

Public Accounts Committee

Oral evidence: Procuring new trains, HC 674

Monday 13 October 2014

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Members present: Margaret Hodge (Chair); Guto Bebb; Meg Hillier; Mr Stewart Jackson; Mrs Anne McGuire; Austin Mitchell; Stephen Phillips; John Pugh; Nick Smith

Gabrielle Cohen, Executive Leader, John Thorpe, Executive Leader, NAO, Geraldine Barker, Director, NAO, and Richard Brown, Treasury Officer of Accounts, were in attendance.

Witnesses: Philip Rutnam, Permanent Secretary, Department for Transport, Michael Hurn, Director, High Speed Rail and former SRO for both Thameslink and Intercity Express programmes, DfT, and Lucy Chadwick, former SRO for Intercity Express (currently DG International, Security and Environment Group), DfT, gave evidence.

Q1 Chair: Welcome. Before we get to the meat of it, one of our obsessions, Philip, is with responsible officers. We have two before us—welcome to both of you—but my understanding is that Lucy Chadwick is former and Michael Hurn is also former. How many responsible officers have you had on this since the project started?

Philip Rutnam: How many since the project started?

Chair: Not people—how many times has the responsible officer changed? If I look at it, for Intercity the first invitation to tender was in November 2007, and the original invitation to tender for Thameslink was in November 2008. How many times have we changed the official who is responsible and accountable for that in the past six or seven years—six years for one and seven for the other?

Philip Rutnam: Six years for which one?

Chair: Well, do it for the two together, because they have been done together, haven't they? November 2007 was when you had the original invitation to tender for Intercity Express and November 2008 was when you had the original invitation to tender for Thameslink.

Philip Rutnam: Since November 2007 there have been seven changes of SRO on the Intercity Express Programme and two changes of SRO on the Thameslink Programme. However, I would point

out that, on the Intercity Express Programme, from 2009 to 2012 Lucy Chadwick was the SRO continuously, save for one period of six months where she was the acting director-general responsible for that part of the organisation, during which she of course continued to take a very close interest indeed in the project.

Q2 Chair: Is that people or times that people came in and out of it?

Philip Rutnam: You asked for changes—transitions—so my answer was about transitions or changes.

Q3 Chair: Are you content with that?

Philip Rutnam: I will count again. So, since November—

Chair: No, are you content with the fact that there were seven changes on the one and three on the other?

Philip Rutnam: I think I said two on the other. We have clearly had much more continuity on Thameslink, which has been beneficial. On the Intercity Express Programme, as I was trying to get at, we have in fact had more continuity than the bare statistic you asked for implied, because throughout the period since 2008 the two people here—one to my left and one to my right—have been responsible for the Intercity Express project. There has been some succession between them—some handovers—because, as I explained, Lucy, for a period, was the acting DG and stepped up into a more senior role. Michael then stepped in to be SRO for IEP. So we have had more continuity than the bare statistic implies. None the less, would I like more continuity still? Of course.

Q4 Chair: Okay. It seems a lot to me. As we go through the problems—I hear what you say, that there was a key period when you had continuity—it is nevertheless worrying that we still have not got to the position where, on major projects like this, we do not have consistent personnel in charge.

Can I now go to the more general question: why on earth did you decide to buy these trains through the Department, rather than through the operators?

Philip Rutnam: I can offer a perspective from looking back on it as Permanent Secretary since 2012. The first question is, why did the state—the Government—take on the responsibility of buying the trains? If you recall, before the Department had its present responsibilities for rail, there was the Strategic Rail Authority. The Strategic Rail Authority was the context in which the first work—it was the origin, if you like—on the plan for the project developed.

Chair: The Strategic Rail Authority went in 2004.

Philip Rutnam: Yes, but the work on the project actually began before—it was going on in 2004.

Q5 Chair: But there was a little thing called privatisation, which was supposed to lead to a transfer of risk away from the Government to the operators, and here we are: the big hand of Government, with no experience, comes in and buys these trains.

Philip Rutnam: Why has Government—whether through the Department or, before that, through the SRA—taken on the role of procuring the provision of the trains? Fundamentally, the answer is that we judge—our predecessors judged, and we continue to judge—that that is the approach which is going to drive the greatest possible value for passengers and taxpayers.

Q6 Chair: Why?

Philip Rutnam: The reason for that is to do fundamentally with three things. First, there is the scale of the procurements and the scale of the need. Big problems needed, in this case, a big answer, so the scale of the procurements was very large, and larger, almost certainly, than any individual train operating company or ROSCO—rolling stock company—could undertake. So it is scale in the first place.

Secondly, there is the fact that the need was a system-level need. It was not just about an individual franchise; it was, in both cases, about multiple franchises or large parts of the network, so, again, the intervention needed to be at a level above individual franchises.

The third thing, which could perhaps be regarded as the most judgmental in a way, is that our predecessors, and we also, thought there was a need for a step change in efficiency of rolling stock operation, in the performance of rolling stock and in the impact that rolling stock had on the network in terms of a step change in energy efficiency and in other performance characteristics, like impact on track.

So we needed a new generation of trains, and the judgment was made that we would get that new generation of trains only by Government stepping in. There are lots of benefits, which I can also talk about, from the private sector's role in rolling stock—the way that franchisees, and indeed ROSCOs at times, have provided rolling stock—but those benefits tend to be for smaller deals. For these very large deals, which were across large parts of the network and multiple franchises, the judgment was reached that Government needed to act.

Q7 Chair: Okay. Let me take the last one first. It comes out in the report that the trains they were buying before were big and were damaging the infrastructure, which was putting additional costs on Network Rail. Surely, in the context of everything—the point will become clear as the questioning moves forward—you just have to change the incentive systems; you do not fix things by saying, “Crumbs, we have a problem here. They are buying trains that are too heavy and destroying the infrastructure, so we will buy the trains ourselves.” What you should have done, shouldn't you, is change the incentive system for the franchise operators to make sure they had regard to the whole service impact?

Philip Rutnam: As I say, that was only one of three reasons, but we certainly should have incentives and try to make sure that the incentives for the franchisees—the operators—are aligned with the outcomes we want.

Q8 Chair: So why didn't we do it in that instance?

Philip Rutnam: I don't know why. I can't answer you, I'm afraid, about 2004, 2005, 2006. I can tell you that we are doing that now.

Q9 Chair: Okay. Let me ask, why didn't you two just look at changing the incentives on the franchises, so that they bought the greener option? You can see why they bought the heavier trains: they would last longer. Well, I assume that was why they bought them. Why didn't you change the incentives on the franchises?

Lucy Chadwick: Some of these are the time scales on which the refranchising was going to be happening.

Chair: Sorry?

Lucy Chadwick: The time scales on which these franchises come up are the obvious moments at which you reset those incentives. Those were some way away. We had a high demand—

Q10 Chair: When did you let the franchises on these two? The franchises were for five years. You started thinking about this, and it's taken you for ever and ever. If you take the franchise for Thameslink, when was that last let?

Lucy Chadwick: At the time at which this programme started, that was still a relatively new franchise, and at that point—

Q11 Chair: When? Give me the dates.

Lucy Chadwick: Do I know those off the top of my head? I am looking at Michael. I'm sorry, I don't, but—

Q12 Chair: I just don't accept that as an excuse. We're talking about extending franchise levels—franchise periods—but we are talking about franchises that were for five years.

Philip Rutnam: No; well, at privatisation, franchises were generally for seven years. Different policies were introduced at the beginning of the last decade, extending some franchises. But the fundamental point was that Thameslink, the Thameslink rolling stock, originally involved three franchises—Thameslink, Southern and Great Northern—and there was no way in which we could just leave it to the three franchisees to act together to achieve the very large investment in rolling stock, the very, very significant investment in rolling stock, that was needed for the Thameslink project, which was another whole generation of new capacity coming into London.

Q13 Chair: You just put it into their contracts; I don't see why not. The irony about this is that we set out to establish a system for running our trains in this country and then suddenly a little problem arises and what you do is you intervene. You come back and say, "Well, we can only deal

with this at the centre,” instead of thinking, “Are there mechanisms within the way we configure the privatised rail system that would allow us to stay true to our purpose?” It’s funny, me arguing this, but I am.

Michael Hurn: As Mr Rutnam says, one of the prime drivers for our involvement in these procurements is the scale of them. They cross a number of franchises; they are multiple franchises. Take Thameslink, for example—a very, very significant train order. It covers three train franchises. Therefore, the Department had to have a role in that procurement to facilitate it across those—

Q14 Chair: The Department could have put that into the franchise agreement. There’s nothing to stop them putting it into the franchise agreement: “When you’re buying trains, you co-operate with franchisee A, B and C.”

Michael Hurn: But that wasn’t the sole reason why we, as a Department, procured these trains. It was the scale and the finance that triggered our real involvement. As I said, for Thameslink, we need one homogeneous fleet covering three franchises, so we could not leave it to one franchise to represent all three franchises.

Q15 Chair: Well, let me just take you through what I think is some of the impact of this. Once you take that decision, you have to have an influence on what the franchise agreements look like in the future, so you will then constrain what an operator can do about the use of trains, for example, and constrain what an operator can do about timetables, won’t you?

Michael Hurn: My answer would be that we have developed both procurements with a lot of involvement from operators. Operators have a lot of flexibility going forward both on contracts in terms of train service and internal layout, and on potential changes as a result of that, through contract variation, so it is not a complete straitjacket whatsoever for these two contracts.

Q16 Chair: If you buy the trains, the operators will have to use them, and that must impact on their flexibility. You are saying, “We had some conversations to make sure that was right.” Nevertheless, for the future franchises to be competitive, it will have an impact on how they can run that franchise. It will impact on the timetable and it will impact on how they use the trains, I think I am right in saying.

Michael Hurn: But in the case of the Intercity Express Programme, there is a lot of flexibility in terms of its interior layout: seating, density for luggage—

Q17 Chair: It doesn’t matter. You are not answering the question. The question is: if it’s a national procurement, by the state, in a place where we’re assuming we have a privatised service, you will limit and constrain, in the future, the flexibility of that service. You may have had negotiations with the current operators, but in the future they will be constrained.

Philip Rutnam: You are absolutely right. There will be constraints, but we are likely to get better results than if we adopted a hypothetical alternative such as, in the case of Thameslink, asking three companies with different owners, objectives and agendas to co-operate to buy £2.5 billion-worth of trains. Above all, I am concerned about delivery driving value for passengers and taxpayers,

and adopting such a hypothetical alternative appears to be a sure recipe for non-delivery. Those companies have different objectives, and the franchises typically last for seven years, and in some cases a bit longer. The trains, assets and services will be there for a generation—25 or 30 years.

Q18 Mrs McGuire: I am a trifle confused. Are we talking about three companies that build trains?

Philip Rutnam: No.

Q19 Mrs McGuire: So they are three companies that operate trains. I would have thought that they have shared objectives.

Philip Rutnam: The question was why we adopted the approach of buying the trains—a number of years ago, why did the Government take on the role of doing these procurements? That is an understandable question, and I was saying that one of the reasons is because in both cases—IEP and Thameslink—the trains, assets and rolling stock will be used by more than one franchisee on different bits of the network. IEP will operate on both the East Coast route and the Great Western route. We think that having a homogeneous fleet that can operate on both routes or either route offers a big advantage in terms of value for money.

Q20 Mrs McGuire: Was there no way in which you could have reconciled those differing objectives?

Philip Rutnam: Let's take the case of IEP. We asked the two franchisees, Great Western and East Coast, to take on joint responsibility for a £7 billion NPV procurement, which is a risky route. You need to have a single customer when you are buying something. You need a clear line of responsibility, which is a message I have often heard from this Committee.

I don't think we wanted to do this, because the Government don't naturally seek to play such a role, but given the structure of the rail industry, with all the advantages for Government comes some responsibility in some circumstances. We have recognised that responsibility here by trying very hard to drive greater value for the taxpayer in some circumstances where we cannot leave it to franchisees. We have multiple franchisees holding franchises that typically have life spans of seven years. The franchisees therefore have a shorter time horizon than the interest of taxpayers in the assets, which last a generation.

Q21 Chair: Let me ask you two questions, because you keep talking about value for money. If, for example, passenger numbers go down, or if HS2 means that there is less demand on a line, and the operators do not need as many trains, who picks up the bill?

Philip Rutnam: Ultimately, taxpayers will pick up the bill.

Chair: Why?

Philip Rutnam: Because—

Q22 Chair: Do you mean you, the Department for Transport, or the fare payer?

Philip Rutnam: The way that fares are set is another set of questions altogether, but let's regard the variable as ultimately being the taxpayer, which certainly tends to be true in the forecast.

Q23 Chair: So the risk comes back to Government and away from the operating companies.

Philip Rutnam: We have certainly taken a significant level of risk in undertaking the procurements. We think, and there is a huge body of evidence and analysis that underpins this statement, that the risk is more than amply justified by the huge benefits. What's more, to echo some of our previous debates, if we did not make this investment, you, and many others besides, would be criticising us intensely for failing the rail industry, passengers and taxpayers by failing to ensure that we have the rolling stock that is needed.

Q24 Chair: No. In a position in which the risk has been transferred, we might have thought that the operators would be expected to pick up that risk. I have one final question. Let us suppose that there is a Labour Government, and that that Labour Government decide to freeze fares for five years—I have no idea whether that is in our manifesto, because I am very detached from it, and I have no idea who is going to win the general election. Who would then pick up the tab for these trains? Have you built that into your calculations?

Philip Rutnam: The way that the regulation of rail fares operates essentially means that if decisions are made to lower or raise regulated rail fares, that has an impact on the Department's budget. Assuming that the Treasury agrees to flex our budget or that the funds are found from somewhere else, if it is an increase in the spend on rail, other things to do with rail do not change—to approximate to a simple order of magnitude. I think the idea that the Treasury will not continue to scrutinise, test and challenge our budget is a bit hypothetical so, if you will forgive me, I don't want to speculate any further on the consequences of a potential manifesto commitment.

Q25 Chair: Maybe I shouldn't have put it in that context. If someone decided to freeze fares for five years, in the way you have done it, the taxpayer would pick up the tab.

Philip Rutnam: Fares decisions—

Chair: No, in terms of procurement. What I'm getting at is that the risk has been transferred to the taxpayer.

Philip Rutnam: The risk of these procurements in relation to the demand for trains—whether passengers will use them and in what numbers—will ultimately find its way to taxpayers. I think that is right. The truth of the matter is that even in franchises, which typically only last around seven years, those risks come back to taxpayers at the end of the seven years when you re-let the franchise.

Q26 John Pugh: I think the Committee is struggling with the fact that you say you are a reluctant purchaser of trains, but you are doing so on a colossal scale. I can understand why; you

have a better eye on the infrastructure and some other elements of the industry. You want to diminish wear and tear, lead to integration and so on, but you have conceded that it severely constrains the train operating company. You gallantly said that they can move the chairs around a little bit to get their costs down if they need to. Have you done any modelling, over the terms of this contract, of the potential repercussions for the taxpayer in terms of subsidy or for the passenger in terms of fares? We all accept that the train operating company has very limited room to manoeuvre in this scenario.

Philip Rutnam: I think there are three points. One is the constraints we have put on operators.

John Pugh: The big constraint is that the operator cannot choose his own kit any more.

Philip Rutnam: Is your question about the impact of those constraints on fares?

John Pugh: Yes, in terms of the operator managing his business. His business is profitable; if demand changes, what can he vary?

Philip Rutnam: There is a fundamental point I want to illustrate first, and I might ask Michael to add to it: conceptually, our ensuring the purchase of these assets imposes a constraint. We have ultimately chosen one option out of many hypothetical options. That, of course, involves a constraint. But in the real world, the arrival of these assets will actually significantly increase the options for operators. They will have many, many options and will be able to offer types of journey that are not available today. For example, there will be more trains available on the network.

Q27 Chair: But they will have to use those extra trains; they will not have the flexibility to say, "We don't want them."

Lucy Chadwick: They have worked in collaboration with us throughout these procurements, from the very beginning. You asked if we had done this on our own; the answer is no. For the three Thameslink franchisees and the two IEPs, we have worked closely with them to assess what they see as the market opportunities. What we have purchased is not beyond what they see as credible. These are against quite pessimistic forecasts in terms of—

Q28 John Pugh: For current franchises that are run differently, in the traditional mode, the cost for the ROSCOs of renting different types of rail kit varies enormously. One way in which franchises model their costs is by deciding what kind of equipment and rolling stock they will use. You have taken that away from them; they cannot do that.

Michael Hurn: For the Intercity Express Programme, I mentioned flexibility in terms of the train's interior, but there is also huge flexibility in terms of route services and train lengths. You will have read in the NAO Report about the concept of a bi-mode train, which can obviously go in electric mode under the wires but can go to a variety of destinations in diesel mode beyond the wires. That gives enormous flexibility for the train service in future. Not all the trains are full-length trains; some are half-length and, at peak, are coupled together to create full-length capability. Off-peak, they can go to a variety of destinations off the wire. The concept we have for the Intercity Express Programme is truly flexible; it is not purely about internal layout.

Q29 John Pugh: So none of the modelling you have done so far alarms you and makes you think that there might be dramatic increases in subsidies or in fares as a result of doing things this way?

Philip Rutnam: These are obviously major investments, which will ultimately have an impact on public finances but they are thoroughly justified on the grounds that they are needed to deal with demand and the pressure on capacity that exists now. They will generate revenue in their own right and create many more options for operators on, for example, the East Coast and Great Western lines, to serve destinations more frequently or to serve additional destinations. Without the investment we would not have the frequency of services to Bristol—from two an hour now to four an hour, as planned with IEP. We would not have services from London to Cheltenham and Gloucester going from every other hour to every hour. We would not have journey time savings. We would not have all those things. You cannot just abdicate—

Q30 John Pugh: Yes. With due respect, we are not talking about frequency, but about the cost of travel. That is what the Public Accounts Committee is largely about. A coincidental benefit of doing it this way is that you get greater control over other franchises, don't you? Presumably, there will be a big cascade of rolling stock from the exercise, some of which will go to Northern franchise or whatever, from Thameslink or whatever. There is an added control factor for you. On the other hand, things such as the Northern franchise could do a more traditional deal by keeping appalling old stock like the Pacers running because they are very cheap to run. What is your view of how it should be done, given that you have put the model in place for one area? The Northern franchise is one of the biggest franchises coming up. Are you considering the same model?

Philip Rutnam: The Government's objective, within the financial constraint that we have, is to provide the best possible services across the country, including in the Northern franchise, TransPennine and other franchises. You are right that a benefit of both projects—for example, Thameslink—is that it should free up a significant amount of rolling stock that would be available for use on other routes, possibly in the north or other parts of the country. The rolling stock will belong to the rolling stock companies that you referred to. We take a mixed approach, looking to the market to solve problems where it can and intervening only when and where needed, and where we think that the intervention is going to produce better value for money.

You mentioned Pacer trains. The Government are well aware that Pacer trains are towards the end of their life—indeed, some would say beyond the end of their life. We are well aware of that and the Government have already said that they intend to ask bidders for the Northern franchise how they would replace the Pacer trains, either as a part of the core proposition or as a priced option. The Government have recognised that, in that particular case, abdicating responsibility—not doing anything—is not going to give the best possible answers. The Government have signalled that they are willing to intervene in that case.

Q31 John Pugh: But you're not necessarily using the standard model there in the Northern franchise so far?

Philip Rutnam: Standard model, meaning?

John Pugh: In the sense that you will not provide the rolling stock; you will simply specify things in the contract.

Philip Rutnam: There is a mix of models in use.

John Pugh: You'll not be buying rolling stock for Austin and me, anyway.

Philip Rutnam: We will clearly be specifying the sort of output that we are expecting from franchisees, just as we have for other franchises already awarded. In particular, we want to see good proposals brought forward for updated, new rolling stock that could be made available and used on a network such as Northern. The mixed approach that I mentioned has had some very significant successes. We recently awarded a single franchise for the Thameslink, Southern and Great Northern network. The proposal of the winning bid included investment by the franchisee and the rolling stock company with no state support—no funding from us—for new vehicles to serve Gatwick airport and new vehicles on the Great Northern line. The market can deliver. It is just that we do not assume that the market will deliver in each and every case. We recognise that this is a complicated industry, in which the Government play a critical role.

Q32 John Pugh: Okay. I have two quite simple, factual questions. The total contracts we are looking at today are £7.6 billion and £2.8 billion. In its evaluation of this, the NAO is not quite sure whether or not it is good value for money, but you must have some idea what you were looking at from a standard public procurement. Have you any figures you could present to the Committee of what it would have cost had you pursued the standard public procurement route rather than this route, taking into account the fact that standard public procurement would not have included maintenance and all the other factors that are rolled into this contract?

Chair: PFI versus non-PFI.

Lucy Chadwick: Sorry, I don't have the figures that we undertook at the initial—

Chair: Well, you must have looked at it at the time.

Lucy Chadwick: Yes, it was initially looked at in IEP at the very beginning of the procurement, but I am sorry I don't have those figures easy to hand. What certainly came out was that the PFI approach offered the best value for money; I just can't present the numbers.

Q33 Chair: I have to say, I was going to pursue this issue. You cannot make that assertion without the evidence. All the evidence that we have had in this Committee around PFIs suggests they are hugely expensive to future generations and not necessarily the best value. You may have done it for other reasons to do with availability of capital, but you cannot make that assertion and argue it on a value for money basis without the evidence.

Geraldine Barker: What we say in the Report is that it was not an option that was looked at for Thameslink, but it was looked at for IEP. The Department decided to pursue this route because of the risk transfer. It felt that—

Chair: That's a different argument from value to money.

Lucy Chadwick: It is a value for money argument in terms of the average of outcomes that we are actually seeking from this particular contract.

John Pugh: Yes. Obviously there are a lot of considerations, such as what it may do to your budget and all that sort of thing, but I think we just like to know what the figures would be if you simply go out and buy the trains straight out of the train shop, as it were. It would be helpful to have those figures.

Q34 Chair: Yes, and how much should you have to pay? You were raising this finance at a very difficult time so in the end how much extra did we pay for that—either the fare payer or the taxpayer?

John Pugh: The last question—

Chair: Wait, maybe they have got an answer to that one, John.

Philip Rutnam: In both cases, as I understand it, affordability was a factor. It was the determinative factor in Thameslink and it was a factor in IEP, but in both cases the Government at the time was also of the view that a PFI-type approach could secure some significant benefits in terms of value for money, not least in creating very strong incentives on the rolling stock manufacturer and its funders to ensure that the trains are delivered on time to the spec that was given and, because of the maintenance obligation over the life of the contract, that they would continue to operate to that standard throughout.

Q35 Chair: You're not answering the question, Mr Rutnam, and so I am going to ask you to send us a paper in time for us to incorporate it in the report on the calculations on actual expenditure between a straight public acquisition and PFI, and a note on how much extra you have just paid because of the time at which we were borrowing. We need to know that. We are looking back at that and we need to know about both those issues. What was the premium that the taxpayer or fare payer had to pay because of the difficulty in the financial markets? What was the straight difference in financial calculation between a public acquisition and a PFI acquisition?

Michael Hurn: There was some analysis undertaken for the Intercity Express Programme.

Chair: Good, so you can let us have the figures. We want the figures.

Michael Hurn: We will have those for you. Just to repeat, for the Thameslink Programme—

Q36 John Pugh: Just one further straightforward question, which I am happy to be provided with an answer to after the meeting. Obviously, the trains we are purchasing cost quite a lot of money to run. The fuel costs of electrification are quite significant in terms of what they are replacing. Can you send me some figures that indicate the difference and running costs in fuel alone?

Philip Rutnam: Fuel costs of electrification?

John Pugh: Yes, fuel costs. Electrification versus diesel.

Philip Rutnam: So obviously with electrification there is an electricity consumption cost that is usually a tiny fraction of the monetary cost of diesel as the fuel for running trains in the absence of electrification is—

John Pugh: In percentage terms what is the sort of ratio between the two?

Philip Rutnam: Okay, I can give you that.

Lucy Chadwick: It is also worth understanding that there are maintenance savings, from which you gain, and others, so I think we can give you a sense of those.

John Pugh: That would be helpful, thank you.

Austin Mitchell: We used to have a rather good British train manufacturing industry before the rail privatisation bugged it all up. Hitachi and Siemens are two foreign firms and I wondered what specifications and attempt you made to insist what proportion of the manufacturing capacity was done in Britain.

Philip Rutnam: We do still have a British train manufacturing industry. I can say a little bit more about that in a moment. To answer your question, our approach to procurement in this case was geared above all to driving value for money, which was getting the best possible product that was compatible with the specification—

Austin Mitchell: Not to reviving British manufacturing.

Philip Rutnam: —and the lowest price, to drive value for money.

Austin Mitchell: Price.

Philip Rutnam: And to comply with our legal obligations, because, as you will know, European law requires public procurement to be open and non-discriminatory, not to discriminate against other member states, and therefore not to have national manufacturing obligations. That would have been a blatant breach of European law. So we did not have obligations to manufacture these trains or components in Britain.

I will make two other points, though. I am pleased to say, not least because of the scale of investment and the scale of the procurement, which we were talking about earlier, one consequence has been that Hitachi, a Japanese multinational, has decided to invest heavily in the UK, to assemble the trains in County Durham in the north-east, to develop the supply chain in the UK and to do all sorts of things in the UK, including relocating its global rail business from Japan to the UK.

Before these procurements we had really one assembler and manufacturer of trains in the UK—Bombardier based in Derby—and we now have two. Hitachi is locating those activities globally in the UK. That is very significant. The other point is that since the Thameslink procurement in 2011, you probably know that the Government undertook a review of its approach to public procurement and tried to ensure that we are attributing as much value as we can within European law to contributions to the supply chain.

Some important developments in procurement practice and policy have happened since then, all compatible with European law. They include asking manufacturers to indicate, just as a

point of information, what share of their supply base for the product will be located in the UK. It is only a point of information and is nothing to do with evaluation in the bids. We also attach points where we can to the employment of apprentices and the use of SMEs, wherever that may happen in the EU.

Some important developments have happened in procurement policy, but our approach to procurement in the Department and across Government continues to be based firmly on compliance with our legal obligations and driving the best possible value for money.

Q37 Austin Mitchell: I am glad that Hitachi are giving us some crumbs from the table out of the goodness of their heart, but I am sad to see the lack of concern for British manufacturing on the part of the Department.

Let's move on. It is a new method of purchasing. Why not do this through the ROSCOs? Is it too big?

Philip Rutnam: Can I just say that the Department does not show a lack of concern about UK manufacturing? The Department works very consciously to try to help the UK rail supply base to develop. We work very closely with the Rail Supply Group, for example. That needs to be kept separate as an objective.

Q38 Austin Mitchell: The industry has been badly damaged by the lurching of orders up and down and then the failure to order.

Philip Rutnam: It needs to be kept separate as an objective from our approach to procurements for the reasons I have described. I could say more about the smoothing of orders if you like in a moment, but I think Michael was about to answer your question.

Michael Hurn: I was going to say earlier that it is not purely about the manufacturing of the trains; it is about long-term maintenance, which has depots and maintenance costs throughout a long period of time. In terms of a UK supply chain, it is not purely looking at train manufacturing. A lot of the value in both contracts is associated with train maintenance and that in itself produces a lot of value in a supply chain for the UK.

Q39 Austin Mitchell: Were the ROSCOs cut out because they were milking the industry of too much?

Michael Hurn: In answer to your question about the rolling stock companies, both the Intercity Express Programme and the Thameslink Programme are big train orders. We explained earlier that they are much higher in terms of orders compared with traditional train orders, about 100 to 200 carriages. Therefore, in terms of financing, it may be beyond the capability of some rolling stock companies to fund all of those orders in one go, so the Department became involved in helping secure the finance for these deals.

Lucy Chadwick: There was a ROSCO involved in one of the bids on IEP. This was not close to the ROSCOs; the scale of it meant that they would need to either club together or join up with some other financiers to be able to do so. This was absolutely not about cutting them out entirely; it was

about shifting the nature of what we were buying and the incentives in terms of the performance that we wanted out of them.

Q40 Austin Mitchell: I have a question about when it comes to ending the contracts and passing them on to somebody else, or keeping people bidding for the traffic. The Intercity purchase was more controversial than Thameslink. What happens if bidders do not want to have these trains or want another kind of train? What does it do then about the incumbency?

Philip Rutnam: If the bid is for franchises, to go back to your point about constraints, we will be specifying in the franchise for East Coast, for example—we have specified—that they will use these trains. So it is undoubtedly a constraint, but that goes back to the reasons why we took this approach. As I think I have tried to explain already, in the absence of this approach, we think you would have a lower value, less effective rail industry.

Now, that says something about the need for and the responsibility of the state to intervene. I am unapologetic. We need to take a non-ideological, mixed and very pragmatic approach to this. Different solutions work in different circumstances.

Q41 Austin Mitchell: You are creating a distinction between two classes of travel. One is on the electrified lines, like Great Western and Intercity, which now have these smashing, super new trains, and one is for the rest of them. Northern trains are the classic example. We are asked to travel like cattle in outdated stock which cannot be adapted for the disabled on First TransPennine, which is forced to transfer some of its best trains to Chiltern for fat southern commuters because you, the Department, messed up the contracts and they were not able to put in a bid to have the trains for long enough. So we are having two classes of travel—one for the rest of us, and one for the super-duper inter-city people.

Philip Rutnam: There are a number of points in there. First, on the Northern trains that have gone to Chiltern, we are working very closely with the industry on that, and we are confident that we will deliver a solution which will ensure that TransPennine has the fleet that it needs. I can say that; we are very confident we will deliver a solution. That is the specific issue. It is about 5% of TransPennine's fleet by vehicles, as I understand it. We are working very closely on that, and we will deliver a solution.

On the second, wider point about two classes of traveller, I have a couple of observations. Believe me, we understand very well the dissatisfaction with aspects of performance on, for example, the Northern network. Sometimes the rolling stock is very crowded, and its average age is high. We understand those issues very well, and they need to be addressed. I have already mentioned Pacers. The Government are working actively to address points like that. You will see, in the invitations to tender that come out for Northern and TransPennine, the Government's intention to take service quality significantly forward in those parts of the network, helped not least by the programme of electrification, which will reduce journey times and ease the rolling stock situation.

Can I make one other point, as a quite significant aside? You talked about two classes of traveller: those who are on the electric network using the fast, glitzy IEP trains and those who are not. Actually, one of the things that IEP does—Michael referred to bimodal trains, which are both electric and diesel—is significantly improve the offering and the service that could be made available to people whose journeys are partly on the electric network but mostly off it. The journey from

London to Hereford or Worcester, at the moment, is partly on the electric network and partly off, and there are no plans to electrify the bit from Oxford to Hereford and Worcester. IEP will give those passengers the same performance on the electric network as anybody else on that network and a better end-to-end experience than is available at the moment. It is more like one class; that's the point I am trying to make.

Austin Mitchell: I hope you tell that to your Minister before she faces the insuperable difficulty of getting to Grimsby by train on Thursday.

Q42 Chair: I just want you to clear up one thing about the use of British manufacturing. Am I right in thinking that 95% of the trains used in Germany, Italy and France are built domestically?

Philip Rutnam: I know that it is a high proportion, but I don't know that it is exactly 95%. You raise a very interesting issue. We have an open market for public procurement in the UK, as you know.

Q43 Chair: All I am saying is that when you then pray in aid European procurement rules, Germany, Italy and France are all also constrained by those rules and manage to ensure that 95% of their trains are manufactured domestically.

Philip Rutnam: We have an open approach to public procurement in terms of our philosophy and the detail of our approach. Our approach is driven, as I said, by the genuine wish to comply with our legal obligations and by value for money.

Q44 Chair: That's fine. If I may say, you're giving me a different answer, Mr Rutnam. If you are saying that we do it because we want to test the market in a different way, that's fine, but don't tell us that we are forced to give it to Siemens because of European rules. The French, Germans and Italians manage to get around those rules. That is what I am saying.

Philip Rutnam: I don't know what legal environment exactly they face in those countries—

Chair: They face the same as us. They will be as constrained by European—

Philip Rutnam: Or the level of scrutiny that they are subject to. We certainly feel subject to a high level of scrutiny.

Chair: Well, I do not accept that.

Q45 Stephen Phillips: I want to start by following up on that point. They are subject—you would have to accept—to precisely the same rules as the Government of the United Kingdom. Are they not?

Philip Rutnam: The European directives are the same, yes.

Q46 Stephen Phillips: Yes, so the landscape in which procurement occurs in Italy, Germany or France is no different whatsoever from the landscape that prevails in the United Kingdom. That is correct, is it not?

Philip Rutnam: I would not want to make that statement without checking exactly the domestic transposition of the directives and what the practices are within those countries.

Q47 Stephen Phillips: So what you are telling this Committee is that there a different legal regime applies in Italy, France and Germany from that which applies in the United Kingdom. Is that your evidence?

Philip Rutnam: No, what I am saying is that I know that the directives are the same, but I cannot give you a detailed statement about the nature of the domestic legal regime, because it is not something that I have checked.

Q48 Stephen Phillips: I am not asking you about the domestic legal regime; I am asking you about the procurement regime that applies in those countries, which is governed by European Union law. It is the same, is it not?

Philip Rutnam: European Union law is obviously the same.

Q49 Stephen Phillips: Right. I wanted to ask you a little more about procurement. IEP is a massive project, is it not?

Philip Rutnam: Absolutely.

Stephen Phillips: And we are looking at the procurement of something like 2,000-plus carriages over the course of the four-year period. Is that right?

Philip Rutnam: On IEP, it is 866 vehicles, which will be delivered between 2017 and 2020.

Q50 Stephen Phillips: Fine. If we add up IEP, Thameslink and Crossrail, there will be 2,600 new carriages between 2016 and 2020. Correct?

Philip Rutnam: IEP is 866, Thameslink is 1,140 and, from memory, Crossrail is 600.

Michael Hurn: It is around 600.

Philip Rutnam: Around 600. Right.

Q51 Stephen Phillips: I do not think that you are taking issue with my figure of 2,600 new carriages.

Now, you have twice said in your evidence this afternoon that the Department's sole driver is to try to drive greater value for money from these procurement processes. You gave an

explanation at the beginning of your evidence as to the three reasons why the Department believed that this process or form of procurement was the better route to follow in order to give that value for money. Do you remember that?

Philip Rutnam: Yes.

Stephen Phillips: Those three reasons basically come down to economies of scale, don't they?

Philip Rutnam: Not quite.

Stephen Phillips: Ms Chadwick is nodding.

Lucy Chadwick: It is one of them.

Q52 Stephen Phillips: What are the others?

Philip Rutnam: The three points I made were—

Stephen Phillips: The first was economies of scale. Then you spoke about multiple franchises, but what you were actually talking about was economies of scale. You then spoke about step change.

Philip Rutnam: The third point was actually about incentives. The first point is indeed an economies of scale point about rolling-stock investment. The second point is about the fact that we have franchises that are often, but not always, smaller than the level at which it makes sense to invest in the rolling stock. The economy of scale that is optimal for the franchise may be smaller than the economy of scale that is optimal for the rolling stock. The third point is about misalignment of incentives—

Q53 Stephen Phillips: Pause there, if you would. If your sole driver is deriving greater value for money for the taxpayer, how does that influence a decision to go down this procurement route rather than one that involves the franchisee purchasing the rolling stock?

Philip Rutnam: I was trying to explain that. First, the franchisee typically has a franchise for seven to 10 years. Unless we do something different about it, their incentive is to optimise their position over seven to 10 years, but, in the case of high-speed trains, the assets can last for 40 years.

Q54 Stephen Phillips: That's a case for all procurement of rolling stock being done by the Government, rather than the franchisee, but Mrs Hodge's question at the beginning, which you were trying to answer, is this: why on this occasion did you choose to go down this route, rather than the other route of making the franchisees purchase the rolling stock?

Michael Hurn: If I may respond, one of the biggest drivers is scale, as you rightly pointed out. These are much bigger orders than the normal orders in the rail industry. For Thameslink, an order of 1,140 carriages is very significant—it is one the largest for 30 years. The other element is the fact

that the train orders for IEP—the Intercity Express Programme—and Thameslink span more than one franchise, so there is a need to have a central body such as the Department for Transport facilitating that procurement across more than one franchise.

Q55 Stephen Phillips: Why?

Michael Hurn: I will give you a really good example. For the Thameslink Programme, the type of train that is needed to deliver the passenger benefits—it is all focused on passenger benefits—is to have a homogenous fleet with one type of train that can operate with a regular service through the central London core section.

Q56 Stephen Phillips: I don't want to stop you, Mr Hurn, but you are now talking about passenger benefits. I understood from Mr Rutnam that the driver in the procurement process is trying to secure the greatest value for money for the taxpayer and the fare payer, but now you are talking about other benefits, such as the homogeneity of the rolling stock.

Michael Hurn: I am saying that passenger benefits are driven by having a homogenous fleet, which drives value for money.

Q57 Stephen Phillips: In what way does the homogenous fleet drive greater value for money for the taxpayer?

Michael Hurn: Because if you have different types of trains going through the central London section of Thameslink, with different performance characteristics, different acceleration and different capacity, that will affect the number of trains you can operate through that core section, because you will not have a regular, uniform operation in terms of frequency. Therefore, you lose capacity through that central London section.

Q58 Stephen Phillips: But that is not looking at value for money for the taxpayer through the procurement process, is it? You are looking at subsequent benefits.

Michael Hurn: I am looking at the overall, whole-life costs and the value for money of the projects as a whole.

Q59 Stephen Phillips: Let's move on. Mr Rutnam, if I can come back to you. You are aware of a school of thought that Mr Mitchell alluded to during his questioning—I presume that the Department is aware of it—that suggests that placing one of these massive orders is anti-competitive because of the peaks and troughs in ordering that it causes over a number of years in the industry. What is your response to that?

Philip Rutnam: I am aware of that school of thought, and I don't agree with it.

Q60 Stephen Phillips: Is that your personal view or the view of the Department?

Philip Rutnam: It is the view of the Department. I would even venture to suggest that it is the view of the National Audit Office, which commented that the level of competition that we achieved in these two procurements compares favourably with the level of competition achieved by train operating companies in the procurements of rolling stock they have made since 2000.

Q61 Stephen Phillips: Let's try to unpack that a little. What assessment did the Department conduct when it formed the view that it wished to procure rolling stock through these massive orders? What assessment did it make of whether it was likely to result in a higher cost than if the orders were placed piecemeal over a number of years?

Lucy Chadwick: We did look at options, particularly for IEP, which was undertaken by the TOCs as small orders. We looked at the relative value for money of that approach versus this.

Q62 Stephen Phillips: And was an impact assessment carried out by economists within the Departments?

Lucy Chadwick: My understanding is that it was done by E and Y.

Stephen Phillips: I am not interested in your understanding. I am interested in what happened.

Lucy Chadwick: E and Y undertook that work on our behalf with our economists and concluded that the economies of scales and the homogeneity of performance made this a better value for money proposition than a series of smaller orders.

Q63 Stephen Phillips: Mr Rutnam, when did the Department's view change in that regard? In the early 2000s, it was of the view that smoothing in the market is extremely important for the purpose of delivering competitiveness.

Philip Rutnam: I was not in the Department in the early 2000s, so I will look to my colleagues to see whether that is correct and, if so, when. *[Interruption.]*

Stephen Phillips: Since they do not know, perhaps you will write to us and let us know.

Geraldine Barker: May I just clarify a point? What Mr Rutnam said is right: we do note in the Report that the level of competition achieved was comparable. But I draw your attention to paragraph 9, page 7: in our research we found that there were differing views.

Chair: You do not come down on one side or the other.

Geraldine Barker: No.

Chair: You have to be careful, Mr Rutnam—

Stephen Phillips: To be fair to Mr Rutnam, he said it may even be the view of the National Audit Office.

Philip Rutnam: No, I was actually referring to page 26, paragraph 2.9, which states: “the level of competition compares favourably with that achieved for rolling stock procurements led by train operating companies since 2000.”

Chair: And paragraph 2.5 on page 25 states: “We found that there are different views on what is the optimal procurement strategy to achieve value for money in the rolling stock market. One view is that smoothing demand could help to generate value for money.”

Philip Rutnam: I accept that there are different views. I think the question was whether there are schools of thought, and I agree that there are different schools of thought.

Q64 Stephen Phillips: I think you had better write to us. I particularly want to know if the view inside the Department has changed.

May I ask you another, related question? Given the size of this procurement, particularly for the IEP, it was almost inevitable that consortia would be formed among the manufacturing companies, as indeed happened in relation to at least one of the bids. That is right, is it not?

Philip Rutnam: It often happens in the rolling stock market, yes.

Q65 Stephen Phillips: And that is anti-competitive by its nature.

Philip Rutnam: I do not agree with that. Having been a competition regulator in a previous life, I would say that what matters is whether there is effective competition at the level of the product, which is the product market into which consortia are competing.

Q66 Stephen Phillips: Let us do some first-year economics together. If you decrease the number of those who are going to bid for the contract by people clubbing together and forming consortia, you are naturally not going to get as good a price as if you had placed smaller orders. That is right, isn't it?

Philip Rutnam: I do not think that first-year economics would take you to that conclusion. I think first-year economics would tell you that the effectiveness of competition depends on the behaviour of the parties in the market. If there are two parties in the market and they are competing vigorously with each other, you can still have a very competitive outcome. In theory, a perfectly competitive market with an endless number of suppliers can deliver lots of benefits. It also has downsides, though, in terms of economic welfare. For example, there are often barriers to innovation, because of the inability to internalise those gains.

Q67 Stephen Phillips: A final line of questioning from me. The IEP procurement changed quite late in the day, didn't it?

Philip Rutnam: In what respect?

Stephen Phillips: I can see Ms Chadwick nodding.

Lucy Chadwick: There were some changes. Absolutely.

Q68 Stephen Phillips: There were some changes, and you already had one preferred bidder at that stage. Is that right?

Lucy Chadwick: Yes.

Q69 Stephen Phillips: And you simply went ahead with that preferred bidder without re-letting or re-tendering the contract. Is that right?

Lucy Chadwick: We very carefully assessed whether those changes were within the original confines of the procurement.

Stephen Phillips: That is a legal answer, which goes back to, “We don’t want to be sued for breach of European procurement rules.”

Lucy Chadwick: That was one line of—we also looked at the question in terms of whether we had still retained what we regarded, through competition, was the best value proposition, and we were content that we had.

Q70 Stephen Phillips: What was the exercise that was undertaken? Was it a desk exercise? Was it done by economists within the Department? Was it a decision taken by the Permanent Secretary or by Ministers? How on earth did you decide, given that the parameters of the project had changed pretty significantly, that it was appropriate to proceed with a preferred bidder, rather than re-tendering the entire contract, given that its fundamentals had altered?

Lucy Chadwick: We asked ourselves a range of questions. The first question, which had come out from the Foster review, was whether we still had the right solution. So we looked at all the options that Foster had put on the table, and we assessed whether we still believed we had a sensible solution on IEP.

Q71 Stephen Phillips: But a sensible solution is a very different thing from a solution that is driving the greatest value for the taxpayer, about which Mr Rutnam has spoken three times.

Lucy Chadwick: I will come on to those elements if I can.

Stephen Phillips: That is the one I am interested in.

Lucy Chadwick: On the first question, if we hadn’t had the right solution in terms of best value when there were better value solutions out there, we would have stopped the procurement at that stage. The second question was whether, through those changes, we had still preserved value, and what were the alternates and the cost? As we looked at those, there was at least £100 million in potentially abortive procurement costs and restarting, as much as a loss in terms of delay of benefits. All those were factors in our assessing whether we had still got a bidder who had clear blue water between it and its next bidder.

Q72 Stephen Phillips: Do you mean “clear blue water” in terms of the offering or delivering value for money for the taxpayer?

Lucy Chadwick: In terms of the offering, which was generating value for money for the taxpayer.

Q73 Chair: Can I ask a question on that? Then I will go to Guto. I assume that you are referring, Stephen, to the fact that the revised bid was a 38% reduction in costs.

Stephen Phillips: Yes.

Chair: Because you had a different train design and a different financing package, right?

Lucy Chadwick: Yes.

Q74 Chair: When I saw that 38% reduction in costs, what I read, apart from the issue of whether we should have retendered, was a suggestion that we were being really ripped off in the original tender.

Lucy Chadwick: I have asked myself similar questions. What we did achieve, through the work that we undertook and the focus on cost and pressures in the Government sector, was a very different proposition. A large proportion of that was released by the decision to electrify, but, actually, Agility Trains made further offerings. Some of that was because this was a globally important deal for them: they wanted to establish a foothold in Europe—it is in Newton Aycliffe. But what we did do was preserve what was actually a value-for-money proposition by comparison with any other competitive alternatives.

Q75 Chair: Do you accept that, if Andrew Foster had not reviewed it, we would have paid 38% more?

Lucy Chadwick: Well, we did not conclude the procurement; we were not able to do so, given where we were with the financial markets. The Foster review gave us an opportunity to ask some very serious questions—

Chair: But they were going to rip us off before then.

Lucy Chadwick: Well, we would not have proceeded if we had not had that revised bid—

Q76 Chair: One of the justifications for this whole exercise was that we need these new trains. So there you are with a bid, which then magically gets reduced by 38%, and you said, “We wouldn’t have gone ahead with the original bid.” So what was your plan B at that point?

Lucy Chadwick: Well, we had an improved proposition from Agility which did, actually, manage to be the best value for money in terms of any other order—

Q77 Chair: No, what was your plan B before? From whom did you have a proposition? Was it—

Lucy Chadwick: Agility Trains gave us a revised proposition—

Q78 Chair: They come in with a bid and at some point you say, “We can’t finance this.” They then come back and reduce the bid by 38%, which, as you say, is partly due to electrification, but there is a rip-off element in there. If they had not reduced their bid, what would you have done to ensure new trains on those lines?

Lucy Chadwick: If we had not had the revised Agility proposition, we would have been outside of the procurement and not achieved value for money, and we would have needed to have gone through some form of reprocurement.

Q79 Chair: What would you have done to achieve your value-for-money objective of new trains that this procurement was to deliver? What was your plan B, or were you so tied to plan A—

Philip Rutnam: We would have cancelled the procurement. The truth is, we would have needed another big, deep think about what was the best—

Q80 Chair: You didn’t have a plan B.

Philip Rutnam: There are high-speed, Intercity 225 trains running on these two routes at the moment, so they can continue running at rather high cost and with rather less comfort for passengers, slower journey times and lots of things. It is not as though the existing service cannot continue, because it can, but we are trying to do something much better. So, in truth, we would have needed a big pause and think to come up with a plan B. I am not aware that, in our cupboard, we had the fall-back.

Lucy Chadwick: We had a continuing service operating and we could have life-extended some of the rolling stock. That was not what we had chosen to do—that was our minimum—and any investment was always going to be better than that.

To meet the demand on the network we would have gone through some form of further procurement. Whether that was us or the train operating companies, and whether that was PFI or publicly funded, would have been decided in a process that we would have gone through. That, unfortunately, would have delayed further the benefits and we would have been in a position that we would have been very dissatisfied with. In hindsight, we are in an extremely fortunate position in that Agility revised the proposition and brought it down, so we were able to achieve best value for money by comparison with others.

We did an extraordinarily robust analysis, which we shared with the NAO at the time, which included legal as much as anything. We had input from technical advisers from the sector to look at this question really hard. Had we got, at that point, a sensible proposition, or not? Our conclusion was yes, we did, which is why we proceeded.

Q81 Guto Bebb: I just want to follow up a couple of issues that have been raised by other Members. In terms of the homogeneous trains, I am interested in the comments that you make in relation to the fact that that will result in a cost saving across the network. Occasionally this Committee is willing to say that Departments are guilty of not taking into account the big picture; so the question I would ask is, if you are claiming that having this procurement for a homogeneous fleet of trains to service the network is providing a wider cost benefit for the network, are there any figures to support that situation, and to what extent would that have played a part in your procurement decision? I am not quite clear how a general saving of that nature would impact upon the specific procurement process that we are examining today.

Michael Hurn: As I mentioned earlier, the value of both these contracts is not purely about the capital cost per train. It is a long-term maintenance contract, so by having a large fleet for either project, with a maintenance part of that, you can get some real economies of scale in maintenance. In the case of Thameslink, 1,140 carriages is a very significant fleet in terms of economies of scale. By having a larger fleet you do drive through those economies quite significantly.

Philip Rutnam: And there are also gains from a homogeneous fleet in terms of capacity, because if the trains following each other have got similar operating characteristics, you can actually get more trains through, which then creates more train paths, which then creates the opportunity, the possibility, of serving more destinations, or the same destinations more times. It is a very significant benefit.

Q82 Guto Bebb: I did understand that when you were giving the evidence. The question I would ask is, were there any calculations associated with those assertions? Again, if you are talking about value for money, I think that that is an important point that you are making, but were there any figures related to those assumptions?

Michael Hurn: Of course, when we looked at the bids coming from the bidders with our technical advisers, we looked at benchmarking of these prices. I cannot, obviously, talk about the outcome of that benchmarking, because it is commercially sensitive, I am afraid; but we did, with our advisers, look at a quite considerable amount of benchmarking, to make sure that both bids are value for money, both in terms of the up-front cost but also for long-term maintenance costs, which is a very significant part of the value of these deals.

Q83 Chair: You looked at that, but what the Report actually says, on page 33, paragraph 2.30, is that “the fleets are more expensive than other broadly comparable new train types.”

Michael Hurn: Again, I come back to the point that you have to look at the entire costs of these projects: the whole-life costs, so the combination of capital costs—

Q84 Chair: I will read the sentence again: “The fleets are more expensive than other broadly comparable new train types.” I think you did a gold-plated acquisition here. They are more expensive. It is not a question of maintenance. This is more expensive.

Michael Hurn: I am sorry if I am repeating myself, but we are very much buying a train service. We are not buying purely a train vehicle or maintenance package. It is a long-term train

service contract, particularly in the case of IEP, which maximises the benefit for passengers. So the whole-life cost needs to be taken account of, and the long-term benefit—

Q85 Guto Bebb: Can I just follow up on that proposition? I am fairly sympathetic to the argument you are making; the problem I have is that when we are asking for figures relating to the argument you are making, you are saying it is protected by commercial confidentiality and benchmarking. So in effect we are in a position here where what I believe is a fairly reasonable argument that you are making cannot be tested on the actual value for money issue. This Committee is all about value for money, and I was wondering whether the National Audit Office did any analysis on the benchmarking that was undertaken.

Geraldine Barker: Certainly the Department provided us with the information that we needed to reach the conclusions in the Report. At 2.30—the Chair is quite right—it states that the comparison is based on “the combined capital and maintenance costs per carriage”. I think that the next sentence is the useful one. We go on to say, “the fleets are more expensive than other broadly comparable new train types. This is a function of the Department procuring a new design for the trains that would deliver long term benefits”. Figure 6 sets out what those costs are.

Chair: Stephen wanted to ask what are the longer-term benefits.

Q86 Stephen Phillips: What are the long-term benefits that make these trains of value for money for the taxpayer, notwithstanding their higher costs?

Michael Hurn: Most of the Intercity Express Programme is more seats, so greater capacity, and more frequent trains. They are more reliable trains. They accelerate quickly, hold the acceleration and get reliable train services. There are quality benefits as well, so it is a whole package of things. There are also very significant improvements in journey times, and Mr Rutnam mentioned some examples earlier. In terms of the offering to passengers, it will be a very significant improvement.

Q87 Stephen Phillips: Does that offering include greater ability on the part of those who work on the train to work, including in standard accommodation?

Michael Hurn: Absolutely. There are some comfort benefits within the interior of the train, in terms of things like leg room, luggage space, overhead luggage space—

Stephen Phillips: We are more interested in working sockets, speaking from personal experience.

Lucy Chadwick: Wi-fi. There will be wi-fi on all of the IEP trains.

Michael Hurn: The whole specification of the Intercity Express Programme has always been about: what does it mean for the passenger? Long-term interests of the passenger and long-term value for money over the whole life cycle of the project.

Q88 Guto Bebb: The other question I had was related to some questions that Mr Pugh asked. In particular, the Report notes the fact that you built into the PFI contract an ability to benefit from any future refinancing. The question I would ask is: could you give us an indication of at what sort of levels of borrowing cost that sort of refinancing would start to reap benefits for the taxpayer?

Philip Rutnam: We are already in detailed discussions with Agility about the potential for refinancing the Great Western element of the deal, which was concluded in 2012—financing was raised in 2012—when market conditions were significantly worse than they are now. We are in detailed discussions with them. Figure 6, which Geraldine Barker referred to, brings out the fact that for the East Coast deal, where the financing was raised earlier this year, we managed to get significant savings on that because, among other reasons, market conditions have moved on. On Great Western, we are already in advanced discussions with Agility about refinancing that. That is the first one that I would expect to refinance.

Q89 Guto Bebb: Are you in a position to hazard a guess as to the value of that refinancing to the taxpayer?

Philip Rutnam: I am not, no.

Q90 Nick Smith: As someone who travels on Great Western, I am pretty sympathetic to your position. It is a second-rate service at the moment, so I am looking forward to the new trains, new service and better scheduling. I hope that maintenance costs will be lower, too. I suppose I am troubled about the costs to passengers, so more information on that would be helpful.

I have a related question. At the same time as electrification was agreed for the London to Swansea route, it was also agreed that there would be electrification of the valley routes, which is particularly important for Ebbw Vale to Cardiff in my constituency. That has been delayed because of differences about who is going to pay for it between London and Cardiff. Because of those delays over who is going to pay for it in the round, will the cost of the build for electrification and the cost of the trains to go with it have gone up?

Philip Rutnam: Just to be clear, the UK Government continue to expect electrification to continue. Our responsibility is London to Cardiff, and then we agreed with the Welsh Assembly Government that our responsibility would be Bridgend to Swansea, and that was linked to the Welsh Assembly Government's role on the valley lines and also Cardiff to Bridgend. Our expectation is that that will proceed. We are, as you say, in continued discussion with the Welsh Assembly Government, but I am optimistic that we will reach an agreement and the project will proceed as scheduled. Certainly, work has not stopped.

Q91 Nick Smith: I am glad that you are optimistic. It is really important for the regeneration of the valleys that we get people from the top of the valleys down to the jobs market around the M4, Cardiff and Newport, and hopefully across to Bristol too. But I am worried that it has been delayed for a year, and it may not be agreed for many months yet. I am worried that there will be added costs because of this delay, both for new carriages and for doing the works. What do you think that will be?

Philip Rutnam: I have to say I am not aware of extra costs; that is not an issue that has been raised with me, at least not in relation to the bits that the Department is responsible for. I would just say again that I am optimistic. I think I am optimistic with reason, and I hope that the matter will be concluded shortly.

Q92 Nick Smith: Have you looked at whether or not there will be any increased cost because of this time delay?

Philip Rutnam: I have not raised that specific question. I will do so, now you have raised it with me, and I am happy to write to the Committee on that, if that would be helpful.

Q93 Chair: There are two areas that I want to pursue. Then I think we are probably getting to the end.

First, I have a processy question: there was huge delay through this. Looking particularly at the specifications—I put this to you, Mr Rutnam—it is not good enough, is it, to have a specification where you can purchase anything between 500 and 2,000 carriages? It is not good enough to have a specification that suggests six different routes and then eliminates some; it is not good enough to decide on electrification halfway through the process of purchasing; it is not good enough to make bidders revise their bids three times because you have changed your depot proposals and because of the financial situation. That is not good enough, is it?

Philip Rutnam: I have some sympathy with what you say. In particular, the range of 500 to 2,000 does strike me as very broad. The practical range that was used during the programme proposals was more between 500 and 1,000. I hear what you say about the fact that electrification came along after we had started the programme and, in an ideal world, we would be able to think about these things perhaps the other way round. So I hear what you say. I have read carefully what the Report said on that.

The one point I would make in defence is that it was always stressed, through the programme, that it needed to be flexible to respond to changing circumstances, because there was always a debate—there had been a debate for some time—about what the right scope of electrification was. That accelerated, I think, after Andrew Adonis was appointed as Secretary of State, but there was recognition that there needed to be flexibility. However, I take the point that the clearer one can be, provided you are clear and right about a requirement, the more stable the procurement process after that.

Q94 Chair: Okay.

Can I ask about your staffing—we have been here before—and the lack of suitably qualified and experienced staff? On this particular contract, I looked at your report and accounts and compared 2013-14 with 2012-13, and saw that you have increased your non-payroll staff by nearly 100%—92%. That is presumably to have consultants to deal with issues such as this, isn't it?

Philip Rutnam: We did increase our number of contractors and interims very significantly, not least after the franchising programme went awry; we wanted to get that back on track.

We have another programme now, which is quite well advanced, to recruit more permanent staff. We have some additional flexibility from the Treasury in relation to some quite specialised roles for that recruitment process, to reduce our reliance on interims and contractors. However, I would say that there will always be a role—when we have peaks of workload it sometimes makes sense to have contractors and interims, rather than just to staff permanently at the highest level.

Chair: But in 2013-14 you doubled them. In your report and accounts it is increased by 92%, and you now have 113.2.

Philip Rutnam: The numbers went up, and they are on average significantly more expensive than permanent staff.

Chair: How much are you paying for them?

Philip Rutnam: I would like to have more permanent staff, to change the balance. We have a programme in train on that. We have other programmes, too, on this critical issue of capability and skills. For example, we have launched our own commercial fast-track programme, to hire in young, talented people, often fresh out of university, who are interested in a career in government and have a particular interest in developing commercial skills. We have launched that and there are already 10 people in the Department, as of last month, and I will see more of those as well.

We are doing a range of things. However, make no mistake: for me as Permanent Secretary this is the biggest strategic challenge—to make sure that we have the capabilities and the skills, as well as the capacity, to deliver on the huge agenda that the Government sets for us.

Q95 Chair: Okay. So you are trying to do that in 2014-15. You did not manage it in 2013-14. How much did you spend in 2013-14 on consultants? Do you know?

Philip Rutnam: On consultants in the Department.

Chair: Just on this bit of it.

Philip Rutnam: On this project.

Chair: Yes. I have got it down as 113.2 non-payroll staff.

Philip Rutnam: 113.2 non-payroll staff in the Department.

Chair: I assume that is all consultants. Maybe I am wrong.

Lucy Chadwick: No, that is across the whole Department.

Philip Rutnam: That would be across the whole Department.

We have figures here on how much we spent on advisers on these projects—on Thameslink and IEP.

Q96 Chair: Okay, give us those.

Michael Hurn: On the Thameslink Programme, £32 million has been spent on advisers.

Q97 Chair: Over what period?

Michael Hurn: In total, or—

Chair: Well, give us both.

Michael Hurn: These have been released publicly before. So it is £32 million in total for Thameslink.

Philip Rutnam: From inception to date.

Michael Hurn: From the start to the contract close, and for the Intercity Express Programme, a figure of £41 million from start to now.

Q98 Chair: But you've still got consultants monitoring now, haven't you?

Michael Hurn: We have technical advisers assisting us with monitoring the progress.

Q99 Chair: How much are they costing you a year?

Michael Hurn: I don't have the figures to hand unfortunately.

Q100 Chair: How are you managing conflicts of interest?

Michael Hurn: We have a rigorous conflict-of-interest check when we have the invitation to tenders come in for our consultants. One of the things we ask our consultant bidders to make very clear, as part of their proposals, is whether they have any conflicts of interest—

Chair: But they can go back out again.

Michael Hurn:—and indeed, how they have managed them.

Q101 Chair: Just because you have a firm of consultants doesn't mean you have got the same person, does it?

Michael Hurn: That's right.

Q102 Stephen Phillips: Mr Rutnam, I think Ms Chadwick referred to this: when the alteration in the IEP project took place and you decided to carry on with one bidder, there was a robust analysis, which led you to that conclusion—which was in part conducted by Ernst and Young.

Lucy Chadwick: Not at that stage, so when we proceeded with the procurement, PWC were our financial advisers. They did do some value analysis. Ernst and Young were involved at the beginning of IEP when we were looking at the different financing issues.

Q103 Stephen Phillips: Was the decision to proceed with the existing preferred bidder taken inside the Department as a result of departmental analysis only?

Lucy Chadwick: Yes, entirely.

Q104 Stephen Phillips: So on the one occasion on which you might think it might be sensible to bring in outside consultants to make that assessment, it was not done.

Lucy Chadwick: We used our advisers. So we used our technical advisers, our legal advisers and our corporate finance advisers, who had been working with us, to make sure we had the very, very best analysis alongside our own—

Stephen Phillips: Was that analysis shared with the NAO, Geraldine?

Geraldine Barker: As part of this review, yes.

Stephen Phillips: And the NAO was content that it was a robust piece of analysis?

Geraldine Barker: Yes.

Q105 John Pugh: Can I ask you about the future—maybe future sessions you appear in here? It seems to me that you are heading for a perfect storm. Most of this session has been about the kind of control you have tried to exert on the market and the different views about how effectively you have done that, but are you not facing a scenario with partial electrification occurring throughout the country—in many parts of the country, it is projected—and equally, the cashiering of old diesel stock, which will soon be unsuitable by European emissions standards, and for which you are going to need more control and for which the ordinary franchising model is inadequate?

Philip Rutnam: I would not say we have got a perfect storm. I would say that there are a lot of challenges. There are challenges that come first and foremost from the popularity of the railway. Passenger demand doubled in the last 20 years and demand is up 60% on freight. We need to make sure that there is the capacity to deal with the demand we have now and the demand we are expecting in the future. If you look at the change in the total quantity of rolling stock since privatisation, there has actually been quite a modest increase—single-figure percentage points, I think, in the total amount of rolling stock. There has obviously been a change in the mix—

Q106 John Pugh: We are scheduled for a huge turnover in diesel stock though, aren't we?

Philip Rutnam: Going ahead, the really big thing that is happening on the railway is investment in capacity and electrification. There are increases in capacity into the major cities—not just London, but Birmingham and Manchester as well, and others—and electrification. There is electrification of a number of major routes—the great western main line and, in time, the midland

main line. In the north as well, there is the trans-Pennine route and Liverpool to Manchester and so on—there is a whole series of major electrification projects. I think you are right that that poses a number of challenges. It poses challenges to the Department, to the ROSCOs and to the train operating companies. In truth, we have to work together on this. We really have to work together. I spend quite a lot of time with the rail industry, and I would say that beneath the competition for things like franchises, there is a good recognition of the need for a collaborative approach to how we deal with rolling stock cascades and rolling stock investment to make sure that it is lighter, more energy efficient and so on. We will continue to deal with these issues. There is no simple answer. We will continue with a mixed approach: state intervention in some areas, the market delivering in others, and franchising delivering many benefits. As the ultimate funder for large parts of the rail network, the Government have a big role, and we recognise that. I will continue to put a lot of resources into that.

Q107 Chair: I have two final, short questions. First, I read in the papers this morning that you have put off the open competition for the Great Western franchise. Is that related to the acquisition of trains?

Philip Rutnam: We haven't made a final decision. We have said that we are seeking to negotiate with First Great Western an extension to their franchise of three and a half years, which would run from September 2015 through to March 2019. Whether or not we do that will depend on the outcome of the negotiations, but we are in a single-tender negotiation with them about a potential extension, subject to very significant value-for-money tests.

Q108 Chair: And that's because of this?

Philip Rutnam: It is because we particularly want, if we can, one operator to work with during the introduction of a whole series of changes on the Great Western: the introduction of the IEP fleet from 2017 through 2018 or 2019, and the major works that are happening on the infrastructure—the electrification programme, what is happening at Reading, and so on. It goes back a bit to the emphasis I was trying to put on collaboration in my answer to Mr Pugh.

Q109 Chair: My final question is why was there such a negative reaction in the industry to the IEP programme when Thameslink got such a positive reception?

Philip Rutnam: I will offer a personal perspective and then ask my colleagues whether they would like to add anything. I have thought a lot about this. I really do think that IEP and Thameslink are both great projects that will provide huge benefits to the public, when they are delivered. They are absolutely the right thing to be doing. However, I also think that, to be honest, we approached IEP in particular as rather too technical an exercise—we saw it too narrowly. We had huge challenges in making this thing happen—the financial crisis, the general election, the spending review—and we had to overcome all sorts of things, and we did overcome them in the end. Nevertheless, throughout that process, our heads were too much down into the detail of how to make the thing happen and how to deal with the specific parties we needed to work with—the bidders and the train operating companies. We did not think enough about the wider engagement and communication programme that is required for something like this. It is a transformative project and we should have communicated it much better. That includes listening better.

Lucy Chadwick: I wouldn't disagree with that. I think it is a really important lesson. Foster highlighted that we were too hidebound by procurement confidentiality once we got into the procurement phase. That will certainly be an important lesson that I will take away, as much as I know the organisation will do as well. I entirely concur with Mr Rutnam.

Chair: Good. Thank you very much indeed.