Department
for Transport

HS1 Control Period 2 - Stations Review

Final Decision

August 2014

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Executive summary

1. This document contains the Department for Transport's conclusions on the periodic review of station access charges for the four HS1 Ltd. stations (St Pancras International, Stratford International, Ebbsfleet International and Ashford International). These conclusions cover the Long Term Charge element of station access charges at those four stations for the period 1 April 2015 to 31 March 2020, known as Control Period 2.

2. It sets out the background to the periodic review, including the contractual basis for the review, the roles and obligations of the relevant organisations, the process followed to date and the findings of the reviews of the charging proposals made by HS1 Ltd.

3. The conclusions contained in this document follow an engagement process led by HS1 Ltd., and represent the results of formal consultation exercises by both HS1 Ltd. and the Department for Transport, as well as numerous other instances of collaboration between HS1 Ltd. and its stakeholders, including those train operators which use the HS1 network (and stations).

4. HS1 Ltd. has submitted its proposals for the Long Term Charge element of the station access charges for Control Period 2. The Department for Transport has considered these proposals against the requirements of the Concession Agreement (which governs the relationship between the Department for Transport and the concessionaire operating the HS1 network) and the HS1 Station Leases (which sets out the rights and obligations of both the Department for Transport and HS1 Ltd. in respect of the four HS1 network stations).

5. The Department for Transport has also consulted interested parties on its draft conclusions. This document contains the comments received from consultees, and the Department for Transport's views on these responses, which have informed the conclusions contained herein, and informed the Department for Transport's decision to approve HS1 Ltd.'s proposals.

6. This document contains information on the close-out of this periodic review, including its implementation and the ongoing monitoring of the Department for Transport's decision in Control Period 2. For any further information, please use the contact details at paragraph 1.16 of this document.

DEPARTMENT FOR TRANSPORT
AUGUST 2014

1. Introduction

1.1 This chapter sets out background information on HS1 Ltd. and on the stations periodic review process, including the contractual basis for conducting periodic reviews. It also sets out information on this decision document.

Background and contextual information

Background on HS1 Ltd.

1.2 HS1 Ltd. holds a concession until 2040 to operate and maintain the HS1 network between St Pancras International and the Channel Tunnel and to operate four stations (St Pancras International, Stratford International, Ebbsfleet International and Ashford International) along the HS1 network route.

1.3 The [Concession Agreement] sets out the terms of the agreement between HS1 Ltd. and the Secretary of State for Transport ("SoS"), who owns the HS1 railway network, including the four stations named above.

1.4 The HS1 Station Leases[1]; separate documents to the Concession Agreement, set out the terms of the agreement between HS1 Ltd. and the SoS in respect of the four HS1 network stations, including the rights and obligations of both parties.

Background to the review

1.5 The HS1 Station Leases requires HS1 Ltd. to produce Life Cycle Reports ("LCRs") for each of the four HS1 network stations in advance of each of HS1 Ltd.'s five-year control periods. HS1 Ltd.'s Control Period 2 ("CP2") will run from 1 April 2015 until 31 March 2020. The contents of each LCR as required by the HS1 Station Leases are set out in Annex A to this document. As well as meeting those content requirements, HS1 Ltd. must also achieve the Life Cycle Purpose for each station.

1.6 The Life Cycle Purpose (paragraph 2.1 to Schedule 10 of the HS1 Station Leases) is defined as "to ensure that each Station shall be in good and substantial repair and condition during the whole of the Life Cycle Period". The Life Cycle Period is defined in the HS1 Station Leases as "the period of fifty (50) years commencing on 1 April 2011" (Schedule 10 of the HS1 Station Leases, definitions). This is the approach that has been adopted for the CP2 review.

1.7 For future reviews, however, the Department for Transport ("DfT") has discussed with HS1 Ltd. the feasibility of taking an approach to the Life Cycle Period that is consistent with the approach required by the

[1] Ashford International is contained within a separate lease

Concession Agreement in respect of periodic reviews for the route element of the HS1 network. This would mean that, instead of a fixed end date of 1 April 2061, HS1 Ltd. would adopt a rolling 40-year view in terms of achieving the Life Cycle Purpose. In practice, this means that, at each periodic review for the HS1 stations for the duration of the concession, HS1 Ltd. will act as if it is retaining the concession for a further 40 years. HS1 Ltd. and DfT believe that this approach potentially presents the best option for ensuring asset stewardship of the HS1 stations and achieving the Life Cycle Purpose. This option will be explored fully as part of DfT's post-project review and as part of the ongoing asset handback condition work mentioned elsewhere in this document.

Role of DfT and the Government Representative

1.8 Under the terms of the HS1 Station Leases, DfT is required to approve the LCRs for each of HS1 Ltd.'s five-year control periods. Under the HS1 Station Leases, the SoS may appoint a Government Representative, defined as "such person(s), firm(s) or company(ies) that the Secretary of State may appoint to be his representative(s) or any substitute as may be appointed from time to time pursuant to paragraph 4.1[2] of the Concession Agreement." (Schedule 10 of the HS1 Station Leases, definitions).

1.9 Paragraph 4.1 of the Concession Agreement states "The Secretary of State may appoint, from time to time after giving prior notice to HS1 Co[3], the Government's Representative (or more than one) to be his representative (or representatives) in relation to the HS1 Concession and in relation to the obligations of HS1 Co as a network provider of HS1. Without limiting the Secretary of State's obligations in respect of such matters, HS1 Co agrees that each Government's Representative shall carry out or exercise in respect of this Agreement such of the functions, duties, rights and obligations of the Secretary of State under this Agreement as the Secretary of State may notify to HS1 Co from time to time. The Secretary of State shall give to HS1 Co notice of his intention to change the Government's Representative (or any of them), of the identity of the Government's Representative (and if more than one then of each of them), and of the date upon which that change shall have effect."

1.10 Paragraph 5.3 of Schedule 10 of the HS1 Station Leases provides that the Government Representative must, within two months of the date of receipt of the LCRs, indicate whether they approve or reject the LCRs and, if the LCRs are rejected, the reasons for this.

Purpose of this document

1.11 Pursuant to paragraph 5.3 of Schedule 10 of the HS1 Station Leases, this document sets out DfT's decision on the CP2 review of the four

[2] Which relates to the Government's Representative
[3] i.e. HS1 Ltd.

railway stations on the HS1 network which form part of the HS1 Concession.

1.12 It includes DfT's decisions on:

- whether HS1 Ltd. has had regard to, and fulfilled, the requirements and obligations upon it by virtue of the HS1 Station Leases with respect to a stations periodic review;
- whether there are any deficiencies within the LCRs with respect to those areas listed in the HS1 Station Leases which would render the LCRs deficient should they be absent from them;

1.13 This document also includes information on the end to end process for the CP2 stations review, including information on the implementation of the decisions contained within this document.

DfT decision

1.14 As set out in paragraph 5.3 of Schedule 10 of the HS1 Station Leases, DfT must decide whether or not to approve the LCRs within two months of the date of their submission by HS1 Ltd. As HS1 Ltd. formally submitted the LCRs on 30 June 2014, DfT is required to make its final decision on or before 31 August 2014.

1.15 This document constitutes satisfaction of that provision, and informs stakeholders of DfT's decision to approve HS1 Ltd.'s LCRs.

Contact information

1.16 If you have any further comments which you wish to make on this decision document, or any other aspect of the CP2 stations review, please contact DfT using the details below:

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2. Process for the CP2 stations review

2.1 This chapter sets out the process followed to date by HS1 Ltd. and other stakeholders for the CP2 stations review.

2.2 This chapter also sets out the requirements of the LCRs, and considers whether the LCRs meet the requirements of the HS1 Station Leases.

2.3 This chapter explores the work done by DfT and by EC Harris, acting as DfT's appointed technical advisers, to reach the conclusions set out in this document. These conclusions take into account the requirements of the LCRs, the provisions of the HS1 Station Leases and HS1 Station Access Conditions ("SACs") and comments received from stakeholders in response to DfT's formal consultation.

General principles for the CP2 stations review

2.4 This section sets out the general principles of the CP2 stations review.

Scope of this periodic review

2.5 This review considers the setting of the long term charge ("LTC") figure payable by train operating companies ("TOCs") using the HS1 stations, covering CP2 from 1 April 2015 to 31 March 2020. The LTC element of station access charges paid by users of the station is used to fund renewal and replacement work carried out by HS1 Ltd. at the four stations on the HS1 network. The renewal and replacement work scheduled for any given control period is set out in the LCRs and updated by the Asset Management Annual Statement(s) ("AMAS") in each year for that control period.

Exclusions from this periodic review

2.6 This review does not cover the track or 'route' aspect of the HS1 network. The route itself is subject to periodic review by the Office of Rail Regulation ("ORR") on a five-yearly basis, as set out in the Concession Agreement. The ORR has concluded its first full periodic review of HS1 Ltd.'s route ("PR14") and its determination is available on the ORR website.

2.7 DfT notes that, as a result of the PR14 review, HS1 Ltd. has undertaken a number of 'line of sight' initiatives in relation to enhancing the customer experience, particularly at the HS1 stations. Further details can be found in the ORR's determination. Where there is read-across to initiatives at stations as a result of this work, DfT would expect to work closely with HS1 Ltd. and other stakeholders.

2.8 This review does not cover HS1 Ltd.'s other income streams from its stations portfolio, including income from retail, advertising or car parks at stations. These income streams are unregulated and not subject to scrutiny by either DfT or the ORR.

2.9 This review also does not cover Qualifying Expenditure ("QX"). QX is the expenditure associated with maintenance and repair.

2.10 Maintenance is defined in the SACs as the carrying out of in relation to every part of the Station any treatment, operation or work of a routine and foreseeable nature whether necessary at regular or irregular intervals…the replacement of such parts of the Station as required, or are designed for, regular replacement; and…any inspection or certification required…and in relation to the Equipment, all treatment, operations and works which are recommended in a current manufacturer's operating or maintenance manual…at the intervals and in the manner so recommended.

2.11 Repair is defined in the SACs as the carrying out of (a) any work required to keep the Station in good and substantial repair and condition; and (b) any work required so that the Station is safe for operation and/or use in compliance with the requirements of any Statute for any purpose permitted by the Station Access Agreement.

2.12 QX is calculated by HS1 Ltd. on an annual basis, in consultation and negotiation with the TOCs which use its stations. QX is calculated in accordance with the provisions set out in the SACs and annexes specific to each HS1 station.

Cost allocation

2.13 Given that some of HS1 Ltd.'s income streams are regulated by the ORR, or are not regulated at all, HS1 Ltd.'s costs must be apportioned across its various activities to ensure that there is no double counting, or that no costs are omitted.

2.14 We echo the comments contained within the ORR's PR14 final approval document on cost allocation:

"Throughout the PR14 process, we have held regular trilateral meetings with HS1 Ltd. and DfT to agree a set of principles and an approach for the way in which HS1 Ltd.'s costs are allocated. Following these meetings we set out the principles and approach that HS1 Ltd. should use to allocate costs across the price controlled part of the HS1 network (including freight), stations and unregulated activities for the 5YAMS.

As part of HS1 Ltd.'s 5YAMS consultation, we considered the methodology used to allocate costs across the price controlled part of the HS1 network, stations and unregulated activities. This methodology was set out in a cost allocation paper that HS1 Ltd. submitted to us in September 2013. We reviewed that paper and are broadly content that it provides an appropriate allocation of HS1 Ltd.'s costs and is consistent with the principles and approach discussed in the trilateral meetings with HS1 Ltd. and DfT.

We have reviewed HS1 Ltd.'s changes to its cost allocation methodology[4] *and are content that it is still appropriate. We also accept HS1 Ltd.'s confirmation that the allocation of wear and tear between operators and the apportioned delivery of savings in the OMRC model is correct.*

We are content with the process of engagement between ourselves, DfT and HS1 Ltd. around cost allocation, which has allowed us to have a clear understanding of the way in which costs have been split across the different areas of the HS1 Ltd. business."

Process for the CP2 stations review

2.15 This section sets out the process followed for the CP2 stations review, summarising key milestones and explaining the consideration and challenge which has been given to HS1 Ltd.'s final LCRs.

2.16 DfT notes that, throughout the CP2 stations review, HS1 Ltd. has engaged fully with its stakeholders, in a timely fashion and has strived for a 'no surprises' approach. We look forward to that approach continuing into CP2 and beyond.

Production of life cycle reports

2.17 HS1 Ltd.'s work on the CP2 stations review began in 2012 with a detailed planning phase which continued into early 2013. HS1 Ltd.'s initial discussions took place:

- around the scope of works for the production of the LCRs and supporting financial model (with a view to the future engagement of consultants);
- with DfT to ensure the alignment of objectives and processes in order to create a streamlined process for all parties (including TOCs);
- with Network Rail (High Speed) ("NR(HS)");
- with a view to organising its own resources.

2.18 Once the scope of works had been agreed, in 2013, HS1 Ltd. procured a consultant to develop the LCR and financial model. The consultants were required to:

- provide a detailed programme of activities to deliver the agreed scope of works;
- work with identified stakeholders and factor in appropriate time accordingly;
- deliver the LCRs and supporting model within a tight timeframe (six months, with three months contingency) to allow for consultation.

2.19 Halcrow, the consultants acting for HS1 Ltd. to deliver the LCRs and supporting model, submitted that documentation to HS1 Ltd. in

[4] As a result of comments on HS1 Ltd's September 2013 paper.

September 2013. Following an HS1 Ltd. review, the documentation was submitted to DfT.

2.20 Sessions were then held with DfT and other stakeholders in September 2013 to discuss:

- key drivers and assumptions used by HS1 Ltd. and its consultants;
- interim results;
- timescales for the review;
- DfT's approach;
- TOC comments; and
- next steps.

2.21 In October and November 2013, HS1 Ltd. collated the feedback received from stakeholders and updated the documentation in advance of formal consultation. In November 2013, HS1 Ltd. held further stakeholder workshops, to discuss:

- progress/changes during DfT's review;
- feedback on the DfT review;
- emerging views;
- further TOC comments; and
- next steps.

2.22 Through December 2013, HS1 Ltd. used these comments to finalise the LCRs and supporting documentation for its formal consultation.

2.23 DfT worked with its technical advisers, EC Harris, to produce an interim review on the LCRs, prior to HS1 Ltd.'s formal consultation. DfT received this interim review in November 2013. The scope of the review and its findings, are set out below.

Scope of EC Harris first review

2.24 For the pre-consultation version of the LCRs, EC Harris was asked by DfT to:

- Assess the draft LCRs for the four HS1 stations and review the Life Cycle Cost ("LCC") models and the financial model used to determine the LTC, and any other associated documentation;
- Determine if the LCRs, the associated LTC/LCC models and any other relevant or supporting documentation:

- contain the appropriate renewal activities
- enable the efficient delivery of asset management activities
- align with the intended AMS
- align with HS1 Ltd.'s General Duty under the Concession Agreement
- comply with Schedule 10, Annex 1 of the HS1 Station Leases
- align with recognised best practice and benchmarking for asset management

- Assess and consider any deficiencies or issues that impact the LCRs that were previously identified during the 2012 AMS review.
- Assess and challenge the appropriateness of the definitions and assumptions underpinning the financial models, particularly the definitions of renewals.
- Identify and recommend, as appropriate, any aspects that would need to be improved or expanded in accordance with the Concession Agreement or HS1 Station Leases or industry good practice.
- Produce a report highlighting deficiencies, omissions or errors in the available documentation, models, including an overview of the findings and recommendations.
- Prioritise deficiencies and/or issues that impact the approval of the LCRs/AMS and those that would merit future consideration.
- Facilitate workshops for familiarisation with the available CP2 package and to present/discuss findings and recommendations.

Findings of EC Harris first review

2.25 EC Harris made 124 individual comments, grouped into nine overall recommendations for HS1 Ltd., which were:

- DfT should set (i) a baseline asset inventory, (ii) a target handback asset state and (iii) the volume and type of non-physical assets, such as data and information, which should also be handed back at the end of the concession. (Good practice)
- The LCC models could be enhanced by analysing alternative intervention strategies and the monetary impact these may have on the overall LCC. (Good practice)
- Investigate with DfT the potential to merge the escrow accounts across the four stations so as to reduce some elements of the 'cost of borrowing' in the future. (Good practice)
- To provide DfT with an explanation of the benchmarking process adopted and the top fifty most expensive item estimates presented in a reasonable level of detail to enable assessment. (Good practice)
- Ensure that the correct intervention types, i.e. renewals, are used in the LCC models and that there is no cost duplication between work activities and on-costs and between asset and sub-asset renewals. (Obligation)
- Remove non-verified items and ensure that asset and asset quantities contained in the LCC models are correct. (Obligation)
- Ensure that the intended asset life expectancies are used in the LCC models for calculating the overall LCC for each station. (Obligation)
- Revisit on-costs to remove duplication and errors, enhance descriptions provided and ensure correct application in the LCC models. (Obligation)

- Update the LCC and LTC models to allow variance analysis to be undertaken throughout the control period. (Obligation)

2.26 EC Harris also identified 60 obligations on HS1 Ltd. by virtue of the HS1 Station Leases, in respect of developing a package at a stations periodic review. As the 7 April 2014 version of the LCRs only represented an interim version prior to formal submission, the full table of compliance is not printed here, but can be found in the EC Harris final report accompanying this decision document.

2.27 HS1 Ltd. was provided with a copy of the full report and asked to address these recommendations and the underpinning comments, as well as to review the proposals against the criteria in the HS1 Station Leases.

HS1 Ltd. response and amendments prior to formal consultation

2.28 DfT and EC Harris worked with HS1 Ltd. to agree a number of amendments to the original proposals offered by HS1 Ltd.

2.29 These amendments comprised a number of changes to the proposed overheads, resulting in a significant reduction to the proposed LTC figure. It was also agreed that a number of line items previously contained within the LTC figure would move into QX.

2.30 The overall changes in the LTC proposals are captured later in this chapter. The way in which the nine specific recommendations (as noted at paragraph 2.27) made by EC Harris have been addressed are as follows:

- HS1 Ltd. and DfT are working together to address the asset baseline condition recommendation, produce the asset inventory and agree a handback condition before the start of CP2.

- Enhancement of the LCC models is one part of HS1 Ltd.'s proposed improvement to the asset management system, particularly as QX and LTC are modelled more closely in the future.

- As stated in a letter of 11 December 2013 to HS1 Ltd., DfT's view is that the Concession Agreement does not currently permit the merger of the escrow accounts. DfT recognises, however, that there may be financial benefits to merging the accounts and the appropriateness of a merger, whilst taking account of the relevant issues, may be considered in the future.

- HS1 Ltd. has provided an explanation of the benchmarking process, as well as the 'top fifty' items list.

- DfT acknowledges that the review process has tried to ensure the avoidance of duplication and that the correct intervention types are used. A number of changes have been made to this effect, including the significant move from the ‘baseline’ to the ‘asset stewardship’ approach. Since moving to the asset stewardship approach, HS1 Ltd. has continued to review and modify its findings. DfT notes that the impact of these changes is not financially material.

- HS1 Ltd. has updated and audited the LCC models in light of the challenge received from EC Harris and provided a commentary in the model to explain the basis for its decisions.

- HS1 Ltd. has fully reassessed the asset lives used within the LCC under the asset stewardship approach on a line by line basis based on SPONS[5], application of engineering judgment, known degradation experience taken from Ashford International and customer requirement. HS1 Ltd. is confident that, given available information, the asset lives used within the LCC models are appropriate. HS1 Ltd. will have further information at CP3 and onwards to further refine its views on asset lives. HS1 Ltd. has performed a number of checks – including an audit by AECOM – to ensure that the designated asset lives are used in the model calculations in the correct way.
- HS1 Ltd. has revisited on-costs and removed a significant amount of duplication. HS1 Ltd. has also committed to tracking on-costs over time, as project experience is built up and assumptions for future control periods can be revised.
- HS1 Ltd. has noted that the variance analysis is complicated by the SACs changes that occurred during CP1. HS1 Ltd. has committed to a programme of work to have the methodology to calculate variances in place by the start of CP2. Further comment on this point is provided at paragraphs 2.160-2.168 of this document.

HS1 Ltd. formal consultation

2.31 In accordance with condition 105.3.2 of the SACs, HS1 Ltd. has consulted stakeholders on its LCRs, during an eight-week consultation from 6 January 2014 to 28 February 2014.

2.32 HS1 Ltd. performed further model checks and analysis to supplement the consultation and on 31 January 2014, issued an update to take account of this further analysis. The overall impact of this update was a reduction in CP2 charges as against current charges, giving a total of £6.4m (compared with the £6.9m being collected in CP1).

2.33 HS1 Ltd. supplemented the consultation document with bilateral sessions in early February 2014, and an industry workshop on 19 February 2014.

2.34 Two responses were received, from Eurostar International Limited ("EIL") and London and Southeastern Railway Limited ("LSER") which HS1 Ltd. has taken into consideration as part of its production of the LCRs.

2.35 Additionally, DfT has considered the consultation version (incorporating the 31 January 2014 update) of the LCRs against the requirements set out in the HS1 Station Leases.

2.36 DfT notes that some of the comments made by consultees are outside the scope of the stations review process, and are governed or constrained by the terms of the Concession Agreement. Whilst those recommendations are not able to be addressed as part of the CP2 stations review process for this reason, DfT will keep them under consideration in the future to determine whether they are achievable.

[5] SPONS is a regularly-updated price list book containing asset prices across various infrastructure types.

Amendments as a result of HS1 Ltd.'s formal consultation

2.37 As a result of the consultation comments received, HS1 Ltd. made a number of changes to the LCRs submitted on 30 June 2014. These had the effect of reducing the 31 January 2014 proposed figure of £6.4m to a revised figure of £5.8m.

2.38 These amendments can be summarised as follows:

- Funding of station key assets. There has been a reduction in the renewal life cycle for CCTV and customer information screens (from 20 to 10 years). There has also been a reduction in the square meterage used for calculations. There was no specific LTC funding put by for toilet replacement (although the funds used did come from the LTC escrow accounts, with the expenditure incurred in the 2013/14 reporting year).o
- Station plans. The submission contains up-to-date station plans (although there is no change in allocation of LTC across operators).
- Efficiency overlay. An overlay of 0.6% per year is included over the 45-year forecast period, impacting unit costs on a year-on-year basis.
- LTC/QX. A number of items have moved from LTC to QX (calculated with TOCs on an annual basis) with an undertaking to improve the forecasts for future QX.
- On-costs. HS1 Ltd. will review on-costs associated with the contractual framework and track actual on-costs when projects are undertaken so that this analysis can be used in future reviews.
- Asset management suite. The 7 April 2014 version contained the full suite of asset management documentation.
- Hand-back condition. The 7 April 2014 version of the LCRs contains a commitment to undertake this workstream.
- Fixed versus rolling review period. Whilst the CP2 review has been undertaken on a 'fixed' 45-year look ahead, DfT expects that for future reviews, a 'rolling' 40-year view will be adopted.

2.39 These amendments have been taken into account as part of DfT's consideration of the 30 June 2014 LCR submission.

2.40 The change in the LTC figures is set out below by both station and TOC.

Table 2.1 - evolution of the LTC by station				
Station	**6 January LTC (£m p.a.)**	**31 January LTC (£m p.a.)**	**7 April LTC (£m p.a.)**	**Reduction (from 31 January update) LTC (£m p.a.)**
St Pancras	4.54	4.16	3.81	-0.35
Stratford	0.82	0.71	0.65	-0.06
Ebbsfleet	0.86	0.75	0.69	-0.06
Ashford	0.65	0.74	0.68	-0.06
TOTAL	**6.87**	**6.35**	**5.83**	**-0.52**

Table 2.2 - evolution of the LTC by TOC				
Operator	**6 January LTC (£m p.a.)**	**31 January LTC (£m p.a.)**	**7 April LTC (£m p.a.)**	**Reduction (from 31 January update) LTC (£m p.a.)**
EIL	3.85	3.64	3.34	-0.30
LSER	2.09	1.86	1.71	-0.15
EMT	0.93	0.85	0.78	-0.07
TOTAL	**6.87**	**6.35**	**5.83**	**-0.52**

2.41 HS1 Ltd. has worked with its consultants to reconfigure the financial model underpinning the LCRs, to make it more user-friendly, flexible and logical. The financial model has been independently audited by AECOM.

Consideration of the final life cycle reports

2.42 HS1 Ltd. informally shared the LCRs with stakeholders on 7 April 2014. This permitted DfT the opportunity to consider its decision on the LCRs, and to consult upon that proposed decision, prior to issuing it.

2.43 HS1 Ltd. formally submitted the LCRs on 30 June 2014, which started the timeframe for the approval process set out in the HS1 Station Leases.

Process for review of the final life cycle reports

Review by EC Harris

2.44 EC Harris considered the final LCRs, building on the work it had carried out for the consultation version of the LCRs. The scope of the second EC Harris review, and EC Harris' findings, are set out in this section.

Scope of the EC Harris second review

2.45 For the version of the LCRs submitted informally on 7 April 2014 and in final copy on 30 June 2014, EC Harris was asked by DfT to:

- Critically assess the final LCRs concerning the four HS1 stations and the associated renewals and replacement activities.
- Determine whether the LCRs were sufficient to deliver effective asset management in line with the Asset Management Strategy ("AMS") and HS1 Ltd.'s General Duty under the Concession Agreement.
- Undertake a detailed review against Schedule 10, Annex 1 of the HS1 Station Leases of the LCRs, Whole Life Cost Model and separate model converting the output into the LTC.
- Undertake a detailed review of (any) amendments and general HS1 Ltd. response to those areas identified by EC Harris in its first review as not met, or only partially met.
- Assess the comments provided by stakeholders in response to HS1 Ltd.'s January 2014 consultation against the response provided by HS1 Ltd., determining whether the response was appropriate (or highlighting where DfT is required to take into account differing viewpoints, and conclude accordingly).
- Assess and consider any deficiencies or issues that impact the LCRs that were identified as part of the AMS review which was undertaken in 2012.
- Assess and challenge the appropriateness of the definitions and assumptions which underpin the financial models, particularly the definitions of renewals.
- Assess the LCRs and financial models against recognised best practice and benchmarking for asset management and make recommendations if appropriate.
- Undertake a review of the model to ensure that it remains consistent with the model used to produce the LCRs which were consulted on.
- Produce a short report highlighting identified omissions or errors in the available documentation as well as an overview of the findings. The report should also highlight any further recommendations to be taken forward in the short, medium and long term.
- Attend a workshop to assist DfT in presenting its draft conclusions to stakeholders on the final LCRs.

Interim findings of the EC Harris second review

2.46 EC Harris' second review was made available alongside DfT's consultation document (see paragraphs 2.48-2.50). The report was constructed based on the LCRs shared informally with stakeholders on 7 April 2014. Between 7 April 2014 and the submission of the final LCRs on 30 June 2014, discussions took place with HS1 Ltd. over the content of the LCRs, which led to a number of modifications to the LCRs.

2.47 DfT asked consultees to consider that the EC Harris report accompanying the consultation document did not cover, in full, amendments made to the LCRs up to 30 June 2014. The interim findings of the second review, as well as the DfT consultation process, are set out below.

DfT consultation on the life cycle reports

2.48 DfT wrote to stakeholders on 1 April 2014, detailing the process for the remainder of the CP2 stations review. This letter is attached for reference at Annex C. The consultation ran from 2 July 2014 to 23 July 2014.

2.49 On 14 July 2014, DfT held a workshop to discuss the draft decision document and its proposed conclusions. The outcomes of this workshop, as well as formal written responses to this consultation were taken into account in the production of this final decision document. DfT is grateful for the stakeholder participation in the workshop.

2.50 DfT received five consultation responses from East Midlands Trains ("EMT"), Kent County Council ("KCC"), HS1 Ltd., LSER and EIL.

General consultation comments

2.51 EMT, EIL and LSER supported HS1 Ltd.'s open consultation approach and stakeholder involvement in the CP2 review process. EMT added that the end result represented a fair result in relation to St Pancras International. EMT supported the proposal to introduce a rolling 40 year review horizon approach, rather than using a defined end date. DfT's views on the adoption of a 40 year rolling cycle are set out in paragraph 1.7 of this document.

2.52 KCC noted that the HS1 concession needed to be operated on a commercial basis, but sought assurance that the level of access charges did not act as a deterrent for both potential and current TOCs using the HS1 network to making additional station stops at Ashford International and Ebbsfleet International.

2.53 DfT notes KCC's concern over the viability of TOCs making station stops at Ashford International and Ebbsfleet International. DfT believes that a strong challenge has been brought by EC Harris and other interested parties and that the proposed charges represent the best deal for station users.

2.54 The station calling pattern which a TOC makes is a commercial decision for the TOC, particularly in the case of EIL, which is not a franchised TOC and uses the HS1 network on an open access basis. DfT considers that the approved reduction in LTC should make station calls more attractive from a financial perspective, as the cost per train is reduced (although there are obvious impacts on journey time as a result of more frequent station stops).

2.55 DfT also notes that it has not received (nor has the ORR as appeal body under the Railway Infrastructure (Access and Management) Regulations) any representations that the station charges are acting, or would act, as a barrier to entry to current or future TOCs. Nevertheless, DfT will continue to monitor any developments in this area and remains open to representations.

2.56 HS1 Ltd. responded that it had adopted a transparent and collaborative approach; an aim recognised by other respondents. HS1 Ltd. covered the process of the review to date, noting that it was working towards compliance with some of its obligations; discussed in further detail below. HS1 Ltd. also expressed support for DfT's planned post-project review.

2.57 HS1 Ltd. also set out its key workstreams for improving its plans for CP2 and beyond, as follows:

- evolution of asset management modelling, including the specification and degradation of assets, supplemented by the asset handback condition review referred to in paragraphs 3.17-3.19 of this document.
- greater integration with QX to allow whole-life cost optimisation.
- improved variance analysis to allow better engagement with stakeholders, testing of asset management strategies and refinement of forecasting.
- reviews of allocation of LTC across TOCs, and the review period horizon (fixed or rolling).

2.58 DfT is grateful for HS1 Ltd.'s continued commitment to ensuring compliance with its obligations under the HS1 Station Leases and Concession Agreement and looks forward to working with HS1 Ltd. on the workstreams set out above, and on its Delivery Plan for CP2.

2.59 LSER welcomed HS1 Ltd.'s commitment to six-monthly 'line of sight' reviews of the initiatives agreed between HS1 Ltd. and TOCs. LSER's expectation was that part of this work should include flexibility around how funding is used within a control period.

2.60 DfT also welcomes this commitment and agrees that HS1 Ltd.'s approach to funding must accommodate bringing work forward (or indeed, backwards) and take note of customer requirements. DfT considers that HS1 Ltd.'s approach to the construction and modelling of the LCRs is commensurate with this aspiration.

Requirements and deficiencies of the life cycle reports

Requirements and deficiencies set out by the HS1 station leases

2.61 Paragraph 5.2 of Schedule 10 of the HS1 Station Leases sets out what the LCRs must contain in order to be considered for approval. The full list of required contents can be found in Annex A of this document and is not repeated here for reasons of brevity.

2.62 Through conducting station reviews and setting the LTC, HS1 Ltd. must achieve the Life Cycle Purpose for the duration of the Life Cycle Period (as previously stated, DfT will work with HS1 Ltd. to consider adopting a rolling 40-year view for future periodic reviews, consistent with the terms of the Concession Agreement).

2.63 Paragraph 5.4 of Schedule 10 of the HS1 Station Leases sets out a list of required information whereby, if any of that information is absent from the LCRs, the LCRs may not be approved by the Government Representative. The full list of required information is found at Annex A.

2.64 Paragraphs 2.31-2.36 of this document set out the position with regards to the consultation version of the LCRs. DfT worked with EC Harris to consider whether HS1 Ltd. met all of these requirements in the LCRs shared with stakeholders on 7 April 2014, prior to formal submission on 30 June 2014. Whilst there was a large movement towards full compliance, a number of obligations remained only partially met or not met. As the 7 April 2014 version of the LCRs only represented an interim version prior to formal submission, the full table of compliance is not printed here, but can be found in the EC Harris final report accompanying this decision document.

2.65 HS1 Ltd. committed to addressing a number of the outstanding areas in advance of its final submission on 30 June 2014. DfT's expectation was that many obligations which were non- or partially compliant would actually be compliant in the 30 June 2014 submission. In its interim second report, EC Harris has made an interim overarching recommendation that, in light of the areas of non- and partial compliance, DfT rejects the final LCRs.

2.66 DfT acknowledged that recommendation but given that full consideration of the 30 June 2014 LCRs may have materially changed this proposed conclusion and that EC Harris' interim recommendation was based on the information available to it prior to 30 June 2014, DfT did not propose to reject the LCRs at that point.

2.67 DfT and EC Harris held discussions with HS1 Ltd. about control actions to ensure a greater degree of compliance, prior to submission to DfT for approval on 30 June 2014. HS1 Ltd. agreed that a number of its obligations which were not met, or partially met, would be addressed in the 30 June 2014 submission.

2.68 As was set out in the consultation document, given inherently short timescales, it was not possible to consider fully the revised LCRs in the two days between submission of the LCRs and the publication of the consultation document on 2 July 2014. Following submission of the final LCRs, EC Harris produced a table setting out HS1 Ltd.'s compliance against its obligations according to the 30 June 2014 version of the LCRs. Some obligations were not assessed, as they were subject to control actions by HS1 Ltd. which had not been carried out at the time of EC Harris' analysis.

Table 2.3 - Summary of obligations set out in Schedule 10, Clause 5 and Annex 1 of the HS1 Station Leases (30 June 2014 version of LCRs)

Met	Partially met	Not met
5.2.1-a, 5.2.1-b, 5.2.1-c 5.2.1-d, 5.2.1-e,5.2.1-f 5.2.1-h,5.2.2-c, 5.2.4-c 5.2.5-a,5.2.5-b, 5.2.5-c 5.2.6-c(i),5.2.6-e,5.2.7 5.2.8, 5.2.9, 5.2.10-a 5.2.10-b, 5.2.11-a, 5.2.11-b 5.2.12 Annex 1-1 Annex 1-2 Annex 1-4 Annex 1-6 Annex 1-6a Annex 1-7 Annex 1-7a	5.1, 5.2.2-a, 5.2.2-b 5.2.4-a, 5.2.4-b (not assessed) 5.2.4-d (not assessed) 5.2.6-a, 5.2.6-b, 5.2.6-c(ii) 5.2.6-d, 5.2.13, 4.1 Annex 1-3a (not assessed) Annex 1-3b (not assessed) Annex 1-5a (expenditure) (not assessed) Annex 1-5b (expenditure) (not assessed) Annex 1-5c (expenditure) (not assessed) Annex 1-5a (revenues) (not assessed) Annex 1-5b (revenues) (not assessed) Annex 1-5c (revenues) (not assessed) Annex 1-5 (not assessed)	5.2.1-g Annex 1-6b Annex 1-6c Annex 1-6d Annex 1-6e Annex 1-7b Annex 1-7bi Annex 1-7bii Annex 1-7biii Annex 1-7biv

2.69 Whilst the updated version represented a welcome move towards increased compliance, there remained a number of areas in which HS1 Ltd. was either non-compliant or only partially compliant. Some of the areas in which HS1 Ltd. remained partially, or non-compliant impacted on the DfT's ability to approve the LCRs as submitted.

2.70 DfT and EC Harris worked with HS1 Ltd. through the DfT consultation period and beyond to amend the LCRs to ensure the maximum possible compliance with HS1 Ltd.'s obligations. The revised, final compliance matrix is set out below.

Table 2.4 - Summary of obligations set out in Schedule 10, Clause 5 and Annex 1 of the HS1 Station Leases (final August 2014 version of LCRs)		
Met	**Partially met**	**Not met**
5.1, 5.2.1-a, 5.2.1-b, 5.2.1-c	5.2.1-g	
5.2.1-d, 5.2.1-e, 5.2.1-f	5.2.2-a	
5.2.1-h, 5.2.2-c, 5.2.4-c	5.2.2-b	
5.2.4-d, 5.2.5-a, 5.2.5-b	5.2.4-a	
5.2.5-c, 5.2.6-c(i), 5.2.6-e,	5.2.4-b	
5.2.7, 5.2.8, 5.2.9, 5.2.10-a,	5.2.6-a	
5.2.10-b, 5.2.11-a, 5.2.11-b,	5.2.6-b	
5.2.12, 5.2.13	5.2.6-c(ii)	
Annex 1-1	5.2.6-d	
Annex 1-2	Annex 1-3a	
Annex 1-3b	Annex 1-6b	
Annex 1-4	Annex 1-6c	
Annex 1-5a (expenditure)	Annex 1-6d	
Annex 1-5b (expenditure)	Annex 1-6e	
Annex 1-5c (expenditure)	Annex 1-7b	
Annex 1-5a (revenues)	Annex 1-7bi	
Annex 1-5b (revenues)	Annex 1-7bii	
Annex 1-5c (revenues)	Annex 1-7biii	
Annex 1-5	Annex 1-7biv	
Annex 1-6		
Annex 1-6a		
Annex 1-7		
Annex 1-7a		

2.71 It is important to point out that the core of the proposals has been accepted, by TOCs, DfT and EC Harris, and that many of the outstanding areas of work relate to detailed technical issues that do not materially impact on DfT's conclusions.

2.72 As contained within EC Harris' final report accompanying this decision document, for those obligations which remain not fully compliant, HS1 Ltd. has agreed control actions and timescales for carrying out those actions, in particular around the variance analysis obligations (i.e. how the funding profile for a current or future control period may change if life cycle works are brought forward, deferred, cancelled or altered).

Consultee comments and DfT response

2.73 In our consultation on the proposed conclusions, we invited consultees to comment on HS1 Ltd.'s obligations under the HS1 Station Leases, the extent to which these obligations are currently met and the timescales for areas of resolution.

2.74 DfT did not receive any specific representations on the compliance matrix, or on HS1 Ltd.'s compliance with its obligations under the HS1 Station Leases and Concession Agreement. The evolution of the compliance matrix, and the current situation around HS1 Ltd.'s compliance, is set out above.

2.75 **DfT conclusion**: There is a clear requirement for HS1 Ltd. to demonstrate its compliance with its obligations under the HS1 Station Leases. Whilst, at the time of publication, HS1 is not fully compliant with all of its obligations, HS1 Ltd. has satisfactorily resolved many of the outstanding compliance issues, or has set out a plan for how it will resolve those which remain partially-compliant, before the start of CP2. DfT is therefore content to approve the LCRs in the form agreed with HS1 Ltd. As discussed later in this document, DfT expects to audit HS1 Ltd.'s compliance with its outstanding obligations in CP2.

Stewardship

2.76 A number of comments were received in response to HS1 Ltd.'s consultation on the LCRs, in relation to HS1 Ltd.'s stewardship of the HS1 network, as informed by the asset management suite of documentation.

2.77 LSER welcomed HS1 Ltd.'s transparent and open approach and stressed the importance of its continuation and the importance of regular reporting against the 'line of sight' initiatives which have been agreed as part of the ORR's PR14 determination. LSER has also asked for information on HS1 Ltd.'s ongoing discussions with DfT.

2.78 DfT intends that publication of this decision document (and the consultation document which preceded it) serves as a useful record of discussions between DfT and HS1 Ltd., as well as setting out the challenge which DfT (along with EC Harris) and TOCs have brought to HS1 Ltd.'s proposals.

2.79 LSER asked to see a copy of the process used for withdrawals from the escrow account and for an undertaking that such withdrawals would not delay essential work from happening.

2.80 The high-level process for withdrawals from the stations escrow accounts is set out in Schedule 10 of the Concession Agreement. DfT has worked with HS1 Ltd. to produce a 'process map', which is at Annex D to this document, for information purposes. The process map is kept under review to take account of changing circumstances and to allow for the inclusion of efficiencies as the process is more frequently used and opportunities for improvements become apparent.

2.81 DfT's view is that safety critical work is of an absolute priority and should never be delayed as a result of a process malfunction. DfT expects HS1 Ltd., as concessionaire, to adopt a pragmatic approach to funding its renewals work and cannot envisage a situation where a responsible infrastructure manager such as HS1 Ltd. would allow safety- or performance critical work to lapse or be delayed. The timescales for completion of escrow withdrawals, and the required information for such requests to be approved, are set out in the Concession Agreement and in the agreed process map and are understood by all parties. In the event that timescales cannot be met, early notification of this would assist in ensuring that an alternative can be sought which would remove the potential for any delay to critical work being carried out.

Function of the AMS

2.82 With reference to Figure 1 of HS1 Ltd.'s AMS, EC Harris questioned how the AMS was cascaded down to those physically delivering the work. Figure 1 of the AMS states that HS1 Ltd. and DfT are the only users of the AMS and EC Harris has questioned whether the translation from AMS to those 'on the ground' takes place within the AMAS or Asset Management Plan ("AMP"). If it does not take place within these documents, HS1 Ltd. was asked to explain the process.

2.83 HS1 Ltd. acknowledged that this reference was not quite correct and has since amended it, although a revised process map has not been provided. HS1 Ltd. added that the AMS is developed in conjunction with NR(HS), as the delivery agent, whilst building experience, expertise and learning. HS1 Ltd. said that a key action during and following the review process is to set the five-year budget for CP2 and to convert this into the specific projects using the project management and resource allocation tools employed. This will then be embedded into the cycle of update-review-variance analysis that HS1 Ltd. has committed to, as well as the annual statements which HS1 Ltd. is obliged to provide and which NR(HS) is heavily involved in preparing.

Consultee comments and DfT response

2.84 Consultees were invited to provide comments on HS1 Ltd.'s asset stewardship proposals, the underpinning asset management documentation and HS1 Ltd.'s compliance with its Life Cycle Purpose.

2.85 LSER welcomed the inclusion of the process map for escrow withdrawals, and confirmation of DfT's view on the timing of works (in relation to safety- or security-related works). LSER also welcomed the ongoing workstream which is looking at where risk and liability for any underfunding of the escrow accounts sits.

2.86 **DfT conclusion**: DfT's conclusion is that the Life Cycle Purpose, as defined in the HS1 Station Leases, has been met for the purposes of CP2. DfT has set out clearly above, its view on the funding of safety-critical renewal work and expects that HS1 Ltd. acts in a manner consistent with this, should such a situation ever arise.

Costs and fees

Cost of debt

2.87 In the consultation document, we noted that HS1 Ltd.'s proposals assumed a cost of debt of 6%. It has been noted that for the ORR's PR14 process, a cost of debt of 4.3% was assumed (and subsequently agreed in the ORR's approval of HS1 Ltd.'s PR14 submission). DfT asked HS1 Ltd. for an explanation of this apparent inconsistency.

2.88 HS1 Ltd. responded that the same cost of debt has been used for both PR14 and the CP2 stations review. HS1 Ltd.'s Weighted Average Cost of Capital ("WACC") (6.6% nominal), with inflation set at 2.75% drives the discount rate within the annuity and this includes a 4.3% long term debt cost. Separately, there is a 6% overdraft cost of funding when the escrow account balance is modelled as negative. The 4.3% noted above is a long term bond debt cost secured on the HS1 network assets which can be secured at cheaper rates than a short term overdraft facility. HS1 Ltd. adds that overall, the models are insensitive to even large changes in this assumption as the escrows are assumed to be in deficit for only a few years and only towards the end of the period under review

Builders Work in Connection

2.89 EC Harris noted that different Builders Work in Connection rates ("BWIC") had been used for the four stations. This was felt to be broadly justifiable, particularly in the case of St Pancras International.

2.90 DfT questioned why a BWIC rate of 5.5% has been used at Ebbsfleet International, but a BWIC rate of 5% used for Stratford International.

2.91 HS1 Ltd. explained that a 5% nominal rate had been used for Stratford International. Ebbsfleet International also used a 5% nominal rate, plus 0.5% due to two additional platforms. Ashford International uses a 5% nominal rate, plus 0.5% for additional link bridges and platforms.

'Loss of maintenance credits'

2.92 DfT asked for an explanation of what was meant by a 'loss of maintenance credits' in HS1 Ltd.'s submission.

2.93 HS1 Ltd. explained that when the SACs were updated in 2012, some cost items were taken out of LTC and put into QX. Instead of re-opening the LTC amounts, HS1 Ltd. agreed to provide a ‘credit’ to operators to offset the additional QX costs during CP1 only. During CP2, HS1 Ltd. will no longer provide such credits given that the LTC and QX amounts are being re-based. Use of the term ‘loss of maintenance credits’ is intended to capture this change in approach.

Network Rail High Speed management fee

2.94 The management fee charged by NR(HS) is set at 10%. The ORR's approval for the PR14 process, however, agrees a management fee of 8% for NR(HS). DfT asked HS1 Ltd. to explain this discrepancy.

2.95 HS1 Ltd. explained that the NR(HS) management fee is levied by NR(HS) to operate and maintain the HS1 route as part of its core obligation in the Operating Agreement with HS1 Ltd. This fee was originally set at 10% but reduced to 8% in the ORR's PR14 final determination.

2.96 HS1 Ltd. further explained that the 10% NR(HS) management fee assumed in the station model is not a management fee, but is a mark-up applied by NR(HS) in the event that NR(HS) is the delivery agent for a project (i.e. renewal work) which is above and beyond its core station management obligations. The mark-up represents any administration and other costs associated with delivering renewal works and is set by the HS1 and NR(HS) contractual framework.

2.97 In the draft conclusions document, DfT said that it may review in future control periods the appropriateness of the level of this mark-up, given similar charges levied - particularly in relation to ORR's PR14 route review. Further comments on the management fee are set out below.

On-costs

2.98 EC Harris queried how the figures for on-costs had been derived and whether they were based on historical data or another source.

2.99 HS1 responded that it supplemented the notes provided in the summary slides accompanying the LCRs with discussions with TOCs which went through the purpose and derivation of the amounts on a line-by-line basis. HS1 Ltd. has taken some historical experience into account where this exists, but acknowledges that such historical information is inherently limited due to insufficient time having elapsed to undertake a lot of the projects.

2.100 HS1 Ltd. added that the on-costs emerged from significant debate between professional experts and reliance on accepted industry standards and practices. These numbers have evolved over time, with the 'asset stewardship' (the approach set out in the final LCRs) on-cost assumptions being lower than the original baseline on-cost assumptions. HS1 Ltd. has also committed to TOCs that it will track actual on-costs over time as experience with relevant projects increases, using the asset management system which HS1 Ltd. has under development and use this to revisit and update the assumptions used for future control periods. HS1 Ltd. also set out the checks which it had undertaken:

- Many line-by-line reviews of the models – including on-costs and all other assumptions – carried out internally. This has involved applying the changes to the on-costs (e.g. the move from the baseline model to the asset stewardship approach) and ensuring that the changes drive consistent results in the LTC calculated.
- Line-by-line reviews and self-audit by HS1 Ltd.'s modelling consultant, including varying lines in specific ways to check that the changes to the end results match the expected model calculation.
- An audit by AECOM designed to test whether the model processes information in the manner it is designed to do (as opposed to whether the assumptions themselves are correct). This did not involve a review of every single cell in the model but HS1 Ltd. applied a standard audit methodology to spot-check key assumptions.

Cost rate of interventions

2.101 EC Harris questioned why some elements in the LCC models received similar interventions, but at a different cost rate (e.g. the cost of ironmongery for fire doors varied significantly across interventions). The specific areas are highlighted in the EC Harris draft report accompanying this consultation document.

2.102 HS1 Ltd. has stated that the underlying cause of this is the model structure which has formed the basis of the review. HS1 Ltd. has acknowledged that the asset categories could have been clearer and as a result has used its own detailed knowledge of the assets to vary the costs, given the inability to vary the asset categories.

2.103 As HS1 Ltd. continues to improve its asset management systems and identify the best asset hierarchy, it has undertaken to make the necessary modifications so that it is clearer which assets the line items in the models refer to.

2.104 HS1 Ltd. has spent considerable time during the review process identifying and tracking the source of movements between the initial model and the asset stewardship proposals and will endeavour to do so over time. HS1 Ltd. has pointed out that the more fundamental the changes to the model (e.g. in the categorisation of assets and changes to line items), the more difficult it will be to track the sources of changes in the future.

2.105 DfT notes the response from HS1 Ltd. Of critical importance to DfT is the ability to reconcile an escrow withdrawal request from HS1 Ltd. - which may take place several years in the future - with a specific line item in the approved LCRs. It is not clear that the current ambiguity in the way items are expressed would allow DfT to do this in the case of some future renewals works. In the worst case, this may delay or prevent the release of funds to HS1 Ltd. until it can be determined that the withdrawal is being sought in line with the approved LCR.

2.106 As such, DfT agreed with HS1 Ltd. that the approved model must include further explanation of similar LTC interventions for CP2 only. Whilst HS1 Ltd. has provided further information on the specific line items, for the most part these appear to function as a restatement of the information which was originally available, rather than allowing any further differentiation between line items. DfT notes that similar interventions for CP3 onwards are likely to be addressed as part of HS1 Ltd.'s ongoing establishment of an overarching asset management system. Further comments can be found in the EC Harris addendum report accompanying this document.

Consultee comments and DfT response

2.107 Consultees were invited to provide comments on the 'costs and fees' section of the consultation document.

2.108 At the stakeholder workshop, EIL questioned the level of on-costs and the ability of TOCs to influence the costs, scope and delivery of a project, which was of key interest to TOCs, particularly given that HS1 Ltd.'s contract with Network Rail does not expire until 2086.

2.109 HS1 Ltd. has committed to using its new asset management system to more closely track the way in which projects are undertaken. Regular lessons learned reviews and the efficiency overlay which HS1 Ltd. has applied in CP2 will assist HS1 Ltd. in achieving further efficiencies in project costs.

2.110 EIL noted that the management fee was out of line with that agreed in the PR14 process and questioned where the incentives for efficiency lay. EIL noted that the contract with NR(HS) represents a significant proportion of costs and has questioned what HS1 Ltd. might commit to in terms of efficiency and benchmarking. EIL has suggested that this decision document could provide support for this commitment, keep the situation under review and confirm a lowering in the LTC settlement.

2.111 DfT agrees that HS1 Ltd. should set out its proposed approach to ensuring that its contract with NR(HS) represents an efficient price and how future efficiencies within that contract (particularly given its value and duration) will be explored. DfT agrees that benchmarking of the contract may represent one way in which consideration could be given to this issue and suggests that the extensive benchmarking programme which HS1 Ltd. has committed to as a result of PR14 could be extended to include this contract, without the need for a market test. Without any underpinning analysis of potential efficiencies at this time, DfT is not able to reduce the annuity which TOCs are required to pay in CP2.

2.112 **DfT conclusion**: DfT is content with the expression of the costs and fees incurred by HS1 Ltd., and their treatment with the LCR financial models. HS1 Ltd., however, is expected to:

- keep its overall project costs under review, in particular the level of on-costs and to ensure that TOCs have the opportunity to work in collaboration with and challenge HS1 Ltd. on the scope and delivery of future major projects.
- to produce more specific reference for CP2 line items, if possible, cross-referred to a station plan or plans, so that it can be definitively determined which line items relate to which station assets.
- to assist in the determination of CP3, produce LCR models which allow those using them to draw sufficient distinction between different (but similar) line items and cost interventions.
- set out and explore opportunities for efficiencies within the NR(HS) contract, which should include benchmarking of that contract.

Funding

Escrow funding profile

2.113 Modelled profiles for escrow account funding have been produced well beyond the end of the current concession in 2040. The funding profiles suggest that, in years with significant planned renewals expenditure at any given station, the expenditure is funded through an extreme ramp up, with - broadly speaking - 30% of the required funding sought the year before the expenditure, 40% sought the year of the expenditure and the remaining 30% sought the year after the expenditure has occurred.

2.114 DfT notes that this 'lumpy' approach is significantly different to the flatter, smoother funding profile approved by the ORR in its PR14 determination. DfT believes that sudden ramp-ups may cause difficulty for users of the network in terms of having adequate funding in place, and may represent uncertainty for TOCs.

2.115 HS1 Ltd. has said that it will commit to further smoothing of the escrow funding profile over the life of the concession. HS1 Ltd. recognises that the current approach is simplistic and does not provide a great deal of accuracy. HS1 Ltd. acknowledges that further work is required in this area, but the initial focus is on maintaining a detailed picture of projects for any five years in advance of its taking place and, more generally, thinking about different asset categories and determining more accurately how projects will be phased.

2.116 DfT welcomes HS1 Ltd.'s commitment to a more smoothed funding profile to provide greater certainty of required contributions and to reach a 'steady state' earlier on in the concession period. DfT will expect HS1 Ltd. to provide a much smoother funding profile as part of its Control Period 3 ("CP3") LCR submission.

2.117 EC Harris questioned what the closing balance for the escrow accounts should be for the end of year 4 (31 March 2014) in CP1 when calculating the LTC annuity. EC Harris' calculations, shown below, appeared to demonstrate a slight shortfall in achieving the required contributions (even when current Authorised Investments and their returns were taken into account).

Table 2.5

	Annuity (based on forecast escrow balance as at 31 March 2014) (real, 2013/14 prices, £000s)	Annuity (based on actual escrow balance as at 31 March 2014) (real, 2013/14 prices, £000s)	Difference between actual annuity and forecast annuity (£000s)
Stratford	650.8	652.5	-1.7
St Pancras	3,811.9	3,827.1	-15.1
Ebbsfleet	685.5	687.5	-2.0
Ashford	679.1	671.9	7.2
Total	**-**	**-**	**-11.6**

2.118 HS1 Ltd. said that this is due to the fact that it collects LTC payments in arrears. The balances as at 31 March 2014 would not reflect the period 13 payment which, whilst due, would not have been paid into the escrow accounts at the time the calculation was made. The forecast figures have accrued for this payment, even though it had not been received.

2.119 EC Harris queried how the costs in the final year of CP1 (1 April 2014-31 March 2015) were calculated, given that there appeared to be a different approach adopted for that year, in comparison to the methodology used for CP2.

2.120 HS1 Ltd. responded that the process for determining spend in any given year remains the same and that the budget and forecast is derived from the preceding periodic review assumptions and updated year-on-year through the annual statements and the emerging view of spend. For the remainder of CP1, HS1 Ltd. has used its current knowledge of what work is required and scheduled in this time period. HS1 Ltd. also noted that the comparison with the forecast and budget is made considerably more complex by the change to the SACs during CP1 and the consequent reallocation of certain works from LTC to QX.

2.121 HS1 Ltd. added that the works forecast to be undertaken in the last year of CP1 have been taken from the budgets developed by NR(HS) and HS1 Ltd. Those budgets reflect the most recent knowledge of works to be undertaken and incorporate any understanding about the actual costs where available.

Movements from LTC to QX

2.122 As the review process has moved forward and following engagement with stakeholders, HS1 Ltd. has moved a number of line items from LTC into QX.

2.123 We note representations from operators in response to HS1 Ltd.'s consultation on the LCRs. In particular, we note EIL's request that HS1 Ltd. conduct QX reviews with its users on a five-yearly basis, in order to give TOCs more certainty over when and how much QX expenditure will be incurred. The current time horizon for QX is one year.

2.124 HS1 Ltd. has committed to working with NR(HS) to provide a five-year forecast of QX which will offer greater certainty.

2.125 DfT is grateful for confirmation that HS1 Ltd. will commit to five-yearly reviews of QX and welcomes the increased certainty that this will bring to TOCs.

CIS and CCTV

2.126 TOCs which responded to HS1 Ltd.'s LCR consultation commented on the appropriateness of CIS and CCTV renewal being carried out at 20 year intervals, a frequency which might lead to obsolescence of the equipment.

2.127 As a result, HS1 Ltd. agreed to reduce the frequency of CIS and CCTV renewal to 10 years. EC Harris commented that the updated LTC proposals did not appear to reflect the impact of this change in renewal cycles, suggesting a clear comparison between various versions of the LTC models take place to track the updated funding requirements.

2.128 Whilst EC Harris has been unable to make a direct comparison between the final version of the LCRs and the January 2014 model, EC Harris has conducted a line check of the available models and has confirmed its satisfaction with the approach adopted.

Environment and energy initiatives

2.129 In its response to HS1 Ltd.'s LCR consultation, LSER asked for a commitment to carbon reduction and increased energy efficiency. EC Harris also asked for clarification on how (if at all) energy and environment initiatives were reflected in the LCC calculations.

2.130 HS1 Ltd. replied that, as part of its 'line of sight' initiatives being undertaken as a result of PR14, it has committed to reviewing opportunities for energy efficiency and carbon reduction. HS1 Ltd. is also currently undertaking a feasibility study on regenerative braking.

2.131 HS1 Ltd. has also noted that its proposals are consistent with the requirements of its environment policy. HS1 Ltd. has not applied any speculative overlays for future changes, but the relevant line items in the LCRs reflect all known current and future initiatives.

LTC contributions from other sources

2.132 In its response to HS1 Ltd.'s consultation on the LCRs, LSER commented that contributions should be made to the upkeep from all those that benefit from use of the station, including retailers, TOCs with diversionary access and those who use that part of the station which is managed by Network Rail Infrastructure Limited (St. Pancras Low Level).

2.133 EC Harris also noted that one of the 2012 versions of the AMS included contributions from retail, which were missing from future AMS' and the LCRs.

2.134 LSER also questioned whether HS1 Ltd. considered that there was any risk to TOCs, given that the renewal of the roof of the 'Thameslink box' at St. Pancras International station is outside the 45-year period under review as part of the CP2 process, but may be considered part of HS1 Ltd.'s LTC responsibilities.

2.135 Additionally, LSER asked for confirmation on the extent of the retail contribution to LTC at each station and how such contributions are calculated.

2.136 In response, HS1 Ltd. said that, in line with the contractual provisions inherited on the sale of the HS1 concession, retailers do not make a contribution to LTC; neither do diversionary operators or First Capital Connect Ltd. (which uses St. Pancras Low Level). HS1 Ltd. state that this would be difficult to implement for two reasons:

- There are no contractual provisions which would permit recovery of any such contributions.
- From a practicality point of view, LSER and EIL pay no contribution to Transport for London ("TfL") (even though many LSER/EIL passengers arrive or depart via London Underground services).

2.137 HS1 Ltd. has suggested, however, that these issues can be explored in the review of LTC allocation principles, in advance of the next stations periodic review.

2.138 HS1 Ltd. further explained that the table in the 2012 AMS relating to retail contributions was left over from the pre-sale structure of a previous financial model which assumed that there would be both a retail contribution and a 7.5% deduction payable to HS1 for 'reasonable costs'. These elements were not reflected in the contractual framework so were not reported in this way after the 2012 AMS. HS1 Ltd. acknowledges that the AMS should not have reported retail contributions in 2012 that only appeared due to use of the pre-sale model template.

2.139 Regarding the renewal of the Thameslink box, HS1 Ltd. suggested that these were best addressed as part of the asset condition handback issues and the study underway with DfT and EC Harris. HS1 Ltd. also noted that any move to a rolling 40-year outlook (as discussed in this document) may address some of the issue in any event.

2.140 DfT agrees that it is currently impractical to levy charges on diversionary users, St. Pancras Low Level users and TfL and that doing so is not an expectation which the department has of HS1 Ltd..

2.141 DfT notes the point on the Thameslink box renewal and agrees that this issue is likely to be resolved by a move to a rolling horizon approach, as discussed elsewhere in this document.

Enhancements

2.142 LSER questioned how station enhancements would be dealt with in CP2, should they be required.

2.143 HS1 Ltd. has already highlighted that the SACs, as currently drafted, do not provide for 'enhancements' and has recommended that this be addressed before the start of the CP3 review.

2.144 DfT agrees that this issue needs to be resolved during CP2. Provision for enhancements will become particularly important as demand increases and technology on all fronts improves. DfT notes that there are no enhancements planned for CP2 and expects that HS1 Ltd. takes forward this work early in CP2.

Consultee comments and DfT response

2.145 Consultees were asked to provide comments on the 'funding' section of the consultation document.

2.146 At the stakeholder workshop, the issue of retailer contributions to LTC was raised. Whilst it was noted that the Concession Agreement or HS1 Station Leases do not provide for HS1 Ltd. to recover LTC contributions from retailers at its stations, they do not prohibit such recovery either. Retailers do, however, make QX contributions to the station upkeep. EIL and LSER reiterated their view that retailers (as well as other users of stations, in the case of the LSER response) should make contributions to the LTC. EIL noted that this was in line with the TOC experience of current users making contributions to future expenditure.

2.147 EIL noted that retail leases come up for review on a regular basis, and would welcome a commitment to introduce an LTC contribution to future new leases. EIL also proposed that this decision document should make allowance for progressively increasing retailer contributions in CP2.

2.148 Given that retailers benefit from the renewal and replacement of station elements and equipment, it does not seem unreasonable to DfT that consideration be given by HS1 Ltd. to determining an appropriate level of retailer contribution to the LTC. DfT agrees that lease breaks would present a suitable opportunity to insert provision for any such contribution. There may, however, be valid reasons, not evident now, why retailers cannot be compelled to make contributions to the LTC, it would be inappropriate for DfT to require the LTC annuity figure for CP2 to anticipate retail contributions which it may not be possible to levy. DfT will expect to see the product of HS1 Ltd.'s work on this issue, including a robust explanation for any proposal not to levy retail contributions.

2.149 EMT asked HS1 Ltd. to provide information on the financial implications of transferring items from LTC to QX in respect of St Pancras International. HS1 Ltd. has provided these figures to TOCs.

2.150 LSER also noted that the issue of the 'Thameslink box' may be resolved by a move to a 40-year rolling horizon approach.

2.151 EIL suggested that the 10-year timescales for the replacement of CIS and CCTV equipment could be increased, and that this assumption should be tested as part of the CP3 review.

2.152 The frequency of interventions is largely a commercial negotiation between HS1 Ltd. and its users. DfT has no objection to amending the frequency of an intervention, if it better reflects the needs of TOCs (and their customers) and HS1 Ltd., and if the revised frequency remains consistent with the Life Cycle Purpose.

2.153 **DfT conclusion**: DfT is content with the approach adopted in respect of the funding of the escrow accounts for CP2 and the annuity which this represents for TOCs. DfT expects:

- HS1 Ltd. to develop a smoother funding profile for the four station escrow accounts in advance of the CP3 review.
- HS1 Ltd. to introduce five-yearly (rather than the current annual) reviews of the QX figure charged to TOCs.
- HS1 Ltd. to explore retail contributions to the LTC figure, given that retailers benefit from renewal and replacement work carried out at the four HS1 network stations, and to present its findings to DfT.

Modelling and efficiency

Underlying assumptions

2.154 In response to HS1 Ltd.'s consultation on the LCRs, EIL stated that there was scope to consider the assumptions that underpin the LTC model cost estimates. EIL has speculated that the underlying assumptions in the LTC model are too conservative and has suggested that a review of the assumptions which underpin the LTC estimates be carried out, to ensure that they are both realistic and efficient.

2.155 HS1 Ltd. held a number of meetings with TOCs to discuss detailed assumptions and the working of the model following the publication of its January 2014 consultation. Key areas of challenge included the on-costs, and the efficiency overlay assumption to be applied. In response, HS1 Ltd. has set challenging efficiency targets. HS1 Ltd. has undertaken to continuously review and improve the model assumptions as part of the ongoing development of the modelling approach, and to continue to engage stakeholders in this process

2.156 EC Harris also questioned the rationale for HS1 Ltd.'s flat rate assumption of 2.75% for inflation.

2.157 HS1 Ltd. has used an annual Retail Prices Index ("RPI") assumption of 2.75% within the forecasts. This assumption is based on triangulation from a variety of external forecasts and is consistent with the RPI assumption that HS1 Ltd. has used within the PR14 process, and which has been approved by ORR as part of that process.

2.158 As the modelling is based on a 45 year forecast, HS1 Ltd. noted that a small variation in actual RPI does not materially alter the proposed annuity. Whilst the actual RPI will likely be different to that forecast during CP2, any variation will be reflected in the charges collected from TOCs and the allowance spent on renewals in nominal terms.

2.159 HS1 Ltd. further noted that there will be the opportunity to reset RPI assumptions in 2020 if there is a fundamental shift in the forecast long term view of RPI in the future, away from the consensus range currently used. This will also impact on the nominal interest rate and cost of capital assumptions used.

Variance analysis

2.160 HS1 Ltd. was asked to provide information on the variance analysis carried out as part of the production of the LCR around differences between the forecast amounts and the actual out-turn values (in terms of the acceleration, deferral and omission of renewals).

2.161 HS1 Ltd. responded that variance analysis in CP1 is complicated by:

- the lack of granularity and clarity in the financial models established prior to sale of HS1 Ltd., which form the basis of the current LTC charges; and
- a change in the SACs involving reallocation of some works from LTC to QX, meaning that the original plans used to calculate the current LTC to operators is no longer appropriate as a baseline, even though the HS1 Station Leases requirements set it as such. There is no category within the variance analysis envisaged by the HS1 Station Leases that caters for this change.

2.162 HS1 Ltd. added that it had shown in the LCRs the forecast and actual spend in CP1, as well as a forecast of spend in the final year of CP1 (along with identifying some of the underlying causes).

2.163 HS1 Ltd. said that recent works - such as carpet replacement at Ashford station - have been on-budget or cheaper. There have been other instances of planned interventions not taking place; either because of the impact of the changes to the SACs, or because HS1 Ltd.'s understanding of the asset management approach has improved.

2.164 HS1 Ltd. noted that all of the works have been undertaken so as to comply with its obligations and the Life Cycle Purpose. Any deferrals / permanent omissions have been assessed to not compromise the performance of the station assets, and this can be seen from the operational data and availability.

2.165 Given the circumstances of CP1 and the fundamental review of the financial models and approach, HS1 Ltd. is not seeking a share of the Life Cycle Works savings. Further, the share to which HS1 Ltd. is eligible will be reviewed as part of ongoing discussions around the treatment of the escrow account, including allocation of risk. This work is currently being undertaken in conjunction with DfT, ORR and TOCs.

2.166 HS1 Ltd. considers that the CP2 proposals are a firm basis for variance analysis in the future. By the start of CP2, HS1 Ltd. has undertaken to have the methodology and processes in place to complete this analysis. This will involve:

- producing a methodology paper setting out the definitions of variance categories and how these would be calculated. This work would be undertaken with full consultation and agreed with DfT. HS1 Ltd. notes that the extensive experience from NRIL and other sectors where such analysis is undertaken would allow the development of general principles as well as some worked examples to provide more detailed guidance in future application. HS1 Ltd. has undertaken to complete this work by November 2014.
- developing a tool to implement the process, to be completed by the end of February2015. Part of this stage would involve:
  - establishing the governance arrangements and processes and how information is populated in the tool. HS1 Ltd. notes that this is particularly important given the sub-contracting of station operations and works; and
  - linkages to the asset management systems being developed by HS1 Ltd.
- reporting and analysis embedded into business as usual, including being captured within the standard templates for DfT sign-off of the release of escrow funds, and within the quarterly reports which HS1 Ltd. will provide to supplement the AMAS. These reports will provide a look-ahead and flag any possible changes to the forecast budget. This work will take place from April 2015 onwards.

2.167 HS1 Ltd. is of the view that it has fully met the purpose of the provisions, given that:

- Only efficient expenditure has been proposed and approved within CP1. This has been verified via the audit of the starting escrow balances, and the establishment of ongoing processes for DfT approval of escrow withdrawals. HS1 Ltd. is of the view that it has demonstrated efficient procurement practices commensurate with the specific nature of the projects being undertaken.
- HS1 Ltd. has confirmed that it is not seeking any share of Life Cycle Works Savings.
- HS1 Ltd. believes that it continues to meet the asset stewardship obligations and Life Cycle Purpose as required by the HS1 Station Leases.

2.168 HS1 Ltd. has undertaken to continue improving the quality of its variance analysis in the future (and indeed, must do so, given its obligations in respect of the HS1 Station Leases). Further information on this matter is available in the EC Harris addendum report accompanying this document.

Efficiency overlay

2.169 Following engagement with TOCs, HS1 Ltd. has introduced into its models an efficiency overlay of 0.6%, applied year-on-year to the unit costs across all asset categories and modelled over the duration of the concession. EIL and LSER have noted the introduction of this overlay in their responses to HS1 Ltd.'s consultation. HS1 Ltd. acknowledges that this will be a challenging target to hit.

2.170 DfT agrees, and has asked HS1 Ltd. to be as mindful as it can be of unforeseen factors which may jeopardise its ability to hit this target (such as a sudden increase in prices).

2.171 HS1 Ltd. acknowledges that this will be a challenging target, and that there is a tension between trying to forecast an uncertain future whilst locking away the 'right' amount of money for future asset requirements.

2.172 Whilst this target will no doubt be challenging; not least because of the inherent difficulties in making such long-term forecasts, DfT would remind consultees that the efficiency overlay can be reviewed on a five-yearly basis (or an interim basis) and may be revised depending on the information available and to take account of changing circumstances. DfT would also note that application of an efficiency overlay, whilst a question of good practice, is not a contractual obligation. DfT expects HS1 Ltd. to act responsibly in terms of setting stretching but achievable goals.

Approach to modelling

2.173 HS1 Ltd.'s model for CP2 employs a primarily time-based approach. Given the age of the assets (with the exception of the slightly older Ashford International station) we agree that this is a sensible approach.

2.174 DfT has asked HS1 Ltd. to explain its plans for the longer term; in particular, any plans to move to a condition-based and, even later, a risk-based, approach to its modelling for future control periods.

2.175 DfT has noted HS1 Ltd.'s response to this in paragraph 3.16 of this document.

Consultee comments and DfT response

2.176 Consultees were asked to provide comments on the 'modelling and efficiency' section of the consultation document, and on the EC Harris report accompanying the consultation document.

2.177 At the stakeholder workshop and in its written response, EIL reiterated its point regarding the underlying assumptions used, specifically in terms of how the cost rate of interventions had changed in some instances where an intervention had moved from LTC to QX. HS1 Ltd. was asked to verify that there were no underlying assumptions used in the modelling work which were no longer valid as they were too conservative.

2.178 HS1 Ltd. has expressed confidence that its work on the creation of a new overarching asset management system will correct any erroneous underlying assumptions which may exist. DfT acknowledges the impact that such a new system, functioning as expected, would have and recognises the number of checks and audits which have been undertaken on the model used for the CP2 review.

2.179 DfT expects HS1 Ltd. to ensure consistency of cost rates across interventions, whether QX or LTC, unless HS1 Ltd. is able to adequately demonstrate why this should not be the case. DfT awaits with interest the results of HS1 Ltd.'s revised asset management system and considers that such a system is one of the many ways in which HS1 Ltd. may be able to introduce further efficiency into its costs.

2.180 EIL welcomed the introduction of the efficiency overlay, and suggested that any proposed removal or reduction of the efficiency overlay should be fully justified to DfT and stakeholders.

2.181 DfT agrees that, whilst the efficiency overlay is not a contractual requirement, HS1 Ltd. should be able to justify why it wishes to change or remove the overlay, should such a situation arise in future. Where possible, however, such a conversation should form part of an ongoing periodic review, rather than occurring as a separate negotiation outside of the periodic review process.

2.182 **DfT conclusion**: DfT is content with the modelling which HS1 Ltd. and its consultants have undertaken, and with the efficiency overlay which has been applied for CP2. DfT expects that:

- HS1 Ltd. meets its obligations in respect of variance analysis and will ensure that this is the case in the course of CP2.
- HS1 Ltd. provides robust reasoning for any changes to the efficiency overlay which it wishes to make.
- HS1 Ltd. can demonstrate consistency across QX and LTC interventions (or reasons why consistency is not possible).

3. Implementation of the CP2 review and beyond

3.1 This chapter sets out the next steps to close out the CP2 review and to give effect to this decision document. It also sets out longer term next steps, including how DfT's decision will be monitored in CP2.

Next steps for the CP2 review

Implementation

3.2 Paragraph 5.13 of Schedule 10 of the HS1 Station Leases states that "subject to any modifications pursuant to paragraph 8[6], the Tenant[7] shall implement the Life Cycle Report as approved or determined". This essentially formally applies the charges contained within the LCRs.

3.3 Corresponding clauses in the SACs provide for the formal implementation of the review to take place. Condition 105.3.5 of the SACs states that "Where the Life Cycle Report for the Station, including any modifications to the Long Term Charge proposed by the Station Facility Owner[8] and notified to the Users[9] in accordance with Condition 105.3.2, has been approved by the Government's Representative or otherwise determined in accordance with the LTC Schedule at least 30 Business Days prior to the commencement of the relevant Review Period[10]…the Station Facility Owner shall no later than 10 Business Days from the date of such approval or determination give written notice to each User (a "**Review Notice**"):

- specifying the Long Term Charge…for the first Relevant Year in the next Review Period; and
- providing any additional supporting information as the User may reasonably require in a form and to an amount of detail which is sufficient to make a proper assessment of the effect of the modification(s) to the Long Term Charge."

3.4 Condition 105.3.2 provides for HS1 Ltd. to consult on its LCRs. The LTC Schedule is that as set out in Schedule 10 of the HS1 Station Leases. The Relevant Year is the first year of CP2, i.e. 1 April 2015-31 March 2016. A User is a passenger operator or non-passenger operator.

[6] (which concern interim reviews)
[7] i.e. HS1 Ltd
[8] i.e. HS1 Ltd
[9] i.e. TOCs
[10] i.e. Control Period

3.5 Following approval or determination of the final LCRs, HS1 Ltd. is required to produce the Review Notices, ensuring that they are consistent with the requirements of the SACs and that they are served on Users within the prescribed timescales. Under the Conditions of the SACs, these notices must be produced by HS1 Ltd. by close on 12 September 2014 (i.e. within ten business days of the publication of this document).

3.6 HS1 Ltd. will also need to work with Users who are party to a station access agreement ("SAA") in order to agree an amendment to the SAA reflecting the revised LTC figure for CP2 and ensure that these are in place before the start of the next control period.

Post project 'lessons learned' review

3.7 The CP2 stations review has been the first such periodic review of HS1 Ltd.'s stations. As such and because it is a matter of best practice, DfT will undertake a post project review of the CP2 stations review process.

3.8 We expect that all aspects of the CP2 stations review will be open to consideration and do not intend to limit the scope of the review to the role of DfT.

3.9 As organisations which have been involved for the duration of the review, the feedback we receive from stakeholders will be critical in ensuring that any lessons are learned and improvements made, to be carried forward in future stations periodic reviews. As such, stakeholder contributions will be most welcome. We will write with further details about this review at a later date.

Beyond the CP2 review process

Monitoring the decision in CP2 and beyond

3.10 The review process does not stop with the issue of a final decision. DfT will monitor HS1 Ltd.'s progress against the agreed LCRs throughout CP2 to ensure that agreed outputs are being met within the agreed cost envelope.

3.11 Monitoring of expenditure will also take place through the escrow withdrawal procedures set out in the Concession Agreement and HS1 Station Leases. DfT is conscious that the frequency of required escrow account drawdowns will increase, and we are working with HS1 Ltd. to ensure that a robust process is in place to allow the drawdown to take place smoothly and in good time, refining the process as it is used and opportunities for efficiencies become apparent.

3.12 DfT is also reviewing the criteria under which HS1 Ltd. may make Authorised Investments using the funds in the escrow accounts, to increase the return on these accounts and to reduce as a result the funding required from TOCs. HS1 Ltd. is undertaking its own discussions with TOCs regarding the risk and liability for underfunding of the escrow accounts with a view to establishing a form of joint investment board to consider how best to invest escrow funds within the permitted framework.

3.13 Escrow withdrawal requests will, of course, be subject to comparison with the contents of the final LCRs and AMAS submitted by HS1 Ltd., and DfT would expect the proposed drawdown to reconcile with these agreed documents.

3.14 DfT also retains a right of audit over the escrow accounts, and we expect to use the audit tools available to monitor delivery over CP2.

3.15 DfT welcomes any approach from interested parties in this regard, provided that these have been discussed with HS1 Ltd. in the first instance.

3.16 Beyond CP2, we acknowledge HS1 Ltd.'s commitment to moving from a time-based approach to its asset management, towards a condition-based and, even later in the concession period, a risk-based approach. DfT looks forward to working with HS1 Ltd. for what will no doubt be a challenging but necessary change in approach to asset monitoring as the HS1 network assets continue to age. DfT further welcomes HS1 Ltd.'s forthcoming introduction of a new asset management system which will look at, amongst other things, asset criticality (which will feed into future whole life cost modelling).

Asset baseline condition workstream

3.17 As part of the handback process prior to the end of the current concession in 2040, it will be important for DfT and HS1 Ltd. to have a shared understanding of the asset condition at stations from this point forward, as well as an agreed metric against which to measure asset condition. HS1 Ltd. and DfT will also need to agree a handback condition for specific assets against this metric, to ensure that the HS1 stations are in an appropriate condition to achieve the Life Cycle Purpose beyond the end of the current concession.

3.18 DfT, assisted by technical advisers EC Harris, is working with HS1 Ltd. to agree metrics and asset condition against these metrics, well before the end of the concession to facilitate a 'no surprises' approach. This work will no doubt influence the required LTC in the long term, in terms of ensuring that there are sufficient funds being deposited in the station escrow accounts to meet the agreed handback condition. As customers and stakeholders, your views on this piece of work will be important and we will look to involve you in it as the work progresses.

3.19 Whilst this piece of work sits outside the overall CP2 process as set out in the HS1 Station Leases and HS1 Station Access Conditions, DfT and HS1 Ltd. are working towards having an asset baseline condition and handback condition agreed before the start of CP2, which will remain in effect until the end of the concession in 2040.

Interim review of the compliance matrix

3.20 As previously discussed, HS1 Ltd. has made an undertaking to be compliant with all of its obligations in respect of a stations periodic review by April 2015. DfT intends to conduct a mid-control period audit of the compliance matrix within CP2, to determine whether HS1 Ltd. is compliant - or moving towards compliance - with these obligations (including that it remains compliant with those obligations which are currently compliant).

3.21 As in many cases, the obligation is locked into the content of the LCRs, which will not change during a control period, DfT does not anticipate many currently compliant options becoming non- or partially compliant; however, DfT believes that there is merit in undertaking a thorough review of progress against these agreed actions.

HS1 Ltd. initiatives

3.22 In its final submission, HS1 Ltd. has undertaken to carry out a number of initiatives in CP2 and beyond. These comprise securing benchmarking partners and developing benchmarking activities in advance of CP3; an asset handback condition metric (as covered previously in this document) and enhancing the asset management capability.

3.23 DfT will be working with HS1 Ltd. and its partners to ensure delivery of these initiatives and will be monitoring delivery of this work against the timescales set out in HS1 Ltd.'s final CP2 submission. As it has done in respect of the PR14 process, DfT expects HS1 to produce and maintain a register of the obligations it has committed to during the CP2 stations review process. These obligations will, in part, be monitored thought the six-monthly 'line of sight' meetings which HS1 Ltd. has already established (and which are already taking place) with TOCs.

3.24 Interested parties should contact HS1 Ltd. for further information on these initiatives in the first instance.

Annex A

A.1 This annex contains the provisions of the HS1 Station Leases relevant to a stations periodic review.

A.2 This extract (paragraph 5.2 of Schedule 10 of the HS1 Station Leases) sets out what the Life Cycle Report for each station must contain:

"5.2 Each Life Cycle Report shall, in respect of each Station, include:

Works undertaken and costs incurred

5.2.1 a summary of the following in respect of the current Review Period:

(a) the Life Cycle Works carried out by the Tenant (or that it is anticipated will have been carried out by the end of the current Review Period);

(b) the Available Life Cycle Funds at the end of each Financial Year (or the anticipated Available Life Cycle Funds by the end of the last Financial Year in the current Review Period);

(c) the Life Cycle Works Cost (or anticipated Life Cycle Works Cost by the end of the current Review Period);

(d) the Deferred Life Cycle Works Savings (if any) approved in previous Life Cycle Reports;

(e) the Life Cycle Works Savings (if any) brought forward from previous Review Periods;

(f) the effect of any Relevant Changes of Law that have occurred during the Review Period;

(g) an analysis of breakdown frequencies and the performance of the Elements of the Station which were identified in the Asset Management Strategy as being monitored by the Tenant;

(h) the renewals and replacements (if any) undertaken by the Station Operator in order that it discharged its Safety Obligations in respect of the Station but which were not identified in the current Life Cycle Report (“Station Safety Works”);

5.2.2 in respect of the current Review Period a progress report, comparison and reconciliation by reference to the Life Cycle Report approved for the current Review Period of:

(a) the Life Cycle Works actually completed to date against those anticipated giving the reasons for any differences;

(b) the Life Cycle Works Cost incurred to date against those anticipated giving the reasons for any differences;

(c) the Life Cycle Works Savings achieved to date against those anticipated;

5.2.3 a summary of the following up to the end of the previous Review Period for each Element of the Station of:

(a) the aggregate amount of the Life Cycle Works Cost;

(b) the aggregate amount of the Deferred Life Cycle Works Savings (if any); and

(c) the aggregate amount of the Life Cycle Works Savings (if any);

Forecast Life Cycle Works

5.2.4 in respect of the next Review Period:

(a) the Tenant's detailed proposals for the carrying out of the Forecast Life Cycle Works including any notices consents and approvals required in order to carry out and complete them;

(b) the Forecast Life Cycle Works Cost;

(c) the effect of any Relevant Changes of Law that will occur during the Review Period;

(d) the forecast amount of Available Life Cycle Funds at the end of each Financial Year;

5.2.5 in respect of the remainder of the Life Cycle Period a summary of any changes to:

(a) the Forecast Life Cycle Works to be undertaken in each subsequent Review Period and Overhang Period in respect of each Element of the Station;

(b) the Forecast Life Cycle Works Cost in each subsequent Review Period and Overhang Period in respect of each Element of the Station; and

(c) a forecast of the amount of Available Life Cycle Funds for each subsequent Review Period and Overhang Period;

Deferrals

5.2.6 the Tenant's proposals (if any) for:

(a) the deferral to any later Review Period or Overhang Period or the permanent omission of any Life Cycle Works that are identified in the Asset Management Strategy as being required in the Review Periods and/or Overhang Periods following the Review Period in which the Life Cycle Report is produced; and/or

(b) the distribution of any Deferred Life Cycle Works Saving pursuant to paragraph 7.1; which shall include:

(c) in respect of a proposal in relation to a proposed deferral or permanent omission:

(i) confirmation by the Tenant that the proposed deferral or permanent omission will not result in the Tenant being unable to comply with its obligation under Clause 4.3.1 and 4.14 or the Life Cycle Purpose to be achieved; and

(ii) a report setting out the likely effect on performance arising out of or in connection with the proposed deferral or permanent omission;

(d) the forecast Deferred Life Cycle Works Saving arising from paragraph 5.2.6(a); and/or

(e) the forecast reduction in the Long Term Charge, the LTC and the Tenant's Share arising from paragraph 5.2.6(b);

The Government Representative may reject the Life Cycle Reports on the grounds set out in paragraph 5.4 of Schedule 10 of the HS1 Station Leases. These are as follows:

5.4.1 further details or information should be included in the Report or provided in support of the Tenant's proposals;

5.4.2 if the report is implemented, it will not permit the Tenant to comply with its obligations under clauses 4.3.1 and 4.14 or the Life Cycle Purpose to be achieved;

5.4.3 the Tenant's proposals regarding the deferral or permanent omission of any Life Cycle Works do not accurately reflect the condition of the Station or the remaining useful life of the Element of the Station;

5.4.4 the Forecast Life Cycle Works Cost for the next Review Period exceeds such amount as a prudent land owner responsible for the structural integrity and maintenance of the Station behaving with due efficiency and economy, may incur in carrying out the Forecast Life Cycle Works in the next Review Period provided that where the Tenant has subcontracted its obligations in respect of renewal and replacement of the Station to the Station Operator, the Tenant shall be deemed to have acted as a prudent land owner responsible for the structural integrity and maintenance of the Station behaving with due efficiency and economy where it has used reasonable endeavours to manage the Station Operator;

5.4.5 a Deferred Life Cycle Works Saving that the Tenant proposes should be distributed may be required for the carrying out of any Life Cycle Works to any Element of the Station up to the earlier of (i) the expiry of two subsequent Review Periods and (ii) the expiry of the Term;

5.4.6 in relation to the distribution of any Life Cycle Works Saving proposed by the Tenant, the matters set out in paragraphs 7.3.1 or 7.3.2 apply;

5.4.7 a modification to the LTC proposed by the Tenant is not required or is not permitted by paragraph 5.7;

5.4.8 the Tenant's proposals for any modifications of the Asset Management Strategy (including the Life Cycle Budget) do not accurately reflect its proposals in respect of any of the matters set out in the Life Cycle Report to which the Government's Representative has not withheld its approval;

5.4.9 the Adjustment Arrangements which the Tenant has implemented and/or proposes to implement as a consequence of the Tenant having made an Adjustment to the Available Life Cycle Funds in the current Review Period (or anticipated to be made prior to the end of the current Review Period), do not sufficiently mitigate the likelihood that:

(a) the Life Cycle Budget will or is reasonably likely to be exceeded in respect of any Element of the Station;

(b) there will be a shortfall in Available Life Cycle Funds required for Life Cycle Works in respect of any Element of the Station in any Review Period or Overhang Period; or

(c) there is, or may with the passage of time, be an event or events that may give rise to an Event of Default.

Annex B

B.1 This annex contains a glossary of the terms used in this document.

AMAS - Asset Management Annual Statement

AMS - Asset Management Statement

Concession Agreement – The Concession Agreement for the design, construction, financing, operation, repair and maintenance of High Speed 1, between The Secretary of State for Transport and HS1 Ltd.

CP1 – HS1's Control Period 1 (October 2009 – 31 March 2015)

CP2 – HS1's Control Period 2 (1 April 2015 – 31 March 2020)

CP3 – HS1's Control Period 3 (1 April 2020 – 31 March 2025)

DfT – Department for Transport

EIL – Eurostar International Limited

EMT - East Midlands Trains Limited

FOIA - Freedom of Information Act 2010

the HS1 network – the physical HS1 infrastructure, including both route and stations

HS1 Ltd. – HS1 Limited

HS1 Station Leases - the lease document dated 30 September 2010 setting out the terms for the lease of the four HS1 network stations

IM – Infrastructure Manager

KCC - Kent County Council

LCC - Life Cycle Cost

LCR - Life Cycle Reports, as defined by Schedule 10, section 5 of the HS1 Station Leases

LTC - Long Term Charge (used to fund renewal and replacement work)

LSER – London & South Eastern Railway Limited

NR(HS) - Network Rail High Speed Limited

ORR – Office of Rail Regulation

QX - qualifying expenditure (used to fund operation and maintenance work)

PR14 – The 2014 Periodic Review of HS1 Ltd., conducted by ORR

RPI - Retail Price Index

SACs - the HS1 Station Access Conditions

SoS – The Secretary of State for Transport (for England and Wales)

TOC – Train Operating Company

WLCM - Whole Life Cost Model

Annex C

C.1 This annex contains the text of a letter sent to stakeholders on 1 April 2014.

1 April 2014

BY EMAIL ONLY

Dear colleagues,

HS1 CP2 stations review – next steps

I thought it would be helpful to write to you, setting out the timescales and process for the remainder of the Department for Transport's ("DfT") ongoing stations review for CP2.

The process takes account of the requirements of Schedule 10 of the HS1 Station Leases ("the lease"), and of the HS1 Station Access Conditions ("the SACs").

<u>HS1 Ltd. publication of station life cycle reports</u>

Clause 5.1 of Schedule 10 of the lease requires HS1 to submit the life cycle reports ("the reports") no later than nine months before the end of the current control period. In practice, this gives a date of 30 June 2014. However, given that HS1 Ltd. began work on the stations review much earlier than would have been necessary to meet these timescales, HS1 Ltd. is likely to be in a position to submit earlier than this date.

As a result, HS1 Ltd. has agreed to release the final reports to stakeholders on 7 April 2014. However, it is important to note that this would not constitute formal submission of the reports to DfT as, pursuant to clause 5.3 of Schedule 10 of the stations lease, DfT must reach a decision on the report within two months of its formal submission.

DfT wishes to conduct a consultation on its decision on the reports, and this early release of the reports to stakeholders allows this to take place within the timescales stipulated by the lease.

DfT will use the time between this early release of the reports and the backstop date for submission of the reports to produce a draft decision, which will then be consulted on upon submission of the final reports on the backstop date.

DfT consultation on station life cycle reports

Clause 5.8 of the lease states: “The Government’s Representative shall, in reviewing and approving any modification to the LTC for a Station, consult such person and to such extent as it shall consider appropriate”.

Further, Condition 105.3.4 of the SACs states: “The Government’s Representative shall, in reviewing and approving any modification to the Long Term Charge proposed by the Station Facility Owner, consult such persons and to such extent as the Government’s Representative shall consider appropriate”.

Whilst the interpretation of these clauses suggests that a consultation on the decision is optional, DfT believes that there is value in conducting a consultation. DfT expects to consult on its decision shortly after formal submission of the reports to us by HS1 Ltd. at the end of June 2014. Given the timescales set out in the lease, it would be difficult to perform a meaningful consultation without early sight of the reports, and the opportunity to produce a proposed decision on which to consult.

That said, the timescales will be necessarily short, and we have allowed for a consultation period of three weeks. We plan to hold a half-day stakeholder workshop on 14 July 2014, between 0900 and 1200 at Great Minster House to discuss the proposed decision. Should you wish to attend, please contact me using the details above. Should you wish to make a written representation in response to the consultation, the deadline for these responses will be 23 July 2014. Further details will be contained in the consultation document itself; the purpose of informing stakeholders now is to allow them to plan their resources accordingly.

Post-consultation and implementation

Following the receipt of any formal responses, DfT will consider these and, where appropriate, incorporate them into the final decision, to be published on or before 31 August 2014.

HS1 Ltd.’s reports have already been consulted on, and adjusted accordingly, taking into account comments received. DfT’s draft decision will be constructed based on the requirements set out in Schedule 10 of the lease, and based on the findings of HS1 Ltd.’s reports. Judgments based on the evidence presented by all parties throughout the process will already have been made and will form part of the decision. It is therefore likely that adjustments to DfT’s draft decision will only be made in the light of new evidence presented by stakeholders in response to the consultation.

DfT expects that implementation of the review will take the form of amendments to the extant station access agreements, through adjustments to the LTC figure (and any other adjustments which may prove necessary). DfT and HS1 Ltd. will work together with stakeholders to produce these amendments to the station access agreements following publication of DfT’s final decision.

Post-project review

Given that this is the first review of the HS1 stations to have been carried out and, because it is 'best practice', DfT intends to conduct a 'lessons learned' review following the implementation stage of the stations review. We will write with further details in due course; your contributions to the lesson learned review would be very much appreciated.

<u>Timescales</u>
The table below summarises the timescales proposed for the remainder of the CP2 stations review.

Timescales	Action
7 April 2014	HS1 informally circulates the final stations life cycle reports.
7 April 2014 – end June 2014	Stakeholder consideration of the reports.
30 June 2014	HS1 formally submits the report.
2 July 2014	DfT issues consultation on its proposed decision.
14 July 2014	DfT holds stakeholder workshop on its proposed decision.
23 July 2014	Consultation closes.
End July - August 2014	Any required alterations made to DfT decision in light of workshop and consultation responses.
By 31 August 2014	Final DfT decision issued.
September 2014-November 2014	Implementation phase – Review Notices issued and adjustments made to Stations Access Agreements.
November 2014-February 2015	Lessons learned review carried out.

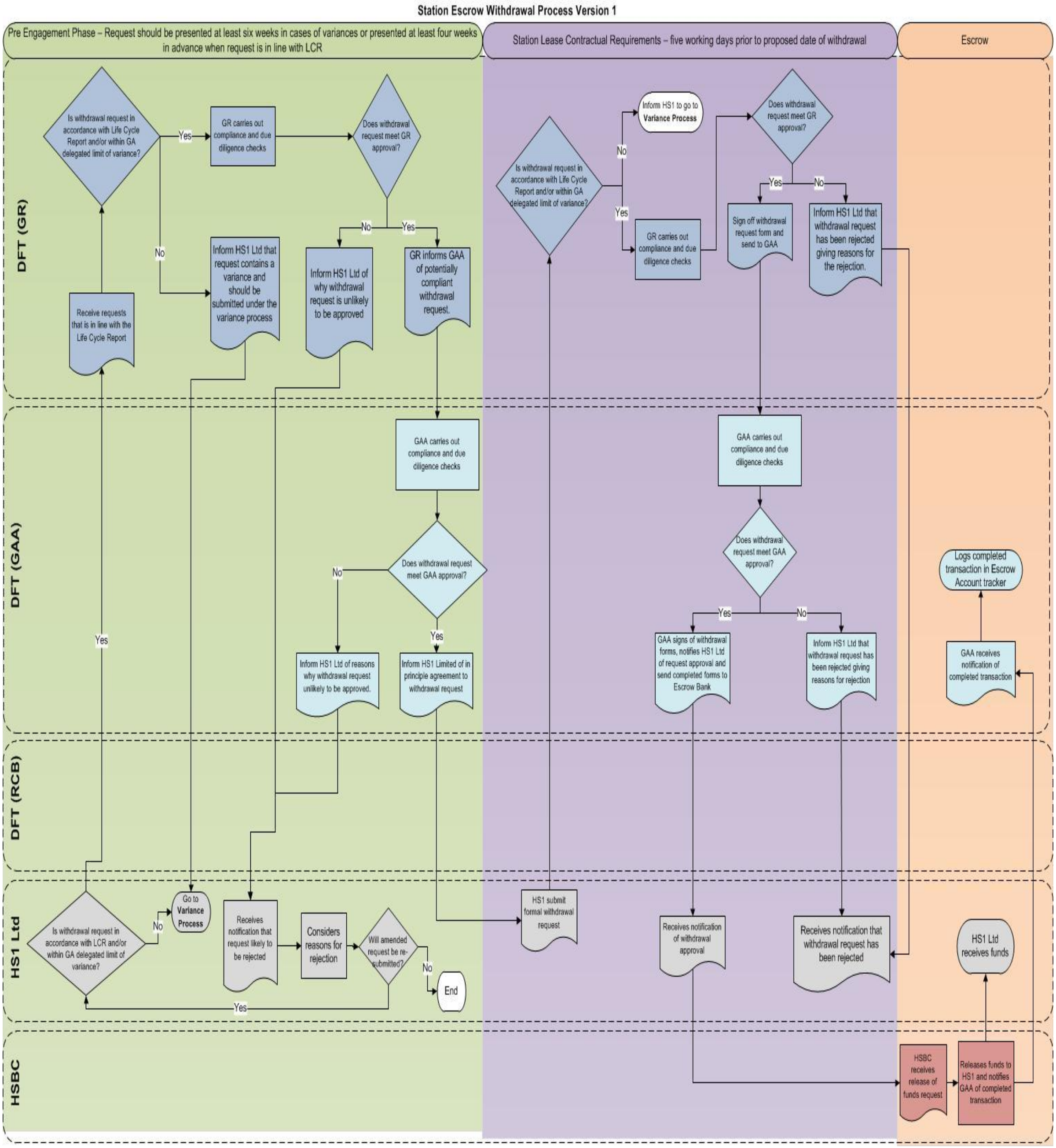
This letter has been sent to those in the attached annex. If you have any queries about this letter, or wish to indicate your attendance at the above-mentioned workshop, please contact me.

Yours sincerely,

Paul Stone
HS1 Concession Manager

Annex D

D.1 This annex contains a map of the processes used to make withdrawals for renewal and replacement works from the stations escrow accounts.



Station Escrow - Variances - Withdrawal Process Version 1