Eurostar International Ltd
Times House
Bravingtons Walk
London N1 9AW

eurostar.com

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[redacted]
HS1 Concession Manager
Department for Transport
[redacted]
33 Horseferry Road
London SW1P 4DR
By email [redacted]

[redacted]

HS1 STATIONS REVIEW (CP3) DRAFT DECISION – CONSULTATION RESPONSE

This is the response of Eurostar International Limited (EIL) to the consultation by the Department for Transport on its draft determination in relation to the HS1 Stations Review.

This is an important document. The proposals by HS1 anticipate cost increases of up to 59% in the relevant categories of charge. This is an extraordinary level for a regulated infrastructure asset that is relatively new and for which there has been 10 years continuity of ownership. A principal concern of EIL in its engagement is that these proposals are not supported by robust forecasts or, indeed, any track record of effective policies or efficient forecasting and spend. Indeed, the repot produced by GHD and others for the Department of Transport demonstrates a consistent pattern of HS1 failing to achieve industry best practice and standards and failing to track or deliver previous commitments or expected compliance.

In these circumstances EIL does not believe that the approach adopted by the draft determination is appropriate. Essentially the determination (which the exception of maintaining the current efficiency overlay) allows HS1 the extraordinary price increases sought and allows HS1 a Control Period's grace to achieve levels of compliance, standards and monitoring that should already have been reached after 10 year's ownership of the asset. The view of EIL is that the onus should be on HS1 to demonstrate basic, efficient management of the assets and that increases should be withheld until this is achieved. To do otherwise is to reverse the burden of proof.

In addition, EIL is not satisfied that the Department's draft determination is sufficiently rigorous and evidential. The draft determination comprises just 8 pages in its consideration of some very technical and complex issues. It asserts its provisional conclusions but provides very little by way of supporting consideration and almost nothing by way of supplementary evidence or analysis. It appears to rely for any challenge function solely on the opinion of one external report. It did not consult, discuss or disclose the scope or terms of reference for this report, nor sought views on it in draft – other than those of HS1. In fact, the sole interaction with other stakeholders until the workshop on 24th July, was to have read their response to the HS1 proposals. Since the response of EIL focused on the absence of evidence and analysis in

the HS1 proposals and how this undermined the ability of stakeholders properly to assess the proposals, we do not consider this an adequate basis for engagement.

Overall, the engagement of the Department, and the depth of its supporting analysis in relation to stations falls substantially short of that currently being undertaken by the ORR on related issues. Whilst the GHD report has been provided, this itself is limited in a number of key areas (such as efficiency and benchmarking) and, as this response makes clear, more information and much more analysis is required for consultees to provide any meaningful response to a number of the questions in the draft determination. Furthermore, the Department has allowed itself only 15 working days to undertake a full and proper consideration of this and other responses and form an evidential view and complete its own drafting and sign-off process. Given the extent and nature of the issues raised by this draft determination, EIL considers this a wholly inadequate timescale to undertake meaningful consideration. We will wish to understand fully, point by point, the basis on which each of our comments has been considered and determined.

Finally, and in this regard, we would welcome clarification from the Department of the procedural steps it has undertaken to ensure that it's quasi-regulatory functions in relation to this review have been undertaken independent of its reversionary interest in the Concession.

Scope of the GHD Review and Exiting CP2

In its response to HS1 EIL raised concerns about weakness of management in QX spend. This includes the absence of effective and consistent performance measuring and benchmarking; inaccuracy of budgeting; weak costs control and procurement practices; and a failure to produce a forward look for QX, despite this being asked for in the Department's previous determination. In our view performance on QX (which should be easier to predict and manage) is a strong indication of the likelihood of strong and efficient control of long-term costs and renewals.

The concerns over management of the assets are supported by the findings of the GHD report which "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" and that "only one of the recommendations has been acted on throughout CP2, and is a work in progress". This is damning – not just of HS1's management of its obligations within CP2 but of the Department's own monitoring of them. Further evidence of these weaknesses is provided in HS1's failure – after 10 years – to achieve either ISO 55000 or ISO 55001 which are basic indicators of good practice.

The Department's response to this is weak. A range of items (such as AMS delivery plans) which should have been delivered by the end of CP2 and are now postponed until CP4 and all it promises is a "lessons learned report" and ongoing review and assessment "where recommendations are **accepted by both** HS1 and the Department" (our emphasis). This is totally inadequate. There is no explanation provided as to why the Department considers further delays to implementation acceptable, no meaningful attempt to hold HS1 to its CP2 outturns and, on this basis of such inadequate past performance, the Department intends to allow increases of over 35% on future charges. What incentive for improvement does this provide?

Asset Condition

This is a good example of the overall flaws in approach within both the HS1 proposals and the draft determination. The document notes that HS1 contend that the definition of hand-back condition can drive increases in cost; the Department asserts that it is fit for purpose. However, no information is provided as to the basis for HS1's view or the Department's (provisional) refutation of it. It does appear to be the case that there are very substantial increases in renewals spend (e.g. on roofs) just ahead of the Concession hand-

back but no analysis is provided as to the extent these may be driven by hand-back conditions and, if so, the extent to which these differ from any alternative cycle of renewal.

We want to know how and where HS1 believes hand-back definitions have impacted on costs, whether the Department agrees and whether the Department has considered other relevant examples, definitions and outcomes that might provide a basis for supporting the current definitions or suggesting alternatives? What is the materiality of this for charges?

Absence such indications, consultees (who almost by definition will not be expert in such a field) are left with the choice of either:

- Commissioning their own expert analysis (which would be disproportionate and arguably paying to make up for the Department's shortcomings); or
- Being unable to meaningfully answer the question – having no basis other than speculation.

Station Enhancements

The draft determination states that "The Department concludes that the principle of user pays should continue for the short term". We are concerned with this statement because:

a) What HS1 has proposed – and EIL and others have supported – for the future is ***beneficiary pays***. This is fundamentally different from "user pays" since it allows for the possibility of HS1 itself contributing as one beneficiary; and
b) In the short-term, agreements have and continue to be reached on an ad hoc and commercial basis and EIL does not see the merit of the Department endorsing and potentially embedding) into these discussions a "user pays" principle.

However, EIL is content to engage on the development of a future enhancements framework which focusses on a "beneficiary pays" approach.

LTC Contributions from Other Sources

EIL is extremely concerned by the Department's provisional views as expressed in this section. These seem to be exclusively driven by the Department's consideration of its ability under the Concession to determine whether the LTC should be applied to TSGN or retail outlets.

However, this is separate and additional to the responsibility of the Department to determine whether the charges being levied on rail operators have been fairly determined and apportioned in relation to the relevant regulations (the 2005 regulations as amended in 2016). It should not be the case that that 100% fall to rail operators, irrespective of use or occupation, simply because the Department may not be able to require HS1 to levy contributions from other users.

EIL would therefore like to understand how the Department has assessed the contributions of railways undertakings as being fair and proportionate and, independently, what assessment the Department has made of the compliance of the HS1 station charges with the regulations. We consider it important that we have the opportunity to consider this analysis and engage with it.

Once again, we would like to know how the Department has acted to keep its determination independent of its interests in the TSGN franchise and whether there has been any discussion between the TSGN franchise

team in DfT and the determination team (recognising that the determination team has not invited such discussion from other operators).

EIL would therefore like a formal determination as to whether the level of apportionment of costs to rail users is compliant with Directive 2012/34 as transposed into UK via the 2016 Access Management Regulations.

Annuity/Long Term Charge

Efficiency

We welcome the Department's proposal to reinstate an efficiency overlay. However, we wish to understand the basis on which is concluded that 0.6% is sufficiently challenging, especially in the near term. Indeed 0.6% looks undemanding compared with the efficiency assumptions on the national network (who have a far more demanding estate) or indeed the internal cost efficiencies being delivered by operators.

We are concerned that the draft determination document appears to take at face value HS1's assertion that it is committed to chasing efficiency improvements without any evidence that this has previously happened or been achieved. All HS1 offer is anecdotal examples and an assurance that some purchases are competitively tendered. Furthermore, HS1 saying there is a lack of evidence to support an overlay is surely a reversal of the burden of proof and a necessary presumption towards efficiency.

The GHD report can find little or no structured, quantifiable evidence of efficient delivery by HS1. Among the weaknesses identified in the GHD report are:

- the absence of any cost efficiency plan; and
- the absence of any data which would indicate whether the 0.6% efficiencies required for CP2 have, in fact, been delivered.

In fact, the GHD reports notes that HS1's proposals "contain no objective measures of what efficient delivery means or how it will be measured". This is shocking.

However, we also believe that both the GHD report and the department's draft determination themselves fall short of what is required by failing to conduct any benchmarking (beyond limited consideration of NRIL). Benchmarking could and should have been provided either with international comparators or with other relevant sectors, such as airports or shopping malls. No unit cost efficiency data is provided – or has been sought.

We would like to understand what analysis the Department has undertaken in relation to its draft determination the scope for efficiency, including historical performance, unit cost analysis and benchmarking.

Lifts and Other Categories of Spend

The document notes that lifts and escalators etc are "one of the largest categories of renewal spend". It cites some of the reasons why spend is higher than anticipated, however it provides no analysis as to whether what HS1 is proposing is reasonable, for instance with regard to benchmarking or other comparative data. The evidence from the GHD report would suggest that it is not given that HS1 (after 10 years) is still working from manufacturer guidelines, rather than a risk-based or predictive approach.

And whilst lifts is one of the largest categories of spend there are at least 14 others – some of them larger – which are not mentioned at all. In this context Question 5 seems is another example of a question to which consultees can provide no meaningful response without information which is simply not provided:

- what is the baseline level of performance we are accepting;
- what is the confidence of the Department that HS1 asset knowledge and forecasting is robust enough to deliver the linkage between cost and outcome; and
- how does the Department intend to enforce the outcomes?

EIL welcomes the concept that funding might be directly linked to performance outcomes and active choices made as to the trade-offs between the two but without the basic controls identified above being in place EIL would not have confidence that such a system would work. We therefore reject it at this stage.

Contingency

The consideration of contingency is weak.

It notes that "stakeholders did not provide views on this" but fails to note that was because it was not included in HS1's original costings on which we were commenting. It notes that HS1 has "worked with our independent consultants" and has "subsequently developed an approach based on specialist cost consultant advice, mindful of operators affordability concerns". However, operators have not been asked or consulted about the final position is affordable – or their view of affordability, as opposed to HS1's view of what our view might be. Furthermore, GHD Report highlights the limitations of HS1's consideration of efficiency. These include:

- the inclusion only of the "medium" and "maximum" spend scenarios in the calculation of contingency, excluding the "minimum" case;
- the fact that HS1 has including as risk (essentially an additional cost to operators) the cost consequences of its own "poor maintenance practices" and "maintenance regime failures"; and
- the failure to undertake a Quantitative Cost Risk Analysis.

Given this, we do not believe it is sufficient for the Department, in making its draft determination, to reply simply on an estimate by GHD that HS1 proposals (over 20 years) "may be reasonable" because they are within 30% on the NRIL figure for the next 5 years.

The Department is aware that similar discussions about appropriate contingency are happening in relation to the track access review but does not reference these. There appears to be no consideration of whether these discussions might provide relevant for stations also. For instance, there is no discussion of the interrelationship between contingency and Escrow. Neither is there any meaningful discussion as to the evolution of risk and contingency over time (we would certainly expect near-term costs to be more predictable and require much lower levels of risk and contingency). Consequently, operators are completely unsighted as to whether this even formed part of the consideration of the Department's independent consultants and, if so, what their view was.

The Department says that HS1's contingency and risk proposals are "appropriate" but provides no evidence, information or analysis as to how it has formed the view as to how it has reached this level of confidence given that the best GHD could offer was that such a contingency and risk element "may be reasonable" based on one very crude semi-comparator benchmark and whilst highlighting numerous flaws in the supporting analysis.

Annuity Period

This section is far too superficial.

In relation to the basis in the Concession Agreement, it does not discuss the difference between "pay forward" and "look forward". It says "ORR have indicated that they think a 20 year annuity may not be possible..." but makes no acknowledgement of ORR's evolving thinking on this topic. Nor does it acknowledge the Department's own role, including its ability, with HS1, to amend that agreement.

It notes HS1's alternative proposal but – unlike the ORR on track access – has not engaged with operators to explore and discuss this or other options, or indeed sought to capitalise on this parallel work.

It notes under HS1's proposal that "cost beyond 10 years are uncertain" but does not seem to take this into account in its assessment of the robustness of HS1's proposals anywhere else in the document. This is important because one of the key points for EIL in its consultation response was there is a particular need to ensure that extraordinarily high cost increases are supported by commensurately robust evidence. Trains have been operating on HS1 for 17 years and SPI has been open for 10 years. The fact that there are still such concerns about asset knowledge is a serious failing of stewardship. EIL does not believe that significant increases in charges can be justified based on previous and continuing failures of this nature. Yet this and the approach in the rest of the draft determination are strongly indicative of Department reversing this "burden of proof" and allowing HS1's proposals as the default.

In relation to track access, HS1 has forecast an additional net 10,000 trains per annum by 2040 from a new operator entering the market. Whilst the arrival of a new operator is perfectly possible, EIL does not believe that the overall size of the available market would support such a net increase in services (especially given the proposed HS1 price increases). It is entirely unclear whether HS1's forecasting of station renewals has assumed an increase in footfall consistent with their own traffic forecasts. If so it raises further questions of credibility but also of intergenerational equity – the idea the Eurostar passengers today may be asked to support the costs inflicted by a competitor operator who may or may not materialise in future.

In its consideration of the risks of underfunding, the Department considers the risk of a cost shock. However, this implies that any failure of forecasting should simply be accommodated by operators through compensating charges. There is no consideration that this might represent, first and foremost, a failure of forecasting and that some of that risk and cost burden should therefore be carried by HS1.

Asset Stewardship

The Departments invites consultees "to provide their comment on HS1 Ltd's asset stewardship proposals, the underpinning asset stewardship proposals, the underpinning asset management documentation and HS1 Ltd's compliance with its Asset Stewardship Life Cycle Purpose".

These are complex and technical areas. They are summarised in the HS1 proposals; however, operators do not have access to the underpinning documents. In any case they are area in which operators cannot – and should not – be expected to be expert.

It is therefore utterly insufficient for the Department to throw out such a broad ranging question without providing and supporting insight and analysis whatsoever.

Costs and Indirect Costs

Indirect Costs

We agree with the comments relating to concern about the maturity of asset knowledge. We also agree with the need to undertake a more fundamental review of the escrow accounts.

It is not clear how the Department proposes to apply these considerations in relation to the costs in CP3-4 in forming a view as to whether these are reasonable and efficient.

Costs of Debt

The Department notes HS1's explanation. However, it provides no view as to whether you regard it as credible. In particular the costs of maintaining funds in an overdraft fund (and the deficit costs) when the Escrow account is not forecast to go into deficit for at least 25 years.

Modelling and Efficiency

The draft documentation notes EIL's concerns that the modelling is too conservative and suggested an independent review.

The documentation notes HS1's response on RPI and investment. For which it is "grateful" and "content".

However, the assumptions and methodologies underpinning HS1's modelling are not just limited to RPI and which accounts the money is held in. So, has the Department undertaken any such review or has its consideration been limited to simply asking HS1 to clarify these limited aspects of it? If no review has been carried out, why not? On what objective and evidential basis did the Department form the view that such independent assurance was not necessary. This is particularly the case because the GHD report points to a range of weaknesses that create concerns about HS1's current management and would support the call for an independent review, these include "numerous inconsistencies across the [Life Cycle Reports], "a significant number of general errors" where information has been duplicated across LCR's, the inability to align asset management strategies with the Long term Cost and Long Term Charge models, and the failure to properly audit the Long Term Charge model with Spreadsheet Monitoring Best Practice.

At the heart of this is are two fundamental failures: the failure to properly link the strategies by which the assets are management with the models used to calculate the costs and charges for that work; and the failure to properly assure the sole model responsible for calculating charges.

In these circumstances, and coupled with "the lack of scope of the renewals planned for CP3" which GHD also reports, it is difficult to see how the department could assure itself that the funding it proposes to allow as a result of its draft determination is actually necessary or will be spend efficiently and effectively.

Efficiency Overlay

As indicated earlier, this section is far too superficial.

- What view has the Department formed as to current efficiency?
- On what objective or evidential basis has the department formed a view that 0.6% this will "no doubt" be challenging, especially in the earlier control periods.

Given the concerns raised by EIL in our response (showing the historic pattern of spend and HS1's repeated inability to forecast at all – let alone accurately,on QX for example), there is every reason to believe that HS1

is currently very inefficient. This is supported by the concerns the document raises over asset costs and lifecycles. In particular, the Department states "The Department is also concerned that 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". Since manufacturers guidelines are, almost by definition, highly conservative, this is fundamental to efficiency. It is also an unacceptable position 10 years into the Concession. This is illustrated by the higher than expected failure rates (and subsequent costs) on lifts and travellators. HS1 explain this by saying the equipment was not designed for the quasi-outdoor conditions of the stations. However, there is no evidence that manufacturers or warranties have been challenged; HS1 who should have conducted diligence accept to liability; and their approach (as reported by GHD) appear to be just to incorporated the higher failure rate into all future lifecycles forecasts (and costs), without challenging whether equipment might efficiently be replaced with deigns that improve on this.

Once again, The Department should not be allowing cost increases of 35% (even after the reinstatement of some efficiency overlay) whilst these concerns persist. Otherwise, what is the incentive on HS1 to improve?

In general, the Department appears not to have undertaken any work – or, if it has, not shared or discussed this work – to enable an objective consideration of the position. In this context the question "what level should it be set" and "any views on how efficiency could be applied more effectively" represents another abrogation in failing to provide consultees with any supporting evidence and analysis which might support informed consideration.

Eurostar has achieved 2% pa efficiencies in controllable costs since 2011 and will achieve further efficiencies this year and across our 20 year planning horizon. EIL's position is that no real terms increases in charges should be permitted until HS1 has demonstrated over CP3 a track record of efficient delivery and the implementation of the CP2 commitments, including in relation to asset management and forecasting/modelling.

Approach to modelling

See above.

The Department indicates that there is scope for HS1 to improve its modelling and that it would be preferable to move to condition-based or risk-based approaches. Given this, why does it consider that the current approach is "sensible for CP3" and why – and on what basis of review – is it "content with the modelling HS1 Ltd and its consultants have undertaken"?

Even with the (inadequate) efficiency overlay added back, this still amounts to an increase in charges of 50%. Why is the Department content with approving such an increase given the indicated immaturity of modelling methodology?

Summary

EIL considers HS1 proposals inadequate in their level of quantifiable evidence (as opposed to selective and anecdotal example). We are disappointed that in so many instances the necessary information was not made available to the consultants conducting the review, and we believe that this also prejudices the ability of customers and stakeholders to comment also. We entirely reject HS1's assertion that efficiency should not be an expected part of any determination unless the need for it can be proved; we believe that the fundamental responsibility is for HS1 to demonstrate it is spending its customers' money efficiently, before it is given any more, rather than the other way around.

The GHD (and others reports) are useful but limited. In part they are limited by HS1's failure to be able to provide adequate data/documentation for review, but also in scope. EIL is particularly disappointed at the absence of meaningful benchmarking, in particular in relation to efficiencies.

Nevertheless, a clear pattern emerges: ten years into the management of its asset it has failed to certify to normal professional standards. It cannot link its asset management strategies to it cost calculations and the charging model. The model which is relied on to calculate charges has not been adequately audited/assured. It has failed to monitor or deliver the commitments from previous control periods and cannot demonstrate any efficiency achieved. Indeed, it has no proposals for what efficiency means or how it should be measured. Its allowances for risk charged on to operators include the costs of its own management failures.

Against this background, and noting the almost complete absence of supporting explanation or analysis within the Draft Determination Document, EIL considers it unsupportable that the Department should allow the proposed cost increases and maintaining only a limited efficiency requirement.

EIL firmly believes that funding should be held flat in real terms for the next control period with HS1 required to demonstrate the remedial improvements necessary to allow for an effective basis for future determination in CP4.

Yours sincerely,

Gareth Williams
Strategy Director and Company Secretary

ANNEX Response to Questions

1. There is a lack of adequate information provided to properly answer the question; how can respondents comment on HS1's obligations under the station leases when these are not published and the GHD reports not provided? From the description provided it appears that "an assurance of continuous improvement" is a totally inadequate response to a fundamental failure to act on previous commitments. The department should not be permitting increases in charges until improvement has been demonstrated as opposed to – yet again – promised.

2.No adequate information or analysis is provided to allow respondents to form any meaningful, evidential view as to the proposed (retained) definition and approach.

3.Any station enhancement framework should be based on the principles of "beneficiary pays" and not "user pays".

4. This is an active and important debate in the context of the track access review where Eurostar has proposed alternative approaches which could be adapted for stations. We believe that the Department should withhold any final determination on this issue until it has had an opportunity to consider the draft determination of ORR in relation to track renewals and escrow.

5.In principle yes, in practice such proposals are stymied by the fact that HS1 cannot provide a reliable analysis of baseline performance and we are not starting from a position whereby we can be confident that current spending is efficient.

6.Frankly, this is the Department's job – or at least to provide sufficient analysis and consideration to enable stakeholders (who are, by definition, not subject experts) to reach an informed view. No such analysis or information is provided.

7.It is essential to maintain an efficiency overlay; operators have a right to expect that efficient will be applied over the full period for which charges are levied. The Department calls 0.6%pa "clearly challenging" but does not explain how it has reached this view. In fact such evidence as is available – such as trends in spending, the failure of hS1 to implement the actions committed in CP2, and the fact that, 10 years in, HS1 is still planning to manufacturer guidelines – all point very clearly in the opposite direction of demanding far higher efficiency targets in the earlier control periods at least. DfT should not simply be "reinstating" (or , more accurately, requiring HS1 to maintain the current...) efficiency overlay, it should be setting out alternative proposals with reference to analysis, such as historic performance, unit cost comparators, and/or top-down benchmarking. It does none of this; it simply throws the question back at operators. Eurostar's position is that no real terms increases in charges should be permitted until HS1 has demonstrated over CP3 a track record of efficient delivery and the implementation of the CP2 commitments, including in relation to asset management and forecasting/modelling.