Rail Partners' response to ORR's periodic review of HS1 Ltd 2024 (PR24) – consultation on matters to be determined

In line with our response to ORR's draft determination, we support ORR's proposed determination regarding HS1 Ltd's estimated renewals costs, and acknowledge the proposed reduction in HS1's Route Operations and Maintenance (O&M) charge.

The context

Rail Partners notes that there is potential for international rail freight growth on HS1 Ltd infrastructure under the right conditions, and that there are a number of parties interested in operating new international open access passenger services which would introduce competition to this market. It is important that the regulatory framework supports the introduction of new services to support the financial sustainability of HS1 Ltd and provide additional options for passengers and freight customers.

The freight and logistics sector is highly price sensitive with customers operating on low margins and rising charges have driven modal shift from freight customers towards more carbon intensive modes – particularly road haulage. Although charges remain at a level that is prohibitive for many freight customers, the proposed reduction in freight charges set out in the draft determination was a welcome first step that will help to improve the competitiveness of rail freight.

In this context, it is vital that HS1 Ltd's costs and charges are set at an efficient level in order to facilitate this potential growth.

Renewal costs

We understand that ORR has not received new analysis from HS1 Ltd relating to renewals costs since its draft determination and therefore considers that its previous decisions remain appropriate. We support this decision.

We recognise the risk that renewals annuities may need to increase in future control periods if the reduced renewals charges prove insufficient to fund the long-run renewal costs of the network. However, this must be balanced against the strong incentive that these lower cost estimates create to drive efficient delivery, and as such we consider that this risk is acceptable.

Setting a stretching target for renewals efficiencies at this point incentivises the right behaviours from HS1 Ltd during control period 4 (CP4), and gives HS1 Ltd time to consider how it can most efficiently deliver its renewals in future control periods. In the absence of a stretching target, there is a risk that opportunities for efficiency are not explored, and inefficiencies become baked into the projected future cost base. As these costs are ultimately passed on to train operators through the charges they pay, a higher cost base would reduce the commercial viability of existing and prospective passenger and freight services using HS1 Ltd infrastructure.

Setting charges at an efficient level today may also give operators an opportunity to become more established during CP4. This is particularly important given the heightened level of interest from new entrants to provide services on HS1 Ltd infrastructure, and the government's aspirations to grow rail freight volumes by 75% by 2050.

If it becomes clear that renewals charges will need to increase in the future, despite the strong incentive that ORR's decisions places on HS1 Ltd to identify efficiencies, it is vital that this is communicated to users of the HS1 network with as much notice as possible.

O&M charges

ORR has reviewed further analysis from HS1 Ltd and Network Rail High Speed (NR HS) relating to O&M, and is minded to determine that the efficient cost HS1 Ltd can pass on to operators is reduced by £11.5m compared to HS1 Ltd's Five Year Asset Management Strategy. This is a smaller reduction than the £14.7m reduction ORR proposed in its draft determination.

In our response to ORR's draft determination, we supported the proposed £14.7m reduction to O&M charges. The smaller reduction now proposed will mean that higher costs are ultimately passed on to the users of the HS1 network, including freight services which operate within the highly price sensitive logistics sector. However, we recognise the balance that ORR must strike in enabling HS1 Ltd to finance its operations and plan its business with a reasonable degree of assurance.

As outlined above, setting challenging cost efficiency targets helps drive the right incentives on HS1 Ltd to reduce its supplier costs. Without stretching efficiency targets now, there is a risk that inefficiencies become baked into the O&M cost-base permanently. During CP4, ORR should continue to monitor HS1 Ltd's O&M costs closely.