

Maintenance

Introduction

1. This appendix provides some further information on certain aspects of the ROSCOs' maintenance services. We cover the following areas:
 - (a) the ROSCOs' accounting treatment of maintenance services;
 - (b) recovery of maintenance overheads;
 - (c) Angel's approach to pricing dry leases, in particular the margin transferred from the non-capital rental to the capital rental;
 - (d) a summary of the instances where Angel has refused to offer dry leases;
 - (e) a summary of the instances provided to us by the ROSCOs in which they considered that TOCs had performed maintenance poorly; and
 - (f) a summary of the instances provided to us by the TOCs where they considered that maintenance pricing was not sufficiently transparent.

Accounting treatment of maintenance service activities

2. The ROSCOs account differently for soggy, wet and dry leases.¹ This section outlines how each ROSCO accounts for maintenance services under these three lease types.

Soggy leases

3. When operating under a soggy lease, each ROSCO charges the TOC a fixed monthly non-capital rental. Expenditure on maintenance includes planned maintenance events plus any unplanned maintenance events and maintenance cost overruns. As maintenance events of rolling stock are cyclical and the cost of carrying out these events may vary, the fixed monthly income from non-capital rentals does not match the timing and cost of associated maintenance expenditure incurred by each ROSCO. The mismatch in timing affects the way each ROSCO records non-capital rentals in its financial records.

HSBC

4. HSBC makes a number of accounting adjustments to address the mismatch in timing between maintenance income and expenditure. [✂]

Angel

5. To match income with expenses, Angel defers a portion of the non-capital rental received. This deferral is for accounting purposes only so Angel conducts the calcu-

¹We explain the terms soggy, wet and dry leases in Section 5 of the main report.

lation on a whole portfolio basis, not on a lease-by-lease basis. This means that there are no individual fleet maintenance balances which Angel monitors.

6. Angel stated that, as maintenance contracts did not generally require prepayments and accruals tended to occur within the year with no year-end balances, it did not record prepaid maintenance on its balance sheet.

Porterbrook

7. Porterbrook defers the portion of non-capital rentals relating to future maintenance events. Porterbrook records maintenance expenditure when incurred and releases an amount from deferred income equal to the amount of the maintenance expenditure.
8. Porterbrook also does not prepay maintenance costs.

Dry leases

9. The three ROSCOs all adopt different approaches to dry leases.

ROSCO A [REDACTED]

10. ROSCO A uses a maintenance reserve on a dry lease. It calculates a maintenance reserve charge using a similar process to that of calculating a non-capital rental, [REDACTED].² ROSCO A considers the cost of maintaining the rolling stock over the whole of its life and over the dry lease term [REDACTED].
11. Any cash received by ROSCO A is placed on deposit and any interest earned is added to the balance. ROSCO A expects the maintenance reserve balance to equal zero at the end of the assumed life of the rolling stock.
12. [REDACTED] This ensures that the maintenance reserve remains at a level which contributes to meeting the whole-life cost of the asset. [REDACTED]

ROSCO B [REDACTED]

13. When ROSCO B agrees a dry lease with a TOC, [REDACTED], the TOC may be required to pay a maintenance reserve charge.³ The maintenance reserve charge is intended to achieve two aims: (a) to ensure that a TOC contributes to the next maintenance event and (b) to act as a form of security to ensure that ROSCO B has sufficient funds towards the cost of the next maintenance event should the TOC default and the lease be terminated. The maintenance reserve charge is calculated by reference to the cost of planned maintenance events and the frequency of the events as set out in ROSCO B's whole-life maintenance plans.⁴ [REDACTED]
14. [REDACTED]⁵

²[REDACTED]

³The particular form of the lease, including the level of any maintenance reserve charge, will depend on negotiations between ROSCO B and the TOC.

⁴For example, a maintenance event that occurs every four years at a cost of £8,000 per vehicle would give rise to an annual maintenance reserve charge of £2,000 per vehicle per year.

⁵[REDACTED]

ROSCO C [REDACTED]

15. ROSCO C does not charge a maintenance reserve rental on a dry lease.⁶ [REDACTED]

Wet leases

16. Accounting for wet leases is similar to soggy leases. The main exception concerns HSBC, [REDACTED].

Recovery of overheads

17. The approach taken to maintenance pricing and the recovery of overheads differs between the three ROSCOs.
18. [REDACTED]
19. [REDACTED]
20. [REDACTED]

Analysis of Angel's approach to pricing dry leases

21. As set out in the main report, we identified that a premium of up to [REDACTED] per cent had sometimes been applied to the capital rental on Angel's dry leases. [REDACTED] We tested the possibility of Angel tying maintenance services to leasing so as to exclude competitors by considering what premium Angel had applied to dry leases. We assessed whether a tied soggy lease rental was cheaper than a dry lease rental.⁷
22. Angel provided data for [REDACTED] dry lease offers it has made on MOLA rolling stock. These related to [REDACTED].

⁶[REDACTED]

⁷We explain the principle of tying in detail in Section 7 of the main report.

23. Table 1 shows that only in one case [REDACTED] was the margin transferred from the non-capital rental on the soggy lease to the capital rental on the dry lease sufficient to make the tied soggy lease cheaper than the dry lease.⁸ In most cases the margin transferred was between [REDACTED] and [REDACTED] per cent, less than the [REDACTED] per cent usually added in non-capital rentals. TOCs have agreed dry leases on the terms offered in [REDACTED] of the [REDACTED] cases.

Instances of Angel's refusal to offer dry leases

24. Angel told us that it had refused to offer dry leases on a number of occasions but explained the specific reasons for such refusals. The instances of refusals and Angel's explanations are set out in Table 2.

⁸[REDACTED]

TABLE 1 Angel's dry lease pricing

Rolling stock	Franchise	Vehicles	Soggy lease			Dry lease			Soggy or dry rental cheaper	Increase in capital rental	
			Initially quoted capital rent (soggy lease)	Initially quoted non-capital rent (soggy lease)	Sum of soggy lease rentals	Contracted capital rent (dry lease)	Assumed price of maintenance (non-capital rental less [%] mark-up)	Sum of dry lease cost		Increase in capital rental on dry lease	Increase in capital rental on dry lease as % of non-capital rental (excluding [%] mark-up)
			A £	B £	C=A+B £	D £	E=B/[%] £	F=D+E £		G	H=D-A £
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]

Source: CC analysis.

TABLE 2 Instances of Angel's refusal to offer dry leases

Franchise	Angel's rolling stock	Comments by TOCs	Comments by Angel
[REDACTED]	[REDACTED]	[REDACTED]	<p>Angel concluded that it was not appropriate to offer a dry lease for these fleets due to:</p> <ul style="list-style-type: none"> • capability considerations: the bidder did not have the necessary component change facilities and it only had limited experience of maintaining the rolling stock it would be taking on lease; • the fact that it had existing committed maintenance contracts with third party suppliers; and • ongoing technical issues associated with known faults on the units.
[REDACTED]	[REDACTED]	[REDACTED]	<p>Angel stated that the long-term interests of the fleet were best served by retaining control of the fleet via a soggy lease arrangement due to the combination of:</p> <ul style="list-style-type: none"> • technical issues associated with known faults on the units- Angel considered that these were better managed by a consistent overhaul supplier than by the bidder moving to a different overhaul supplier; • the lack of heavy maintenance history of the bidder for the rolling stock it would be taking on lease; • a bad experience with some aspects of heavy maintenance carried out by previous lessees of similar fleets; and • the benefit of one ROSCO managing maintenance across multiple fleets through spares float management (because there would have been a problem if the fleets were split as there were insufficient spares to go around).
[REDACTED]	[REDACTED]	[REDACTED]	<p>Angel considered that there were many factors present that raised serious concerns over a dry lease:</p> <ul style="list-style-type: none"> • the bidder had no experience of the maintenance requirements of the rolling stock it would be taking on lease; • the complexity of the types of maintenance that would be required for the rolling stock the bidder would be taking on lease (including the historic and endemic issues associated with certain components that would impact on the rolling stocks' performance); • the pressure on existing floats of key components; and • the size of the fleet meant that planning the maintenance programme to cover all repair events would have been very complicated. <p>However, Angel committed to trying to award more heavy maintenance work to [REDACTED] once it had assessed its heavy maintenance capability.</p> <p>Angel could not recall [REDACTED] ever requesting a dry lease for the [REDACTED] fleet. It submitted that [REDACTED] claim must have resulted from a misunderstanding of some kind on the part of [REDACTED].</p>

Source: CC analysis of TOC responses to CC's questionnaire, Angel's response to maintenance questionnaire.

Instances of poor maintenance by TOCs

Angel

25. Angel provided a number of examples where it considered that certain TOCs' performance of maintenance services had not been adequate. Angel categorized these examples as follows:

- (a) *Overdue maintenance or deferred work*: By monitoring the performance of maintenance activities, Angel noted cases where maintenance had been deferred

due to material or labour shortages and passenger revenue-earning service demands ([REDACTED]).

- (b) *Redelivery concerns:* TOCs are responsible for keeping rolling stock in good condition (with the exception of fair wear and tear). Angel stated that most lease redelivery programmes have identified unsatisfactory maintenance (particularly in relation to interior conditions) resulting in significant remedial costs. For example, the transfer of the [REDACTED] resulted in costs of £7.4 million, 88 per cent of which related to interior costs.
- (c) *Improvement notices:* Angel provided an example of a notice from the ORR in [REDACTED] to [REDACTED] for returning rolling stock in an unsafe condition following maintenance.
- (d) *Audit and assessment:* Angel gave examples of failures in maintenance noted during its routine audit and inspection of TOC maintenance activities. For example, Automatic Warning Systems receiver date checks were not carried out on [REDACTED] units operated by [REDACTED] and pools of oil were found on engine tops on a [REDACTED] unit operated by [REDACTED].
- (e) *Additional work at overhaul:* The need for additional maintenance had been discovered during overhaul by third-party maintenance providers, after the original maintenance had been undertaken by the TOC (for example, repairs to cab impact damage on [REDACTED] vehicles operated by [REDACTED] and inter-vehicle gangway renewals on [REDACTED] units operated by [REDACTED]).
- (f) *National incident reports:* Angel reviewed the National Incident Reports (NIR) for examples where maintenance failures were considered responsible for reported incidents. It submitted that this gave an indication of poor maintenance on the part of the TOCs.
- (g) *Rejected warranty claims:* Angel stated that nearly half of all warranty claims were rejected and that 20 per cent of these rejections were found to be the result of TOC error or poor maintenance by the TOC.

HSBC

26. HSBC provided a list of incidents noted during recent leases where maintenance performed by the TOC was considered to be substandard. We categorized these incidents as follows:
- (a) *Overdue maintenance:* Maintenance had not been completed within the specified period, or had been delayed to the very end of the lease to 'optimize' the rolling stock's time in service. For example, [REDACTED].
 - (b) *Incomplete maintenance:* Where a TOC failed to perform the necessary maintenance. For example, [REDACTED].
 - (c) *Incorrect maintenance:* Where a TOC had not performed necessary maintenance to the standard expected of it by HSBC. This included cases where [REDACTED]. It also included cases where [REDACTED].
 - (d) *Damage to rolling stock:* Where, as a result of deficient TOC maintenance, rolling stock assets had been returned to HSBC with damage or missing parts. [REDACTED]

Porterbrook

27. Porterbrook provided us with 12 monthly reports that listed the instances where it considered that TOCs had not performed maintenance in a satisfactory manner due to delay or performing below the appropriate standard.

Complaints from TOCs on transparency

28. We received submissions from four TOCs criticizing the level of transparency in non-capital rentals and maintenance reserves to the extent that this hindered their ability to switch to a dry lease in certain instances: [REDACTED].