

24 November 2020

James Osborn

Executive, Access and Licensing

Office of Rail and Road

25 Cabot Square

London

EC14 4QZ

Dear James

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

We have now had the opportunity to consider the documents provided to you by Abellio East Midlands Limited (“EMR”) and provided to us under your letter of 12th November 2020. Accordingly, as requested, we are pleased to set out below our comments on the documents provided by EMR.

Notwithstanding the considerable extension of time afforded to EMR to prepare a response to our section 17 application, we are very disappointed to conclude that the documents provided by EMR do not, in our view, provide the ORR or Hitachi Rail with the necessary level of openness and transparency on the make-up of the charges proposed in the enclosed Depot Access Agreement (DAA).

In particular, the documents provided do not demonstrate how the DAA charges reflect the cost to EMR of providing access and/or providing the supply of those services, plus a reasonable profit. The ORR’s guidance issued in connection with the Railways (Access, Management and Licensing of Railway Undertaking) 2016 at paragraphs 3.4 to 3.6 is clear as to the expectations placed on facility owners:

“3.4 Paragraph 1(6) of Schedule 3 of the 2016 Regulations requires that the charge imposed for track access and the supply of services within these service facilities must not exceed the cost of providing it, plus ‘a reasonable profit’. We expect the service provider to be able to demonstrate how charges reflect the cost of providing access to its service facilities and/or the supply of services within those facilities, if requested.

[...]

3.6 Service providers may publish their charges in different ways, but we expect them to be open and transparent about charges for services.... “

Cost build-up

To illustrate this significant concern we have highlighted the following example drawn from the two key documents provided by EMR: (1) “NL S17 – Price list for NL IEP Services for 30.10.20.xlsx” (“NL Price List”) and (2) “NL S17 20200901 Cost Structure analysis for 30.10.20.xlsx” (“NL Cost Structure Analysis”). The issue described below is applicable to all charges included in the NL Price List.

The NL Price List provides at column ‘M’ the ‘Unit Price per job’ in respect of each task identified in columns ‘B’ and ‘C’. Columns ‘N’ and ‘O’ provide a breakdown for the Unit Price per job by identifying the ‘Direct Costs per job’ and the ‘Overheads per job’; thus together the ‘Direct Costs per job’ and the ‘Overheads per job’ make up the total ‘Unit price per job in column ‘M’.

The NL Cost Structure Analysis document (which we find very difficult to follow) confirms that EMR calculate the total exam cost by reference to 'overhead hourly rate' plus direct labour hourly rate, exam labour (which we take to mean number of individuals), exam standard time and exam material. How these elements then inform the cost buildup of 'Direct costs per job' and the 'Overheads per job' is entirely absent from the NL Price List and is a key piece of missing information and lacks the required level of transparency demanded by the ORR guidance cited above.

We have extracted the 'Direct Costs per job' in respect of the activities that would be provided pursuant to Schedule 5 (1 day maintenance exam), Schedule 6 (Fuel point exam), Schedule 7(3)(Nose end and DOO clean) and Schedule 19 (CET) which together comprise the overnight maintenance at Neville Hill ("Overnight Maintenance"):

[Redacted]

Having regard to the data derived from the performance of Overnight Maintenance at Neville Hill by EMR over the last twelve months, we would estimate, on a very conservative basis, that it takes one individual 2.5 hours to complete the Overnight Maintenance tasks on a 9 car IEP unit and 1.5 hours on a 5 car IEP unit. We do not believe the time required to perform Overnight Maintenance is a matter in dispute.

Applying our knowledge of the time required to perform the Overnight Maintenance tasks, the direct labour rate (excluding 'overheads per job') amounts to [Redacted] per hour in the case of Overnight Maintenance tasks for 9 Car Bi Mode units and [Redacted] per hour for 5 Car Bi Mode Units. We do not consider that this hourly direct labour rate can possibly reflect the actual hourly cost of that labour to EMR plus a reasonable profit (noting that overhead costs are already separated and so this analysis is confined to the pure cost of labour).

In the alternative, if the direct labour hourly rate for work arising cited in the NL Price List ([Redacted]) has been applied by EMR to calculate the direct costs per job, then this would indicate that EMR have planned for 5.69 hours to complete the Overnight Maintenance Tasks on 9 car Bi-modes, which is considerably in excess of the 2.5 hours actually required to perform the Overnight Maintenance tasks (itself a conservative estimate), as evidenced from data over the last twelve months. Furthermore, if, as indicated in the NL Cost Structure Analysis, 'overheads' are calculated on an hourly rate, then this significant over estimate of the time required to perform the Overnight Maintenance tasks would have a correspondingly significant impact on the 'overheads cost per job' cited in the NL Price List.

Clarification request (1): It is critical to any analysis of the NL Price List that EMR provide evidence to the ORR and Hitachi Rail of their assumptions in respect of A.) direct hourly rate, B.) time assumed for each 'job' ('i.e. exam labour'), and C.) materials (which we believe is limited to sand and screen wash as required as Ad Blu and diesel is charged separately). As stated above, EMR's NL Cost Structure Analysis clearly identifies each of these as component items in the cost build-up of direct labour cost per job. We assume this information to be readily available and must have been used to arrive at the charges stated in the NL Price List. Accordingly, please can this be urgently provided to the ORR and Hitachi Rail.

Overheads

We note, from EMR's NL Cost Structure Analysis that the first two elements used to build up their costs are a) EMR Overheads and b) Depot Overheads. However, there is nothing in either the NL Cost Structure Analysis or the NL Price List to show how each of those elements are calculated or apportioned in accordance with depot usage by the EMR as DFO and other beneficiaries (including Hitachi Rail).

With regard to Depot Overheads, we understand that the depot is used

- During the day, solely by EMR for heavy maintenance, which requires additional indirect support such as engineers, exam planners, material planners etc. which are not required for our overnight servicing ("Day Work"). We would expect EMR to pick up all the overheads associated with Day Work
- Overnight by EMR for both Heavy Maintenance, with its associated additional overheads, and overnight servicing. Hitachi Rail and other beneficiaries for basic overnight servicing only. We would expect that all users should pick up a reasonable share of the total overhead costs attributed to Neville Hill Depot according to their share of overall usage, and that should be demonstrated to the ORR and Hitachi Rail.

Clarification request (2): Please can EMR provide more detail on how EMR Overheads and Depot Overheads are calculated and then apportioned in accordance with depot usage by the DFO and other beneficiaries (including Hitachi Rail)?

We further note that in respect of each 'job' identified in the NL Price List the 'Overheads price per job' makes up a different percentage or proportion of the total 'Unit Price per job'. By way of a spot check extracted from the NL Price List, we can see as follows:

[Redacted]

We also note too, that the Variable Work Arising hourly rate includes an element of overhead comprising ^[Redacted] of the total hourly rate. We cannot see how this is tenable or reasonable, as all the depot overheads are already being fully recovered through the minimum service level charges.

Clarification request (3): The above table is illustrative by way of example. We would expect overhead costs to be consistently applied across jobs and would ask for EMR to provide an explanation of how overheads are calculated/allocated to each job. Again, we assume this information to be readily available and must have been used to arrive at the charges stated in the NL Price List.

Train movements

In respect of 'train movements', NL Cost Structure Analysis explains that the costs comprise 'NL Depot Drivers' and 'NL Operations'. Although we have been provided with a cost per train for depot moves (see rows 37 and 38 of the NL Price List identifying a Unit price per job of [Redacted]), that cost is not split by NL Depot Drivers / NL Operators and there is no explanation about how the overall 'Unit price per job' for train movements is calculated.

We are aware that the total time a driver is on a Hitachi Rail IEP unit is no more than 45 minutes, which includes both the evening arrival and morning departure.

On this basis, the direct hourly labour rate of train drivers would appear to be in the region of [Redacted] ([Redacted]). Again we do not consider that this hourly direct labour rate can possibly reflect the actual hourly cost of that labour to EMR plus a reasonable profit (again noting that overhead costs are already separated and so this analysis is confined to the pure cost of labour). It is also considerably in excess of the direct labour hourly rate ([Redacted]) provided in respect of work arising.

Clarification request (4): Please can EMR provide to the ORR and Hitachi Rail more detail on how the cost of train movements is calculated in the NL Price List, including EMR's assumptions in respect of time required for each train movement and hourly rate of train drivers applied and the amount allocated to 'NL Depot Drivers and NL Operations' as identified in NL Cost Structure Analysis?

We would observe finally that across the industry it is usual to agree access charging based on the number of hours per task, a reasonable labour rate, material, plus appropriately allocated depot overhead, plus margin. We are unclear (and remain concerned) as to why EMR are unable to provide this information, despite repeated requests made by Hitachi Rail to do so since 2018.

Given the significant price differential in the access charges proposed by EMR compared to the charges proposed by other facility owners in the region for the same services (and which are available on the public register), it is essential that this information is provided to the ORR in order that an informed determination under section 17 of the Railways Act 1993 can be made.

In light of the multiple extensions granted in respect of our application, we would request that a strict timeframe for response be applied in respect of any further clarification requests made of EMR. We consider that any further information requested of EMR in respect of the matters identified in this letter should be readily available on the basis that the documentation provided by EMR under your letter of 12th November could not have been prepared without reference to such information. In respect of any matter which may be regarded as commercially sensitive as between Hitachi Rail and EMR and cannot be disclosed to Hitachi Rail, we would be willing to discuss how this may be managed, including whether such commercially sensitive material is provided only to the ORR for the purposes of the ORR's section 17 deliberations and not disclosed to Hitachi Rail.

We are available to provide any further clarification should you wish to discuss any aspect of our application or subsequent correspondence.

Yours sincerely,

[Redacted]

Andrew Rogers
Contracts & Projects Director
Hitachi Rail Limited

Copied to:

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