THE OFFICE OF RAIL AND ROAD
166th BOARD MEETING (supplemental)
2 January 2020, 16:00 – 17:00
ORR London Office, 10th floor, 25 Cabot Square, London E14 4QZ and by telephone conference

Non-executive members: Declan Collier (Chair), Stephen Glaister, Anne Heal, Bob Holland, Michael Luger, Justin McCracken, Graham Mather

Executive members: John Larkinson (Chief Executive), Graham Richards (Director Railway Planning and Performance); Ian Prosser (Director Railway Safety).

In attendance: Russell Grossman (Director of Communications), Tess Sanford (Board Secretary), Liz Thornhill (Director of Legal Service)

Other ORR staff in attendance are shown in the text.

Item 1 WELCOME AND APOLOGIES FOR ABSENCE

1. The chair welcomed everyone to the meeting. Apologies had been received from Michael Luger, Dan Brown (Director, RME and Strategy), and Juliet Lazarus (General Counsel).

Item 2 DECLARATIONS OF INTEREST

2. No new relevant interests were declared.

Item 3 APPROVAL OF PREVIOUS MINUTES AND MATTERS ARISING

3. It was noted that the draft minutes which had been circulated were offered for information only at this stage. Approval was not sought as not all comments had been received.

Item 4 HS1 – PR19 FINAL DETERMINATION

Steve Fletcher, Carl Hetherington, Feras Alshaker, Joe Quill, Debbie Daniels, Laura Majithia, Steven Dennis, Matt Foster joined the meeting for this item.

4. Graham Richards introduced the item, thanking the team for the work that had been done since the last board meeting, and the most recent consultation which had closed only six working days previously.
5. Feras Alshaker introduced the board paper. Of the seven matters which the board had been minded to determine, the paper recommended that six remained unchanged and one was adjusted in the light of representations and evidence offered by HS1.
6. The original 5YAMS submission from HS1 in May had included an annuity figure of £38.2m but following ORR's review of the submission this figure had been reduced in the draft determination to £26.1m. The November 5YAMS had sought a figure of £28.1m, which had again been reduced by the board's decisions on 10 December to £26.3m. If all the decisions

recommended today were agreed, the overall figure would reduce further to £25.9m.

7. The board noted the impact of this annuity figure on the anticipated charges compared to the current charges.

Issues where the board is recommended to confirm its determination

8. **13% allowance for risk in CP4-10 renewals** – this determination had been endorsed by all stakeholders and no new evidence to make any change had been offered. The board confirmed its determination.

9. **Average interest rate assumption 2.5% on authorised investments CP4-10 with an 80%/20% split between investments and the current account**. HS1 had again argued that this would risk underfunding the escrow account but also acknowledged that the risk was small. There was no new evidence offered since the May 5YAMS on either the interest rate or on the split between investments and current account.

10. The board noted that the rate figure does affect the renewals annuity assumption but ultimately was an assumption for forecast purposes and would not preclude HS1 from making different choices in practice (within the concession agreement terms). It was important that ORR was clear about its underlying thinking and would monitor against its assumptions through the control period. Both ORR and HS1 would also have the opportunity to reflect on learning if the outcomes were different from those assumptions when considering CP4.

11. The board confirmed its determination.

12. **Average interest assumption in CP3 of 1.22%** - the arguments against changing this were the same as those set out above: it was an assumption for planning and no new evidence had been offered to justify a change.

13. The board confirmed its determination.

Asset life assumption

14. The board had set less conservative asset lives than HS1 had argued for in the 5YAMS. Most stakeholders agreed, except HS1. ORR's position was that because the future is uncertain and there is a lack of data as the asset is still relatively young, there should be a less conservative approach to asset life. It was still early in the life of these assets and as HS1's evidence base was built then asset life assumptions could be revisited. This reduced the burden on operators.

15. The board noted that there was no specific new evidence and ORR staff had proposed the asset life adjustment on the basis of best practice. The board was assured that there had been a productive relationship on the whole PR19 process, which had iteratively delivered agreement in all but this final handful of areas. They were content that HS1's evidence and views had been carefully considered.

16. The board confirmed the determination, noting that adjusting the asset lives assumption was a reasonable step at this time, but it would be possible to revise this later as the evidence of asset condition emerged over time. The gathering of such evidence had been stipulated for CP3.

10% project management allowance

17. Key stakeholders were content with this proposal which they said was in line with benchmarks. HS1 had argued that top-down benchmarking was not

appropriate and had asked for 13%, but this was still not well evidenced and was outside the industry norm range of 8-12%. They argued that ORR had not given detail on how it believed work costs could be brought down by repackaging but this was not accepted – it was not ORR's role to plan HS1s workbank.

18. The board considered the allowance a challenging but achievable target. If possible, examples of situations where ORR saw there were opportunities to make savings should be included in the final determination document.
19. The board confirmed its determination.

20. **Increase in internal costs** – in the November 5YAMS, HS1 had presented new internal costs which the board had not allowed as there was very little evidence for them. In its response to the December consultation, HS1 had provided more evidence on the costs.
21. ORR staff's position was that the increases HS1 predicted in costs were not sufficiently justified, in particular there was very little information to explain where the estimate had come from, and for HS1's internal costs they could be absorbed through more efficient operations (as there was no separate efficiency target for internal costs). This particularly applied to the increase in costs of ORR's regulatory functions, where ORR staff had reviewed the costs directly and did not agree that the projected increase would be needed.
22. Cybersecurity cost increase as a result of law change – the board noted that the relevant change of law had been known in December 2018 and that Network Rail Infrastructure Limited (NRIL) had forecast its cost impact shortly thereafter, suggesting that HS1 could have done the same.
23. The board noted that there had been no overall efficiency assumption applied on HS1's internal costs and that 3.6% was a reasonable aim for internal cost efficiency over the five year period. This was less than 1% year on year for the five years of CP3.
24. The board asked why HS1 had said that ORR had 'declined to discuss these costs' (as set out on slide 11). Staff stated that although HS1 had been invited to provide additional evidence to support their request for internal cost increases following the November 5YAMS, nothing substantive had been provided to demonstrate that the costs were efficient. HS1's comment had been made publicly and it would be important to refute it firmly in the final determination.
25. The board noted that in the May and November 5YAMS HS1 had stated that it was fully compliant with cyber requirements, but it now argued that it would need more money to meet those requirements.
26. The board discussed the need for consultant work on the charging model, which was a cost that could have been anticipated and planned for (if HS1 followed best practice). HS1 also seemed to predict a significantly higher cost for regulation, but ORR could see no grounds for that prediction.

Issues where the board is recommended to change its determination

R&D treatment

27. Staff had proposed at the December board meeting that R&D should be funded out of the renewals pot and were still clear that this would be the best solution. However, HS1 pointed out that its charging model would not

allocate that cost fairly between operators. HS1 Ltd had proposed stronger governance and transparency around the use of funds and the recommendation now was that this was an acceptable alternative as the governance would be similar to the renewals governance. Staff now recommended that for pragmatic reasons around the lack of time available to adapt the charging model, R&D should be treated as internal costs rather than a renewal for CP3.

28. The board discussed the impact of this recommendation on operators and the particular advantages around transparency and equity that needed to be secured by better governance. If the funding was not used, the underspend could be recovered as a lower charge in CP4, (but not as a refund at the end of CP3).
29. The board discussed how the governance requirements could be enforced as a concession breach. In addition to this, the operators would also be required to engage with and join the R&D panel.
30. The board determined that £2m R&D should be funded as an operating and maintenance cost.

31. The board noted the work that had been done to deliver a significant efficiency challenge including frontier shift on renewals costs, a reduction in PMO costs and efficiency on contracting. The efficiency on NR(HS) was similar to NRIL's on an exit to exit basis. But NR (HS) had known what the challenge on NRIL was, as ORR set it last year, so it looked like they had risen to the challenge offered by Rebel group, and included those efficiencies in its base cost, so we did not need to adjust them. But we noted that this might have come across to EIL as we had done less. It would be helpful to have some of these examples highlighted in the final document.
32. The delegation of final sign off of the final determination to John Larkinson was confirmed.

HS1 team left the room and the call

AOB

33. The board briefly discussed very poor **performance by some TOCs** (TPE and Northern were highlighted) over the holiday period particularly following the December 2019 timetable changes.
34. TPE had announced planned service cancellations at the timetable change. This was communicated to the PMO very late in the process. Those cancellations had now been extended to the end of January 2020 and the number increased. In addition, unplanned cancellations had been very high, raising potential issues around passenger information. Other recent issues with major impact for consumers included a power outage in East Croydon and the retention of non-accessible rolling stock.
35. The consumer team would review TPE issues at an internal meeting next week with particular attention to ORR's expectations around passenger information.
36. DfT's franchise director had asked for a meeting with the ORR and NR on performance. The PMO would also be reviewing the December timetable introduction: the board were reminded that ORR had written to the PMO in

December highlighting a number of areas of risk and concerns including issues around train crew.

37. The board agreed that there were a number of areas which required more investigation and were mindful of the work done in 2019 to follow up licence breaches on GTR and Northern. They asked for an update as soon as possible on areas of potential investigation or enforcement.

38. **John Larkinson also reported on** ORR's role in authorising operators of last resort in situations where governments wished to remove or curtail franchises and that there had been no recent update from DfT on progress on the development of the white paper. Some issues raised by ORR before Christmas remained outstanding.