

Our reference: HRE-ORR-0001

27 August 2020

James Osborn

Executive, Access and Licensing

Office of Rail and Road

25 Cabot Square

London

EC14 4QZ

Dear James

APPLICATION BY HITACHI RAIL LIMITED UNDER SECTION 17 OF THE RAILWAYS ACT 1993

Thank you for your letter of 20 August 2020 enclosing a copy of Abellio East Midlands Limited's ("AEM") representations dated 18 August 2020 ("the DFO Response") and inviting Hitachi Rail Limited ("Hitachi Rail") to provide any comments it may wish to make in respect of the DFO Response.

Accordingly, we have set out below our comments on the DFO Response. Where comments have been provided we have addressed these under the relevant paragraph heading set out in the DFO Response (which itself is structured to follow the format and order of Hitachi Rail's section 17 application):

Section 2.1 Title of proposed contract or amendment

- Section 2.1 should now read: *"Proposed Depot Access Agreement (non-TOC Beneficiary) between Hitachi Rail Limited (Beneficiary) and Abellio East Midlands Limited (Depot Facility Owner) for access to and light maintenance services at Leeds Neville Hill Depot (the "Proposed DAA") to commence at 00:00 on 18 October 2020."*
- A fixed term Depot Access Agreement was entered into between Hitachi Rail and AEM on 18 August 2019 and was originally due to expire on 31 March 2020. The fixed term Depot Access Agreement was entered into to allow time for further commercial discussions and, if such commercial agreement could not be reached, to allow time for a determination by the Office of Rail and Road in accordance with section 17 of the Railways Act 1993.
- Hitachi Rail and AEM have subsequently agreed to extend the fixed term Depot Access Agreement on two occasions (first to 30 May 2020 and then to 17 October 2020 to accommodate AEM's request to delay their response to Hitachi Rail's section 17 application from 6 April to 3 August 2020).
- The fixed term Depot Access Agreement will expire at 23.59 on 17 October 2020.

Section 3 Executive Summary

We are concerned that the DFO's Response may lead to over complication in respect of the question and the determination sought by Hitachi Rail Limited.

The scope of the Beneficiary Depot Services in the Proposed DAA and scope of services (i.e. activities/operating manuals) are agreed between the parties (including the time required for each activity).¹

The only matter not agreed is the Access Charge to be applied in respect of the Beneficiary Depot Services.

The simple question is whether or not the Access Charges proposed by AEM in respect of the Beneficiary Depot Services for the future Proposed DAA (i.e. from 18 October 2020) satisfy the regulatory requirement (i.e. do they reflect the actual cost of AEM providing such services plus a reasonable profit)?

Accordingly, we would make the following further observations:

- Historic matters relating to the introduction of the IEP fleet and previous fixed term Depot Access Agreement arrangements entered into between Hitachi Rail and EMT and Hitachi Rail and AEM are not relevant to this section 17 application - which is to determine future charging for Beneficiary Depot Services set out in the Proposed DAA from 18 October 2020 based upon a certain minimum service level.
- We would wish to express significant concern if, as AEM's Response requests, any perceived historic costs incurred by East Midlands Trains or East Midlands Railways as a result of IEP mobilisation or changes to the IEP fleet introduction at Neville Hill are taken into account in calculating the cost of providing future Beneficiary Depot Services under the Proposed DAA. We would wish to underline that Hitachi Rail, East Midlands Trains and AEM agreed commercial terms in respect of mobilisation costs (including Hitachi Rail paying for training activities for depot personnel) and access under the terms of the fixed term Depot Access Agreements up to 18 October 2020 and therefore, in the view of Hitachi Rail, East Midlands Trains and AEM were (and will be) properly compensated for all services provided prior to 18 October 2020.
- Hitachi Rail would further request that the Office of Rail and Road notes section 6.1 of Hitachi Rail's initial section 17 application which outlines the infrastructure investment made by Hitachi Rail (and at Hitachi Rail's cost) at Neville Hill to upgrade infrastructure at Neville Hill to facilitate the introduction of the IEP fleet.
- The reference to uncertainty arising from a potential future transfer of the DFO status of the Neville Hill Depot is outside the control of Hitachi Rail as Beneficiary and should not affect or inform the calculation of charges by the Depot Facility Owner. An event that may or may not occur in 2021 should not influence or inform the assessment of charges to be applied on and

¹ The parties agreed a Transition Period Side Letter dated 15 August 2019 (Enclosure 2 of Hitachi Rail's section 17 application) in respect of capacity management at Neville Hill Depot during the introduction of the IEP Fleet and withdrawal of the LNER legacy fleet. Hitachi Rail's minimum service levels required following the expiry of the transition period as defined in the letter are set out in the annex to the Transition Period Side Letter for the duration of the Proposed DAA. The transition period has now expired and there is a certain baseline for minimum service levels from 18 October

from 18 October 2020 (which should be the cost of providing the services plus a reasonable profit). The Depot Access Conditions and Depot Access Agreement provide for any future adjustments to the charges arising from a change in circumstances when they occur (including depot usage or a change in Depot Facility Owner status) and should not be prospectively factored in to depot charging.

3.2 Terms not agree with the facility owner

Hitachi Rail does not state in its section 17 application that the Depot Facility Owner's charges will be 'uplifted' for the period 2020/21.

It is Hitachi Rail's understanding that the charges proposed by the DFO should not be limited to any financial year (e.g. 2020/21) but rather would apply for the duration of the Proposed DAA which would continue until it expires in accordance with the generally approved terms of such depot access agreement. Any charging review that becomes necessary should be addressed by way of the mechanism included in the depot access conditions.

Hitachi Rail provided the view in its section 17 application that, in the absence of transparent charging information, the charges proposed by the Depot Facility Owner may exceed the cost to the Depot Facility Owner providing the Beneficiary Depot Service plus a reasonable profit. To date Hitachi Rail has only been provided with a fixed total charge for the period 1 April 2020 to 31 March 2021. Notwithstanding this, Hitachi Rail has sought to break down this aggregate amount to calculate a price for the Beneficiary Depot Services per vehicle (as set out at Enclosure 3 of Hitachi Rail's section 17 application).

The DFO Response at section 3.2 indicates that DFO's charges comprise 1) the cost base, 2) the risk factors AEM has had to consider, 3) an analysis of the direct, indirect and overhead pertinent to the depot, 4) the lease costs.

Hitachi Rail wish to understand (and we assume the ORR also will wish to understand) on a transparent and substantiated basis how either the aggregate charge or the charge per vehicle for the Beneficiary Depot Services is built up having regard to the cost elements cited in the DFO Response (and set out above). We assume that the ORR would wish to satisfy itself that items 3 and 4 listed above are properly apportioned between the DFO and beneficiaries according to their respective usage. We are also unclear why the charges should include any element of risk as this is not provided for in the regulations.

Accordingly, please can the Depot Facility Owner provide to the ORR and Hitachi Rail a breakdown of the cost of providing the Beneficiary Depot Services under the Proposed DAA plus the level of reasonable profit in order to substantiate the statements made in the DFO Response at sections 3.2 and 5 (together with evidence of the same and evidence of correct apportionment of depot costs between the DFO and beneficiaries).

We had assumed that the DFO would provide this detailed and necessary breakdown to the ORR as part of its initial response to facilitate the necessary determination by the ORR and to satisfy the requirements of paragraphs 3.4 and 3.6 of the ORR's guidance. We remain concerned at the lack of transparency over the cost build up and do not consider that external financial audit or general franchise reporting to DfT satisfies this specific requirement.

In respect of the introduction of the IEP fleet at Neville Hill (which has now been completed), please see our comments at section 3.1 above. The Proposed DAA is in respect of future services from 18

October 2020 where the volume and mix of units are certain (as set out in the Minimum Service Levels in the Proposed DAA). Any future potential changes should not be 'priced in' to the DFO charges before they materialise as the Depot Access Conditions provide for charging review mechanisms to address such matters.

In respect of the relevance of Enclosure 3, we would direct the Office of Rail and Road and AEM to the following Depot Access Agreements on the public register under which the same scope of services are provided as requested under the Proposed DAA and which formed the basis of the comparative analysis at Enclosure 3 and can and should therefore be relied upon for comparative purposes:

- Inverness GAD/18/225/234/04/19/01
- Polmadie GAD/18/86/234/19/01
- Heaton GAD/18/326/234/02/19/01
- Edge Hill GAD/18/86/234/04/20/01

In the absence of detailed and transparent information on the build of the DFO's Access Charges at Neville Hill, Hitachi Rail have had to rely on comparative data to highlight significant cost differential in the cost of providing the same or similar services provided by other DFOs located in the north of England and the charges proposed by the DFO at Neville Hill Depot.

Section 4.3 Franchise Obligations

We would refer you to our commentary at section 3.1, in particular:

- Hitachi Rail, East Midlands Trains and AEM agreed commercial terms in respect of mobilisation costs (including Hitachi Rail paying for training activities for depot personnel) and access under the terms of the fixed term Depot Access Agreements up to 18 October 2020 and therefore, in the view of Hitachi Rail, East Midlands Trains and AEM were (and will be) properly compensated for all services provided prior to 18 October 2020.
- Hitachi Rail would further request that the Office of Rail and Road notes section 6.1 of Hitachi Rail's initial section 17 application which outlines the infrastructure investment made by Hitachi Rail (and at Hitachi Rail's cost) at Neville Hill to upgrade infrastructure at Neville Hill to facilitate the introduction of the IEP fleet.

Accordingly, such matters should not inform any analysis of charges for future Beneficiary Depot Services under the Proposed DAA on the basis that the DFO has been (and will be) properly compensated for such matters up to 17 October 2020.

Section 5 Charges

We are not able to comment on the internal procedures applied by the DFO for validating Access Charges proposed to potential beneficiaries.

The description of the internal processes applied by the DFO in modelling depot pricing (without any relevant breakdown showing how the charges for the Proposed DAA are actually built up) does not satisfy the regulatory requirement or provide requisite degree of transparency on pricing.

We would reiterate our request that the DFO provide such reasonable and detailed evidence of how the Access Charges proposed by the DFO satisfy the regulatory requirements and comprise the genuine cost of providing the services plus a reasonable profit (see earlier commentary at sections 3.1 and 3.2).

Section 6.1 Enhancement details

Hitachi Rail installed additional fuel points at Neville Hill which has provided Neville Hill Depot greater capability to service modern DMUs rather than the now obsolete and outgoing HSTs.

Yours sincerely,

[Redacted]

Andrew Rogers

Head of Projects & Contracts East

Hitachi Rail Limited

cc [Redacted] , Commercial Regulatory Access Manager, Abellio East Midlands Limited