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OFFICE OF RAIL REGULATION

13 July 2012

**Geoff Jones**  
**Head of Regulation**

HS1 Limited  
73 Collier Street  
London  
N1 9BE

**BY EMAIL ONLY**

Dear Geoff,

## **ORR decision: High Speed 1 Limited (“HS1 Ltd”) freight avoidable costs review 2011**

### **Purpose**

1. The purpose of this letter is to let you know our decision in relation to your proposals on the freight avoidable costs review conducted by HS1 Ltd between January and July 2011. Our decision has been held pending the outcome of other workstreams, including the consultation on standard freight access terms and freight access agreements. We also held our decision pending receipt of information from HS1 Ltd on development costs for Class 92 locomotive signalling modifications.

### **Background**

2. In 2009 when we carried out an initial review of the structure and level of HS1 Ltd's access charges, we agreed with HS1 Ltd that it would review the level of freight avoidable costs and, if appropriate, review the level of freight access charges for the remainder of the control period. This agreement was reflected in our [regulatory statement](#) dated 30 October 2009.
3. To date no HS1 Ltd freight access agreements setting out charges to be levied over a period in excess of working timetable have been entered into; any that are will require ORR's approval under the Railways Infrastructure (Access and Management) Regulations 2005.

4. In this context this decision sets out the revised daytime rate for freight access charges that, for the remainder of the control period, we expect to be reflected in any HS1 Ltd freight access agreement that requires our approval.

## HS1 Ltd proposals

5. HS1 Ltd:

- a. proposed that the night-time rate would continue to be set at the discounted rate of £4.00 per train-km for the remainder of control period 1; and
- b. sought our approval to reduce the daytime rate charged to the freight operators to £6.92 per train kilometre, which is a reduction of 21 pence per train kilometre than the current rate (£7.13 per train kilometre). HS1 Ltd proposes that this applies for the remainder of control period 1 (until 31 March 2015). This proposal differs from that set out in HS1 Ltd's consultation document (a reduction of 9 pence per kilometre from the rate of £7.01 per train kilometre).

6. An overall summary of the proposals, which enabled HS1 Ltd to reach the daytime rate of £6.92 per train kilometre, is set out in table 1 as follows:

Table 1: Summary of proposals

Cost category	Current total £k / (£ per train-km)	Proposal set out in the consultation document £k / (£ per train-km)	Revised proposal following consultation responses / (£ per train-km)
Variable Operations Maintenance Renewal (OMR)	457.4 (2.05)	457.4 (2.05)	457.4 (2.05)
Avoidable freight specific costs	422.8 (1.89)	283.5 (1.27)	273.1 (1.22)
Avoidable track OMR	708.5 (3.18)	802.6 (3.60)	802.6 (3.60)
New item (freight market studies)	-	20.0 (0.09)	10.0 (0.04)
<b>TOTAL</b>	<b>1,588.7 (7.13)</b>	<b>1,563.5 (7.01)</b>	<b>1,543.1 (6.92)</b>

7. HS1 Ltd consulted on these proposals and received four responses from the freight industry, which can be accessed on the HS1 Ltd [website](#). These responses were from DB Schenker Rail (UK) Ltd, Europorte, Network Rail Infrastructure Limited and Rail Freight Group.

8. The consultees agreed with HS1 Ltd proposals in a number of areas but there were five outstanding issues where there remains disagreement between HS1 Ltd and the freight industry. We have considered HS1 Ltd's views and the responses received in the areas of disagreement and our view on each of these is set out below.

### **Outstanding issues**

*Consultation Question 2: Are the calculations and proposals in relation to the other freight specific costs appropriate? Do stakeholders have access to any other relevant information or know of helpful top-down comparisons?*

9. The consultee's views on other freight specific costs were focussed in three areas; staff full time equivalents, flat detection systems and professional subscriptions. They considered these costs to be too high.
10. We consider HS1 Ltd's estimates of costs related to staff and flat detection systems, to be included as part of freight specific costs, to be appropriate. This is because the costs of:
  - a. 2 full time equivalent employees (FTEs) are related to a number of actual and prospective operators across the network, and the complexity of arrangements that are needed to facilitate effective and successful freight operations for the remainder of the control period.
  - b. wheel flat detection system has been put in place in order to manage risks associated with operating freight on HS1 Ltd network.
11. On professional subscriptions, after considering the consultation responses, HS1 Ltd has revised its cost proposals in this area. We agree with revised proposition of HS1 Ltd not to include Rail Net Europe (RNE) and European Infrastructure Managers (EIM) memberships as part of freight specific costs. This is because HS1 Ltd is likely to remain a member of these organisations should there be no freight operations on HS1 Ltd network. On this basis, the cost of professional subscriptions to be included in freight specific costs has been reduced from £12,000 per annum to £1,632 per annum.
12. We do, however, expect all these costs to be reviewed by HS1 Ltd again as part of the review of their freight costs for control period 2 and we will review their submissions in reaching our decision for control period 2.

*Consultation Question 4: Is the methodology we have used to calculate the avoidable track costs for Ripple Lane sidings appropriate?*

13. Consultees said the cost for Ripple Lane sidings was too high and have not been sufficiently challenged by HS1 Ltd.
14. HS1 Ltd stated that the Ripple Lane sidings were designated as a freight avoidable piece of infrastructure in the detailed charging analysis carried out prior to the sale of HS1 Ltd. HS1 Ltd does not consider that the sidings are essential to operations as services currently originate from Singlewell Depot or from France. Further, there are other points

of entry to the network, so the exchange sidings are only in place because of prospective freight operations. There has been no change in the actual or potential use of the sidings to suggest that this designation should be amended.

15. Given that the Ripple Lane sidings were designated as a freight avoidable piece of infrastructure in the detailed charging analysis referred to above and since then there has been no change in the actual or potential use of the sidings, we are satisfied that the current methodology remains appropriate.
16. HS1 Ltd in its submission to us has also stated that it is in the process of considering whether it continues to make sense to have a different contractor for Ripple Lane sidings to the rest of the network. This is part of considering the contractual options it has in relation to the current arrangement with Network Rail (CTRL) Limited ("NR (CTRL)") and the nature of that relationship going forward. HS1 Ltd expects to have detailed proposals on this as part of the periodic review leading into the next control period. We are content that this thinking forms a part of the next periodic review.

*Consultation Question 5: Is the 50% weighting applied to the freight OMR costs in relation to the Freight Chords appropriate?*

17. Consultees would like to see more scrutiny and challenge applied to the 50% weighting.
18. HS1 Ltd in its submission to us states that the freight chords are avoidable costs and this classification is consistent with the original analysis approved by ORR in previous charges consultations prior to the sale of HS1 Ltd.
19. HS1 Ltd acknowledges that the costs attributed to the chords are based on an engineering judgment; however, it does not consider that the consultees in their responses have provided sufficient or robust analysis to justify changing its approach. In addition, under the terms of the operator agreement with NR (CTRL), HS1 Ltd does not currently have the ability to carve out the provision of freight OMR services for these parts of the infrastructure, but HS1 Ltd is considering future options as part of the periodic review leading into the next control period.
20. We agree that the 50% weighting applied to freight OMR should be continued for the remainder of control period 1, given that it was consulted on and used to determine the charges for passenger services for the current control period. We will, however, revisit this assumption as part of the work which will be done for the next periodic review settlement of HS1 Ltd.

*Consultation Question 10: What freight market studies do stakeholders consider are likely to be required during the remainder of the Control Period? How much are they likely to cost?*

21. Two consultees suggested that HS1 Ltd should not carry out market studies. One of them indicated that this was because HS1 reflected only a small part of the logistics chain, and the other suggested that market studies were not a priority compared to timetabling analysis and developing an offer for high-speed freight. One consultee

indicated that they would be keen to see what comes out of any studies completed by HS1 Ltd.

22. After considering the consultation responses HS1 Ltd has revised its proposal and reduced its annual allowance for market studies from £20,000 per annum to £10,000 per annum. HS1 Ltd considers this to be still sufficient to keep them well informed on how to best facilitate freight on HS1 Ltd network. We are satisfied with this revised proposal noting HS1's keenness to facilitate freight operations on its network.

*Consultation Question 11: What do stakeholders consider to be the best way of recovering the 'mothballing' costs associated with the freight-specific infrastructure?*

23. One consultee suggested that ORR should advise how such costs are treated elsewhere. Another consultee indicated that levying such costs would represent a mark-up and suggested that these costs should be recovered via the freight supplement levied on franchised passenger operator. One consultee said that given the level of competition in the freight industry, there was little scope for the freight operators to contribute to these costs.

24. HS1 Ltd suggested in their consultation that they expect to recover these amounts via the freight supplement and if that was not possible they will recover these costs via freight avoidable costs. The costs would be amortised over time, in line with the nature of the costs and the expected benefits to future operators.

25. We are satisfied with this approach for CP1. However, we would expect to review the level of costs and the approach taken as part of the Periodic Review for CP2.

### **Our decision**

26. Based on our review of HS1 Ltd proposals, consultation responses to the proposals and our decisions on outstanding issues we :

- a. accept HS1 Ltd's proposal to reduce the daytime rate<sup>1</sup> to £6.92 per train kilometre for freight operators, which is 21 pence per train kilometre lower than £7.13 per train kilometre current rate, for the remainder of control period 1,
- b. note that HS1 Ltd will include charges for high-speed freight in its November 2012 network statement.

### **Implementation of our decision**

27. With effect from today's date, this decision sets out the revised daytime rate for freight access charges that, for the remainder of the control period, we expect to be reflected in any HS1 Ltd's freight access agreement that requires our approval.

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<sup>1</sup> The night-time rate would continue to be set at the discounted rate of £4.00 per train-km for the remainder of control period 1.

28. We suggest that any revised version of your Network Statement reflects this decision.

29. This letter will be available on our [website](#). I am also copying it to DB Schenker Rail (UK) Ltd, Europorte, Network Rail Infrastructure Limited and Rail Freight Group.

Yours sincerely

A handwritten signature in blue ink that reads "Paul McMahon". The signature is written in a cursive style with a large initial 'P'.

**Paul McMahon**