Department for Transport

HS1 Stations Review (Control Period 3)

Draft Decision

Moving Britain Ahead

July 2019

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Executive summary

1 In January 2018 the Department for Transport (the Department) set out its approach to the High Speed 1 (HS1) Stations Review for Control Period 3 (CP3)[1] covering the period 1 April 2020 to 31 March 2025. This periodic review determines the Long Term Charge (LTC) to be paid by train operating companies.

2 This document contains the Department's draft conclusions on the periodic review of station access charges for the four HS1 network stations (St Pancras International, Stratford International, Ebbsfleet International and Ashford International).

3 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 ongoing reviews of the charging proposals made by HS1 Ltd.

4 The draft conclusions contained in this document follow an 18-month engagement process and formal consultation led by HS1 Ltd, as well as numerous other collaborations between HS1 Ltd and its stakeholders, including those train operators which use the HS1 route and stations.

5 The Department appointed technical advisers, GHD, and participated fully with the HS1 Ltd engagement and consultation.

6 HS1 Ltd submitted its proposals for the LTC element of the station access charges for CP3 on 31st May 2019. The Department, with the support of GHD, has considered these proposals against the requirements of the Concession Agreement (which governs the relationship between the Department and HS1 Ltd as the concessionaire operating the HS1 network) and the HS1 Station Leases (which sets out the rights and obligations of both the Department and HS1 Ltd in respect of the four HS1 network stations).

7 **The Department is therefore consulting interested parties on its draft conclusions, with consultation starting on 1st July 2019 and concluding on 11th August 2019.**

8 **This document contains a number of questions to which consultee responses are invited; although it is not necessary to limit responses to the questions asked if you believe that an important topic has been missed.**

9 It also sets out the next steps, including details of a workshop to discuss these draft conclusions, your responses, and how these will be used in the close-out of this periodic review, including its implementation, and the

[1]https://www.gov.uk/government/publications/dfts-approach-to-the-hs1-stations-2019-periodic-review

ongoing monitoring of the Department's decision for CP3.

10 For any further information, please use the contact details at paragraph 1.18 and 1.19 of this document.

DEPARTMENT FOR TRANSPORT
JULY 2019

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 consultation document, and the steps to be taken up to the close of this consultation.

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[2]; separate documents to the Concession Agreement, sets 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") and Asset Management Strategies ("AMS") 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 3 ("CP3") will run from 1 April 2020 until 31 March 2025. 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 CP3 review.

[2] Ashford International is contained within a separate lease

1.7 At CP2, the Department discussed with HS1 Ltd the feasibility of taking an approach to the Life Cycle Period that is consistent with the approach required by the 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 the Department believe that this approach presents the best option for ensuring asset stewardship of the HS1 stations and achieving the Life Cycle Purpose.

1.8 Whilst this option has not been formally introduced for CP3, the 40-year look ahead is concurrent with the 50-year asset stewardship through to 2061 for CP3. The Department has concluded that the intention to move to a 40-year rolling asset stewardship and LTC model remains appropriate, and will be formalised ahead of CP4. This is discussed later in respect of the calculation of the LTC.

Role of the Department and the Government Representative

1.9 Under the terms of the HS1 Station Leases, the Department is required to approve the LCRs and AMSs 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.[3] of the Concession Agreement." (Schedule 10 of the HS1 Station Leases, definitions).

1.10 The HS1 CP3 stations review is being undertaken by the SoS's appointed Government Representatives for the HS1 concession.

Purpose of this document

1.11 Pursuant to paragraph 5.3 of Schedule 10 of the HS1 Station Leases, this document constitutes the Department's proposed decision on the CP3 review of the four railway stations on the HS1 network which form part of the HS1 Concession.

1.12 It includes the Department's proposed 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; and
- whether the Department approves the LCRs.

[3] Which relates to the Government's Representative

1.13 This document also includes information on the end to end process for the CP3 stations review, including information on the next steps following this consultation.

Timescales and next steps for this document

1.14 This section sets out the timescales and next steps for this consultation document, and ways in which stakeholders will be able to engage with the remainder of the process.

The Department's consultation document and your responses

1.15 HS1 Ltd formally consulted on its LCR proposals in February 2019, giving stakeholders the opportunity to comment. HS1 Ltd's informal sharing of the LCRs prior to formal submission has also given stakeholders further opportunity to comment. Respondents are therefore requested not to raise issues related to this review which have previously been closed off satisfactorily by HS1 Ltd in their consideration of responses to the consultation on the LCRs.

1.16 The Department is interested in evidence-based, material points in response to the questions asked in this document. Consultees are reminded that this document is consulting on the Department 's decision on the LCRs - not on the LCRs themselves, although the Department accepts that the proposed decisions are themselves informed by the LCRs, and it is not possible to separate the two. Interested parties are therefore requested not to raise representations on issues that HS1 Ltd has already closed off satisfactorily.

1.17 Following this consultation, we will make decisions having regard to the representations of relevant parties, technical advice we receive from GHD and the responsibilities and obligations on HS1 Ltd as set out in the HS1 Station Leases.

1.18 Any response you wish to make should be sent in electronic format to:

Sam.hart@dft.gov.uk

Simon.Pinney@dft.gov.uk

1.19 Alternatively, you may send your response in hard copy to:

Sam Hart

HS1 Concession Manager

Department for Transport

33 Horseferry Road, Zone 4/18

London

SW1P 4DR

Tel: 07584 617 773

1.20 The Department will be issuing the final decision on 31 August 2019 following the close of the consultation on 11 August 2019. Please ensure that you submit any representations that you wish to make on or before this date, otherwise it may not be possible to take your response into account when finalising the Departments' decision.

Workshop

1.21 A Stakeholder workshop to be held at High Speed 1 Ltd, Kings Place on 24 July 2019 at 11am. If you have not already confirmed your attendance at this workshop and wish to do so, please contact the Department using the details in paragraphs 1.18 and 11.19.

1.22 The purpose of this workshop is to discuss this draft decision document and its proposed conclusions, in the context of the final HS1 Ltd LCRs for CP3, as formally submitted to the Department on 31 May 2019.

1.23 The Department and its' technical advisers presented their findings to HS1 Ltd following the review of the draft LTC submission. It was acknowledged that HS1 Ltd had insufficient time to include all the requested clarifications and amendments into the Final Submission of 31 May 2019. The Department requested that the supplementary information, evidence and assurance be provided by HS1 Ltd which they then submitted to the Department on 26th June 2019. The Departments' technical advisers will present their updated findings following a review of this supplemental information at the stakeholder workshop to be held on 24 July 2019.

1.24 The outcomes of this workshop, as well as formal written responses received to this consultation, will be considered by the Department prior to issuing its final decision. As such, stakeholder participation in the workshop would be greatly appreciated.

1.25 An agenda containing further details of the workshop will be issued to interested parties. A note of this workshop will be taken, and made available to attendees shortly afterwards.

Freedom of Information and personal data

1.26 Information provided in response to this consultation, including personal information, may be subject to publication or disclosure in accordance with the Freedom of Information Act 2000 ("FOIA") or the Environmental Information Regulations 2004.

1.27 If you want information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.28 In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

1.29 The Department will process personal data in accordance with the General Data Protection Regulation 2016/679.

2. Process for the CP3 stations review

2.1 This chapter sets out:

- The process followed to date by HS1 Ltd and other stakeholders for the CP3 stations review.
- The requirements of the LCRs, and the ways in which the LCRs can be deemed deficient in accordance with the HS1 Station Leases.
- The work done by the Department, and its' appointed technical advisers GHD, to reach the draft conclusions set out in this document, as considered against the requirements of the LCRs.

2.2 The LCRs have been considered against the requirements of the HS1 Station Leases and HS1 Station Access Conditions ("SACs"), as well as against the representations which have previously been made by HS1 Ltd's stakeholders.

General principles for the CP3 stations review

2.3 This section sets out the general principles of the CP3 stations review.

Scope of this periodic review

2.4 This review considers the setting of the long term charge ("LTC") figure payable by train operating companies ("TOCs") using the HS1 stations, covering CP3 from 1 April 2020 to 31 March 2025. 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 Asset Management Annual Statement(s) ("AMAS") for that control period. The Department's role is to approve the LCRs and AMAS.

Exclusions from this periodic review

2.5 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 and Road ("ORR") on a five-yearly basis, as set out in the Concession Agreement.

2.6 However, the Department have continued to engage with the ORR on the route review and expect the ORR to continue conducting a rigorous challenge process to ensure the best and most efficient outcome for all parties.

2.7 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 the Department or the ORR.

2.8 This review also does not cover Qualifying Expenditure ("QX"). QX is the expenditure associated with the costs and expenses reasonably incurred by HS1 Ltd through providing and procuring amenities and services (note this means services specific to stations; not train services) at its stations, including the operation of the station itself.

2.9 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 HS1 SACs and annexes specific to each HS1 station.

Cost allocation

2.10 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.

Progression through the CP3 stations review

2.11 This section sets out the process of the CP3 stations review so far, summarising key milestones and explaining the consideration which the Department has already given to HS1 Ltd's LCRs.

2.12 HS1 Ltd set out a progressive assurance, 'no surprises' approach to engage with regulators and stakeholders from the start of the review process. Whilst HS1 Ltd have engaged in a timely fashion, and we do not question the hard work, dedication and feedback opportunities presented, the Department feels there remains room for improvement in the depth of information provided and will identify lessons to be learned at the end of the review.

2.13 However, the Department is assured by HS1 Ltd that for the remainder of the review and into CP3 and beyond they will make improvements to the communication of their plans for the new control period.

2.14 It is recognised that the process to determine the UK's exit from the European Union has caused additional pressures for all stakeholders throughout the review to date. We are grateful for parties' participation and engagement considering these pressures.

Production of life cycle reports

2.15 HS1 Ltd started work on the CP3 stations review in late 2017. This began with a detailed planning phase which continued into early 2018.

2.16 This was followed by a series of quarterly workshops with all stakeholders all throughout 2018 and into early 2019 leading up to the draft submission in February 2019.

2.17 Throughout this process HS1 Ltd collated the feedback received from stakeholders, including the Department and updated the documentation accordingly, in advance of its formal consultation.

2.18 The Department worked with its technical advisers, GHD, to produce an interim review on the LCRs, prior to HS1 Ltd's formal consultation. The Department received this interim review (Familiarisation Report) in December 2018. The scope of the review, and its findings, are set out below.

Scope of GHD first review (Familiarisation Report)

2.19 The scope of the first review was for GHD to produce a Familiarisation report looking back to CP2 and the progress made by HS1 Ltd since 2015.

2.20 The Familiarisation Phase comprised of a document review and interviews with HS1 Ltd to review progress made throughout CP2 against obligations, comments and recommendations made in the 2014 Periodic Review.

2.21 GHD produced a report setting out its findings on the familiarisation report, which are summarised below.

Findings of GHD first review (Familiarisation Report)

2.22 GHD published some preliminary findings report on the HS1 network including a preliminary review of the stations in December 2018

2.23 The key output from this phase was the identification of areas for further investigation and development of proposals for the review phase. These areas are in addition to the main activity, which is to assess compliance against the stations asset management obligations contained within the HS1 Leases.

2.24 GHD found that no systematic approach to the close out of partially completed obligations, recommendations and comments made throughout the CP2 Periodic Review has been employed. Progress against the items identified has been made, however, this has been typically as a result of other initiatives embarked on by HS1.

2.25 HS1 are adopting an approach to asset management which is to be consistent with the international standard ISO55000, which is considered best practice. This has however amended the suite of documentation planned to be produced by HS1, which will potentially create inconsistencies with requirements stated in the clauses of the HS1 Lease (these are set out for reference at Annex D).

2.26 The level at which HS1 Ltd is managing station assets has been changed to a system level rather than an element level. For example, rather than quantities of components being captured (with low visibility to which asset they relate), the whole asset system is counted once only. This has an impact on the strategy, plans, lifecycle models and accounting methods employed by HS1 Ltd through CP3.

2.27 GHD discussed with HS1 Ltd their progress against the compliance matrix produced for CP2, focusing on those identified as 'Partially' compliant. Progress as reported by HS1 Ltd against each of the partially compliant clauses and annex requirements is summarised in Appendix A of the GHD

Familiarisation Report. GHD found that only one of the recommendations has been acted on throughout CP2, and is a work in progress.

2.28 There is no clear audit trail that HS1 Ltd has systematically addressed the actions required to achieve full compliance for the clause and annex requirements previously identified as partially compliant at CP2. Where progress has been made in relation to a partial compliance, this has been triggered by business as usual activities. As HS1 Ltd moves towards ISO 55001 management system, this should, in a mature state, support the ongoing improvement of the system.

2.29 GHD recommended ongoing review and assessment of progress against recommendations both through the CP3 submission process and ongoing into the CP3 delivery period. Where recommendations are accepted by both HS1 Ltd and the Department, it is proposed that a tracking document and progress report against target dates is established and included in regular reporting to support continuous improvement.

2.30 As with findings against the obligations from the lease agreement, progress against the Comments and Recommendations, GHD has noted that some items that remain open, have not been tracked by HS1 Ltd or systematically closed out. The progress made, as reported by HS1 Ltd against the 'Deferred' and 'Outstanding' recommendations is summarised in Appendix B of the GHD Familiarisation Report.

2.31 HS1 Ltd reported the close out of two observations, with 11 remaining to be addressed and two requiring further information.

2.32 The GHD first report also contains a list of key recommendations (Table 14 - Key Recommendations at the end of the Verification Review). No changes were made to the recommendations as a result of HS1 Ltd's response to the Primary report.

2.33 Progress reported by HS1 Ltd against the key recommendations is summarised in GHD's Familiarisation Report.

2.34 In summary, 11 of the recommendations have been acted on, closed out, or are a work in progress. A further seven recommendations have not been closed out over CP2.

2.35 The Departments conclusion in response to the findings of the Familiarisation Report is to undertake a lessons learned exercise with a formal action plan to be taken forward between the Department and HS1 Ltd with agreed outputs and timescales. This action plan will include progress relating to the recommendations, obligations and compliance issues raised in the GHD reports. It is proposed the action plan will be monitored by the Department at monthly progress meetings with HS1 Ltd, with updates reported to the quarterly station asset review meetings.

Question 1: Consultees are invited to comment on HS1 Ltd's obligations under the HS1 Station Leases, the extent to which these obligations are currently met and the proposed process by the Department to seek assurance of continuous improvement against an agreed action plan.

HS1 Ltd Approach

Stakeholder Engagement

2.36 As noted in GHD's Familiarisation Report, the approach also does not reflect on lessons from CP2 to inform the approach and avoid pitfalls from the last review, which should have been done and incorporated prior to June 2017.

2.37 The approach as described, is high level and does not provide sufficient detail from which to assess the development of plans for CP3, however GHD recommended a number of improvement areas for consideration.

Adoption of the principles of the ISO 55000 series

2.38 HS1 has chosen to adopt the principles defined in the International Organisation for Standardisation ISO 55000 series Asset Management in relation to the management of the assets for which they are responsible.

2.39 The intent is to adopt a consistent approach across all assets, with the noted exception of where the HS1 concession directs divergence for Stations from Route and other assets in the asset management system documentation suite; this is due to the need to consider separate renewal plans from the qualifying expenditure (used to fund operation and maintenance work) plans.

2.40 The HS1 asset management system, which is at the heart of the ISO 55000 series, is in the process of being established for station asset management and is expected to come into operation as a system in CP3 and will be tracked through the action plan proposed in consultation Question 1.

2.41 As the principles of the ISO 55000 series represents current best practice for asset management, adoption of these principles by HS1 Ltd in relation to station assets including their renewal is considered by the Department to be a positive move forward.

2.42 Successful establishment and operation of the asset management system by HS1 Ltd for station assets would be a significant improvement that can be expected to lead to a coordinated and systematic approach to station asset management.

2.43 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. The Department carried out its own review of the consultation version of the LCRs, as detailed below.

GHD Second Review (Review Phase)

The Department's review of the consultation version of the life cycle reports

2.44 The Department worked with GHD, to perform a challenge function on the technical points of HS1 Ltd's consultation version of the LCRs against the requirements set out in the HS1 Station Leases.

2.45 In GHD's second report, they note inputs to the LCC models include material quantities, unit rates and on costs. (Unit rates and on costs are discussed in section 3.5 of the GHD second report). The models did not contain any provision for contingency or risk.

2.46 The LTC models cover the 40-year period 2020/21 to 2059/60. The annuity calculation is set at a level such that the escrow balance in 2059/60 becomes zero. The annual charge to TOCs during a Control Period is set to be the average cost of the annual LTC calculation over a Control Period, which is then shared out to the access beneficiaries in proportion to pre-agreed parameters.

2.47 The LTC model indicates that the Financial Assumptions (e.g. inflation, escrow amount available for long-term investment and cost of borrowing) need to be aligned with the route assumptions.

2.48 As well as making further revisions as a result of this second review by the Departments' advisers, HS1 Ltd has also made amendments in light of comments received from those who responded to its consultation on the LCRs.

Process for review of the final life cycle reports

Review by GHD

2.49 GHD was instructed to consider the final LCRs, building upon the work it had carried out for the consultation version of the LCRs. The scope of the second GHD review, and GHDs' findings, are set out in this section.

Scope of the GHD second report (Review phase)

2.50 GHD was asked by the Department to include in their second review activities on:

- Critically assess the final Life Cycle Reports (“LCRs”) concerning the four HS1 stations and the associated renewals and replacement activities.
- Full review of Draft SAS
- Full review of cost efficiency plan
- Review enhancements framework
- Review benchmarking
- Review Draft LCR and 4x station LTCs

- Review treatment of enhancements
- Review handback condition definitions
- Review of treatment of works beyond 50-year life cycle, and impact of moving to a 40-year rolling programme, taking account of emerging future railways considerations
- Review approach to dealing with change, taking account of emerging future railways considerations
- Determine if the LCRs submitted by HS1 Ltd, the associated LCC/LTC models, and any other relevant or supporting documentation:
  - Contain the appropriate renewals activities
  - enable the effective delivery of asset management activities
  - align with the amended AMS
  - align with HS1 Ltd's Life Cycle Purpose under the HS1 Lease
  - comply with Schedule 10, Annex 1 of the HS1 Lease, and the Ashford Lease
  - Align with recognised best practice and benchmarking for asset management
  - Include proposals around efficiencies and securing the best possible deal for operators (and therefore passengers).
- Capture lessons learned and identify new risks and potential changes required to the periodic review framework.

Findings of the GHD second report (review phase)

2.51 The GHD second review has demonstrated that a significant number of the comments it made through its first review have now been addressed by HS1 Ltd and its partners. The full comments made by GHD are available in its second report which accompanies this consultation document. The key findings, on which the Department has proposed conclusions and on which we are seeking your views, are set out in the sections below.

Requirements and deficiencies set out by the HS1 station leases

2.52 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.

2.53 In paragraphs 2.27 to 2.34 of this document on the consideration of the consultation version of the LCRs, we set out how and why we believed the LCRs did not contain all of the information required by the HS1 Station Leases. The Department has worked with GHD to consider whether HS1 Ltd has met all of these requirements in the final LCRs.

2.54 As previously explained, through conducting such stations reviews and setting the LTC, HS1 Ltd must also achieve the Life Cycle Purpose for the duration of the Life Cycle Period (as previously stated, the Department will work with HS1 Ltd to consider adopting a rolling 40-year view for future periodic reviews, consistent with the terms of the HS1 Concession Agreement).

2.55 Consultees are asked to note that the Department and GHD held discussions with HS1 Ltd about control actions to ensure full compliance, prior to submission to the Department for approval on 31 May 2019. HS1 Ltd agreed that a number of its obligations which were assessed as being not met, or partially met, could be addressed through the provision of supplemental information and evidence, but this would not be included in the final LTC submission, but provided separately by 26 June 2019. The Department welcomes HS1 Ltd's commitment to ensuring compliance in all of its obligations under the HS1 Station Leases.

2.56 Given inherently short timescales, it has not been possible to consider fully the supplemental evidence provided by HS1 Ltd after their 31 May 2019 submission, in the days between submission of this additional evidence (26 June 2019) and the publication of this document. The Departments' technical advisers will present their updated findings following a review of this supplemental information at the stakeholder workshop to be held on 24 July 2019.

2.57 Therefore, as set out above, it may be the case that the compliance matrix in GHD second report (review phase), will require updating to take account of amendments made to the LCRs.

2.58 The Department and GHD will review the final LCRs and work with HS1 Ltd during the consultation period to produce a revised compliance matrix to be published alongside the Department's decision. The Department recognises that the compliance matrix is a work in progress, and subject to ongoing discussion with GHD and HS1 Ltd.

2.59 The Departments' draft conclusion is therefore that there is a clear requirement for HS1 Ltd to demonstrate its compliance, and to do so in the submission made on 31 May 2019. We are not able to form a view on whether we can approve the LCRs because we had received incomplete information at the time of publishing this draft decision consultation. As set out in 2.56 we will review HS1 Ltd's supplemental submission of evidence and discuss this with parties at the planned workshop.

2.60 The Department acknowledges the position set out in the GHD report. However, given that there is information the Department still has to consider, which may materially change this proposed conclusion, and that GHD interim recommendation was based on the information available to it prior to 31 May 2019, DfT does not propose to reject the LCRs at this point. The Department is of the view that some of these areas - particularly where work is identified as to be undertaken in CP3 - do not materially affect our consideration of the LCRs, and do not act as a barrier (in and of themselves) to approval of the LCRs.

3. Draft Decisions following the CP3 stations review

3.1 This chapter sets out the key issues emerging from the stations review, comments from the Department having taken account of feedback from its' technical advisers and stakeholders.

3.2 The clear feedback from stakeholders throughout the process has been HS1 Ltd's approach to pre-funding renewals and managing the trade-offs between long-term asset availability and condition, performance and value for money has resulted in a LTC that is financially challenging.

3.3 In their Final Submission, HS1 Ltd set out a number of options for the Department to consider, whilst noting their approach to the stewardship of the assets in the long term is set out in the Concession Agreement and the HS1 Lease with the Department. HS1 Ltd have stated they would expect assurance from the Department that any move away from the current approach to long term asset renewals to be consistent with those agreements.

3.4 The Department will present its initial findings on the options to amend the annuity calculation for the LTC as soon as possible, but in any case, at the workshop to be held on 24 July 2019. Our initial thoughts are set out from paragraphs 3.17 to 3.28.

3.5 Whilst the asset stewardship purpose is a Concession Agreement concept, and does not directly inform our view on the LCRs, the recommendations of GHD around the AMS and LCC's (set out in the previous section) will impact on the LCRs, which in turn drives the value of the LTC. We are therefore inviting operators views on how any modification of the annuity calculation can seek to ensure there are sufficient funds in the station escrow accounts to deliver the renewals required to meet the asset stewardship and life cycle purpose.

Conclusions following HS1 Ltd's formal consultation

Asset Condition at Handback

3.6 HS1 Ltd contend that the current definition of asset condition at handback within the Concession Agreement drives increased costs, particularly near the end of the Concession term.

3.7 We are working in parallel to the Draft Determination with HS1 Ltd to come to an agreement in time for the Final Determination on this issue. Our assertion is that the definition, set out in the Concession Agreement, of "good and substantial repair" remains valid and that costs can be reduced and controlled as HS1 Ltd adopt their plans to improve asset monitoring and intelligence, and meet their efficiency targets. We believe there is no need to alter the definition for asset handback condition, assuming the AMS set out by HS1 Ltd is fully implemented, as this will drive efficiencies; more accurate cost inputs and provide more surety on asset condition and renewals. As the AMS matures through each CP review the greater the assurance that the renewal plans support handback of assets in a state 'good and substantial repair' will be met. The Department will write to HS1 Ltd requesting a detailed delivery plan describing how and when they intend to fully implement the AMS before the start of CP4.

3.8 Additionally, by moving to a 40-year rolling view of asset stewardship would help mitigate any cost shocks in future control periods and at the end of the current concession. This was previously agreed at CP2 but has not been formally implemented as discussed in paragraphs 1.7 and 1.8.

3.9 Comments are sought on the Department's conclusion that the definition of asset condition at handback should be retained, and that focus is placed on asset monitoring.

Question 2: Consultees are invited to provide comments on the draft conclusion that the definition of asset condition at handback should be retained, and that focus is placed on asset monitoring.

Station enhancements

3.10 Whilst enhancements are not currently covered in the station leases, and is outside the scope of the review decisions, the Department recognises the need for a clearer framework should the need arise for future enahancement works.

3.11 The Department concludes that the principle of user pays should continue for the short term, and agree with HS1 Ltd's approach to consult on changes to the Network Statement that clarify the policy on station enhancements, their approach, charging principles, approvals process, and how they would seek to resolve any disputes.

3.12 The Department will continue to work with HS1 Ltd to develop options longer term options for a station enhancements framework on the HS1 network, which would require amendment to the Concession Agreement.

3.13 Without prejudice to agreeing an enhancements framework, stakeholders should note the Department published its' Rail Network Enhancements Pipeline (RNEP)[4] in March 2018 describing a wider approach to enhancements on UK railways where government funding is required, which should also be read in conjunction with Rail Market Led-Proposals[5] setting out guidance on how the Department expects to receive market-led proposals, and the process by which they will be considered.

[4] https://www.gov.uk/government/publications/rail-network-enhancements-pipeline
[5] https://www.gov.uk/government/publications/rail-market-led-proposals

Question 3: Consultees are invited to provide their comment on how the processes described in this section are applied to station enhancements on the HS1 network, or on alternative proposals.

LTC contributions from other sources

3.14 The Department recognises the issue raised through the stakeholder engagement process, by current contributors to the LTC, that the user pays principle, at St Pancras International station, does not take account of the Thameslink, Southern and Great Northern (TSGN) franchise.

3.15 Again, whilst this is outside the scope of the review decisions, the Departments' HS1 station regulatory team, are working with the specification team for the TSGN franchise within the Department alongside HS1 Ltd to identify and review a range of options that potentially requires the TSGN franchise to make an appropriate contribution to the LTC for St Pancras International Station. Any options that are subsequently taken forward for adoption will not be in place for the start of CP3, but could be introduced as part of an interim review at the point a new TSGN contract is let[6] or at the start of CP4, whichever is sooner. The Department and HS1 Ltd will keep stakeholders informed of progress as options are developed.

3.16 The Department has reviewed the Concession Agreement and believes there is no mechanism to allow for LTC charges to be applied to retail outlets at the HS1 stations, given retail income is unregulated.

Annuity/ Long Term Charge

3.17 The charges paid by operators at each station are built up from a 40-year forecast of cost, which is then smoothed into an annual annuity, and finally converted into the share attributable to each operator.

3.18 The annuity approach used at CP1 and CP2 took estimated station costs for 40 years (LTC) commencing at the start of the control period being reviewed. Assumptions were applied as to the inflation expected on these costs and the rate of return that could be expected from cash placed on escrow. The model calculates the annual annuity payment that leaves the escrow balance at zero at year 40. The approach has the advantage of aligning with the 40-year period over which the engineering work underlying the LTC is assessed.

3.19 In their Final Submission HS1 Ltd set out the proposed changes in the LTC. Overall the LTC has increased by £5.1m p.a. (79%) between CP2 and CP3. For reference, the change in proposals for the LTC figures are set out below by both station and TOC.

[6] The Department have launched the Rail Review to make ambitious recommendations for the future of the railway, including franchising. Achieving the best outcomes for passengers will be the key factor in any decisions taken and we will update the market on our conclusions in due course. In that context, we are currently reviewing the rail franchise schedule. There is no change for current franchise competitions. The current TSGN franchise is due to end in 2021.

Station	CP2 LTC (£m p.a.)	Removal of Efficiency uplift (£m p.a.)	Other changes between CP2 and CP3 (£m p.a.)	CP3 LTC (£m p.a.)
St Pancras	4.282	+0.771	+2.559	**7.612**
Stratford	0.770	+0.101	+0.687	**1.558**
Ebbsfleet	0.731	+0.191	+0.737	**1.659**
Ashford	0.763	+0.102	+0.001	**0.866**
TOTAL	**6.545**	**+1.165**	**+3.985**	**11.695**

Table 3.1 - evolution of the LTC by station

3.20 HS1 Ltd stated the increase in LTC is comprised of an 18% increase from the removal of the CP2 efficiency overlay; and a 61% increase from other changes to the renewals programme, mainly bringing forward lift and escalator replacements and application of an appropriate risk and contingency allowance.

3.21 These figures include the removal of the 0.6% p.a. compounding 'efficiency overlay' that was applied to unit costs in the PR14 numbers. While HS1 Ltd recognised the need to stretch themselves and chase efficiency improvements, they also stated a lack of evidence to support such an overlay that reduces the 40-year budget by approximately 25%.

Operator	CP2 LTC (£m p.a.)	CP3 (£m p.a.)	Difference (CP2 to CP3) LTC (£m p.a.)	Difference (CP2 to CP3) LTC (%)
EIL	3.726	6.364	+2.638	**+70.1%**
LSER	1.943	3.772	+1.829	**+94.1%**
EMT	0.876	1.558	+0.682	**+77.9%**
Total	**6.545**	**11.695**	**+5.150**	**+78.7%**

Table 3.2 - evolution of the LTC by operator

3.22 Increased frequency of interventions for lifts, escalators and travellators, which is one of the largest categories of renewal spend. This is driven in part by the observed degradation in asset condition which has been greater than expected – the assets in place were designed for 'inside' operation but the level of moisture in the air is more equivalent to 'outside' conditions. It is also driven by the work HS1 Ltd have done with operators around operational criticality, identifying that these assets are key to the passenger experience and cannot be out of service for any extended period;

3.23 Application of an appropriate risk and contingency allowance, reflecting the uncertainty associated with the cost of the renewals programme over a 40-year time horizon. Since publishing their stakeholder consultation, HS1 Ltd worked with our independent cost consultants to estimate the appropriate level of risk and contingency to be applied to stations renewals costs.

3.24 HS1 Ltd highlighted in their Stations LTC Review consultation that the station renewals plans did not include a risk / contingency element, and noted that their specialist cost consultants suggested an allowance of 20-30% could be considered. Stakeholders did not provide views on this figure in their consultation responses to HS1 Ltd, who subsequently developed an approach based on specialist cost consultant advice, mindful of operators' affordability concerns which was included in their final submission for the LTC.

3.25 Use of a longer annuity period was dismissed as projections by HS1 Ltd and review work by GHD has focussed on the 40-year period in line with the requirements of the concession agreement.

3.26 As a possible option, HS1 Ltd has calculated an annuity based on the estimated costs for 20 years. This approach is not considered appropriate as

- it does not align with the engineering timeframe; and
- it excludes substantial costs arising beyond the 20-year period – as a result although the annuity at CP3 is lower, substantial increases are likely to be needed at subsequent control period reviews to address underfunding at CP3. The ORR has also indicated that they think a 20-year annuity may not be possible under the concession agreement.

3.27 HS1 has also put forward a 'buffer' option which retains the 40-year period but limits application of the risk mark-up to the first 10 years. This option is considered to have merit as:

- costs beyond 10 years are uncertain and it seems inefficient to place substantial escrow money in low interest bank accounts (c1.2%) over decades to cover such possible cost variations
- it increases the affordability of the LTC benefitting operators

3.28 There will be a need to quantify the risk related to potentially under-funding of the escrow and future renewals, exploring issues such as:

- Likelihood that a cost shock will occur in future
- How far does the period review process every 5 years mitigate future cost shocks and smooth the annuity profile?
- As asset monitoring information and intelligence develops over time, there will be greater certainty on asset costs and lifecycles, and improvements in efficiency to reduce costs

Question 4: Consultees are invited to comment on how a modification of the annuity calculation can seek to ensure there are sufficient funds in the station escrow accounts to deliver the renewals required to meet the asset stewardship obligations and life cycle purpose, as well as mitigating future cost shocks.

Question 5: Consultees are invited to comment on whether they are willing to accept lower customer experience and service quality outputs from critical assets such as lifts and escalators to reduce charges.

Asset Stewardship

3.29 Part of HS1 Ltd's asset stewardship duty is to efficiently manage the funds held in the escrow accounts for future renewal activities. It is important the cash flow does not impede delivery of renewals.

3.30 During CP2 HS1 Ltd, with the consent of the SoS moved the station and route escrow accounts to a new bank following the processes set out in the Concession Agreement to retain compliance.

3.31 The new bank accounts have streamlined the escrow payments and withdrawals process, using internet banking, ensuring urgent works are not delayed. Additional checklists have been put in place to ensure the Department has the all the required information before authorisation of any withdrawal. The quarterly station renewal meetings act as an indicator for forthcoming withdrawals in line with the agreed programme of works set out for the control period.

3.32 The Department is fully engaged with the ORR who have commissioned a review of the escrow accounts to ensure they provide an effective and efficient use of funds. The ORR will report on this area of work through the route periodic review process.

Question 6: consultees are invited to provide their comment on HS1 Ltd's asset stewardship proposals, the underpinning asset management documentation and HS1 Ltd's compliance with its asset stewardship Life Cycle Purpose.

Costs and indirect costs

3.33 HS1 identified that a main factor in the increase in LCC from CP2 to CP3 was the increased frequency of interventions for lifts, escalators and travellators, which is one of the largest categories of renewal spend. GHD has concerns about the maturity of asset knowledge and its application in the LCC calculations. An update will be provided by GHD covering its work on LCC at the workshop on 24th July 2019.

Indirect costs

3.34 HS1 have applied indirect costs covering risk and contingencies as follows:

	CP3-4	CP5-6	CP7-8	CP9-10
St Pancras	15%	15%	10%	**20%**
Stratford	15%	15%	10%	**5%**
Ebbsfleet	10%	15%	10%	**10%**
Ashford	**10%**	**10%**	**15%**	**10%**

Table 3.3 - indirect costs by station and control period

3.35 Given the concerns about the maturity of asset knowledge and its application in the LCC calculations (see 3.33) costs beyond 10 years appear uncertain. Combined with a desire to minimize the inefficient use of cash in low return earning escrow accounts the Department is attracted to the buffer approach to annuities (see 3.27), and seeks the views of interested parties at Question 4 above.

Cost of debt

3.36 HS1 Ltd's proposals assume a cost of debt of 6%. However, 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). The Department asked HS1 Ltd for an explanation of this apparent inconsistency.

3.37 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

Modelling and efficiency

Underlying assumptions

3.38 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.

3.39 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. GHD also questioned the rationale for HS1 Ltd's flat rate assumption of 2.75% for inflation.

3.40 As the modelling is based on a 40-year forecast, HS1 Ltd notes 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 CP3, any variation will be reflected in the charges collected from TOCs and the allowance spent on renewals in nominal terms.

3.41 HS1 Ltd further notes 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.

3.42 HS1 has modelled 80% of the escrow balance being invested and 20% in current accounts. A return of 0.7% is used for the current account and a

1.22% return on invested escrow balances. The 1.22% is based upon yield curves supplied to HS1 Ltd by its treasury advisors.

3.43 The Department is grateful for the further explanation, and content with the response provided, and would welcome any further comments from parties on this issue should they wish to provide further specific evidence.

Efficiency overlay

3.44 Following engagement with TOCs at CP2, HS1 Ltd introduced into its models an efficiency overlay of 0.6%, modelled over the duration of the concession.

3.45 HS1 Ltd acknowledged at the time 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. HS1 Ltd have proposed removing the efficiency overlay and replacing it with risk and contingency estimates.

3.46 Whilst this target will no doubt be challenging; not least because of the inherent difficulties in making such long-term forecasts, the Department would remind consultees that any efficiency overlay may be reviewed on a five-yearly basis (or an interim basis) to take account of changing circumstances. The Department would also note that application of an efficiency overlay, whilst a question of good practice, isn't a contractual obligation. The Department would expect HS1 Ltd to act responsibly in terms of setting stretching but achievable goals.

3.47 The Department is also concerned there is a disconnect between the stated asset management strategies and actual asset knowledge, monitoring and intelligence. Costs are therefore still largely based on manufacturer guidelines, with little application of efficiency measures.

3.48 The Department concludes that it would be appropriate to retain an efficiency overlay for CP3. This would act as both an incentive the drive efficiencies in procurement, and to drive HS1 Ltd to implement robust asset monitoring such that a more evidence based approach is adopted for CP4. As asset monitoring information and intelligence develops over time, there will be greater certainty on asset costs and lifecycles, and improvements in efficiency to reduce costs, and as noted in paragraph 2.113 this will be subject to further review at CP4.

Question 7: Consultees are invited to comment on the proposal to reinstate the efficiency overlay, and at what level it should be set; also, provide any further views on how efficiency could be applied more effectively.

Approach to modelling

3.49 HS1 Ltd.'s model for CP3 employs a primarily time-based approach. Given the age of the assets (with the exception of the slightly older Ashford International station), and the current maturity of the AMS, we agree that this is a sensible approach for CP3.

3.50 Consistent with paragraph 3.7, and in line with the implementation plans for the AMS, the Department will ask HS1 Ltd to explain its plans to improve modelling 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.

3.51 The Department is content with the modelling which HS1 Ltd and its consultants have undertaken, provided that the efficiency overlay applies at CP2 is added back (given the draft conclusions set out above in 3.33-3.35 and 3.48).

3.52 **The Department has listened to the feedback from operators that the 78% increase in the LTC from CP2 to CP3 may cause affordability issues, particularly if repeated in future control periods.**

3.53 **The Department is challenging the calculation of the LTC annuity for CP3, given the draft conclusions set out in the following sections around maturity of asset knowledge (3.33), and the application of risk and contingency (3.34-3.35) and efficiency (3.48).**

3.54 Provisional analysis by the Department has the approach set out in the Draft Determination will reduce the total annual station charges by 25% from the c.£12m proposed by HS1 to c.£9m (18/19 prices). This remains c.£3m pa above current charges (c.£6m pa).

Station	HS1 submission £m	HS1 option 1 (£m)	Efficiency (£m)	Efficiency adjusted option 1 (£m)
St Pancras	7.612	6.716	0.952	5.764
Stratford	1.558	1.442	0.21	1.233
Ebbsfleet	1.659	1.505	0.224	1.281
Ashford	0.866	0.777	0.096	0.681
	11.695	10.44	-1.481	8.959

Table. 3.4 Proposed adjustment to the LTC HS1: Stations LTC (18/19 prices)

3.55 The Department, and GHD, will present more detailed and analysis and findings on the proposed adjustment to the LTC as soon as possible, but will in any case be present this at the workshop on 24 July 2019.

3.56 We would therefore be grateful for early responses to consultation questions 4, 5, 6 and 7 in particular, ahead of the workshop if interested parties have clear views that diverge significantly from the direction set out here.

4. Next steps for the CP3 review and beyond

4.1 This chapter sets out the next steps for the CP3 review beyond the end of the consultation period. It also sets out longer term next steps, including how the Department's decision will be monitored in CP3.

Next steps for the CP3 review

Decision date

4.2 As set out in paragraph 5.3 of Schedule 10 of the HS1 Station Leases, the Department must decide whether or not to approve the LCRs within two months of the date of their submission by HS1 Ltd.

4.3 We will notify stakeholders when we issue the final decision document. The decision will also be made publicly available on the Department's Website.

4.4 If the Government Representative is unable to approve the final LCRs, we will write to HS1 Ltd, and to other stakeholders, setting out the reasons for this, the remedial steps required, and the revised timescales for the review. In any event, the Department would expect to follow the process and timescales set out in Schedule 10, paragraph 5 of the HS1 Station Leases.

Timescales	Action
2 July 2019	Department issues consultation on its proposed decision.
24 July 2019	Department holds stakeholder workshop on its proposed decision.
11 August 2019	Consultation closes.
End July - August 2019	Any required alterations made to the Department decision in light of workshop and consultation responses.
By 31 August 2019	Final Department decision issued.

4.5 Following this consultation, we will make decisions having regard to the representations of relevant parties, technical advice we receive from GHD and the responsibilities and obligations on HS1 Ltd as set out in the HS1

Station Leases. It is therefore likely that adjustments to the Department's draft decision will only be made in the light of new evidence presented by stakeholders in response to the consultation.

4.6 The Department 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). The Department and HS1 Ltd will work together with stakeholders to produce these amendments to the station access agreements following publication of the Department's final decision.

Implementation

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

4.8 Corresponding clauses in the HS1 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[9] and notified to the Users[10] 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[11]…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."

4.9 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 CP3 i.e. 1 April 2020 to 31 March 2021. A User is a passenger operator or non-passenger operator.

4.10 Following approval or determination of the final LCRs, the Department will work with HS1 Ltd 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.

4.11 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 CP3, and ensure that these are in place before the start of the next control period.

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

Post project 'lessons learned' review

4.12 The CP3 stations review has been the second such periodic review of HS1 Ltd's stations. Given the findings outlined in the technical advisers' reports and referenced in this document, and because it is a matter of best practice, the Department and HS1 Ltd have committed to undertake a post project review of the CP3 stations review process.

4.13 We expect that all aspects of the CP3 stations review will be open to consideration, and do not intend to limit the scope of the review to the role of the Department.

4.14 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 the lessons learned review at a later date.

Beyond the CP3 review process

Monitoring the decision in CP3 and beyond

4.15 The review process does not stop with the issue of a final decision. The Department will monitor HS1 Ltd's progress against the agreed LCRs throughout CP3 to ensure that agreed outputs are being met within the agreed cost envelope.

4.16 Monitoring of expenditure will also take place through the escrow withdrawal procedures set out in the Concession Agreement and HS1 Station Leases, and through quarterly station renewal review meetings.

4.17 The Department also retains a right of audit over the escrow accounts, and we expect to use the audit tools available to monitor delivery over CP3.

4.18 Beyond CP3, we acknowledge HS1 Ltd's commitment to moving beyond a time-based approach to its asset management, towards a condition-based and, even later in the concession period, a risk-based approach. The Department 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.

4.19 The Department will set an expectation that asset monitoring and information must improve, and will form a strong focus of our CP3 action plan and monitoring arrangements.

Question 8: consultees are asked to provide any other comments which they may have which are not covered by the other questions contained within this consultation document.

4.20 A summary of the Departments draft decisions and questions for consultees is found in **Annex B.**

Annex A: Annex A: Provisions of HS1 Station Leases

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: Annex B: Summary of Questions

B.1 This annex contains a summary of the consultation questions in this document. Responses are requested no later than 11 August 2019.

Draft Conclusion	Consultation Question
Compliance	
The Departments conclusion in response to the findings of the Familiarisation Report is to undertake a lessons learned exercise with a formal action plan to be taken forward between the Department and HS1 Ltd with agreed outputs and timescales. This action plan will include progress relating to the recommendations, obligations and compliance issues raised in the GHD reports. It is proposed the action plan will be monitored by the Department at monthly progress meetings with HS1 Ltd, with updates reported to the quarterly station asset review meetings.	**Question 1: Consultees are invited to comment on HS1 Ltd's obligations under the HS1 Station Leases, the extent to which these obligations are currently met and the proposed process by the Department to seek assurance of continuous improvement against an agreed action plan**
Asset handback condition	
HS1 Ltd contend that the current definition of asset condition at handback within the Concession Agreement drives increased costs, particularly near the end of the Concession term. We are working in parallel to the Draft Determination with	**Question 2: Consultees are invited to provide comments on the draft conclusion that the definition of asset condition at handback should be retained, and that focus is placed on asset monitoring.**

HS1 Ltd to come to an agreement in time for the Final Determination on this issue. Our assertion is that the definition of "good and substantial repair" remains valid and that costs can be reduced and controlled as HS1 Ltd adopt their plans to improve asset monitoring and intelligence, and meet their efficiency targets.	
Station Enhancements	
The Department concludes that the principle of user pays should continue for the short term, and agree with HS1 Ltd's approach to consult on changes to the Network Statement that clarify the policy on station enhancements, their approach, charging principles, approvals process, and how they would seek to resolve any disputes.	**Question 3: Consultees are invited to provide their comment on how the processes described in this section are applied to station enhancements on the HS1 network, or on alternative proposals.**
LTC Calculation The Department has listened to the feedback from operators that the 78% increase in the LTC from CP2 to CP3 may cause affordability issues, particularly if repeated in future control periods. The Department is challenging the calculation of the LTC annuity for CP3, given the draft conclusions set out in the following sections around maturity of asset knowledge (3.33), and the application of risk and contingency (3.34-3.35) and efficiency (3.48).	**Question 4: Consultees are invited to comment on how a modification of the annuity calculation can seek to ensure there are sufficient funds in the station escrow accounts to deliver the maintenance and renewals required to meet the asset stewardship obligations.** **Question 5: Consultees are invited to comment on whether they are willing to accept lower customer experience and service quality outputs from critical assets such as lifts and escalators to reduce charges.**
Stewardship The Departments' draft conclusion is that, subject to the resolution of outstanding items in respect of HS1 Ltd's Station Leases obligations (please see paragraph 2.55-2.65), the Asset	**Question 6: consultees are invited to provide their comment on HS1 Ltd's asset stewardship proposals, the underpinning asset management documentation and HS1 Ltd's compliance with its**

Stewardship Purpose has been met.	**asset stewardship and life cycle purpose.**
Efficiency The Department concludes that it would be appropriate to retain an efficiency overlay for CP3. This would act as both an incentive the drive efficiencies in procurement, and to drive HS1 Ltd to implement robust asset monitoring such that a more evidence based approach is adopted for CP4. As asset monitoring information and intelligence develops over time, there will be greater certainty on asset costs and lifecycles, and improvements in efficiency to reduce costs, and as noted in paragraph 2.113 this will be subject to further review at CP4.	**Question 7: Consultees are invited to comment on the proposal to reinstate the efficiency overlay, and at what level it should be set; also, provide any further views on how efficiency could be applied more effectively.**
General Comments The Department seeks views on HS1 Ltd's final LTC submission and the Draft Decision consultation document as a whole	**Question 8: Consultees are asked to provide any other comments which they may have which are not covered by the other questions contained within this consultation document.**

Annex C: Glossary of Terms

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)

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

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 D: HS1 Lease – Schedule 10 (Annex 1) – Asset Management Strategy Requirements

An Asset Management Strategy ("Strategy") shall comply with each of the following requirements.

1. Scope
The Strategy shall consider only the renewals and replacement of the Station. Maintenance and repair activities shall be excluded.

2. Station Elements
The Strategy shall identify each of the elements of the Station which will need to be renewed and/or replaced during the Life Cycle Period. Unless the parties agree otherwise the elements of the Station shall comprise:

a. substructure;
b. frame;
c. upper floors;
d. roof;
e. stairs;
f. external walls;
g. windows and external doors;
h. internal walls and partitions;
i. internal doors;
j. wall finishes;
k. floor finishes;
l. ceiling finishes;
m. fittings and furnishings;
n. sanitary appliances;
o. services equipment;
p. disposal installations;
q. water installations;
r. heat source;
s. space heating and air treatment;

t. ventilation systems;
u. electrical installations;
v. fuel installations;
w. lift and conveyor installations;
x. fire and lighting protection;
y. communication installations;
z. specialist installations;
aa. site works;
bb. drainage;
cc. external services; and
dd. minor building work.

3. Life Cycle Works

The Strategy shall describe, in reasonable detail:

(a) the renewal and/or replacements works which will need to be undertaken in relation to each of the elements of the Station in order for the Tenant to comply with its obligations under clauses 4.3.1 and 4.14 and the Life Cycle Purpose to be achieved; and
(b) the anticipated year in the Life Cycle Period when such works should be undertaken in order for the Tenant to comply with its obligations under clauses 4.3.1 and 4.14 and the Life Cycle Purpose to be achieved.

4. Performance Monitoring

The Strategy shall identify those elements of the Station for which the Tenant will monitor breakdown frequencies and gather performance data.

5. Life Cycle Budget

Expenditure

The Strategy shall for each of the works identified in paragraph 3 above, contain:
(a) an estimate of the costs of carrying out such works;
(b) a statement of the assumptions, including those in respect of inflation and interest rates, which the Tenant has used in preparing the cost estimates; and
(c) an explanation, in reasonable detail, of the principal components of the cost estimates (including any management fees or contingencies) and the factors on which the costs estimates are based.

Revenues

The Strategy shall contain for each Financial Year of the Life Cycle Period an estimate of: 17

(a) the Long Term Charge which will be received by the Tenant in relation to the Station;
(b) any Income which will be received by the Tenant pursuant to the escrow arrangements in relation to the Station; and
(c) a statement of the assumptions, including those in respect of inflation and interest rates, which the Tenant has used in preparing the estimates of the Long Term Charge and investment income.

Cashflow

The Strategy shall include an analysis of the forecast cashflows of the revenues and expenditures described above and identify any potential shortfalls between forecast revenues and forecast expenditure.

6. Financial Model

The Strategy shall include a financial model and supporting explanatory documentation which enables the parties to determine in relation to the Station:

(a) the Available Life Cycle Funds in a Financial Year;
(b) the financial effect of any acceleration, deferral or permanent omission of any renewals and/or replacements at the Station;
(c) the financial effect any new renewals and/or replacements at the Station not previously included in the Asset Management Strategy;
(d) the extent of any savings arising where the actual costs of undertaking certain renewals and/or replacements at the Station is less than the estimated cost of such renewals and replacement; and
(e) the financial effect of applying any savings to fund the costs of any renewals and/or replacements at the Station which are in excess of the cost estimate for such works.

7. Long Term Charge

The Strategy shall include a financial model and supporting explanatory documentation which enables the parties to:

(a) determine the level of the LTC for the Station which is necessary to fund the proposed station renewals and replacements at that Station;
(b) determine the level of any changes to the LTC for a Station to reflect:

- any changes in the estimated costs of the proposed renewals and/or replacements at the Station;
- any acceleration, deferral or permanent omission of any renewals and/or replacements at the Station;
- any new renewals and/or replacements at the Station; not previously included in the Asset Management Strategy;
- the application of any costs savings or changes in the expected levels of Income