
Subject: *HS1 Discount Policy: Conclusions*

Date: *February 2012*

Context and overview

On 3 October 2011, HS1 Limited published a consultation document on its proposed policy on offering discounts on access charges for High Speed 1 (HS1). The document explained that in certain circumstances, HS1 Ltd is prepared to discount its Investment Recovery Charges (IRC). The proposed HS1 Ltd policy is based on a set of principles:

1. Discounts will be offered on a fair, transparent and non-discriminatory basis;
2. Specific criteria will be applied in order to determine whether or not a discount will be offered;
3. The criteria will be based on identifying rail services, rather than traffic flows;
4. Discounts should not prevent best use being made of HS1 capacity;
5. HS1 Ltd's commercial interests, as a private company with responsibilities to its shareholders, need to be protected; and
6. Discounts will be time-limited.

The consultation document described a process that HS1 Ltd will follow in considering whether to offer IRC discounts, based on satisfying a series of seven tests. It also set out the process to be followed by train operating companies (TOCs) in applying for discounts. Consultees were invited to comment on any aspect of the discount policy.

This paper describes the key points made in their responses by respondents to the consultation and sets out HS1 Ltd's consideration of these issues. A revised and finalised HS1 Discount Policy is also attached. This is in mark-up showing the small number of changes made to the draft policy.

Summary of consultation responses

Six responses to the consultation were received, from:

- Office of Rail Regulation (ORR);
- Network Rail Infrastructure Limited;
- Tony Baldwinson, Proposer – International Night Trains between Manchester and Paris;
- DB Schenker Rail (UK) Ltd;
- London & Southeastern Railway Limited (Southeastern); and
- Eurostar.

The responses are published on the HS1 Ltd website.¹

Overall, the responses were supportive of HS1 Ltd's policy on discounting the IRC and respondents welcomed the intention to offer discounts on a fair, transparent and non-discriminatory basis. The ORR considered the proposed policy to be clear and compliant with the Railways Infrastructure (Access & Management) Regulations 2005 ('the 2005 Railway Regulations'). There were no fundamental objections to the approach proposed by HS1 Ltd.

Detailed comments and HS1 Ltd consideration of responses

The comments received are summarised below according to the headings of the consultation document, preceded by discussion of the comments relating to the scope of the discount policy.

Scope of discount policy

Discounts are only proposed to be offered by HS1 Ltd on IRC rather than any other element of the access charges payable in respect of access to HS1. Most respondents either did not comment on this or acknowledged the point while noting that the IRC discount policy would not affect the existing freight discounts offered on Operations, Maintenance and Renewal Charges (OMRC).

One respondent considered that HS1 Ltd should offer discounts on both IRC and OMRC, suggesting that a market-based pricing approach should be adopted, by which discounts of all applicable charges should be possible. HS1 Ltd considers that this approach would risk the under-recovery of costs, and therefore the HS1 Ltd discount policy will remain confined to IRC.

Another respondent suggested that the geographical scope of the discount policy should be wider than the South East of England and should also apply to potential future North of London services as well. HS1 Ltd confirms that a TOC operating any such services could apply for HS1 discounts in the same way as for services from London to Kent and/or Europe and any application will be treated in the same way by HS1 Ltd, according to the seven tests set out in the policy. However, HS1 Ltd can only offer discounts on charges relating to the HS1 infrastructure, and other infrastructure managers would need to be approached for discounts on infrastructure beyond HS1, whether this is to the north or south of HS1.

Legal basis

The consultation document noted that there is no detailed guidance either at the EU or the UK level on the application of discounts to infrastructure charges, but that HS1 Ltd has developed its approach to be consistent with the 2005 Railway Regulations.

As noted above, ORR stated that it believes that the decision process to be applied by HS1 Ltd on discount applications 'is sufficiently clear and complies with the Railways Infrastructure (Access & Management) Regulations 2005'. No other respondents challenged this view.

Principles

Principle 1 of the discount policy is that 'discounts will be offered on a fair, transparent and non-discriminatory basis'. To support this principle, HS1 Ltd will append its finalised discount policy to the HS1 Network Statement so that the basis on which discounts are offered is clear to all TOCs. This was supported by the ORR which would expect to make changes to

¹ See <http://highspeed1.co.uk/Regulatory>

its criteria and procedures document for HS1 once the HS1 discount policy has been finalised.

Agreed discount schemes will also be published in the HS1 Network Statement. One respondent queried whether this would breach commercial confidentiality. Another respondent noted that publication of agreed discount schemes is critical to ensuring transparency. HS1 Ltd confirms that the key terms of discount schemes will be published so that it is clear what level of discount is being applied to specific rail services. However, TOC-specific information, such as any conditions on the TOC on, for example, the operation of minimum service levels, will not be published.

Principle 3 is that the discount criteria 'will be based on identifying rail services rather than traffic flows'. One respondent suggested that rail services could be defined in terms of specific days of operation as well as peak and off-peak services, and another suggested a category could be put forward for overnight passenger services. HS1 Ltd would be content for rail services to be defined in either of these ways and has amended the discount policy to make this clear.

One of the respondents suggested that higher priority should be accorded to overnight passenger services than for freight trains in the allocation of track capacity, and also that additional discounts should be accorded to international passenger services originating in the North of England that *do not* call at London or South East stations. HS1 Ltd highlights the distinction between the allocation of capacity and the granting of discounts. HS1 capacity is allocated according to Condition D8 of the HS1 Network Code and in accordance with the Declaration of Specialised Infrastructure in respect of HS1, which set out that priority will be accorded to:

- first, high speed international passenger trains;
- second, high speed domestic passenger trains;
- third, high speed freight trains; and
- fourth, other trains.

Discounts, on the other hand, will be determined according to the criteria and tests set out in the HS1 discount policy, with the terms of any discount being established under Test 5. In order to act in a fair and non-discriminatory manner, no other factors will be taken into account in establishing discount levels.

Principle 6 establishes that 'discounts will be time-limited' and this is consistent with the 2005 Railway Regulations. One respondent suggested that discounts should be for a minimum period of three years if there is no pre-existing comparable service pattern in order to increase investor confidence. HS1 Ltd remains of the view that the discount period should be determined under Test 5 at the appropriate level and duration to secure the sustainable operation of the rail service and that TOCs are free to propose a specific discount term. No change will therefore be made to Principle 6.

Discounts criteria

The proposed discount policy described a series of seven tests which HS1 Ltd will apply to determine whether a discount will be applied. Most respondents did not comment on the principle or the detail of the tests.

One respondent proposed that the pricing of access charges should be determined by the overall business case, while making sure that HS1 Ltd's marginal costs are recovered. It was suggested that a mechanism be developed for sharing the commercial risk/reward of operating new services, with access charges reduced or increased in line with revenue generated to reflect the uncertainty of revenue forecasts for new services. HS1 Ltd considers that the proposed approach to IRC discounts achieves a reasonable balance between encouraging new business for HS1 and ensuring a stable and sustainable revenue stream,

and so does not propose to adopt such a risk-sharing mechanism. However, the wording under Tests 4 and 5 has been clarified to make clear that if there is particular uncertainty over revenue forecasts, this will be taken into account when considering whether discounts will be offered and at what level.

One other respondent made a number of detailed points on the discounts criteria:

- *Test 3: discounts for domestic services should be structured to allow the capacity and demand for international services to rise over time.* As outlined above, the HS1 discount policy does not discriminate between domestic and international services, although under the HS1 Network Code, greater priority is afforded to international passenger services in the allocation of capacity.
- *Test 4: commercial viability is difficult to estimate for a new rail service and if open access rail services do not claim ORCATS revenues, they should receive more favourable discounts.* As explained above, HS1 Ltd will happily take into account under both Tests 4 and 5 any particular uncertainty in the demand for new rail services and will make this clear in the final discount policy. However, HS1 Ltd does not consider it appropriate to discriminate in favour of open access operators.
- *Test 5: the charging regimes of Network Rail, Réseau Ferré de France (RFF) and Eurotunnel will need to be dealt with in the appraisal process in a fair and transparent commercial manner given that these affect the commercial viability of train services.* HS1 Ltd confirms that it will take into account the access charges of other infrastructure managers in considering discount schemes. However, HS1 Ltd is only responsible for access charges on HS1 and TOCs must discuss charges for the UK or French national rail networks or for the Channel Tunnel with the relevant infrastructure managers.

Application process

There were few comments on the application process proposed in the consultation document, with one respondent confirming that it is 'reasonably straightforward and clear'. The ORR explains that it expects supporting application forms for framework track access agreements 'to state how the proposed discount satisfies the tests applied by HS1 Limited'.

One respondent suggested that other train operators be offered the chance to comment on a proposed discount scheme in advance of the formal consultation that takes place on framework track access agreements or supplemental agreements. This may provide HS1 Ltd with further relevant information that it may consider before finalising the proposed discount scheme and making the formal request for approval to ORR. HS1 Ltd agrees that this would be useful and an additional step has therefore been inserted into the discount application process, between steps (iii) and (iv), to allow for consultation of TOCs and HS1 Ltd review of responses.

Concluding remarks

Having reviewed the consultation responses from stakeholders, HS1 Ltd considers that the proposed HS1 discount policy is appropriate and consistent with the 2005 Railway Regulations. Minor changes have been made to the wording of the policy, the final version of which is at Annex A. The changes are:

- Under Principle 1, it is clarified that only the key terms of agreed discount schemes will be published in the HS1 Network Statement, rather than TOC-specific details;

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- Under Principle 3, it is clarified that rail services can be defined in terms of services operated on specific days or in terms of overnight services, as well as peak/off-peak services;
 - Under Tests 4 and 5, it is clarified that any particular uncertainty in revenue forecasts for new rail services will be taken into account where appropriate; and
 - There is a new step (iv) inserted in the discount application process to allow for TOCs to make any representations they considered relevant in order to enable HS1 Ltd to make a decision around the requested discount.