

John Larkinson
Chief Executive



Clive Maxwell CBE
Director General, High Speed & Major Rail Projects
Department for Transport
Great Minster House
33 Horseferry Road
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10 August 2022

Dear Clive

Ability to charge an Investment Recovery Charge (IRC) for HS2 Phase One

Please find attached ORR's final decision on the ability to charge an IRC for Phase One of HS2. This follows the consultation on our minded to decision which we published in March 2022.

After careful consideration, we have decided to permit the inclusion of an IRC for Phase One of the HS2 project in any future charging framework for HS2. We consider the rationale to be consistent with the legal requirements to be able to charge an IRC, set out in paragraph 3 of Schedule 3 of the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016. Under those Regulations the final charging framework will still need to be submitted to ORR for final approval.

As the operating model for HS2 and the charging framework develops throughout the different phases of the project, we expect the Department for Transport (DfT) and/or HS2 Ltd to keep us updated. We look forward to a future charging framework application in accordance with the Regulations, and for those responsible for granting access to HS2 to work with ORR on capacity allocation.

A copy of the decision document, the consultation responses and relevant correspondence will be published on our website in due course.

Yours sincerely

John Larkinson
Chief Executive



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1st November 2021

Dear John

Ability to charge an Investment Recovery Charge (IRC) for HS2

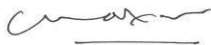
Thank you for your letter of 29 January 2020, responding to my 21 January letter regarding the prospect of levying an Investment Recovery Charge (IRC) on train operating companies as part of track access fees for running services on HS2 infrastructure.

I was grateful for your confirmation that ORR considers the rationale presented in my letter to be consistent with the legal requirements to be able to charge an IRC under the current regulatory regime, subject to the provision of contemporaneous documentary evidence.

I understand that our respective teams discussed an appropriate evidence bundle, which has now been shared with you. This bundle contains evidence, which, as requested, is contemporaneous to the decision to proceed with HS2. Sections of the information provided are confidential and supplied to ORR as such. This is because they provide details of advice regarding the formulation or development of Government policy, communications between Ministers and confidential details of the workings of internal DFT governance processes. This is provided to ORR in confidence and on the understanding that it will not be published in whole or in part, subject, of course, to legal requirements such as FOI. We would welcome early discussion around any such matters.

Once you have taken the steps necessary to consider this evidence, I would be grateful if you could confirm that the ORR are content that the future infrastructure manager of HS2 would be able, if desired, to levy an IRC on future users of the infrastructure, pursuant to paragraph 3 of Schedule 3 to the Railways (Access Management and Licensing of Railways Undertakings) Regulations 2016.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'C. Max', with a horizontal line underneath.



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Dear John

21 January 2020

DFT is preparing for a “Notice to Proceed” decision for Phase One of the HS2 programme. By Notice to Proceed we mean authorisation from Ministers for HS2 to enter into the Major Works Civils Contracts. This is the key go/no go decision for Phase One.

The ability of the Government to secure revenues derived from services run on the railway to defray the costs of construction will be an important factor in this decision. We consider that securing such revenues requires an ability to charge an Investment Recovery Charge (IRC), pursuant to paragraph 3 of Schedule 3 to the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 (the “2016 Regulations”).

I am therefore writing to you to seek clarity on whether our rationale for charging an IRC on train operators running services on HS2 is consistent with requirements in the 2016 regulations.

As you will know, there is an independent review currently underway that will provide recommendations on whether and how we proceed with the HS2 project. This letter in no way prejudices the outcome of that review. While this review proceeds we are authorised to continue with preparatory work, to ensure that we are ready to proceed without further delay for the main construction stage of Phase 1 in the event that the Government chooses to continue.

Under the 2016 Regulations ORR must establish the charging framework and the specific charging rules governing the determination of the fees to be charged by an infrastructure manager for use of railway infrastructure. In respect of HS2, DFT intends, subject to approval by the ORR, that the charging framework should include the ability for HS2 Ltd to charge an IRC to train operators using HS2 infrastructure. I recognise that the charging framework for HS2 will not be determined until much nearer the start of operations. However, a clear understanding of the ORR’s position on this issue is a necessary pre-condition for the Government’s Notice to Proceed decision.

Under the 2016 Regulations, charges must be set at the cost that is directly incurred as a result of operating the train service. The IRC is an exception to this principle and permits the infrastructure manager to levy higher charges if three conditions are satisfied.

We consider that the proposal to charge an IRC for the use of HS2 infrastructure will satisfy the three conditions set out in regulations and that therefore an IRC should be permitted. Annex A to this letter set out our reasons.

The advice to Ministers on whether to proceed with HS2 will need to include advice on whether or not an IRC is expected to be permitted. I would therefore be grateful if you could provide confirmation that from ORR's perspective our rationale outlined at Annex A would be consistent with the requirements set out in the 2016 Regulations. We understand that the rationale will need to be supported by sufficient supporting evidence.

Yours sincerely,

A handwritten signature in black ink, consisting of a series of loops and a final flourish, followed by a period.

Annex A

1. Under paragraph 3 of Schedule 3 to the 2016 Regulations, an Infrastructure Manager (IM) is permitted for to set or continue to set higher charges on the basis of the long-term costs of the project provided that three conditions are met:
 - the higher charges must relate to a specific investment project completed since 1988 or following the coming into force of the 2016 Regulations;
 - the project must increase efficiency or cost effectiveness;
 - the project must be one that could not otherwise have been undertaken without the prospect of such higher charges.

Investment completed post 1988; or following the coming into operation of these regulations

2. Work on Phase 1 of HS2 between London and Birmingham began in 2018 following Royal Assent of the High Speed Rail (London-West Midlands) Act 2017. Although design work on the project is well advanced and preliminary enabling works are being undertaken, approval to commence construction has not yet been given.
3. Phase 2a is planned to extend the line to Crewe and Phase 2b will extend the line in a 'Y' shape to Manchester in the west and Sheffield and Leeds in the east, with connections onto the national network completed by 2035-2040.

Project increases efficiency or cost effectiveness

4. HS2 will form the new backbone of our national rail network, providing new capacity and better connections to our major cities, whilst creating more space for commuter and freight trains on our busiest lines. HS2 is predicted to generate significant transport benefits and economic benefits across the UK, having a transformational effect on the country by supporting growth and increased productivity, particularly in the North. It will improve connectivity, free up space on our crowded rail network, promote regeneration, boost local skills, generate tens of thousands of jobs and help secure the UK's future prosperity.
5. DFT has set out our case on the benefits that the project will bring to the UK in the Strategic Case for HS2, last updated for Phase 2 in July 2017, and which will be further updated in a Final Business Case ahead of Notice to Proceed.

The project could not be undertaken without the prospect of charges based on the long-term recovery of costs

6. The key decision to undertake HS2 Phase One will be when the notices to proceed are issued. A positive decision is dependent on the prospect of the charges for use of HS2 infrastructure including a charge based on the long-term recovery of construction costs, i.e. an IRC. This is for the following reasons:
 - i. The decision to issue the Phase One Notice to Proceed is contingent on the project being agreed by DFT ministers and securing all necessary approvals across Government. In particular HM Treasury's approval is required.

- ii. Ministerial agreement for the Notice to Proceed will also require that the project is supported by an acceptable business case, as required by Managing Public Money. This includes an economic case demonstrating that the project is value for money and a financial case demonstrating that the project is affordable.
- iii. Both the value for money and the affordability assessments in the business case rely on the operating surplus from HS2 being returned to Government. The economic case relies on these revenues being received by Government to offset initial construction costs, while the financial case relies on these revenues being available to Government to pay for additional support to the classic rail network.
- iv. For a project of this scale and duration to be approved, Ministers must be confident that the benefits of the project will be resilient to long term changes in Government policy and the wider commercial environment. This means that there must be maximum flexibility regarding the potential future operational and commercial models for HS2; we have been clear in particular that this must include the possibility of sale of a concession to manage HS2 infrastructure in order to provide early recovery of a significant proportion of the costs incurred.
- v. The ability to charge an IRC is essential in this respect, as it provides an income to the IM that is over and above the direct costs it incurs. Crucially, our analysis shows that without an IRC the sum that could be raised in an infrastructure concession sale would be negligible, effectively ruling out this route as a commercially viable option.
- vi. The consequence of not charging an IRC would be to restrict Government to a limited range of models in which it could rely on recovering surplus revenues via the operator in a franchise-type arrangement, precluding the introduction of alternative models on HS2.
- vii. Further, the absence of an IRC would allow the possibility of open access operators operating services without contributing to the costs of construction because there would be no contractual mechanism by which the Government could charge a “premium” as it currently does in relation to franchised services.
- viii. DFT has assessed the potential revenues to Government under a range of potential commercial models if an IRC were not permitted. This analysis shows that under some commercial models the business case would no longer be able to rely on surplus revenues being returned to government, which would mean that the project would no longer be considered affordable or value for money. This presents a risk that the project may not go ahead without the prospect of an IRC.