



Further PR24 draft determination correspondence

Contents:

1. Letter from Network Rail Infrastructure Ltd (NRIL) Director of Planning & Regulation, 29 November
2. Response from ORR, 9 December
3. Letter from Eurostar General Secretary, 5 December
4. Letter from NRIL Chief Financial Officer, 5 December
5. Response from ORR, 10 December
6. Letter from HS1 Ltd Chief Strategy and Regulation Officer, 10 December

Please refer to our [privacy notice](#) and [accessibility statement](#) for more information on how we publish responses to consultations or research.

Feras Alshaker
Director, Planning & Performance
Office of Rail and Road
25 Cabot Square
London
E14 4QZ

Paul McMahon
Director, Planning & Regulation
Network Rail
Waterloo General Offices
London
SE1 8SW

By email

29 November 2024

HS1 Ltd PR24 draft determination

Dear Feras

I am writing further to our recent meetings on your draft determination and the implications for Network Rail (High Speed) of this. It has been helpful to talk to you on your draft determination and NRIL's and NRHS's response to that. We have some serious and specific concerns with the proposals you have made on the management fee and the investment in enablers to deliver efficiencies in CP4.

NRHS was clear at the outset of the PR24 process that to derive further efficiency would require a step change in asset management and therefore a step change in investment, to move from manual to automated intervention and digitisation.

You have said that NRHS should 'self-fund' some enablers, although ORR's rationale for this remains unclear. NRHS have explained that the enablers included in the 5YAMS are necessary to support delivery of efficiencies in CP4, and to provide for efficiency to be sustainable into future control periods for which the HS1 system is the ultimate beneficiary. HS1 Ltd have also indicated strong support for enablers within their draft determination response.

In addition to NRHS including further supporting information in its consultation response and latest 5YAMS revision to HS1 Ltd, this letter provides further information and clarification in relation to ORR's rejection of enablers and suggestion that these should be self-funded by NRHS.

Firstly, in your draft determination and in subsequent discussions, there are several incorrect assumptions being made around how comparator organisations may elect to 'self-fund' investment for the benefit of its contract or business. To be clear, this is dependent on how a business sets up its cost base and establishes commercial arrangements with customers and it is not true to state that any or all of these costs would necessarily be self-funded. These costs are just not transparent and explicitly shown in a comparator's cost breakdown but they are real costs and will be accounted for and need to be recovered in some form from customers. The approach in which the NRHS management fee was benchmarked takes this into account.

The NRHS management fee is designed to capture the risk that NRHS faces over which it has some degree of control when providing services to HS1 Ltd, the risks are two-sided and have potential upsides and downsides and can be lower or higher than expected; the NRHS management fee is comparable to profit margins observed in the private sector.

The management fee benchmark report undertaken by Oxera in 2023 directly considered the operational profit of comparator organisations, for example, the difference between revenue and operating costs (defined as all costs except interest and tax). Importantly, the benchmark analysis did not differentiate between operating costs directly charged to customers, or those seen as an internal 'overhead' cost which would be offset against contribution from individual contracts.

In your draft determination you identify some of NRHS's proposed enabling cost as needing to be excluded or 'self-funded' from the Annual Fixed Price, for which the rationale is unclear. As noted in the Oxera report (section 4.3 & 6), *"in light of there being no clear rules as to how another company providing services under the OA would split enabler costs between overheads and retained profit, there are grey areas as to how high the actual markup would be in reality. This provides further justification for 'aiming up' when setting the management fee."* The equivalent of these enabler costs would be included in comparator organisations' operational costs and any profit returns realised after deducting these costs.

Therefore, the management fee would need to be set at a value to cover any excluded enabler costs, i.e. higher than 8%. NRHS has always considered that sharing its O&M cost breakdown in this simplistic method is the most transparent way to present its cost base by including all O&M operating costs within the Annual Fixed Price, and to apply the Management Fee as a mark-up to these operating costs. It would seem that NRHS is being penalised in its attempt to be transparent and for a misinterpretation of how the Oxera benchmarking has been conducted. It is also important to note that if enablers are funded from the management fee then, by definition, they are discretionary since the funds available from the management fee cannot be guaranteed for enabler investment if they are required to cover emergent risk. The enablers that NRHS are planning for CP4 are essential to underpin delivery of the CP4 efficiencies.

NRHS has included enabler costs and its management fee in this transparent way in previous periodic reviews, and the approach to benchmarking its fee in this way has also been previously accepted. There does not appear to be any clear rationale nor evidence to support changing the approach for CP4. NRIL and NRHS therefore do not accept that it is appropriate to remove enabler costs from the Annual Fixed Price, without a re-benchmark of the management fee to take this into consideration, which would be expected to result in a higher fee.

Notwithstanding the above, it is incomprehensible that ORR has proposed to support some of NRHS's enabling costs but not others when all enablers are necessary to contribute toward the level of O&M efficiency being proposed in CP4. There appears to be no clear rationale why some enablers would be considered acceptable and others not allowable. For example, you support enablers for improved operational resilience, asset management systems and technology to move from a time based to risk based maintenance; but do not support them for the associated changes to method statements, competencies and training to actually enable our workforce to safely move from undertaking time-based to risk-based interventions with new technology and ways of working. This calls into question how NRHS can be expected to effectively manage its business in such a one-sided manner. In particular, when some architecture to undertake an acceleration towards improved asset management is supported, without recognition of the ability for NRHS's bespoke

workforce to be trained and competent in new ways of maintaining high speed assets; whilst the expectation to maintain safety and performance of a live high speed railway remains.

Lastly, it is unclear why during discussions, several references are being made to how 'other comparator' organisations may invest or self-fund operating costs. As per the discussion above, we do not deny that other organisations might self-fund certain activities or investments – but this needs to be considered in the round with the nature of the business's commercial arrangements and the level of profit/management fee. We have not seen any evidence to support ORR's assertions in this regard. We assume the explanation on benchmarking NRHS's management fee above, based on evidence that has been provided during PR24, now clarifies the position, and that the approach is no different to any equivalent comparator organisation with a similar service offer and risk profile to NRHS.

With the exception of including employers National Insurance Contributions as a headwind, NRHS has not revised its 5YAMS AFP provided to HS1 Ltd but has included its intention to remain open to discussions on opportunities to go further and will of course continually strive to deliver efficiently, which would include, going forwards, seeking new opportunities to deliver more cost effectively.

I hope that the information in this letter (which is replicated in NRHS's recently updated 5YAMS) further supports your final determination decision-making and helps us move to a constructive conclusion for your final determination, so that we can collectively turn our focus onto delivery of the 5YAMS and providing benefits for customers and passengers.

Yours sincerely

Paul McMahon
Director, Planning & Regulation

Feras Alshaker
Director, Planning and Performance



Paul McMahon
Director, Planning & Regulation
Network Rail Waterloo General Offices London
SE1 8SW

9 December 2024

Dear Paul

HS1 Ltd PR24 Draft Determination

Thank you for your letter of 29 November, and the responses to our Draft Determination from Network Rail (High Speed) (NR(HS)) and Network Rail Infrastructure Limited (NRIL). From these it appears that you have misunderstood the Periodic Review process for HS1 Ltd.

In PR24, HS1 Ltd is the regulated entity. HS1 Ltd's Concession Agreement with the Secretary of State requires ORR to review HS1 Ltd's plans for the next control period and independently assure that any costs HS1 Ltd proposes to pass on to operators are efficient and in line with best practice.

HS1 Ltd has presented its costs broken down into key items, for example, renewals by asset type; Operations & Maintenance (O&M) costs broken down into HS1 Ltd's own costs, NR(HS) costs, and pass-through costs. We have reviewed the available evidence on each of these items, to independently take a view on whether HS1 Ltd's costs for each of these items are efficient and in line with best practice. This is the same process we have followed in our previous periodic reviews of HS1 Ltd.

At more than £250m over five years, the O&M costs which HS1 Ltd contracts to to NR(HS) is by far the largest line item in its plans – larger than the total cost for all renewals in that period; and larger than all other O&M costs combined. So, it is reasonable and proportionate that we review this line item in significant detail.

As we stated in our Draft Determination, we are not involved in the contract between HS1 Ltd and NR(HS) and we have no power to direct changes to this contract. However, we are required to ensure that any costs passed on to train operators are efficient. So, if we identify any inefficiencies in HS1 Ltd's costs which arise from its chosen contracts, then we are required to quantify these inefficiencies and deduct this from the charges HS1 Ltd can pass on to operators.

In our Draft Determination we identified specific items which appeared to be inefficient, based on the evidence available to us, and our proportionate review of that evidence. We quantified these potential inefficiencies and set out plausible opportunities for HS1 Ltd to address these inefficiencies. Our Draft Determination



clearly stated that HS1 Ltd may choose to use a combination of these opportunities, or any other means to achieve a similar level of efficiency. Again, it is for HS1 Ltd to decide how it will achieve the efficient costs we determine and if/how it passes on any efficiency challenges to its supply chain. We do not regulate NR(HS)'s costs, or the way it chooses to run its business.

This is the same process we have followed in our previous periodic reviews of HS1 Ltd. The specific items we focussed on in our Draft Determination were the same as those we focussed on at PR19: risk; efficiencies; management fee etc. However, there is an important difference between our conclusions at PR19 and PR24: at PR19, HS1 Ltd was considering a market test of NR(HS)'s contract, which would allow HS1 Ltd to test whether its costs were efficient. During CP3, HS1 Ltd and NR(HS) agreed not to carry out that market study. In the absence of that study, it fell to us in PR24 to satisfy ourselves that HS1 Ltd's costs were efficient.

The periodic review process allows us to present our draft conclusions (the "Draft Determination") then carry out a consultation. This allows stakeholders to provide feedback on our conclusions and additional evidence; and allows HS1 Ltd to propose revisions to its plans. We are grateful to NRIL and NR(HS) for the information provided in response to our consultation and the engagement of the NR(HS) team in stakeholder workshops, which have been productive. The NRIL and NR(HS) responses included new evidence which we had not seen before and some helpful clarifications. We are now going through a process to review this new evidence and, if necessary, update our analysis and conclusions, before reaching our Final Determination.

It is important to note that we have received responses from many other stakeholders and we must consider all of these sources of evidence on their merits and reach measured conclusions. This process is ongoing, so I cannot comment at this time on our position regarding the technical points raised in your letter around enablers and the management fee.

We will continue to engage with you and the NR(HS) team as we progress through the periodic review process.

Yours sincerely

Feras Alshaker

Feras Alshaker
Director of Railway, Planning & Performance
Office of Rail and Road (ORR)
25 Cabot Square
London
E14 4QZ

Sent by email: [redacted]

05 December 2024

Dear Feras,

HS1's revised PR24 5YAMS

I refer to HS1's revised version of their PR24 5YAMS which they published at the end of last week. I am sending this supplementary letter as I am conscious that the scope of the remaining consultation will be narrower than before, and the time available necessarily limited. However, the new HS1 5YAMS proposes such a material change to the ORR's draft determination, that I felt it necessary to register some key observations on the proposals.

In some ways the amendments brought forward by HS1 were not surprising. It is not uncommon for regulated monopolies at this late stage of the regulatory process to adopt some basic, perhaps predictable, approaches to:

- identify further costs in a wide range of areas that it adds to its cost stacks, leaving very little time for those to be properly scrutinised by the regulator and stakeholders; and
- set a more conservative volume forecast estimate to eliminate every opportunity for cost under recovery, whilst increasing unit charges for its users.

On the former, many of the proposed cost increases by HS1 appear to lack reasonable justifications or robust evidence. My team is preparing to speak with your PR24 team about these at a meeting later this week in more detail. But the fundamental point here is that HS1 has left little or no time for the ORR or stakeholders to properly scrutinise these proposed variations. I would contend that, in these circumstances, after nearly two years opportunity to prepare, analyse and present, the presumption should be that HS1 carries the cost risk, and my hope is that our observations also support your robust challenge and ultimate rejection of the proposed cost increases where these lack the necessary evidentiary basis.

On the latter, my team is already in contact with your team to provide evidence supporting our request that the original, higher, international train volume forecast is reinstated. It continues to be a surprise that HS1, uniquely among infrastructure managers with whom we deal, considers itself able to impose its own volume estimates in place of those evidenced by the operator whose business it is to actually plan and run these services. Especially with these fundamental cost consequences. I am confident that our evidence is sufficient and sufficiently robust to support reinstating the HS1's original forecast for international train volumes (which we had previously, in our response to HS1's draft 5YAMS and again in last week's email correspondence with HS1, confirmed we considered appropriate).

However, beyond these specifics, the catalyst for writing is the fact that HS1's revised 5YAMS seems to discard many of the most material aspects of your draft determination. It claims that the ORR fully endorsed HS1's proposed budgets and that HS1 adopted most of the ORR's draft determinations. But under scrutiny it appears

Eurostar International Ltd
6th Floor Kings Place
90 York Way
London N1 9AG

eurostar.com

to reject many of the central pillars of that determination, including the efficiency overlays for renewals, the cost reductions in the NRHS O&M budget, the scope reductions for three stations projects and several PAT amendments the ORR was minded to approve. The net impact, when combined with the cost additions and volume reductions referred to above, results in an OMRC for international trains that is 7.6% higher than the ORR's Draft Determination, and an LTC for EIL that is 15.4% higher than the Draft Determination. The OMRC is now 1.6% higher, in real terms, than the charge determined at PR19, whereas the OMRC proposed by the ORR was more than 5% lower. HS1 also return to the unwelcome argument that the ORR's ability to set an efficient charge can and should be fettered by HS1's own contractual arrangements with NRHS.

Eurostar will, of course, engage fully with the remaining consultation and PR24 process. But it does feel important in advance to register my concern that the integrity of the PR24 process would not be best supported by allowing such a necessarily restricted final process to endorse such material variations to a draft determination reached after far more extensive consultation and review.

Yours sincerely

Gareth Williams

Eurostar General Secretary

Feras Alshaker
Director, Planning & Performance
Office of Rail and Road
25 Cabot Square
London
E14 4QZ

Jeremy Westlake
Chief Financial Officer
Network Rail
Waterloo General Offices
London
SE1 8SW

By email

5 December 2024

Dear Feras

HS1 Ltd PR24 draft determination

Dear Feras

I am writing further to our meeting on 15 November on your PR24 draft determination, further to our response to you on 11 November.

As our response made clear, and I explained when we met, both NRIL and NRHS have significant concerns with your proposals. I won't repeat all of the concerns here, except to say that you have set extremely challenging efficiencies that we do not consider are achievable given the current HS1 system arrangements regarding risk and reward. Changes to the wider HS1 system are needed to help facilitate additional efficiency. We have told you that your proposals risk NRHS breaching the terms of its regulatory consent and importing additional pressure into NRIL's already very challenging financial context. Whilst we support review and change to the wider system arrangements NRHS is unable to unilaterally deliver any changes and support from others is necessary.

As I said during our meeting, and both the NRIL and NRHS responses to your draft determination make clear, we are open to discussions to identify additional efficiency opportunities – which we believe need to be linked to the wider HS1 Ltd system and the risk/reward balance.

Our recent discussions have been very helpful. It was good to hear your arguments and to also confirm that there are areas of NRHS's response to your draft determination, and the greater detail provided, that you said are helpful in your decision-making ahead of the final determination.

In light of our constructive dialogue, and your stated support for looking at the strategic issues affecting the HS1 system, we have reviewed our efficiency proposals. We can propose an additional 3% stretch efficiency on our original proposals of 7%, which we have phased to provide for time to plan and invest to achieve them. The level of efficiency improvement we are now proposing is 10% net, in alignment with those proposed for NRIL for CP7 as part of PR23, for opex. You accepted those proposals and described them as stretching yet realistic. We think that applies equally to

NRHS for CP4, not least due to the much smaller scale of NRHS, where there are far fewer degrees of freedom to make savings.

At this stage we have not identified exactly how these efficiencies would be achieved, and we do not consider that they would be easy to realise. However, in light of our discussion, in particular on the HS1 system, we have sufficient confidence to propose this stretch. We would need to work through the detail with HS1 Ltd, and we would keep your team informed. We are ambitious for an improvement in asset management so would expect asset management acceleration to form a significant share of the efficiency. We would consider with HS1 Ltd the wider system arrangements and how our contract incentivises cost efficiency. Your support for the review of the wider system is essential.

In further discussions with Paul McMahon, you did indicate that our efficiency stretch proposal may not satisfy ORR's requirement and that NRHS should seek to go further still by 'self-funding' some enablers, although the rationale for this is unclear. The enablers included in the 5YAMS are necessary to support delivery of efficiencies in CP4, and to provide for these to be sustainable into future control periods for which the HS1 system is the ultimate beneficiary.

HS1 Ltd has indicated strong support for inclusion of enablers in their draft determination response and our enablers are equally essential as they underpin our efficiency statement. We maintain strong views on funding for enablers, which is why we have written to you specifically in this regard in a separate letter on 28 November.

However, we remain open to discussions on opportunities to go further. My team have been readily engaging with you on this matter, and George Mackintosh and his team will continue to work with your team to discuss the detail of our CP4 plans.

I would be pleased to discuss our proposal further with you and move to a constructive conclusion for your final determination so that we can collectively move our focus onto delivery of the 5YAMS and providing benefits for customers and passengers.

Yours sincerely

Jeremy Westlake
Chief Financial Officer

Feras Alshaker
Director, Planning and Performance



Jeremy Westlake
Chief Financial Officer
Network Rail Waterloo General Offices London
SE1 8SW

10 December 2024

Dear Jeremy

HS1 Ltd PR24 Draft Determination

Thank you for your letter of 5 December 2024, and your offer of discussions to identify efficiency opportunities therein. I also note your specific proposals for a stretch efficiency on Network Rail (High Speed)'s plans, and look forward to seeing these reflected by HS1 Ltd if it supports them.

Thank you for your continued engagement on this matter. We will be publishing your letter, and associated correspondence from Paul McMahon, on the PR24 page of our website, along with our responses to the same.

Yours sincerely

Feras Alshaker

Feras Alshaker Director,
Planning & Performance
Office of Rail and Road
25 Cabot Square London
E14 4QZ

10 December 2024

Dear Feras,

HS1 5YAMS

As you will be aware, the NRHS 5YAMS, issued as a supporting document to our own 5YAMS on 30 November 2024, referenced an aspiration for an additional 3ppt O&M efficiency, taking it from 7% to 10%. NRHS was at the time examining the feasibility of adding such an efficiency and HS1 have been encouraging NRHS to examine the scope for further efficiency in response the ORR Draft Determination to support affordable OMRC charges for our users. We are pleased that, as confirmed by the letter from Jeremy Westlake to yourself date 5 December, NRHS now believes this additional efficiency should be included.

We welcome NRHS's updated view that the service outcomes can be achieved at this improved level of efficiency.

I am at your disposal to discuss the matters raised in this letter.

Yours Sincerely

Mattias Bjornfors

Chief Strategy and Regulation Officer
HS1

CC:

George Mackintosh, Managing Director, NR(HS)