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Dear Sir/Madam,

Shaw Report Scoping Document – November 2015

<u>Introduction to HS1</u>

HS1 Ltd holds the 30 year concession from the Government to operate, manage and maintain High Speed 1, the 109 kilometer high speed rail line connecting St Pancras International to the Channel Tunnel. The line is used for high speed domestic services throughout Kent; international passenger services to destinations in continental Europe, including Paris and Brussels; and for freight traffic. The concession includes the stations along the route: St Pancras International, Stratford International, Ebbsfleet International and Ashford International.

St Pancras International is one of London's major rail stations, the only terminus for international rail services and a destination in itself. It is visited by 48 million people each year and, in the National Passenger Survey carried out by Transport Focus, has been voted the nation's favourite station in each of the eight years since it reopened.

HS1 is owned by Borealis Infrastructure and Ontario Teachers' Pension Plan, who paid the Government £2.1bn for the concession in 2010. As a UK rail Infrastructure Manager it is regulated separately to Network Rail Infrastructure Limited (Network Rail) by the Office of Rail and Road (the ORR).

Network Rail is a key supplier to HS1 primarily through its wholly owned subsidiary Network Rail (High Speed) (NRHS) which delivers operations, maintenance and renewal services for the HS1 route and three of our stations. HS1 also procures system operations and other services from Network Rail either directly or indirectly (via NRHS).

<u>Overview</u>

HS1 welcomes the Shaw Report scoping study (the "study") and is pleased to have the opportunity to respond, as the long-term shape and financing of Network Rail has important implications for the ongoing success of HS1. In addition, as a privately owned infrastructure manager, we believe that HS1 is well-placed to offer a view on some of the questions raised within the study.

The last 10 years have been positive for the rail sector in the UK with growing passenger numbers, long-term improvements delivered in safety and customer satisfaction and the successful introduction of significant new services (such as HS1). To continue this growth and quality improvement into the future, we need a successful and well-regarded rail system with excellent infrastructure at its heart.

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The future shape and financing of Network Rail impacts on HS1 directly in that:

- NRHS delivers operations, maintenance and renewal work to HS1 on our route and at three of our stations. The provision of these high quality services under long-term contracts is critical to the success of HS1. Network Rail provides a separate performance guarantee to HS1 for NRHS's services.
- HS1 either directly or indirectly through NRHS buys system operation services from Network Rail (such as timetabling, delay attribution reporting and major plant hire). Network Rail also makes national decisions (such as on GSM-R roll out) that directly impact HS1 and other infrastructure managers.
- HS1 physically interfaces with Network Rail infrastructure on certain routes and depots which need to be proactively managed. These interfaces are covered by a number of contracts between the parties.

Our experience with Network Rail, especially via NRHS, on the core delivery of route operations and maintenance has generally been positive. However, we recognise the issues highlighted in the study, such as concerns about long-term planning, complexity of railway interfaces and a general culture of inertia which makes it difficult to deliver agile, customer-focussed solutions. Combined with the recent reclassification of the Network Rail debt this review is a timely opportunity to develop an effective and efficient rail system that can deliver sustainably for customers into the longer term.

The study poses a wide range of questions for the industry with regards to Network Rail's future. We have focused our response on those areas which are of most relevance to HS1 or where we believe we can provide insight and have clearly indicated which questions from the study are being directly addressed.

<u>HS1 Response</u>

We have grouped our response into three key areas with the following themes:

1. The future Network Rail structure should be the one that delivers best for customers, safely.
2. The future model also needs to deliver for other UK rail Infrastructure Managers.
3. There is real value in increased private sector involvement in UK rail.

The future Network Rail structure should be the one that delivers the best for customers, safely (Questions 8&9)

A successful Network Rail and UK rail industry is essential for a successful UK plc as a well-regarded, efficient and safe railway system supports connectivity and economic growth.

The UK railway system has evolved over many years and when looking to address the potential impact of further structural changes within Network Rail, we believe it is important to recognise that no network system structure is perfect – it is how everyone in the system interfaces and works together that is important.

Future Network Rail structural options need to be assessed against what best delivers a safe, reliable, financeable and customer-centric railway. We also believe that while the train operating companies (TOCs) and freight operating companies (FOCs) should be the primary customer focus for Network Rail in the future, there needs to be better line of sight to the end passengers and freight customers to ensure the infrastructure delivers what they want and pay for; not what the "engineering system" requires.

We believe that a strong system operator has to be at the heart of any railway system to deliver the core functions in an efficient and co-ordinated manner across the network. Having a clear system operator function has worked well in other markets (e.g. 25 years of National Grid as system operator for the UK electricity system), though we recognise defining and then delivering a system operator within rail is complex. Further work is needed to build on the current ORR / Network Rail system operation work to ensure the functions are properly defined and mapped out.

To drive a step-change in customer focus, the devolution of Network Rail routes should continue, with power and decision making authority given to route leadership teams to ensure that they can deliver what their customers want – something that should be at the heart of all Network Rail activity. This will also allow better benchmarking of routes and lead to the concessioning of the regions into appropriate customer-mapped segments. This could be done on a staggered trial basis rather than the whole of the UK (as per the National Grid distribution sell-off where regions were sold to other private investors in stages). There is significant evidence available from the UK electricity and gas distribution sectors of the benefits of private sector ownership of regional monopolies from benchmarking, innovation, local customer service delivery and efficiency (eg. electricity distribution charges are substantially lower in real terms today than at privatisation, with a substantial improvement in customer satisfaction and reliability).

Network Rail in its current form covers many functions and activities within the rail sector and we believe it should refocus on its core business of delivering safe and reliable, quality railway infrastructure and operations. On this basis, Network Rail should consider disposing of non-core activities as it is unclear how certain undertakings (eg. supporting High Speed Rail in California) support Network Rail's key priorities.

We believe that Network Rail should also consider the sale of their stations. At HS1 we have owned St Pancras International (and three other stations) since 2010 and are proud that it has been regularly voted the 'UK's favourite railway station'. It is our belief that private commercial innovation could realise more value from stations, safely than continued Network Rail ownership will as well as being more trusted on local needs than Network Rail which has to deliver on its wider national role as well. All of the UK airports are critical to the infrastructure of the UK and have all been privately owned for many years.

A strong system operator with a devolved, customer-focussed regional delivery model is the best long-term sustainable solution for UK rail infrastructure.

The future model needs to deliver for other UK rail Infrastructure Managers (Question 12)

As outlined in the study but often forgotten, part of the UK railway infrastructure is not owned by Network Rail. Therefore any changes to Network Rail need to fully consider the possible impacts on these other networks and their owners, in order to avoid any unintended consequences.

There are three main concerns that would need to be addressed in any future changes:

1. HS1 and other third parties must be allowed access to system operator functions at a fair and reasonable price within industry standard arrangements. These arrangements should include commercial agreements with appropriate performance-based incentives. Without this there is potential to introduce additional risk, or inefficiencies through replication of certain core functions.
2. Interfaces with other Infrastructure Managers need to be fully considered when exploring other models – be they physical interfaces where our networks connect or areas where Network Rail has traditionally taken a UK-wide lead on rail issues (such as the GSM-R roll out).
3. Although small in the overall scheme of things, HS1 has long-term contracts with NRHS that deliver operations, maintenance and renewal services on the route and three of our stations. We recognise that NRHS may be seen as non-core, as its potential sale could be beneficial overall by creating value and a credible non-Network Rail OMR provider. If this option were to be pursued it would be mutually beneficial for HS1 to be involved in these discussions.

For these reasons, future structural change in Network Rail would have a significant impact on the business operations of HS1 and it is vital that the implications of any changes on other rail Infrastructure Managers are fully considered. However, if the changes are carried out properly and promptly, this is a real opportunity to improve the quality and efficiency of the overall network.

There is real value in increased private sector involvement in UK rail (Questions 23-27)

Given the funding constraints noted in the study and the forecast gap between costs and funding for Network Rail, new funding has to be found and we believe this will have to come from the private sector.

Private concessions within rail *do* work. The success of the HS1 sale and its performance to-date under private ownership demonstrates this in the following ways:

- The original sale of HS1 in November 2010 delivered £2.1bn sales proceeds back to the Exchequer (above expectations of £1.3bn-£1.9bn) and successfully transferred the majority of risk to the private sector.
- HS1 provides strong evidence that private owners can operate railways safely. The HS1 operation currently has a workforce and contractor Fatalities and Weighted Injuries rate of 0.033 versus 0.1331 for Network Rail (as reported for 2014/15). HS1 has had no RIDDOR reportable accidents for 18 months.
- HS1 has delivered reliable route performance with HS1 infrastructure delays in excess of five minutes averaging less than 0.4% of all services since sale.
- We have driven significant efficiencies in Operations, Maintenance and Renewal Charges (OMRC) since 2010. As reported by the ORR,[1] our first five-year periodic review costs were 16% below the agreed OMRC efficient budget (the majority of which savings were passed directly onto customers) and in our most recent periodic review for charges to 2020 we delivered a further 12% real savings in charges to TOCs (and 60% to FOCs).
- The quality of our stations is clear, with St Pancras International voted the number one station in the National Passenger Survey in every year since its reopening and our three other stations (at Stratford, Ebbsfleet and Ashford) all encouraging significant local growth.
- Improved commerciality in retail, car parking and other commercial areas has delivered significant improvements in margins and customer experience. For example. St Pancras International is home to the first new Fortnum & Mason in 300 years, as well as the first John Lewis at a railway station. It is also the host of acclaimed cultural events, including regular concerts and public art exhibitions in partnership with the Royal Academy. It was, in addition, recognised as the 'Great Place in the UK in 2015' by the Academy of Urbanism.
- We have developed positive regulatory and customer relationships. Our first regulatory periodic review post-sale that set OMRC charges for the period 2015-2020 was agreed 11 months before the start of the control period and the ORR accepted our plans and charges first time – an industry first. This was primarily due to extensive consultation with our TOCs and FOCs about what they wanted from HS1 and their support of our plans. This customer-led regulatory focus has continued with regular 6 monthly CEO line of sight meetings with our TOCs to ensure that we agree on the priorities and delivery areas that matter for their end customers whilst also being held to account for what we promised as part of our regulatory settlement.

[1] http://orr.gov.uk/what-and-how-we-regulate/high-speed-1/annual-reports-on-hs1-ltd

HS1 and other private rail owners (such as Heathrow Express) demonstrate that private companies can fully own and operate critical elements of rail infrastructure in a way that meets long-term stewardship requirements. Our smaller size and reduced complexity compared with Network Rail allows us to fully focus on delivering the excellent route infrastructure and stations that customers expect and are paying for.

We recognise that some stakeholders are concerned about the permanence of concessioning parts of Network Rail, but the reality is that concessioning results in the assets being returned to the government at a pre-agreed time and condition in the future. Therefore if long-term government rail policy changes this is not irreversible. Additionally, the private sector can better realise commercial opportunities and improved customer experiences which Network Rail is simply not set up or equipped to deliver. Some of this additional value will be translated into improved concession prices today and delivers more choice, quality and an improved experience for the end passenger.

We recognise that it is important to learn from the relatively recent experience of full privatisation in rail infrastructure with Railtrack, but we firmly believe that there is greater scope for private sector involvement in railways. Rail is complex but so are the water, electricity, gas, telecommunications and airport industries which have all successfully benefited from 20 years-plus of private sector ownership.

The only sustainable way to meet the expectations of rail passengers, station users and freight customers is for more involvement of the private sector – which can also provide the necessary funding. Long-term debt and funding costs are at generational lows, creating a clear opportunity to allow the investment in growth that the railway clearly needs. Private companies in general cannot raise debt as cheaply as governments, but the margins between the two are now low (<1% pa) and are outweighed by the risk transfer to the private sector and the benefits that the private sector can apply (including more agility, innovation, commerciality and best practice sharing across different sectors). Competition between private concession holders across the country would also help drive efficiency and innovation.

The UK has been hugely successful in attracting tens of billions of pounds of high quality private investment into infrastructure over the last 25 years, driven by strong, transparent long-term regulation and high capital investment requirements. The competition for investing in UK infrastructure is as strong as it has ever been with recent regulatory deals (such as the Thames Tideway Tunnel) attracting high quality investor consortia who are prepared to bid and operate assets at very attractive terms.

There is already substantial private investment in UK rail (such as freight, operators, ROSCOs) and, as HS1 demonstrated in 2010, if structured appropriately there would be significant interest in further investment in UK rail infrastructure – including from our shareholders, Borealis Infrastructure and Ontario Teachers' Pension Plan. This interest would extend to any outcomes from this report and other future possible concessioning opportunities (e.g. High Speed 2).

To attract the widest range of investors and to deliver the most competitive process it is important that any process has the following key characteristics:

- Allows, ideally, full ownership (of either the assets or concession) and, if a concession provides for a longer term, enables the company to deliver long-term value given the risk transfer. A less-preferred variant of this would be a partnership with Network Rail (via for example a joint venture) but this would require meaningful governance rights and decision making power given the amount of capital risk taken on by the investor.
- Preference for large-scale rather than a collection of smaller opportunities to ensure that companies can leverage their own financial resources (and in possible partnership with other investors in a consortium).

* Clear definitions of the assets (ideally via a Regulatory Asset Base), contracts, responsibilities and hand-back conditions to ensure that risk is appropriately understood and priced.

In summary, private ownership of critical UK infrastructure, including HS1, and in other elements of the rail system has been hugely beneficial to UK plc. Private ownership works. It delivers tens of billions of pounds of sales proceeds to the tax payer, providing real long-term risk transfer and private funding for significant investment programmes (often required given ageing UK infrastructure). Private sector innovation and hunger can really drive safe, value-for-money and quality services. Reputation is important for private investors especially for those pension funds and others with clear public accountabilities and they can be trusted to be long term stewards of key infrastructure assets – as demonstrated by their track record in 25+ years of UK infrastructure ownership.

Conclusion

The last 10 years have been positive for rail in the UK. To continue to deliver this growth and satisfy increasing customers' expectations into the longer term we need a sustainable rail system that delivers a safe and enhanced customer service. At the heart of this system is an efficient, focussed system operator delivering quality network services for the operators and other Infrastructure Managers, ultimately for the benefit of the end customers. Route devolution should continue into eventual full concessioning and all non-core assets should be transferred into private ownership, realising value for the taxpayer and delivering better services. Private ownership works and, given the current funding requirements for UK rail infrastructure into the longer term, is the only viable option to deliver a rail network of which we can all be proud in the future.

We hope that these comments help with your assessment of the future shape and financing of Network Rail, and we look forward to seeing your report in the spring. If you require further information or clarification, please email [REDACTED]

Yours sincerely,

Graeme Thompson
Chief Financial Officer