duty to address any constraints created by the contracts, and to any other relevant circumstances.

40. In keeping under review HS1 Limited's compliance with the general duty:

- we note the current very high levels of performance on High Speed 1, while acknowledging that London and South Eastern Railway has yet to start operating a full domestic service. We expect that compliance with the general duty will result in levels of operational and performance meeting the reasonable requirements of train operators using the line and better than the minimum performance levels specified in the concession agreement. In considering what these reasonable requirements are we expect to have regard to the provisions in framework agreements concerning performance;
- as with the national network, we expect that the standard of operation of the network required by the general duty in the concession agreement related to performance will require the infrastructure manager to take actions within its power to minimise delays resulting from all causes, not just those for which it is directly responsible. We acknowledge that train operators too have an important role in minimising delays, and believe it will be important for HS1 Limited to work to establish effective partnership working on performance between itself, train operators, its contractors and adjacent infrastructure managers;
- we expect to work with HS1 Limited, through the processes in the concession concerning the development of an asset management strategy, to develop a range of stewardship indicators, including measures of track quality. This will begin with our review of the initial asset management strategy which HS1 Limited is required to produce by 1 January 2010.

41. The concession agreement and network code for High Speed 1 set out HS1 Limited's obligations concerning enhancements. Our role is to ensure such enhancements are delivered efficiently, consistent with the general duty, and that fair charging arrangements are in place. We would not expect the 'best practice' requirement in the asset stewardship purpose to be used to lead to unnecessary over-specification or as a means of securing unfunded enhancements to the High Speed 1 infrastructure.

Track Access.

42. Simultaneously with entering into the concession agreement, HS1 Limited has entered into agreed framework agreements with Eurostar UK Limited (Eurostar) and London and South Eastern Railway Limited (LSER). We had no functions in respect of these agreements

since they were agreed between the respective train operators and HS1 Limited before our powers concerning approval of framework agreements come into effect on 1 October 2009.

43. We were, however, asked to review these agreements and the network code for High Speed 1 in draft. Following these reviews, the draft agreements and code were amended, and we have told the parties that, had our powers been in effect, we would have been prepared to approve the agreements as entered into.

44. In carrying out our preapproval function in respect of framework agreements, and in dealing with appeals, we expect, subject to our statutory duties, to have appropriate regard to the commercial judgements of the parties and the nature of the HS1 Limited business model. We expect to consult shortly, and conclude by the end of January 2010, on what modifications may need to be made to our existing criteria and procedures for access agreements, and to our policy on the length of framework agreements in the light of the revised regulations and the approach outlined in this statement. We expect to seek views on, among other matters, the appropriate risk allocation for future framework agreements, including appropriate liability caps, liability arrangements contained within part G of the network code, and the appropriateness of prepayment of charges, where the approach taken in the Eurostar and LSER agreements differs from the approach on the national network. Any future changes to our approach would be subject to further consultation as is the established practice on the mainline network .

45. As set out in paragraph 11 above, we support the objective of making best use of the capacity on High Speed 1 for international and domestic passenger services, and potentially for freight services. We are aware that the HS1 railway infrastructure has been designated as specialised infrastructure for the purposes of regulation 22 of the regulations. This designation is set out in the High Speed 1 network statement and means that HS1 Limited may give priority to high speed passenger and high speed freight services if capacity is not available for other services, and may within high speed services give priority to international passenger, then domestic passenger and then freight services¹⁰. Regulation 22 makes this prioritisation subject to various requirements including consulting ORR. We were consulted before this designation was made and, beyond suggesting a wider consultation of industry parties, we made no objection to it.

Stations

46. The concession agreement gives ORR a limited role in monitoring, and, if necessary, taking enforcement action in respect of the provision of certain minimum levels of station facilities (such as

¹⁰ During the London Olympics domestic passenger services are given first priority.

numbers and lengths of platforms). The main stewardship obligations for stations are in leases granted by the Secretary of State to HS1 Limited, and enforced by government. Separate from this, we have an appeal role under the regulations in respect of the terms of access to stations by train operators.

Office of Rail Regulation

30 October 2009

Annex B

Regulation of High Speed 1: Consultation on draft statement by the Office of Rail Regulation (ORR)

1. On 19 August 2009, we launched a consultation on a statement that we proposed to issue setting out our approach to the regulation of High Speed 1, the rail line between London St Pancras and the Channel Tunnel. The purpose of the statement was to set out key elements of the regulatory arrangements for the line and our expected approach to carrying out our functions. We sought views in particular from people and organisations who might, in the future, rely on the statement such as HS1 Limited (the infrastructure manager of the line), the Secretary of State, prospective purchasers of HS1 Limited and its equity and debt providers, train operators using or intending to use High Speed 1 and their customers, and the infrastructure managers of networks adjacent to High Speed 1.

2. We sought responses to the consultation by 23 September 2009. This five week consultation period reflected the fact that there had already been extensive consultation by the Department for Transport and HS1 Limited about the arrangements for High Speed 1.

3. We received responses to the consultation from:

- HS1 Limited
- London and South Eastern Railway Limited (South Eastern)
- Eurostar (UK) Limited
- DB Schenker Rail (UK) Limited
- Rail Freight Group
- Freight Transport Association
- Network Rail Infrastructure Limited
- Hitachi
- Transport for London
- Mr. Tony Baldwinson

Copies of the responses, where respondents commented, are being placed on our website other than the confidential elements of Mr. Baldwinson's response.

4. In the light of the consultation we have made some changes to the statement and published it. This document summarises the responses to the consultation and the changes we have made.

5. Generally consultees were supportive of the proposed statement, and the approach it set out.

6. **HS1 Limited** welcomed our proposal to publish a regulatory statement and considered that such a statement was essential to its ability to finance the operation of its business in the private sector without government support. It

confirmed that HS1 Limited would be placing reliance on the final form of the statement and said that the company attached particular importance to a number of aspects of the statement. HS1 Limited asked that it be given a chance to make representations with respect to any proposal by ORR to change the form of the statement. As set out below we have made some changes to the statement, and before finalising these we did seek comments from HS1 Limited which we have taken into account.

7. From the passenger operator perspective **London and South Eastern Railway Limited** said they had no substantive comments on the statement.

8. **Eurostar (UK) Limited** supported the proposed statement, and emphasised the importance of regulatory oversight of HS1 Limited, with ORR having a pivotal role in ensuring that HS1 Limited customers continue to enjoy the current high level of performance into the future and also that costs are kept under tight control. Eurostar made some specific points:

- it would find it helpful to understand how ORR saw the process for reviewing HS1 Limited's operational, maintenance and renewal costs. The statement sets out our approach to reviews. To the extent appropriate, we would expect to review HS1 Limited's costs in a similar way to that we use to review Network Rail's costs at a periodic review. We expect our consultation at the start of the HS1 Limited periodic review process to include our approach to cost and efficiency assessment.
- it was unclear about the regulatory status of the HS1 Limited network statement, and whether changes to it have the potential to update access charges retrospectively. On this point, our response is that the network statement's role is defined by the Railways (Infrastructure) Access and Management Regulations 2005 and any disputes concerning it are subject to appeal to ORR. Moreover, charges in individual framework agreements are subject to approval by, and appeal to, us. Unless the contract makes provision to the contrary, a change to the network statement does not affect charges in existing contracts. We have inserted text in the final version of the statement to clarify this.
- it welcomed our future consultation on criteria and procedures for approval of track access agreements, and said that its expectation was to be fully consulted on future changes to the HS1 access environment to the standard it had come to expect on the conventional network. We have inserted wording to reflect this point.

9. DB Schenker Rail (UK) Limited emphasised the importance of High Speed 1 to freight as the unique opportunity of a fast link, suitable for higher gauge traffic, from the Channel Tunnel to London, and that it fully intended to operate freight services on High Speed 1 as soon as modifications were made to its locomotives to interface with the signalling system. In the light of this, DB Schenker said it was a keen supporter of ORR's role in the regulation of High Speed 1. It had a number of concerns about the charging arrangements:

- It welcomed ORR's confirmation that it would not expect to change the arrangements for the investment recovery charge as set out in the charging framework. On this point, although we understand that HS1 Limited has no plans to levy the investment recovery charge on freight

operators, it does not preclude the possibility of doing this in the future, in accordance with the regulations.

- while noting that the discount offered by HS1 Limited made the operational, maintenance and renewal charge affordable for freight, it stated that the undiscounted level of charge was in its view unaffordable for conventional (non high speed) freight traffic. It also suggested the discount should apply to day time freight traffic as well as night time freight traffic. DB Schenker asked that a review of the specific costs underpinning the proposed freight operations, maintenance and renewal charge should be carried out before the expected date of operation of freight services during autumn 2010. In response to this point, we have agreed with HS1 Limited that it will review the level of freight avoidable costs over the next twelve months and if appropriate review the level of freight access charges.
- DB Schenker noted that there is no reference in the proposed statement to HS1 Limited's proposal for a capacity reservation charge payable by freight operators for daytime operations, which it strongly opposes. We have not made a change to the statement on this point – we believe it is properly handled through discussion between the parties and appeal to ORR if agreement cannot be reached.

10. The **Rail Freight Group** (RFG) welcomed the statement, but noted that some issues remained concerning the charging regime. RFG supported the need to ensure that the HS1 and national network regulatory regimes were as similar as possible. On charging RFG suggested that some aspects of the freight charges appeared high – principally the avoidable costs, which it asked ORR to consider in more detail. As noted above, and reflected in the final statement, HS1 Limited has agreed to review the level of freight avoidable costs.

11. RFG also suggested that ORR should issue guidance on the form and nature of consultations carried out by HS1 Limited as part of the periodic review process. We have amended the statement to make clear that we would do this if we considered it appropriate. If we were to do so, such guidance would be reasonable and require an appropriate approach.

12. RFG suggests that the regulatory statement should serve as a precedent for ORR's role in future high speed lines. We entirely agree that it is important to establish the regulatory regime earlier than has been the case on High Speed 1, but we expect to discuss the appropriate framework for future high speed lines with government and others at an appropriate time, and the system of regulation set out in the statement we are making on High Speed 1 should not be seen as a precedent.

13. The **Freight Transport Association** (FTA) welcomed the discounts being applied by HS1 Limited to freight access charges, though noting that the charges would still be higher than those for Network Rail Infrastructure. FTA suggested that the discount should not be time-limited, and that ORR should state that mark-ups as permitted by the regulations should not be applied to freight services. We have considered both these points, and believe they are

properly matters for us to consider in approving (or dealing with appeals on) specific access contracts.

14. **Hitachi** had no comments on the statement.

15. **Network Rail Infrastructure Limited's** main interest was in cross-boundary issues, highlighting a number of detailed issues that needed to be resolved about how the high level principles set out in the statement will work in practice. Issues requiring ongoing debate included:

- treatment of the annuity - how in practice ORR would make its judgements around the adequacy of the annuity at any point in time related to discharge of HS1 Limited's asset stewardship obligations. The annuity is a payment made each year by High Speed 1 into a ring-fenced fund designed to pay for the long term cost of renewal and replacement. In response to this we have outlined how this will be part of the periodic review process.
- the detailed approach to benchmarking.
- the approach to making best use of capacity covering the benefits of a more competitive market for international rail services, pricing for freight and the criteria for framework agreements.

16. We have considered each of these points:

- we believe the arrangements set out schedule 10 of the concession agreement between the Secretary of State and HS1 Limited, which are monitored and enforced by ORR, and in particular the periodic review process, are the means by which we would be satisfied about the adequacy of the annuity payment. We have made changes to the statement to reflect this point.
- as set out in the statement, we expect to begin discussions on the approach to benchmarking now that our powers have taken effect, and have changed the statement to make clear that we expect to consult on this.
- we have not done detailed analysis of the benefits of a more competitive market for international rail services to the efficient use of capacity, but believe that experience has shown the benefits of opening up markets of this nature to competition and this is reflected in EU policies. We consider that, subject to the review of avoidable costs, we have said enough about freight charges. We will be consulting shortly on our criteria for framework agreements.

17. Network Rail also states that it proposes to discuss further with HS1 how their respective network statements can be developed so that there is a single source of information for all operators. We note that intention and would be in favour of an approach which, while satisfying the legal requirement for infrastructure managers to publish separate network statements, also made it easier for train operators to understand the arrangements for accessing those networks for through journeys.

18. **Transport for London** supported the approach in the statement. It noted the existence of time limited discounts on access charges for freight operators but was concerned to ensure that such arrangements have no adverse negative impact on maintenance costs and reliability. HS1 Limited's

stewardship duty is not affected by the discounts, and in view of this we do not believe it is necessary to change the statement.

19. **Mr. Tony Baldwinson** asked that a time-limited discount be introduced for off-peak international services serving cities and communities beyond London, attaching an outline business case for night trains between Manchester and Paris. We have written to Mr. Baldwinson suggesting that he discuss this initially with HS1 Limited, with us as the appeal body if it is not possible to reach agreement.

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Annex C

Regulation of High Speed 1

Proposed Statement by the Office of Rail Regulation

Introduction

1. This statement outlines the Office of Rail Regulation's approach to carrying out our functions concerning High Speed 1, the railway from London St Pancras to the Channel Tunnel, under:

- the Railways (Access and Management) Regulations 2005 as amended in 2009 ('the regulations')¹; and
- the amended and restated development agreement between the Secretary of State and HS1 Limited dated 14 August 2009 under which HS1 Limited holds until 2047 the concession to operate the High Speed 1 infrastructure between St. Pancras station in London and the Channel Tunnel portal (the 'concession agreement').

It only addresses our economic regulation functions in respect of High Speed 1 and does not address our safety and competition functions for High Speed 1 which are broadly the same as for the national network. The statement reflects the specific circumstances of High Speed 1, and is not intended to create any expectation about our approach to regulation of the Great Britain national network or other networks, including future high speed lines.

2. In making this statement we recognise that it may be relied upon by HS1 Limited, the Secretary of State, prospective purchasers of HS1 Limited and any new future owner and its equity and debt providers, train operators using or intending to use High Speed 1, and their customers, and the infrastructure managers of networks adjacent to High Speed 1. HS1 Limited has written to tell us that it will rely on this statement.

3. The statement sets out our current intentions as to our approach to the regulation of High Speed 1. Should we intend to change our approach from what is set out here we would consult as appropriate with those affected, consider fully any representations made and provide reasons for the change. Nevertheless, this statement cannot fetter our discretion in relation to the future exercise of our functions; any individual decision, for instance on an appeal under the regulations, will have to be made in the light of all the relevant facts and circumstances at the time and our duties under the regulations

¹ <http://www.opsi.gov.uk/si/si2005/20053049.htm> and
http://www.opsi.gov.uk/si/si2009/uksi_20091122_en_1

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(including, by virtue of regulation 28(1), our duties under section 4 of the Railways Act 1993).

4. The structure of the statement is as follows

- paragraphs 5 to 8 outline the background to the statement
- paragraphs 9 to 13 outline our general approach to the exercise of our functions
- subsequent paragraphs set out in more detail how we expect to apply this approach to access charges (including periodic reviews of the operations, maintenance and renewal charges), HS1 Limited's stewardship duty, track access and stations.

Background

5. The statement reflects close working between the Department for Transport and ourselves to establish a regulatory framework for High Speed 1 consistent with the commitment by ministers that, 'as far as possible, the operation of this line should be subject to the normal regulatory supervision'², while recognising there are differences between High Speed 1 and the national network, and between the respective infrastructure managers, HS1 Limited and Network Rail Infrastructure Limited ('Network Rail').

6. The key elements of this regulatory framework are:

- a new function for us from 1 October 2009 in the pre-approval of all new framework agreements and of revisions to any existing framework agreements (i.e. track access contracts covering the reservation of capacity for more than one timetable period) for use of High Speed 1 following the recent changes to the regulations. This is in addition to the appeal role we have in respect of the terms of track access and more widely under the regulations;
- a new responsibility for us from 1 October 2009 under regulation 13 to ensure that HS1 Limited, with due regard to safety and maintaining and improving the quality of infrastructure service, is provided with incentives to reduce the cost of provision of infrastructure and the level of access charges. This will be achieved through the company's obligations under the concession agreement and the rights and responsibilities conferred on us as a result of that agreement which include:
 - provision for periodic reviews by ORR of the operation, maintenance and renewal charges;
 - a general duty in respect of asset stewardship in the agreement, requiring the company to secure the operation, maintenance, renewal and replacement of the railway

² <http://www.publications.parliament.uk/pa/ld200708/ldhansrd/text/80513-0003.htm>

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infrastructure in accordance with best practice³ and in a timely, efficient and economic manner, and with a long-term (40 year) view. This is similar to that in Network Rail's network licence, but reflects the specific circumstances of High Speed 1;

- enforcement powers for our functions based on those in the Railways Act 1993; and
- an extension of our statutory information gathering powers to our new responsibilities by means of a change to the regulations.

7. Our duties under section 4 of the Railways Act 1993 apply to these functions in accordance with regulation 28(1) of the regulations. We do not have a statutory duty concerning the ability of HS1 Limited to finance its activities (as we do for Network Rail on the national network) because HS1 Limited does not hold a network licence and section 4(5)(b) therefore does not apply to it. In addition, the overriding duty given to us by section 21(1) of the Channel Tunnel Rail Link Act 1996 not to impede the performance of a development agreement⁴ does not apply to the exercise of these functions because this duty is limited to our economic regulation functions for the rest of the Great Britain rail network, under or by virtue of part 1 of the Railways Act 1993.

8. In developing this regulatory statement we have had regard to:
- our section 4 duties in particular our duty under section 4(1)(g) (to enable persons providing railway services to plan the future of their businesses with a reasonable degree of assurance);
 - our relevant functions under the regulations and in particular our new role in the pre-approval of framework agreements and our appeal role;
 - our rights and responsibilities under the concession agreement.

General approach

9. We expect to regulate High Speed 1 so far as possible in the way in which we regulate the national network whilst recognising there are differences between High Speed 1 and the national network, and

³ The concession agreement defines "**best practice**" as meaning in respect of HS1 Co the exercise of that degree of skill, diligence, prudence, foresight and practice which would reasonably be expected from a skilled and experienced infrastructure manager engaged in the provision of high speed railway infrastructure.

⁴ Under the Channel Tunnel Rail Link Act 1996, a development agreement means an agreement to which the Secretary of State is a party and under which another party has responsibilities in relation to the design, construction, financing or maintenance of what is now High Speed 1. The Channel Tunnel Rail Link (Supplementary Provisions) Act 2008 extended the definition of a development agreement to cover the operation of the line. The concession agreement is a development agreement.

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differences between HS1 Limited and Network Rail. In general we would therefore expect to apply our general published policies and principles of regulation having regard to these differences to the extent relevant.

10. We recognise, however, that the government has established the concession agreement, and intends to sell HS1 Limited, so as to help achieve the government's objective of recovering over the term of the concession a proportion of the very significant investment it has made in High Speed 1. In the light of this, the company's business model is different from that of Network Rail. The success of HS1 Limited is likely to depend in a large part on its ability to raise revenue through increased usage of High Speed 1, including by new operators, on a long term profitable basis. HS1 Limited will be seeking to finance its activities through the track access charging regime ~~described~~referred to in this regulatory statement. We expect to have regard to the different characteristics and economics of High Speed 1 and the differences in HS1 Limited's business model, where relevant, in our approach to the regulation of High Speed 1.

11. We support the objective of making best use of the capacity on High Speed 1 for international and domestic passenger services, and potentially for freight services. We also support making best use of capacity on the Channel Tunnel corridor as a whole, and through our role in regulating the national network and High Speed 1 and in the Intergovernmental Commission for the Channel Tunnel, we expect to seek to further it. We consider that it is likely to be facilitated by development of a more competitive market for international rail services

12. Consistent with good regulatory practice, we are in the process of reviewing relevant policies to consider whether any of them should be tailored to take account of our new functions in respect of High Speed 1, and the approach outlined in this statement. If we conclude that any of our policies should be adjusted in this way, or that new policies are required, we expect to carry out a full consultation with interested parties before deciding what, if any, changes should be made.

Network Rail (CTRL) Limited

13. We recognise that Network Rail (CTRL) Limited is currently responsible for operating, maintaining and renewing High Speed 1 under a contract with HS1 Limited that is presently under review with a view to restructuring certain aspects. We support restructuring of the existing Network Rail (CTRL) Limited operator agreement to provide for the opportunity to market test the agreement ~~five years~~in the future after any future sale of HS1 Limited, and the flow-through of the relevant provisions of the concession agreement to the operator agreement, including those relating to periodic and interim reviews of the operations, maintenance and renewal charge. We expect the revised operator agreement to incentivise Network Rail (CTRL) Limited to deliver and, if possible, outperform its obligations to HS1 Limited. We expect that for as long as it holds the operator agreement that Network

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Rail (CTRL) Limited would be closely involved in the processes for periodic reviews, or any interim reviews, set out below.

Track access charging

Charging framework

14. The government has established a charging framework for High Speed 1 through the concession agreement pursuant to regulation 12(4) of the regulations. This charging framework has been established by the Secretary of State following consultation⁵ and is intended to operate in a manner that is consistent with the regulations.

15. In particular this framework provides that track access charges may include:

- an investment recovery charge to recover the capital costs of the High Speed 1 project;
- charges relating to the operation, maintenance and renewal of High Speed 1, including long-term costs of providing for railway services on High Speed 1 (that is, of the operational phase of the High Speed 1 project) including meeting the performance standards, asset stewardship requirements and handback condition required by the concession agreement; and
- discounts in accordance with paragraph 6 of schedule 3 of the regulations.

Investment recovery charge

16. The charging framework provides that access charges levied by HS1 Limited may include an investment recovery charge for the use of High Speed 1 up to a maximum level set by the Secretary of State as a maximum value per minute of train service. We understand that the intention is that HS1 Limited should recover a significant part of the long term capital costs of the project over the life of its concession expiring in 2047 through this charge. We further understand that HS1 Limited intends to levy this charge at the maximum level on all passenger train operators except when it elects to apply a discount in accordance with the regulations. The effect of the cap on the investment recovery charge in the charging framework is that HS1 Limited is likely to recover only a part of the amount of the long term capital cost (after deducting amounts already recovered in the form of domestic capacity charge under the original development agreement and investment recovery charges paid by Eurostar under its original track access agreement) at current values over the life of its concession. Government has advised us that it envisages that any long term capital costs which have not been recovered by the end of the

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<http://www.highspeed1.com/information/?page=1&id=108&category=&pagecategory=>

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concession in 2047 will be recovered under a second concession which it currently intends will run from 2047 to 2086.

17. Given the principle that this investment recovery charge is set at a level to recover the capital costs of the project over the longer term, we would not expect, in considering any appeals concerning this charge, to change the arrangements for it, as set out in the charging framework.

Operations, maintenance and renewal charge

18. Under the concession agreement, the element of track access charges levied for operation, maintenance, and renewal of High Speed 1 Railway Infrastructure⁶ ('OMR charges') is subject to periodic review by ORR. During the course of such reviews we would expect to either approve or determine the level of operation, maintenance, and renewal cost that would be incurred by an efficient operator, and set a level of OMR charges consistent with that. For passenger operators we expect that the OMR charges will, in particular, continue to comprise:

- charges for costs directly incurred as a result of operating train services; and
- charges for fixed and common costs, recovered as long-term costs of providing for railway services on HS1 (that is, of the operational phase of the High Speed 1 project). Charges relating to renewal will be calculated as an annuity based on the long term cost, with a fund, held in escrow, being built up to cover the cost of future renewals.

19. We expect to determine OMR charges by reference to the efficient level of operation, maintenance and renewal costs, and consistent with the concession agreement will not take into account the actual or expected income that HS1 Limited receives from property (including station and depot lease charges and station access charges), retail, car parking or other activities, or from the investment recovery charge. Thus the level of OMR charges is not established using the "single till" model adopted for Network Rail. This is because the concession agreement specifies the specific sources of funding that we can take into account when we approve or determine the level of OMR charges.

Freight charges

20. HS1 Limited plans to levy freight charges based on the efficient costs directly incurred as a result of operating freight train services, in accordance with the regulations. The freight charges that will be levied

⁶ This is defined in the concession by reference to the definition of railway infrastructure in Regulation 3 of the regulations. It includes network, track and the EdF Assets (being the assets which are subject to the EdF Agreements) but does not include any estate or interest over any light maintenance depot, the London St Pancras Station, Stratford Station, Ebbsfleet Station or Ashford International Station.

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by HS1 Limited for the costs directly incurred comprise a 'variable' element to recover wear and tear costs and an element to cover the additional 'avoidable' costs of operating freight train services. In accordance with the regulations, HS1 Limited has applied a significant but time-limited discount to the 'avoidable cost' element of the OMR charges for freight operators. We understand this is to aid the development of new freight services when capacity is under-utilised. We would be prepared to approve charges based on these cost-reflective principles, though as noted in paragraph 25 below there is further work to be carried out in respect of freight avoidable costs.

21. Whilst mark-ups are permitted by the regulations (for example, to enable infrastructure managers to recover costs which are common to different types of train operation) we understand that there are currently no plans by HS1 Limited to charge freight operators any such mark-up. Depending on the ability of freight operators to pay higher charges in the future, in accordance with the regulations, HS1 Limited may seek to recover higher charges from specific freight market segments. Any such mark-up would need to be reflected in an access contract and would be subject to our approval.

Initial review of the structure and level of access charges

22. HS1 Limited has outlined to us how it has established the initial structure and level of the track access charges (excluding the investment recovery charge referred to in paragraphs 16 and 17) that it proposes to implement for the period to 2015 (the first control period). We have also reviewed benchmarking analysis undertaken by HS1 Limited comparing itself against international comparators.

23. HS1 Limited's proposed OMR charges reflect its anticipated efficiency improvement over the course of the first control period, through specific cost savings resulting from restructuring and ongoing improvements in efficiency. We have reviewed HS1's costs and charges, including its international benchmarking analysis. We consider that HS1's international benchmarking analysis is not at a level of robustness that allows unambiguous conclusions to be drawn on the relative efficiency of HS1 Limited to relevant comparator railways, although our analysis does indicate that there may be opportunities for further efficiency improvement beyond the first control period. Before firm conclusions can be drawn on the relative efficiency of High Speed 1 more work, in which we ~~will wish~~ expect to be involved, needs to be done including to understand and potentially adjust for the particular circumstances of HS1 Limited.

24. ~~Nevertheless, based~~ Based on the work we have undertaken to date to assess HS1 Limited's proposed costs and charges we have no evidence to suggest they are unreasonable for the first control period.

25. However, as part of our review of the level of access charges we did not examine in detail HS1 Limited's estimates of the freight avoidable costs that underpin the charges that will be incurred by freight. We understand that HS1 Limited is working with freight

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operators to establish freight operations on High Speed 1. Until there is more clarity on the extent of freight services that will operate on High Speed 1 there will remain uncertainty around the costs of freight, in particular the avoidable costs of freight and the impact of these on freight access charges. We recognise the significant discount that HS1 Limited has offered to freight operators for the first control period and consider this would be likely to offset any inefficiencies in the level of the freight avoidable costs. However, we have agreed with HS1 Limited that the company will review the level of freight avoidable costs during the next twelve months and, if appropriate, review the level of freight access charges.

Periodic reviews

26. The concession agreement sets out the purpose, and, in general terms, the process, for periodic reviews, the first of which is expected to take effect in April 2015. As far as possible the periodic review process has been designed to be consistent with the broad approach that we adopt for periodic reviews on the national network, with charges being determined for each control period lasting five years. The concession agreement requires that a long term (40 year) view of renewal and replacement costs is taken and we will need to ensure that the annuity payments are adequate in the light of this.

27. Establishing OMR charges that are fixed in real terms for the duration of the control period provides certainty to train operators and also provides incentives on HS1 Limited to outperform the decisions made at a periodic review. Any benefits of outperformance in efficiency of renewal and replacement will be available for sharing between HS1 Limited and train operators by way of allocating a percentage (set at 70% for train operators and 30% for HS1 Limited in the concession agreement but subject to possible change by ORR at periodic reviews) to a reduction of the renewal and replacement elements of future OMR charges payable by train operators on High Speed 1. Any benefits of outperformance in efficiency in respect of the operations and maintenance elements would be retained by HS1 Limited for the relevant control period.

28. ~~26.~~ Before each periodic review for High Speed 1 is started we would expect to consult on the detailed process to be followed for the review, and this is reflected in the concession agreement. We recognise that as part of this, HS1 Limited is likely to want to do its own consultations on the level of OMR charges, the performance regime, possessions regime and proposed performance levels before it submits its five year asset management statement which will, as set out in detail in the concession agreement, address all these issues. We expect to issue any appropriate guidance to assist this process.

29. ~~27.~~ Consistent with regulation 13, achieving high levels of operating, maintenance and renewals efficiency on High Speed 1 is important, in order to minimise the track access charges paid for use of the railway by passenger and freight train operators, and ultimately reduce the cost to users and encourage best use of this important

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national asset. We therefore expect that a key part of a periodic review for High Speed 1 will be an assessment of the efficiency of HS1 Limited.

30. ~~28.~~ We expect HS1 Limited to establish an ongoing and robust programme of benchmarking work to compare itself to other high speed railways. We would expect to approve or determine OMR charges that assume HS1 Limited is as efficient as other high performing high speed rail companies, taking into account the specific characteristics of High Speed 1, such as the extent of scale economies achievable by HS1 Limited.

31. ~~29.~~ In particular, following the start of our role under the concession we expect to discuss with HS1 Limited its programme of benchmarking work that will lead up to its submission to us at the first periodic review. We consider that the type of approach to benchmarking which we undertook as part of the 2008 periodic review of Network Rail's access charges (top-down statistical analysis complemented by bottom-up engineering and process benchmarking) represents a sound model for HS1 Limited to follow. We expect its periodic review submissions to us to be supported by this benchmarking. As part of a periodic review we expect to review HS1 Limited's benchmarking and, as appropriate, supplement it with our own work.

32. ~~30.~~ HS1 Limited has certain long term contracts in place with Network Rail (CTRL) Limited, and also with EdF Energy (Services) Limited and EdF Energy plc (together, EdF), which pre-date our regulatory role. In setting OMR charges, we expect to have regard to the terms of the Network Rail (CTRL) Limited operator contract and the arrangements concerning power supplies with EdF. But we expect HS1 Limited to use such rights that it has under these and other contracts to secure efficiency improvement.

Interim reviews

33. ~~31.~~ The concession agreement makes provision for interim reviews of OMR charges in the event of material changes between periodic reviews. If HS1 Limited seeks such a review (the concession agreement does not enable ORR to seek an interim review), we would expect it to be supported by strong evidence as to why such a review is required, and why the issue cannot wait until the next periodic review. The concession agreement also provides that we have discretion to decide that it is not appropriate to increase OMR charges as a consequence of a relevant change and that the costs resulting from such a change may be taken into account when setting OMR charges for future control periods.

Changes to track access charges

34. Given the arrangements described above for setting and amending track access charges and subject to what is said in paragraphs 16 and 17 in respect of the investment recovery charge, it should be clear that any changes made to either the level or structure

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of track access charges for HS1 in a framework agreement will be subject to the approval of ORR. This would not be the case where the framework agreement includes a self-modifying provision; for example the review event mechanism⁷. In particular, HS1 is not able to make changes to charges payable under a framework agreement by amending the tariffs published in the network statement, although we would expect HS1 to update the network statement to reflect any changes which we have approved.

HS1 Limited's stewardship duty

35. 32- The concession agreement gives ORR responsibility for monitoring HS1's compliance with certain obligations and taking appropriate enforcement action, including preventative action in respect of likely future breaches. Our enforcement powers under the concession have been modelled on our enforcement powers under the Railways Act 1993 with powers to make enforcement orders and require compliance with an order through seeking an injunction or other relief or remedy, though without the ability to levy penalties. HS1 Limited's failure to comply with an enforcement order which has not been appealed is an event of default under the concession agreement, which may lead to termination of the concession agreement by the Secretary of State.

36. 33- A key obligation in the concession agreement is the general duty concerning stewardship of the High Speed 1 railway infrastructure. The asset stewardship purpose is to secure operation, maintenance, renewal and replacement, and planning and carrying out of upgrades in accordance with best practice^{7B}, in a timely, efficient and economic manner, and for assets other than those covered by the EdF agreements, taking a 40 year perspective. This is subject to the safety authorisation for High Speed 1 and the minimum capability requirements set out in the concession agreement.

37. 34- The concession agreement contains other specific obligations related to asset stewardship but these are without prejudice to the generality of HS1 Limited's general duty to achieve, to the greatest extent reasonably practicable having regard to all relevant circumstances, the asset stewardship purpose which is summarised in paragraph 33 above.

38. 35- We expect to take a proportionate and timely approach to monitoring and enforcement consistent with our approach for the national network, and recognising the processes set out in the concession agreement.

⁷ See definition of Review Event in Section 7 of HS1 Passenger Access Terms <http://www.highspeed1.com/information/?page=1&id=117&category=64&pagecategory=1>

^{7B} See definition at footnote 3.

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39. ~~36.~~ We expect to have regard to the terms of the Network Rail (CTRL) operator agreement and the EdF agreements in relevant cases as "relevant circumstances" for the purposes of the general duty. We would also have regard to whether HS1 Limited has taken the actions that would be expected of an efficient infrastructure manager complying with the general duty to address any constraints created by the contracts, and to any other relevant circumstances.

40. ~~37.~~ In keeping under review HS1 Limited's compliance with the general duty:

- we note the current very high levels of performance on High Speed 1, while acknowledging that London and South Eastern Railway has yet to start operating a full domestic service. We expect that compliance with the general duty will result in levels of operational and performance meeting the reasonable requirements of train operators using the line and better than the minimum performance levels specified in the concession agreement. In considering what these reasonable requirements are we expect to have regard to the provisions in framework agreements concerning performance;
- as with the national network, we expect that the standard of operation of the network required by the general duty in the concession agreement related to performance will require the infrastructure manager to take actions within its power to minimise delays resulting from all causes, not just those for which it is directly responsible. We acknowledge that train operators too have an important role in minimising delays, and believe it will be important for HS1 Limited to work to establish effective partnership working on performance between itself, train operators, its contractors and adjacent infrastructure managers;
- we expect to work with HS1 Limited, through the processes in the concession concerning the development of an asset management strategy, to develop a range of stewardship indicators, including measures of track quality. This will begin with our review of the initial asset management strategy which HS1 Limited is required to produce by 1 January 2010.

41. ~~38.~~ The concession agreement and network code for High Speed 1 set out HS1 Limited's obligations concerning enhancements. Our role is to ensure such enhancements are delivered efficiently, consistent with the general duty, and that fair charging arrangements are in place. We would not expect the 'best practice' requirement in the asset stewardship purpose to be used to lead to unnecessary over-specification or as a means of securing unfunded enhancements to the High Speed 1 infrastructure.

Track Access.

42. ~~39.~~ Simultaneously with entering into the concession agreement, HS1 Limited has entered into agreed framework agreements with Eurostar UK Limited (Eurostar) and London and South Eastern Railway Limited (LSER). We had no functions in respect

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of these agreements since they were agreed between the respective train operators and HS1 Limited before our powers concerning approval of framework agreements come into effect on 1 October 2009.

43. ~~40.~~ We were, however, asked to review these agreements and the network code for High Speed 1 in draft. Following these reviews, the draft agreements and code were amended, and we have told the parties that, had our powers been in effect, we would have been prepared to approve the agreements as entered into.

44. ~~41.~~ ~~When our functions concerning the~~ In carrying out our preapproval function in respect of framework agreements do take effect, and in dealing with appeals, we expect, subject to our statutory duties, to have appropriate regard to the commercial judgements of the parties and the nature of the HS1 Limited business model . We expect to consult shortly, and conclude by the end of January 2010, on what modifications may need to be made to our existing criteria and procedures for access agreements, and to our policy on the length of framework agreements in the light of the revised regulations and the approach outlined in this statement. We expect to seek views on, among other matters, the appropriate risk allocation for future framework agreements, including appropriate liability caps, liability arrangements contained within part G of the network code, and the appropriateness of prepayment of charges, where the approach taken in the Eurostar and LSER agreements differs from the approach on the national network. Any future changes to our approach would be subject to further consultation as is the established practice on the mainline network.

45. ~~42.~~ As set out in paragraph 11 above, we support the objective of making best use of the capacity on High Speed 1 for international and domestic passenger services, and potentially for freight services. We are aware that the HS1 railway infrastructure has been designated as specialised infrastructure for the purposes of regulation 22 of the regulations. This designation is set out in the High Speed 1 network statement and means that HS1 Limited may give priority to high speed passenger and high speed freight services if capacity is not available for other services, and may within high speed services give priority to international passenger, then domestic passenger and then freight services⁸⁹. Regulation 22 makes this prioritisation subject to various requirements including consulting ORR. We were consulted before this designation was made and, beyond suggesting a wider consultation of industry parties, we made no objection to it.

Stations

46. ~~43.~~ The concession agreement gives ORR a limited role in monitoring, and, if necessary, taking enforcement action in respect of

⁸⁹ During the London Olympics domestic passenger services are given first priority.

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the provision of certain minimum levels of station facilities (such as numbers and lengths of platforms). The main stewardship obligations for stations are in leases granted by the Secretary of State to HS1 ~~Ltd~~Limited, and enforced by government. Separate from this, we have an appeal role under the regulations in respect of the terms of access to stations by train operators.

Office of Rail Regulation

[] 30 October 2009