

Public Accounts Committee

Oral evidence: The sale of Eurostar, HC 564

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Members present: Meg Hillier (Chair); Mr Richard Bacon, Deidre Brock, Caroline Flint, Kevin Foster, Mr Stewart Jackson, Nigel Mills, David Mowat, Stephen Phillips, John Pugh, Anne-Marie Trevelyan

Sir Amyas Morse, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, Matthew Rees, Director, National Audit Office, and Richard Brown, Treasury Officer of Accounts, were in attendance.

Witnesses: John Kingman, Second Permanent Secretary, HM Treasury, Roger Lowe, Senior Responsible Officer for sale of Eurostar, Shareholder Executive, Mark Russell, Chief Executive, Shareholder Executive, and Philip Rutnam, Permanent Secretary, Department for Transport, gave evidence.

Chair: Welcome to the Public Accounts Committee. We are today looking at the sale of Eurostar and how that was managed, based on the National Audit Office Report. We will also look at lessons learned around High Speed 1, and future lessons for High Speed 2. We will come to that in the second part of our session.

I am pleased to welcome John Kingman, second permanent secretary at the Treasury; Philip Rutnam—welcome back—permanent secretary at the Department for Transport; Mark Russell, chief executive of the Shareholder Executive; and Roger Lowe, who is also from the Shareholder Executive and the director of this portfolio. Is that how you describe yourself?

Roger Lowe: Correct.

Chair: Thank you all for coming along.

You might not always hear this from the PAC, but the sale turned out to be a success, in that money was returned to the taxpayer. I note that it was 0.05% of the deficit¹, so we

should not run away with ourselves in saying that it was a great contribution to the Exchequer; nevertheless, it is good to see the taxpayer getting something. Of course, the process was run as a competitive auction to attract bidders to pay a market price for the shares.

We want, with your help, to pick out and identify good practice from the deal. We want to hear whether it was a case of more luck than judgment or more judgment than luck. We also want to hear what lessons can be learned for the future, because this is the test bed for the £62 billion of sales that are planned by the Government, and it is important for the taxpayer that those sales are conducted well and that the lessons learned are played out. I will hand over to Kevin Foster, who is leading our questioning today.

Q1 Kevin Foster: Thank you, Chair. I echo your remarks that overall there are positive comments that come out. However, there are some particular points on which I want to start the questioning. Before we start any sale, one of the fundamental considerations is the valuation and how we arrive at that. The initial Government valuation at the start of the sale process was £305 million. It is interesting to look at the table on page 34 of the NAO Report, where we see a classic smile curve. The UBS pitch book valuation in January 2014 is at a certain level, and the valuation drops just before the sale and then jumps back up again. How did that happen?

John Kingman: Roger might want to comment on that in more detail, but I think the key thing to focus on is that the valuations that we were doing internally were hold valuations, so they were not attempts to guess what a bidder might be willing to pay in current conditions. They were an attempt—this is good discipline—to assess the value of the asset if retained by the taxpayer. In doing that, we deliberately attempt to take a long-term view. The context in which we went into the sale was one where we knew that there was very strong investor—bidder—appetite for these sort of infrastructure assets, which was why we thought that it was a good time to sell, so I don't think it is intrinsically surprising that we got a good price relative to what was a long-run hold valuation.

Q2 Kevin Foster: If I were a taxpayer listening to that answer, I would say, “This is an asset that the Government own on our behalf.” The NAO conclusion was that some asset sales by Government are based on improved efficiency and that that would up the value, yet here that was not the case. Eurostar was an effective investment and a relatively sound business, so surely you would not expect quite such a dramatic change in the value.

John Kingman: It is absolutely correct to say that this was a financial asset, rather than one in which the Government were deeply involved in the management, or one about which someone would expect a dramatic change after it was privatised. The ownership and control of the asset has not changed; all that has changed is a minority interest. But it is a risky business. For sure, this is a business that is affected by all sorts of events in the real world. What you have seen here is bidders with a high appetite for risk. The Government

¹ The total proceeds (£757.1 million) amounted to 0.05% of public sector net debt at the end of 2014-15 (£1,486.5 billion)

have a possibly lower appetite for risk, quite rightly, in terms of how they invest taxpayers' money, so I think that was what played out.

Q3 Kevin Foster: Yet this investment was relatively risky when the Government initially got involved. The taxpayer base had been used to convert it from being—let's be blunt—a frankly failing investment and company, via nationalisation, into a company that was projected to do fairly well with fairly good prospects for the future, so surely there would not be that much risk, particularly looking at shareholders.

John Kingman: It might be worth Mark saying something about the realities of this business, as he sat on the board.

Mark Russell: Yes. As the Chair knows, I was not directly involved in the sale. I was on the board of Eurostar at the time, so I stood away from the process of the sale because of potential conflict, but I sat on the board for five years. I was chair of its audit committee, so I had a pretty good view of the business and the risks. Although I think it is an excellent business that has performed very well in the last three years, as my colleague says, it is absolutely not without risk. Operationally, it is a demanding business. It runs on four different infrastructures and it is quite vulnerable to some macro effects. If you just look at this year, we started off with the attacks in Paris, which had an effect. We had a closure of the tunnel because of a fire. We had the MyFerryLink dispute, which had a knock-on effect to the Eurostar operations, and then we have had the migrant problem.

All of those would have impacted the performance of the business. Although Eurostar is very good at recovering from that type of incident, I would say it is absolutely a business not without risk.

Q4 Kevin Foster: One of the risks is the prospect of competition. Perhaps I can ask the permanent secretary at the Department for Transport how many new operators we are expecting on this line in the next five to 10 years.

Philip Rutnam: That is ultimately a matter for the market rather than for the Department to determine. I am not aware of any present proposal that has a definite date attached to it for the operation of competitive services serving these markets. There have, as you probably know, been a number of suggestions for such services, but anybody coming into the market would need to do a number of things, including acquiring a suitable fleet of trains as well as getting a range of permissions.

One point I would make is that there is in place the international regulatory structure, including a series of undertakings that the European Commission got from SNCF and SNCB as part of this transaction to allow for and facilitate the entry of a competitor if a competitor wishes to enter.

Q5 Kevin Foster: I accept it is legally possible for another competitor to come in, but how likely is that at the moment? Part of the process, as you have touched on, is getting four different bits of infrastructure. There is a real complexity to providing another service on this

line. It is not like a bus service—I can go and buy a bus tomorrow and apply for an ability to run it on a road that is pretty much open publicly. How long will it take for a competitor to come in on this route?

Philip Rutnam: I think it would certainly take several years for a competitor to come in, not least because the competitor would need to start with the acquisition of a suitable fleet of trains. I do not want to offer a view on behalf of the Department as to the likelihood of a competitor entering, but I would say that the possibility of competition is real. You see it in a number of European markets—increasingly so. The UK in many ways led the field. You see the presence of on-rail competition serving long-distance markets, for example, in Italy as well as the UK.

Q6 Kevin Foster: The next part that was interesting was the discount on value around minority shareholder. I accept that, at the beginning of the process, it would not have been possible to have known the final bidder—for obvious reasons—but the final bidder turned out to be someone who was already in an agreement with SNCF, the majority shareholder, as I recall from my reading, and there was a very good shareholder agreement in place to protect the interests of the minority shareholder. Why was a 20% or larger discount applied for a minority shareholder, given that, on the face it, those risks did not appear to be there, certainly to that level?

Roger Lowe: I think it would be fair to say that when you look at any business where you are a minority shareholder and you have a shareholder who controls the business—we should remember that the new shareholders agreement gave SNCF a level of control—you will find yourselves slightly at the whim of the majority shareholder in terms of how the business is run. One way of turning that question round is to look at when people buy a business and gain control of something. Having owned a minority of it, they tend to pay a premium. That premium will be a function of different assets, but if you look at it historically—the empirical evidence—20% is probably at the lower end. You might see Ernst & Young in their evaluations with 30% as the premium they would attach to majority control or the discount for minority control.

Q7 Kevin Foster: As I say, in this instance it was a service. It is a business where the majority of shareholders were already working in private sector partnerships elsewhere. One of the complements in here was the shareholder agreement that was put in place. Why still go for a 20% agreement, given that there is very strong financial protection in there for the minority shareholder?

Roger Lowe: That 20% premium is applied, as John said earlier, to the value to the UK Government as the shareholder of the business. Remember, our valuation was based on what it is worth to the UK taxpayer—not trying to guess what it might be worth to somebody who might buy it. You are absolutely right; it happened that one of the parties in the bidding consortium has existing programmes with SNCF. We are not privy to all the details of those shareholder agreements.

Q8 Kevin Foster: You say that something's worth is based on what it is worth to the owner. The point I was making is that the value of something is what the next purchaser will pay for it—to be blunt about it. If there is an asset on the book, it is ultimately based on what someone would have to pay to acquire it and the benefit of that asset.

John Kingman: This goes back to what I was saying at the beginning. What we are trying to do when establishing a hold valuation is impose a discipline on the privatisation process, not to sell assets at a lower value that represents what we think they are worth if held by the Government for a longer period.

Q9 Kevin Foster: But I would say, to cut in on that slightly, that the experience is not over-selling assets but quite the opposite—under-selling. I notice UBS's name in this when they, of course, did the valuation for Royal Mail. In this instance, the jump in value at the end of the process ended up with the taxpayer. For me, it is normally the other way around. We haven't sold things at a higher value, we have sold them at a lower value.

John Kingman: Apologies, but this is the point I was trying to make. I accept your point that the objective value of an asset is what someone is willing to pay for it. But that is not what we are trying to do here. We are trying to give ourselves a yardstick against which we can compare present market conditions and present investor appetite. I think it is a helpful discipline which we always follow when privatising state assets. We ask ourselves, "Are we selling these for more than fair value?" For example, in all the sales of banking shares that we have undertaken over the last few years, that is something which has a market price, so you could say, "Well, that's its value." But we always do a fair valuation which attempts to say, "Is this a good time to sell?" We find that a helpful discipline and one that I hope the Committee would welcome.

Q10 Kevin Foster: The Green Book requires a comparison of the hold versus the sale value. What was the sale valuation that UBS prepared?

Roger Lowe: The estimate was done on the basis of a dividend discount model—the difference of discounted cash models that the shareholder executive and Ernst & Young carried out. It was also designed to show what the asset would be worth for a reasonable investor, in this case the Government. What sort of hurdle return would they require? The 17% figure you see in the NAO report is its assessment of a hurdle rate of return on a dividend basis that an investor would require.

Q11 Kevin Foster: What was the figure for the benefit of those watching?

Chair: I think it is in figure 14.

Roger Lowe: It was £305 million. That is the central case.

Q12 Kevin Foster: Moving on to the sale process, one of the things I found quite interesting was how it was treated in terms of accounting. When it is held as an asset, it is

illiquid, so it therefore doesn't count against the national debt. Yet when it is sold and becomes liquid, it does. Is that a logical position to be in?

John Kingman: It represents the national accounting position, which is set by international statistical authorities and of which we are captive. Sometimes the national accounting treatment helps us and sometimes it doesn't, but they are standards to which we are subject.

Q13 Kevin Foster: I accept that it is the national accounting standard, but is that standard therefore driving assets being sold, or does it not make a difference?

John Kingman: I think it does make a difference, but I do not think it is a matter of pure accounting. The Government's policy is to sell assets, where it is good value for money to do so and where there is no good policy reason to continue to own them. There is a very good reason for that: if we have a pound tied up in the ownership of a financial asset, that is a pound we cannot use on infrastructure investment, or schools and hospitals. In selling off assets that we do not need to own, we are liberating resources that can be used for other purposes.

Q14 Kevin Foster: I accept the argument around the policy of disposing of assets when there is no public interest in holding them, but looking at how we hold these assets, what I found quite interesting, on page 23, was the £511,000 bill for a transfer between Departments. Perhaps I will be a bit of a layman here, but this went from one Department, where it was owned by the taxpayer, to another Department where it was owned by the taxpayer. Was that £511,000 good value for money?

Roger Lowe: The £500,000 is the bill incurred by Freshfields, our legal adviser, between early 2014 and June 2014. That covered both the cost of transferring the asset out of LCR, a subsidiary—Eurostar was not owned directly by the Department for Transport; it was owned by London and Continental Railways—to DFT and then to HM Treasury. Nearly half of that £500,000 bill was effectively work incurred in the preparation for sale, so starting discussions with SNCF around the protocol around the new shareholders agreement. Around £200,000 was incurred in preparation work and about £300,000 in the actual transfer. Quite a lot of the work that was done for the transfer was then also used as part of the legal vendor due diligence in the final sale process.

Q15 Chair: Was any money spent on a potential transfer to the Department for Business, because that was originally—

Roger Lowe: A transfer to the Department for Business was considered at one point and about £30,000 was probably spent in considering that.

Q16 Chair: Just to be clear, £30,000 was spent in considering a sale to BIS. Can you tell us what that was spent on?

Roger Lowe: It was money that was spent while considering a transfer to BIS. It would also be relevant work when the transfer went to HM Treasury anyway.

Q17 Chair: Was the Business Secretary instrumental in the decision as to whether BIS ended up owning it, or were there other considerations?

Roger Lowe: I am sure that the Secretary of State had ministerial discussions, but I was not party to them.

Philip Rutnam: I think there was an agreement between the Secretary of State for Transport and the Chancellor of the Exchequer that the asset should be transferred ultimately to the Treasury, as the Treasury had the greatest expertise in relation to the disposal of assets. You are quite right that there were some costs, although much less than £500,000, associated with the need to effect this transfer within government—from LCR to the Department, and then from the Department to the Treasury—but we were very clear that this was necessary to safeguard against a potential conflict of interest that otherwise the Department would face in relation to two transactions: the franchising of the east coast main line, a multibillion pound transaction in its own right in which Eurostar was bidding; and, secondly, the sale of Eurostar. I was absolutely clear, as the accounting officer, that this transfer had to take place.

Q18 Chair: Just to finish on this, the transfer went from LCR to the Department for Transport and then to the Treasury. Why did the Department for Transport need to be in that loop? Could it not have gone directly to the Treasury?

Philip Rutnam: I think it was essentially a technicality associated—

Chair: A very expensive technicality.

Philip Rutnam: The transfer from London and Continental Railways to the Department was part of the wider structuring of the transfer from, ultimately, LCR to the Treasury. The fact that it needed to go through an intermediate step at the Department for Transport did not, I think, incur any significant material cost in itself, but it was a necessary step to do with the technicalities of the group status of the Department.

Q19 Chair: Except that we just heard that around £30,000 was spent investigating whether BIS would take it on, so there must have been some cost involved in DFT taking it.

Philip Rutnam: Some.

Roger Lowe: The problem with trying to identify precisely what costs are allocated where is that all the work that was actually done was then used subsequently as part of the sale process. It was not wasted spending.

Q20 Chair: Matthew Rees from NAO is going to come in and then I will bring in Stephen Phillips.

Matthew Rees: We have just collected the information and Roger is correct that it is quite hard to allocate these costs.

Q21 Stephen Phillips: I do not want to get hung up on this £500,000, but we could ask why you went to a magic circle firm? Freshfields did a super job, no doubt—a Rolls-Royce service; £1,000 an hour for a partner—but did you put it out to tender?

Roger Lowe: The original tender for the Eurostar transaction was put out under the Department for Transport a while before this transfer took place. We tendered it in exactly the same way, as financial adviser, across a range of law firms. Freshfields came up with the best bid. I think that, as Government, we do a reasonably good job of trying to negotiate fees with financial and legal advisers. I have no doubt that the job Freshfields did was first rate.

Stephen Phillips: I have no doubt either, Mr Lowe; I have worked for them as well.

Roger Lowe: One thing we should recognise is that the transaction itself was probably one of the cleanest I have seen, in that the residual risk to Government was almost non-existent. The reps and warranties were almost non-existent; I think that goes down to the due diligence work that Freshfields did and the way that the transaction—

Q22 Stephen Phillips: Just going forward, for future asset sales, do you think it is appropriate for the taxpayer to have to fund magic circle rates, or should you all be looking at using firms that might charge a little bit less and not necessarily dot every i and cross every t?

John Kingman: The dotting of i's and crossing of t's can save a lot of money. We used magic circle law firms throughout the financial crisis. They were at times expensive, and I have absolutely no doubt in my mind at all that—

Q23 David Mowat: I think we all agree that taxpayers feel that sometimes the relationship with law firms gets too cosy. Did you ever think about having some kind of relationship through which they would cap their fees? When you are procuring something of the order of £500,000, and you are a prestigious client to people like Freshfields—they like having clients like the Government; it is valuable to them commercially with other people—did you ever think of asking whether or not they would work to a target, and then that anything over the target, if it carried on, would be less?

Roger Lowe: It is a very fair question, and it is something we certainly consider—how we can manage fees as effectively as possible. What I would like to avoid is a situation where a transaction becomes more complex, and the adviser itself is then working purely for its reputation rather than any financial return at all. You would then worry exactly what service you are going to get. But I think it is a very fair question, as to whether it is something we should look at.

Q24 Deidre Brock: I noticed that a valuation report for the Department for Transport on the costs and benefits that would be produced by the whole HS1 project by summer 2013 had not actually been delivered until October 2015. I wondered why the delay.

Philip Rutnam: Quite rightly. It took a good deal longer than we expected. It took, first of all, a bit longer to procure than I had expected, but it took a great deal longer to do. We have been hearing about the complexities of the Eurostar transaction. Well, the evaluation, retrospectively, of HS1, seeking to look at all of its different dimensions, turned out to be a more complex project, so it wasn't possible to do it by 2013. When we received a report at the back end of 2014, if my memory serves me right, we took the view that what was needed was a peer review, to look at this complicated set of questions from another perspective, and a peer review was done by Oxera, and that was a very useful piece of work. It is following receipt of that peer review that we have published it.

Q25 Deidre Brock: Two years is a long time though, is it not, for it to be overdue? It would suggest, perhaps, that this was not much of a priority, despite the fact that all this work was going on around the Eurostar sale.

Philip Rutnam: They are very distinct tasks. I don't think there was really an interdependency between the Eurostar sale and the evaluation of HS1. An important point about the evaluation of HS1 was to seek to learn from that project as much as possible that is relevant to the many, many other activities the Department engage in. I think you are right that it was a challenge for us to make sure that we could assemble inside the Department, and also outside the Department, the right team to undertake the work. I would accept that some of the pressures on resourcing the Department probably contributed to the delay, but I am very pleased that we have now concluded that evaluation and, more generally, we have sought significantly to strengthen our evaluation and monitoring programme in the Department, publishing annual updates to our evaluation programme, including one as recently as October.

Q26 Deidre Brock: Just quickly in terms of lessons learned, I suppose I am asking a question here on behalf of taxpayers, who might be a bit surprised about your choice to use for the Eurostar sale the same financial adviser that you used for the HS1 project. What were your reasons for selecting that same adviser?

Philip Rutnam: Which—

Deidre Brock: The financial adviser.

Philip Rutnam: The adviser that led on the evaluation of HS1 was Atkins, which is a transport consultancy, and the financial adviser that led on the sale of Eurostar was UBS, but perhaps I am missing something.

Matthew Rees: I think it was a question on the UBS involvement in the London and Continental Railways project, rather than the evaluation. I think the question was about the financial adviser's previous engagement in different transactions.

Philip Rutnam: Okay. If that is the question, perhaps Mark or Roger is better placed to answer.

Roger Lowe: When we went out to appoint a financial adviser for Eurostar, we had 25 expressions of interest from a range of financial advisers, some larger, some smaller. We interviewed a number of them and, in our judgment, UBS had the best case in terms of its understanding of the business and, more importantly, of the buyer universe and how we could sell the asset as effectively as possible. We did it very objectively for that particular transaction. We try not to worry too much about who might have been used for a previous transaction. We try to be as objective as possible in appointing an adviser for each individual transaction.

Q27 Chair: What often comes up in this Committee is how much notice is taken of a contractor's previous performance. Did you completely discount UBS's previous assessment on HS1 when making the decision?

Roger Lowe: I think the fact that it had been involved in HS1 would probably have given it an understanding of the industry, which it would be able to use to present a compelling case that it would understand the sale of Eurostar. That would probably help it a little bit compared with an adviser that had never been involved in the industry before. We did not take into account a rating of how it had performed in the HS1 transaction.

Q28 Chair: Is that something that you might reconsider for future?

Roger Lowe: Yes, that is a fair question.

Q29 Chair: In terms of lessons learned, with HS2 coming up, would the Shareholder Executive—the Government, indeed—make a different evaluation of previous performance when determining a future financial adviser? Mr Kingman, perhaps that is for you.

John Kingman: Absolutely. Mark is probably best placed. Mark hires more advisers than anyone else in government, so I would hope that he has a good perspective.

Chair: Mr Russell from the Shareholder Executive, this is being passed along. The ball has fallen with you.

Mark Russell: Maybe I can put it the other way. Had we had feedback that UBS had not advised well on HS1, I think we would certainly have taken that into account.

Q30 Chair: Are you saying that you did not have feedback about UBS's performance on HS1?

Mark Russell: No, we certainly had no negative feedback on UBS. Were we surprised that UBS came out well in the competition? Not really because, as Roger said, it knows this industry very well. That it performed well in the competition was not a surprise.

Q31 Chair: You tell us that it knew the industry very well, but if you look at figure 14, which shows the valuation that it put on the sale in June to December 2014, it was lower even than the Government's, and obviously the sale went for 92% higher than forecast. Does that suggest that it was undervaluing or that it did not know the market as well as you thought? What is your view of that sort of performance?

Mark Russell: Roger can comment, but the fundamental reason is that when you take valuations at the pitch stage, they are almost always valuing on publicly available information. Once it saw the confidential information—the business plans and so on—it revised its view of the business. When we assess advisers at the pitch stage, we look at valuations, but we don't attach an awful lot of importance to them, because they are generally just based on publicly available information that have been gleaned through open sources.

Q32 Chair: So was it more luck than judgment that it went for a higher rate.

Mark Russell: I think it was a good process. I honestly believe that the key reason this went for the sort of price it did was that it was prepared in a way that was, in the end, easy for bidders to assess, because it was potentially a very complex transaction. We, and in particular UBS, generated very good interest. We did really get the power of the auction. Although it maybe does not come out very clearly from the Report, we never gave exclusivity to anybody. That is a great thing to achieve if you can. As soon as you give exclusivity, potentially, your hand is weakened. We never gave exclusivity because the diligence had been done by us.

Q33 Stephen Phillips: This is for Mr Rutnam. One reason it went for a much higher price than the valuation—a point Mr Foster already touched on—was the absence of a competitor on the route. Looking at paragraph 4.8 of the NAO Report, we read that no competition scenarios were modelled, but it also looks as though they were not at the forefront of advice that was given to Ministers when it came to the consideration of the opportunity cost to the taxpayer of the disposal. Why was that the case? Indeed, Mr Rutnam—probably Mr Kingman would like to come in as well—why was this no-competition scenario thought to be valid, given the answers that you gave earlier about the barriers to new entrants to the market?

Philip Rutnam: I can comment on the environment and the competition regime.

Stephen Phillips: Let's deal with the advice to the Ministers.

Philip Rutnam: The point at which this advice was given to Ministers was after the responsibility for the transaction moved from the Department for Transport to the Treasury, so either John or Roger—

John Kingman: The answer is that the valuations that were put in front of Ministers were based on a probability-weighted series of possible outcomes for competition, including, as I understand it, a range of dates at which competitors might come in and a no-competition scenario. Probabilities were assigned to those scenarios and they were weighted accordingly.

That was the basis of the advice that went to Ministers. We did not put in front of Ministers a whole valuation solely based on the proposition that there should be no competition, because we didn't think the probability of that was 100%.

Q34 Stephen Phillips: But the trouble with that is that the principal advice that was given to the Minister was, "Look, the hold value is somewhere north of £300 million. The values that are coming in from the tender are somewhere north of £500 million, so it looks like an incredibly good deal," whereas, in reality, we know that there is unlikely to be any competition on the line, as Mr Rutnam has made clear, for some very considerable period of time.

Chair: And the NAO highlighted that point—

Stephen Phillips: Forgive me. So the hold valuation is out of kilter with the realistic price. That is one reason why this deal looked so damn good for the taxpayer.

John Kingman: I can ask Mr Lowe to take you through the scenarios that we used, but I would say that there is another massive factor here, which is simply that the timing of the sale was one in which investor appetite for buying this kind of asset was extraordinarily hot.

Stephen Phillips: Absolutely.

John Kingman: And in answer to the Chair's question as to whether it was luck or judgment, I would agree with everything that Mark said about the excellence of the process, but the truth is that the timing of the sale was very good.

Q35 Stephen Phillips: We can see that from the number of bids.

John Kingman: Exactly.

Q36 Stephen Phillips: But let's say that that has a premium on it of maybe £100 million.

John Kingman: Possibly more.

Stephen Phillips: It's a great market to sell into. The trouble is that you are still putting a valuation in front of a Minister that is over £300 million, discounting for competition, which as it happens can never—is very unlikely to materialise.

John Kingman: Let Mr Lowe take you through what the assumptions actually were.

Roger Lowe: It is a very good question, because none of us know what will happen in terms of competition. We made a series of assumptions and, like the detail, they were whether competition would appear in 2019, 2022, 2027 or never. We probability-weighted those, with the two central cases having the vast majority of probability, so the 2027 case had

quite a high probability. I genuinely don't know whether competition will have appeared by 2027. It also strikes us that if no competition ever appears on this line and it continues to make very, very large profits, there is a risk that regulation might appear at some stage, so to assume—

Q37 Stephen Phillips: Was that put into your valuation or not?

Roger Lowe: We didn't put the risk of regulation in, but we did look at the risk of different timings of competition, and Ministers did see the values of those different—

Q38 Stephen Phillips: Was there consultation between you and the Department for Transport about the likelihood of an entrant into the market emerging?

Chair: Roland Berger analysed this, didn't they? I'm looking at paragraph 4.7 of the Report, which states that Roland Berger considered that the idea of a competitor "appeared risky amid the significant uncertainty over operations, costs and timing of service introduction which a market entrant would face." So there was some discussion, and it wasn't very positive about the likelihood of competition.

Roger Lowe: Which was one of the reasons why we didn't give the 2019 competition scenario a very high probability.

Q39 Stephen Phillips: Could we go this far, Mr Lowe? With hindsight, it appears that the hold valuation probably estimated the likelihood of a new entrant into the market too highly.

Roger Lowe: I am not sure that I agree with that, because I think our probability weighting was very logical. It was a sensible, empirical way to look at the process. To try and judge with the benefit of foresight or hindsight whether competition will or won't occur is an extremely difficult thing to do. I suppose the other question is, "Did the buyers form a different view?" Quite possibly.

Q40 Stephen Phillips: Well, it looks as though they did!

Roger Lowe: But we don't know what assumptions the buyers made.

Q41 Chair: I am keen to move on to High Speed 1 and High Speed 2, particularly High Speed 2, but earlier I think Philip Rutnam made an interesting statement that Government's appetite for risk is rightly lower than that of a private business. Do you think that was borne out in the evaluation of High Speed 1 or the quality of the business case for High Speed 2?

Philip Rutnam: I am not sure I said quite that.

Chair: Forgive me; it was Mr Kingman.

Philip Rutnam: In any event, on our appetite for risk, in the Department, we define our appetite for risk quite carefully. We define it within a spectrum as an open appetite for risk, which means that we are open for taking risk, but it needs to be carefully considered. Fundamentally, in any business case, it is about making a judgment about the returns to be obtained for taxpayers or passengers on a risk-adjusted basis.

One thing I have learned in Transport is that action and inaction both present risks. Not doing anything may be ostensibly attractive but can often turn out to be the highest-risk course of action of all.

Q42 Chair: In general, through this process—bits of it went very well—do you think there are lessons for the DFT and for government more widely, Mr Kingman, about what skills and practices the Government need to make future sales successful? A lot more are coming down the line; this is just the very small tip of a very large iceberg.

John Kingman: Yes, I do and I think the NAO Report picks out a number of them which are valuable and which we will make sure we take to heart. One of the very clear bits of evidence in the Report is that having a professional group of people who undertake this on our behalf is something—

Q43 Chair: Sorry, do you mean the Shareholder Executive?

John Kingman: Yes, that is what I mean, and in the case of banking assets we have an equivalent called the UKFI and we are bringing those two entities together to create a single professional source of transactional handling skills in government. I think that is vindicated in this Report.

Q44 Chair: Are there any other skills you think need to be developed within government? In this Committee we spend a lot of time looking at major projects. That is something that has changed across Whitehall. Given the scale of asset sales, we have the Shareholder Executive, but within Whitehall there will be civil servants handling this, at an earlier stage very often, when something is still with a Department. Is there a gap in skills there and what would you want to see change?

John Kingman: I think there is a lot to do both in relation to corporate finance skills and commercial skills more broadly. I think we have huge challenges in the civil service. As you rightly say, you can have the experts but the policy people in the Departments also need to be educated to have the right instincts, to ask the right questions.

Q45 Chair: What are you doing to make sure that happens?

John Kingman: Mark is the head of the corporate finance profession.

Chair: Over to you, then, Mr Russell. What are you doing to make sure that happens?

Mark Russell: We are trying to put a boundary, or at least a grouping together of corporate finance professionals. The greatest concentration of corporate finance professionals are in the Shareholder Executive and UKFI, but the model we operate at the moment is one where for various reasons—typically because individual Departments have particular corporate finance specialisms—it makes sense to have small groupings within individual Departments.

One of the key things we are trying to do with the profession is to make sure all those groups link up and share best practice, resource and some type of career structure. Increasingly, those who come into this grouping are probably not going to be people who look for a career in the civil service. The principal reason they come into Whitehall is because they are fascinated by the work, but they like to see some sort of career progression. To the extent that we can have a profession, we can start to do that.

Q46 Chair: Can you tell us how many people are of that professional ilk?

Mark Russell: It depends on how we define corporate finance, but of the order of about 150 people.

Chair: That is 150 people across all Government Departments?

Mark Russell: And some agencies as well, such as the Competition and Markets Authority, the NAO, who have corporate finances.

Q47 Chair: You are counting the NAO in that 150?

Matthew Rees: Just to clarify, the NAO is reviewing transactions, rather than undertaking them on behalf of Government.

Mark Russell: But they are all—

Q48 Stephen Phillips: Mr Russell, to come back to the point that I made earlier, do you think that the possible paucity of expertise within the profession means that you are overpaying for external advisers, because people feel more comfortable going to the Rolls-Royces, rather than to those who might get you there but not necessarily charge quite as much?

Mark Russell: I would not agree with “paucity”—

Q49 Stephen Phillips: Let us leave paucity out of it. Are you paying too much for external advice because you do not have the comfort of the relevant expertise within the profession at the moment?

Mark Russell: As a general answer, yes, we in government are paying too much to advisers, but I don't think it is just in public finance; I think it is across the piece. Do I think it is better than it was? Yes, I do. Do I think one of the key jobs for people like us to do is to bear down on those costs, as most of us have been on the other side of the fence, so we know how people charge and how they might approach a client? Certainly we believe that one of the key roles that we perform is to make sure that advisers are used properly and in the right circumstances—

Q50 Stephen Phillips: And the right advisers who will do the job, but will not necessarily be the most expensive and do more than the job—that is the point that I am driving at.

Mark Russell: We go for value. Back to the point about the magic circle, we forensically look at the value, rather than at price. So if we are paying a bit more for them, are we absolutely getting that sort of value? And our experience has been actually that we do still get some very good value from some of the magic circle, but you can be sure that we are continually quizzing—can we use other types of law firms, can we use alternatives to the big four accountancy firms?

Q51 Chair: Let me bring in the Comptroller and Auditor General. I will come back to Mr Phillips.

Sir Amyas Morse: On the same theme, I am sympathetic to what you are saying, but as I look back, touching on UBS again, it has clearly been quite the item of choice for virtually all the recent transactions, when you think about it. HS1, Royal Mail, RBS, Railtrack—it has been involved in all of them. Would you accept that there is a bit of a risk? If I was to take your logic of concentrating experience together—which, for what it's worth, I agree with, and we are trying to do something similar in the NAO—that same concentration of experience tends to leave you with, and you tend to prefer, however objective you are being, the people who have done the stuff before, because they know the ropes and they do it very well. So I do not think it is unreasonable to see that as a problem.

I am just suggesting that you will need to develop some positive strategy to avoid that—or I am asking you about it. If we are sitting here in a couple of years' time after a lot more transactions and, strange to tell, the same three letters describe the financial adviser in most of them, the question will be rather more difficult to get around, I suspect, so I think some actual strategy to allow you to use a wider range—other than just hoping that they come out of the pack—might be worth thinking about. I do not know what your reaction is.

Mark Russell: That is a very valid point. There is absolutely the danger that you just go into a vicious circle, that those who have the experience are the ones who get the jobs, and so it goes on. I absolutely understand that.

Q52 Chair: So how are you guarding against that?

Mark Russell: First, by ensuring that the procurement processes are pretty robust and open to lots of challenge. We know, when we come before Committees such as this, that those processes will be challenged, so we take a lot of care over them.

Q53 Chair: Do you think you have got it right? You say you take a lot of care and you want to make sure things are robust—do you think you are there now?

Mark Russell: Of course, we want to make sure we get it right.

Q54 Chair: Do you think you are there now, or are there improvements you can make?

Mark Russell: I am sure there are improvements. In those cases where we have advisers potentially scoring on very equal scores, those whom we have perhaps not worked with before we will definitely try to prefer, because we will try to broaden them out. We are absolutely conscious of that.

Q55 Chair: Just to be clear, if a new firm scored well, you would prefer it. You would look to broaden out the pool by going for a firm that has not done—

Mark Russell: Yes, I think we would. If it was a genuinely equal score and we had a firm that we thought could broaden the experience, absolutely.

Sir Amyas Morse: Do you feel you have the expertise in-house to evaluate the relative performance of highly specialised law firms?

Mark Russell: In total, probably not, but we do take care over it and we do—

Sir Amyas Morse: I say that not as a debating point but because you might like to consider some means of—if you are going to be able to make other choices, you might need something to strengthen your ability to make those choices.

Mark Russell: Yes, but within the Shareholder Executive, I have over 20 senior colleagues who have all been involved in tens of transactions and who have all used lawyers, so I look to them.

Roger Lowe: On Mark's comment about broadening the net of advisers, it seems to me that it is important for us that we encourage a broad universe of advisers to want to pitch for Government business, and if we are always going back to the same people, we will lose that. We are very alive to that risk and want to avoid it.

Q56 Stephen Phillips: I want to finalise my line of questioning, if I may. I have been reminded by the NAO of a reference in the European *Official Journal* to a contract out for tender at the moment worth £130 million for corporate finance services to the Government. Are you running the tender process for that, Mr Russell?

Mark Russell: I think it is actually something our Treasury colleagues are running and that we are involved in.

Q57 Stephen Phillips: Who are your advisers on this?

John Kingman: The Treasury regularly refreshes the list from which we can choose advisers if we need to make a decision quickly on retaining advisers, and obviously we refresh that regularly, as you would expect, precisely for the reason that we don't want to be captured by the usual suspects.

Q58 Stephen Phillips: It's going to be the usual suspects who are going to get paid £130 million of taxpayers' money.

John Kingman: I'm afraid I don't know what £130 million refers to.

Stephen Phillips: "Estimated value, excluding VAT: £130 million GBP".

John Kingman: If we are talking about the same thing, my understanding is that this is a generic competition to be on the framework for—to be financial advisers to Government. I don't recognise that figure, I'm afraid.

Stephen Phillips: I have no doubt we will come back to this, but that is the figure given in the *Official Journal*.

John Kingman: I'm just saying I don't recognise the figure.

Q59 Mr Bacon: What was the answer to Mr Phillips's earlier question about whether anyone is advising you on this? Have you employed an adviser to help you select?

John Kingman: The Shareholder Executive is advising on this.

Q60 Mr Bacon: I see. So you are not employing an external adviser for that.

John Kingman: No, not at the moment.

Q61 Stephen Phillips: Is the Shareholder Executive employing external advisers to advise you with regard to this tender?

Mark Russell: No. If this is what it is referring to, no.

Q62 Nigel Mills: I am intrigued by the idea that if the scoring came back even between an adviser with experience of these sorts of transaction and a new one, you would prefer the new one. I guess the only risk of that is that your scoring will ask the question,

“Are these people experienced in doing privatisations or sales of public assets?” and the ones who have done it before will therefore score a lot higher, so unless you take that out of your scoring, it is kind of an impossible fulfilment, isn’t it?

John Kingman: I don’t think so. UKFI has definitely done this—in other words, deliberately changed advisers—not because the advisers they were using had done a poor job, but because they felt it was, in principle, right to use more than one over time. It is absolutely true that one of the things that we will want to weigh is experience of doing the sorts of transaction we are asking for advice on, because we want experienced advice, but that is experience that can be, and is, picked up anywhere in the world. All the firms we are talking about—even the boutiques—will do advice well beyond the UK, so I don’t think that chicken and egg problem really exists in practice.

Q63 David Mowat: I was going to ask the same question that Mr Mills asked. If you wanted to get a wider range of advisers, you would put that into the scoring system in the first place. What stops the procurement process working effectively, and what these guys try to get, is personal relationships with decision makers—not inappropriate ones, but just such that they understand the process and all the rest of it. Are you comfortable that that does not happen and is not the reason why UBS wins all the time?

Mark Russell: We see tens of advisers, as you might imagine. We do not have a rule that we do not see advisers; we do see advisers speculatively because our calculation is that when we put out work for tender, it is better to have a wide range of informed advisers who can pitch intelligently than not. Generally we will talk to most people to the extent that we can share information with them. To John’s point, to the extent that somebody who we have not heard of or used puts up their hand—typically we will have heard of them, but we will not have used them—absolutely we will see them.

Q64 David Mowat: Okay. I just make the point that if you and your teams are and have been working with Government, you know the terrain so well that you almost certainly convert that into a better bid. It is quite hard to do the process you are describing without that. Do you understand that?

Mark Russell: I agree.

Q65 Chair: Mr Kingman, how often do you refresh the list of specialist advisers that you referred to?

John Kingman: I do not know the answer to that question, but I will be happy to come back to you on that.

Q66 Chair: Do you know how often a new name pops on to that list?

John Kingman: Again, I would be happy to get back to you.

Chair: Okay. If you could write to us about that, it would be very helpful.

Q67 Stephen Phillips: Do you know when it was last refreshed?

John Kingman: I am afraid I do not.

Stephen Phillips: Write to us on all three points, please.

Q68 Chair: I am sure somebody behind you is taking a detailed note—the skills of the civil service can certainly achieve that.

To take you back briefly to skills and practices—we will then get on to HS2 briefly—Mr Russell, you talked about being confident that things were moving there, with 150 professionals with the right skills. How will you go about getting Government really up to capacity? How long will that take? This is outside of the Shareholder Executive; this is within Departments.

Mark Russell: Yes. I would not say that 150 is absolutely the wrong figure. I would not say it is very clear that we need 300 or 600—

Chair: So it is not a numbers game.

Mark Russell: No, I do not think it is a numbers game. I think it is absolutely a quality game, because we do not want lots of people who badge themselves as corporate financiers; we want people with good, relevant corporate finance experience, and we need to make sure it is properly deployed throughout Whitehall. The model we have at the moment, as I said, is one of concentration. We have a centre of excellence, but we also have teams within Departments. One of the things we absolutely need to improve is the communication between those two.

I would imagine that we will add to those numbers over the next five years, but I do not think we will be doubling—we might be taking it up to 200; it might be 250. You then go into the areas of project finance and, of course, there are other groupings. Indeed, in Mr Rutnam's Department quite a few of the corporate financiers are also practitioners within project finance as well.

Q69 Chair: Have you looked at the work that the MPA has done in this direction in terms of project management skills? That is a slightly different area, but it is very much related.

Mark Russell: With the recent announcement bringing IUK and the MPA together, we actually see a very complementary group to our own group, and a group that is far more focused on project finance and corporate finance.

Q70 Chair: How much is it costing to bring those two organisations together? How much will the merger cost?

John Kingman: Nothing.

Chair: Nothing?

John Kingman: I cannot see any reason why it should do. The MPA is roughly 80 people strong and IUK is roughly 70 people strong. They are both based in the Treasury building at the moment. I cannot guarantee that there will not be a single penny, but I cannot immediately think of any costs.

Chair: New headed paper, possibly.

John Kingman: I don't think we have headed paper.

Q71 Stephen Phillips: They are both going into a new, wholly-owned Government company, so there must be some costs.

John Kingman: This will be a combined civil service. IUK is part of the civil service and MPA is part of the civil service. They will be a combined civil service entity reporting to the Chancellor and the Minister for the Cabinet Office. They will be based in the Cabinet Office for budgetary purposes. I cannot immediately see why there would be any costs at all.

Q72 Stephen Phillips: I am a little perplexed by that, because the press release in May 2015 said that they would merge, but then that they would be a new, wholly-owned Government company. Are you saying that there is no cost associated with that?

John Kingman: I think we are talking at cross-purposes. I think you are talking about the merger of UKFI and the Shareholder Executive.

Stephen Phillips: Right. We may well be, then.

Q73 Chair: The MPA has its fast stream of project managers and, from what you are saying, it sounds like it is not the numbers of junior people you need. It has also got a way of bringing in senior project managers from industry on a specially enhanced rate. Is that something that the Shareholder Executive is looking at? What power have you got to get that through Departments?

Mark Russell: Our needs are slightly different and, obviously, the type of people we get are slightly different. Our model is to have three sources of people coming in. We bring in people on fixed-term contracts, either at a junior or senior level, and some of those we have made permanent.

Q74 Chair: On civil service rates?

Mark Russell: On civil service terms, absolutely. The second largest way we bring in people is through secondments, typically from law firms and the big accountancy firms. Those are one to three-year secondments.

Q75 Chair: On the industry rate?

Mark Russell: Yes, those are on standard. At the moment we are within the Business Department, so they are on Business Department rates.

Q76 Chair: So, again, civil service rates rather than industry rates.

Mark Russell: Correct.

The other important feature, certainly we think within the Shareholder Executive, is that the mix of skills is civil servants as well as corporate finance practitioners. Partly, what we are doing is trying to connect professionals in the corporate finance world—the advisers—with Government and Whitehall. A good knowledge of how private office and so on works is important.

Q77 Chair: There are a number of issues there, but one that puzzles me is if you are a corporate finance person in the private sector going on secondment on BIS civil service rates. I am sure that BIS civil servants are paid jolly well, but probably not as well as people in corporate finance in the private sector. Are you saying that they take a pay cut, or does their firm pay the difference?

Mark Russell: The latter.

Q78 Chair: And then they go back to their firm and bid to run business advice for the Shareholder Executive.

Mark Russell: We are very alive to that.

Q79 Chair: So can you just explain for taxpayers' and our benefit how you ensure that there are the right safeguards to make sure that they are not using their internal knowledge to go through the revolving door and then go out again to make money for their firm on the basis of what they know?

Mark Russell: Clearly they will return to their firms and organisations with knowledge of government. I would not necessarily see that as a bad thing. Typically, when those firms subsequently pitch, you will not generally find secondees being on those pitch teams. We do not have an absolute rule that they should not be there, but we want to understand the stages and to ensure that there is no knowledge that would not be available to other bidders as well that would give them an unfair advantage. There will be some knowledge, clearly. It is also important to say that when we bring secondees in, they are

secondees, so they report to us and there is no reporting line back into their organisations for the period in which they are secondees to us, so their responsibility is entirely to us.

Chair: Okay, we may come back to that in the future.

Q80 David Mowat: They must have a boss in their home organisation. I understand that when they are seconded to you, they are working in your line, but they will still have a boss back in their home organisation, won't they? It therefore isn't wholly true to say that that have not got that relationship.

Mark Russell: Of course, but our secondment agreements are very clear as to confidentiality and reporting.

David Mowat: I understand that, but I think what I just said is right as well. That is clearly the case.

Q81 Mr Bacon: Mr Russell, perhaps I got this wrong, but did I understand you to say that while they were on secondment to HMG, they could go off and work on a pitch team?

Mark Russell: No.

Mr Bacon: So what were you saying?

Mark Russell: I was saying that we have no absolute rule that when secondees return to their organisations, they then should not appear on the pitch team.

Q82 Mr Bacon: What is the annual cost of the 150 or so people you have working as corporate financiers throughout Whitehall?

Mark Russell: I do not know that figure. I can tell you the cost of the Shareholder Executive, which is of the order of £12 million.

Q83 Mr Bacon: Are you the head of the corporate finance profession?

Mark Russell: Yes.

Q84 Mr Bacon: Wouldn't it be a good idea for you, as head of the corporate finance profession, to know how much HMG spends on employing corporate financiers?

Mark Russell: Yes.

Q85 Mr Bacon: Are you going to find out and let us know?

Mark Russell: Yes, I think that is very fair.

Q86 Mr Bacon: If you could write to us with that, I would like to know that number, and then I would like to compare that with this £130 million number, which is over a period of how many years?

John Kingman: I am afraid I have no idea what that £130 million figure represents.

Chair: We're getting extremely excited about this, but it was not in the Report.

Q87 Mr Bacon: I am not clear in my own mind now. Who is running this tender that is in the *European Journal*? Is it Mr Kingman, or is it the Shareholder Executive?

John Kingman: My understanding is that this is a procurement process being run by the Treasury, but you have the advantage of me. I have not seen this piece of paper.

Chair: Yes, to be fair to Mr Kingman, he hasn't seen this. It wasn't in the Report. So fair enough, but now that is on the record.

Q88 Mr Bacon: It is a Government document, and you are the one who is spending taxpayers' money on this. It is on corporate finance services over a period of four years, according to the tender document, so I would like to know how much we are going to get for £130 million, in terms of bodies and time and so on, over those four years.

Richard Brown: I am not familiar with the detail at all—

Mr Bacon: I can give you the service contract number if you want.

Richard Brown: My understanding is that it is a drawdown contract, so it is possible that there would be no expenditure on it, but it is possible that there could be quite a lot of expenditure on it, depending on the need to get advisers in quickly, as was required during the financial crisis, for example.

John Kingman: I think, if we may, we should come back to you and tell you exactly what this number refers to, because I am afraid I don't know.

Mr Bacon: It is a framework agreement, I understand, so I am sure that you are right, Mr Brown. Some of it will be drawn down and some of it may not be.

Chair: I think, Mr Kingman, we will get some detail in writing from you on that. Time is marching on and we are moving into our quick-fire round, as we say on the Committee.

Mr Rutnam, I want to move on to High Speed 1. Why has it not delivered anywhere near the level of benefits for the taxpayer that were originally expected?

Philip Rutnam: There are two points to make there. The first, as we were discussing earlier, is that we published an evaluation.

Chair: Late.

Philip Rutnam: It is an initial evaluation of High Speed 1, and an evaluation that has been completed eight years after the project opened—in fact rather less than that, in terms of the domestic services. It is six years after the domestic services. The project is such that while the period over which the evaluation itself looks is 60 years, we all know these assets last a very long time, so it could well still be operating in 100 or 150 years. We are therefore actually very early in the life of the project. Also, importantly, in the period from the opening of the project to now—the date of the evaluation—we have had the world's largest recession since the 1930s. That is one major reason: the fact that we are very early in the life of the project and the fact that we have had an enormous correction, if you like—an enormous downturn in the global economy, including the UK economy.

The second reason, which I suspect is perhaps more what you are looking for, is that when the project was proposed and decisions were made in the late 1990s, the level of demand that was forecast for this project, particularly on the international side—it is essentially the international side that has underperformed—was considerably greater than the level of demand that has materialised. The number of international passengers being carried now on High Speed 1 is roughly of the order of 10 million a year, whereas in 1998, the projection that was made for this point in time was about 16 million, so we have had significantly less demand than forecast. There are a number of reasons for that. I have mentioned the international recession, but a second major reason is the huge impact of low-cost aviation and the impact that that has had on market structure. So make no mistake—demand was overestimated back in the 1990s.

Chair: Massively overestimated.

Q89 Kevin Foster: Given the quite eloquent explanation you have given of all the issues that affected your projections around HS1, do you feel that your projections around HS2 will be any better?

Philip Rutnam: If anything, in truth, I think that the risk is that our projections for HS2 are on the too-cautious side. There is a very important distinction between the international services on High Speed 1 and the services projected for High Speed 2.

Q90 Kevin Foster: Fundamentally it is a very fast train between two locations, being blunt, both of which are in a single market area.

Philip Rutnam: No, the market is quite different in both. First of all, there is an element of risk, of course, in any forecast, but there was in particular a high level of forecasting risk in the projections made in the 1990s for what was a wholly new form of travel—international rail travel from London to Paris and Brussels over high-speed lines. There was a significant element of forecasting risk, and much less data was available than for the domestic services that will be operated by High Speed 2. For domestic rail travel, we have

literally tens of thousands, if not millions, of data points, and a sophisticated system of demand forecasting that has developed over several decades into industry standards. Of course, it inevitably also involves a level of forecasting risk. All forecasts involve forecasting risk. One thing you know about all forecasts is that they are likely to be wrong.

Chair: You said it.

Philip Rutnam: They are, inevitably, because they are projections into the future; they are an assessment of the future. That doesn't tell you what the future will be—it is an assessment. The level of forecasting risk involved in the projections for High Speed 1 was much greater than for any domestic services now.

May I make a second point? I want to amplify my point that, if anything, the risk with High Speed 2 is that forecasts are on the cautious side. We have seen, since 1996—so, for the past 20 years, nearly—growth in demand for long-distance rail travel running at just under 5% a year compound, year after year after year. Growth in more recent years has been higher than that. Growth on the west coast main line, which is the principal artery that will be relieved by High Speed 2, has been higher still than that. We have seen growth in travel from London to Birmingham and Manchester more than trebling in those particular arteries.

The central projection in the business case made for High Speed 2 for long-run growth in demand for long-distance rail travel is 2.2% a year. We are looking at a world of the past, where demand growth has been roughly 5% a year compound, and our central projection for the future is 2.2% a year. In fact, beyond 2036, for various reasons I can explain, we assume that demand is flat.

Chair: That was a very full answer. Given where we are at timewise, it would be helpful if we could keep answers a bit tighter.

Q91 David Mowat: I take all the points you have just made on High Speed 2. However, on HS1, looking at the numbers the Atkins report has given to us in 2015, there is a BCR of 0.6—that is with wider economic benefits included. Under your methodology, that means you have higher costs than you have benefits, in spite of the fact that there are people in this team thinking of all the benefits they possibly can to put in at this stage. That means the project shouldn't have been done, under your methodology, doesn't it?

Philip Rutnam: I do not accept that, actually. I will make a couple of points. First of all, it does not include all the benefits that could be thought of. That report was very clear that it did not attempt to quantify impacts of the project on regeneration or on land use, or the potential transformative—

Q92 David Mowat: On that point, it says “benefit cost ratio (including wider economic impact and regeneration)”. Are you saying that it does not include regeneration?

Philip Rutnam: It has not quantified. There is a qualitative assessment of regeneration, but no quantification.

Q93 David Mowat: So when it says that it includes regeneration, it is wrong.

Philip Rutnam: There is no quantification of regeneration.

Q94 David Mowat: But you are telling us now that there are other benefits that you think are going to happen.

Philip Rutnam: It includes wider economic effects in terms of potential impacts on agglomeration, labour market effects and potential effects on competition, but taking essentially a static view of the use of land—

Q95 David Mowat: Okay. Those things were not the two things that you told my colleague were wrong with the business case—they were low-cost airlines and, I think, the recession early in the life of the project. So are there other reasons, as well as those two?

Philip Rutnam: There is a range of reasons. I can go on in some detail on the evaluation, which I think is a very useful piece of work, but it is only telling part of the story of High Speed 1, partly for reasons I have described, and partly because the assessment of the benefits does not capture—

Q96 David Mowat: The difficulty that I have with all that is that we are using a Department for Transport methodology, which has come up with a number of 0.6. That has been put in the public domain and that means there are fewer benefits than there are costs. What you are telling the Committee is, “Okay, yes, that’s what they have come up with—0.6—but ah! They have forgotten all these other things that I know about, but they didn’t put in.” There is a methodological problem then. Why produce a figure patently set at 0.6? Get your money back from Atkins.

Philip Rutnam: I did not say that they had been forgotten; I said that they had not been quantified. There is a good reason why they have not been quantified, which is that they are very difficult to assess. Indeed, it is a challenge and a puzzle for transport planners and economists around the developed world to try to put a value on some of these things.

That brings me to a second, very important point, which goes to why we make decisions about infrastructure. I understand the attractions of focusing on the single point estimate of a benefit-cost ratio, but it does not help us, as decision makers, to focus just on one number. You need to see the case for these projects in a much wider context, in terms of the potential strategic benefit—

Q97 David Mowat: I would be quite satisfied with that answer if it were not the Department for Transport methodology that had been applied to come up with this number. If you are saying, “Actually, we don’t need a methodology, because we knew we had to build the line anyway. By the way, when they come to look at it, there will be loads of other

benefits,” that’s fine but, in that case, don’t have a methodology that for High Speed 2, for example, has a ratio of 2.3, which everybody looks at very seriously and is very important.

Philip Rutnam: We do need a methodology. We are proud of our methodology. Our methodology has repeatedly been reaffirmed as world class by leading economists on this topic around the world, but it does not tell you the whole story, and it has to be seen in context.

Q98 David Mowat: Just to repeat the point, according to your world-class methodology, the number it has come up with shows that the project should not have been done.

Philip Rutnam: No, I would not say that. If you had completed the sentence in a different way, I would have agreed.

Chair: Mr Rutnam, you are in danger of sounding like Sir Humphrey.

Philip Rutnam: I’m sorry. You are quite right that the methodology that the Department has developed and endorsed ends up with a number of, I think, 0.67 as a central estimate of the benefit-cost ratio, with a range going up to 1.2. But we have never said that that methodology captures all the effects of these projects, and nor have we ever said that the decision on these projects should be taken on the basis of a number alone—it has to be seen as part of a much wider business case. Perhaps I could illustrate the point in a different way—

Chair: No, because David Mowat is going to hand over to Stewart Jackson in a minute.

Q99 David Mowat: Other colleagues want to come in, but I just go back to the point that if somebody else’s methodology came up with this answer that you did not like, and there were other things that were not included, I could kind of understand you saying, “They’re not being fair to me.” But, actually, that is not the case; it is the Department for Transport’s world-class methodology, as you called it, that has come up with an answer that says that the benefits that they have thought of—what they call wider economic benefits—are considerably lower than the costs.

The trouble is that when I listened to your answer on High Speed 2, it reminded me of somebody who once said to me, “If people in this organisation spent as much time delivering benefits in projects they had done as they do thinking of the benefits of projects they are about to do, we would be in a lot better shape.” Your answer felt a little like that. You were very coherent talking about the benefits of High Speed 2 and all the rest of it, but here we are with a finished project, and the methodology, which has been looked at by Atkins, presumably with a joint team involving your people as well, has come up with an answer of 0.6. Now, you are telling us there are other things that were not put in and might have been, but that is what I have in front of me, and it is quite disappointing.

Philip Rutnam: I completely accept that that is disappointing. Above all, what I am saying is that that is not the whole story, for the reasons I have tried to illuminate. If I may,

can I just assure you that an immense amount of effort on my part and the part of many other colleagues in the Department goes into the delivery of these benefits, rather than the inevitably somewhat abstract attempt to assess—

David Mowat: Okay. I would just make the point that you might want to look at your methodology.

Q100 Mr Jackson: Mr Mowat is on to a very strong point. It is very difficult for you to pray in aid the methodology, for instance around High Speed 1. When we looked in a report at High Speed 1 as a bespoke project, we specifically raised the issue of the lack of demonstrable data to back up the regeneration impact on north Kent, Thanet and other parts of Kent. There were other issues around transport connectivity. Therefore, a qualitative assessment—rather than the quantitative assessment Mr Mowat referred to—in your methodology is a bit difficult for us to accept at face value. It is incumbent on you to demonstrate—after all, it is in the methodology—the precise benefits in terms of regeneration that High Speed 2 will deliver. We do not have to look into the future; we can look at the past, and you failed to do this with High Speed 1.

Philip Rutnam: I completely agree that it is highly desirable to develop the way in which we think about these projects, both in advance and in arrears—when we are looking back at them—so that we may put a value, a financial value if possible, on the impacts in terms of regeneration, land use, the potential unlocking of value in, essentially, the reorganisation of the economy. If you think back to the railways of the 19th century, they transformed geography—

Chair: We do not need to go back to the 19th century.

Philip Rutnam: I completely agree with that. Technically, it is a very difficult thing to do robustly. Since I met the Committee to talk about High Speed 1 three years ago, we have procured advice from three of the world's leading experts in this sphere, Professors Overman, Venables and Laird. They recognised the difficulty of the task and made some suggestions for how we should develop our world-leading methodology further, essentially to try to develop more scenarios on the impact. This is particularly a question about the really biggest investments; not small-scale investments, but transformative investments—

Q101 Mr Jackson: Can I just stop you there? I am a layman, but my observation is that you make this strategic flaw at the heart of the whole High Speed 2 prospectus, which is the focus on opportunity-cost of work done on the train and work displaced—

Chair: It has changed now.

Mr Jackson: I know it has changed now. There is also a failure, in my opinion, to look at the international experience, which was that economic activity was sucked into the hub, rather than going out to the further reaches, whereas—

Chair: You are in danger of getting into policy.

Mr Jackson: We are talking around methodology and rationale. Whereas at the beginning it should always have been about capacity. I think there you could have built a model around capacity that would have been a lot more persuasive to people like me, who are natural sceptics.

Chair: One final comment on that from you, Mr Rutnam, and then I will go to Caroline Flint.

Philip Rutnam: I will restrict myself to saying that we are continually trying to develop the techniques we use for assessing these projects, in advance and in arrears. I have talked about the work in relation to regeneration and land use. In relation to that famous issue about productivity on trains, we have again developed our own methodology, we have done—if I may use the phrase—world-leading research to assess the value that users attribute to different sorts of journeys and different sorts of journey times. Another major piece of research on that has been published recently, which if anything shows that the value from business users in relation to long-distance rail journeys is higher than when we were debating—

Q102 Mr Jackson: May I just ask for a note specifically on the issues identified by Mr Mowat of economic activity and regeneration and of how that features in, and is important to, the world-class, world-beating model that you are currently using on behalf of taxpayers?

Chair: I think, Mr Rutnam, you have said that often enough that it will have to appear in our report.

Philip Rutnam: I can see that I am going to rue those words, but I will be delighted to provide you with a note—I will try to ensure that “world-leading” does not appear in it.

Chair: We have considered having a bingo card for well-used phrases, although this is the first time we have had that one so often.

Q103 Caroline Flint: Reading the evaluation that was done on the impact of High Speed 1 on the choices that people make about where they live and work, it is clear that it had a considerable impact, but the impact was far less on businesses. Apparently, just over a third of the 70 businesses surveyed referred to High Speed 1 as having a positive impact on their business when asked directly—you could flip that around and say that two thirds did not. So, following on from my colleague’s question, what makes you feel that other projects such as High Speed 2—let’s just stick with High Speed 2—will deliver a higher level of benefits than has been identified so far by your evaluation of High Speed 1?

Philip Rutnam: At the risk of repeating myself, the research done on High Speed 1 was at a fairly early stage in the project. In fact, if you talk to organisations such as Kent County Council, Ashford Council or the east Kent councils, they will talk about the very positive impacts on the regeneration and economic development of east Kent associated with the domestic services on High Speed 1. If you look at the development around King’s Cross

or the development of Stratford, again there is not quantified, but practical evidence of regeneration that is linked—undoubtedly, to my mind—to the project.

Q104 Caroline Flint: One of the things for anyone who represents an area that has been part of a big infrastructure project is that they are big, they are complicated and they take a lot of time. So what have you learned from High Speed 1 about how you can, in real time rather than down the road or when it is completed, get a grip on determining the benefits and making sure that others who are partner to this are making the most of the project as it is built out?

Philip Rutnam: That is a very good point and, partly in response to our experience with High Speed 1 and the disappointment thus far of Ebbsfleet, it has been right at the heart of our work on High Speed 2. How to maximise the benefits of High speed 2 in terms of regeneration, economic development and economic growth, including locally, has been absolutely central to the project over the last several years. Before the election, Lord Deighton led a growth taskforce, which was tasked with coming up with recommendations around that. At a more local level I could point to the proposals for Old Oak Common being led by the development corporation set up by the Mayor, and in Birmingham the work being led by Birmingham City Council, together with HS2 Ltd and the Department, on the Curzon Street quarter. I suppose the general point is to engage early with local authorities and the business community, to think about the planning dimension of regeneration—in some cases the Government have provided seed funding to help get local economic plans off the ground in these areas—and to have clear leadership in the Government.

Q105 Caroline Flint: Thank you for that detail. I am just trying to get a sense of how much you have learned from what perhaps did not transpire as a result of High Speed 1 and how much some of what you are saying will be a real-time engagement. Also, if it becomes clearer as the project is built out that some of the benefits that were initially defined as part of what it can offer are not being met, how flexible are you about being open and transparent about that before we get to the end of the project, or about making adjustments to the project?

Philip Rutnam: We have learned a lot from High Speed 1, both from its successes—King's Cross and Stratford—and from the more difficult cases such as Ebbsfleet.

Q106 Caroline Flint: You say that you have learned a lot, but does that mean that you will be nimbler in the way you approach transport projects?

Philip Rutnam: The other general point I would make is that what we describe as benefits management is having a clear focus, and not just on the physical infrastructure and the services that will run over it, but on how we use that to maximise benefits and build that in from the outset of the project. That is the single biggest thing.

Q107 Caroline Flint: One of the things about High Speed 2 is that it is a massive project. Obviously it is all starting in the south, but it is meant to help power up the north. I am a lay person in this. Why can't the project start at both ends so that you create a dynamic of competition and also investment at two points? I never quite understand, given the nature of this project, which is essentially a line between two points, why they cannot be factored in, with opportunities for generation at both ends so that everyone gets a real-time assessment of creating the skills and jobs and purchasing the materials to build out and everything else that goes with it. These projects last a long time—I think you said 2036. What will they do at the end of the line in the north?

Philip Rutnam: We need to devise, develop and deliver the project in a way that is affordable and that maximises value for taxpayers. It is an enormous undertaking just building phase 1, so it is very clear to the Government that we need to start with phase 1. It is also very clear that starting with phase 1 brings benefits to all places north that will be served by HS2 services, because by doing phase 1 we both relieve the capacity constraints on the most congested part of the west coast main line, which is south from Birmingham and Rugby, and improve journey times for—

Q108 Caroline Flint: So is it a money thing why you can't start at both ends and work your way—

Philip Rutnam: No, it is about maximising the benefits from the project. Phase 1 will bring benefits to Manchester, Liverpool, Glasgow and all points north from Birmingham, as well as—

Chair: Mr Rutnam, I think we may be getting into the world of wishful thinking.

Philip Rutnam: —because the trains will be faster.

Q109 Chair: Can I just ask a few quick-fire questions? The evaluation was late for High Speed 1. Would it not have helped you to get High Speed 2 better planned if you had got that evaluation in when you were supposed to?

Philip Rutnam: We were clearly actively seeking to learn from the experience of High Speed 1. We were not waiting on the evaluation to learn the lessons from High Speed 1. In fact, the point we have just been discussing about regeneration and regeneration strategies—practical action—did not wait on the evaluation. In fact, I would say it is not much covered in the evaluation. The evaluation is a little bit more technical.

Q110 Chair: Let's move on to the Ebbsfleet issue. Why is Ebbsfleet not being developed?

Philip Rutnam: The Government has taken very significant action in the past few years to accelerate development at Ebbsfleet, including setting up the urban development corporation. There is now planning permission in place for 16,000 units.

Q111 Chair: Exactly; there is planning permission, so why has it not happened?

Philip Rutnam: I am not familiar with the whole history of Ebbsfleet, I have to say, but I think the principal factors involved the cost of remediation at Ebbsfleet, which proved to be a barrier to private sector development, and then some of the complexities of planning permission, including the infrastructure needed.

Q112 Chair: Have those lessons been learned for High Speed 2?

Philip Rutnam: We are absolutely focused on how we make sure there are sensible, long-term, viable, active strategies for growth and regeneration around each of the HS2 station sites. It is a core principle of the whole programme.

Q113 Chair: Would you not agree, however, that Ebbsfleet is a double loss for the taxpayer? There are homes that are badly needed, as well as the regeneration value, which means taxpayers are picking up more of the bill for High Speed 1 than they would have had Ebbsfleet been developed.

Philip Rutnam: I agree that it is sorely needed for both those reasons, and I believe it will come. I believe that when we look back at HS1 in years to come, for this and many other reasons, we will say, “The country couldn’t possibly do without this.” In fact, I think we would already say that.

Chair: It might be that the country could do with it a bit quicker. I have two final quick-fire points from David Mowat and Stephen Phillips, and then we will come to a conclusion.

Q114 David Mowat: I spent a long time in the last Parliament looking at the business case for HS2, because I am a big supporter of it and I go to public presentations about it. You said something very interesting and important today about the methodology, as I understand it. You told us that there is, in terms of the benefit-cost ratio—tell me if I have got this wrong—the transport benefits-only one that you always produce; the benefit-cost ratio including wider economic benefits and regeneration; and now you tell us there is a third one, which is even wider economic benefits that may not have been included in the second one. Is that what you are telling us?

Philip Rutnam: That is broadly correct, yes, and it is particularly relevant to projects that have the most potential for transformative effects on economic geography—where people choose to live and locate businesses—and on changes in land use over time, as well as on the sectoral composition of the economy. Both those effects are not captured at the moment in the wider economic benefits, which assume a static approach to land use.

Q115 David Mowat: So you are saying that the one that includes the wider wider economic benefits, which is the one you said would have made HS1 good or above 1, we have not yet done for HS2, because the HS2 second one is only wider economic benefits, not wider wider economic benefits.

Philip Rutnam: We clearly need to find a new phrase for the wider wider economic benefits.

Chair: We have just invented it.

Philip Rutnam: You are correct that we have not yet quantified it. We don't think anyone has yet managed to quantify it robustly around the world. If you look at the strategic—

Q116 David Mowat: I will leave it there, because the Chair asked me to be quick. I want to make a final point: you might want to get some of your people to do some work on this before you produce reports that say you have a 0.6 BCR, which comes to the Public Accounts Committee, where you then have to say, "Well, it's only 0.6 because it's only wider benefits, not wider wider benefits."

Philip Rutnam: We tried to communicate that around the time the evaluation was published, but clearly we could do better on that, as we could on many other things.

Q117 Stephen Phillips: I think this question is for you, Mr Russell, but it might be for Mr Kingman. It is the point that we were at cross purposes over earlier. How much is it costing to bring together the Shareholder Executive and UK Financial Investments? If you don't know, could you write to us?

Mark Russell: Actually, I don't know. It is still a work in progress. The two groups do not come together at all—

Q118 Stephen Phillips: Who is going to be the chief executive of the new company?

Mark Russell: I am.

John Kingman: I cannot give you a number, but there will be some costs for various reasons. They will not be huge, and we will be happy to give you the details.

Q119 Stephen Phillips: Right. Who are the advisers on putting the new GovCo together?

Mark Russell: We have some legal advisers, just on setting up the company.

Q120 Stephen Phillips: Could your letter to us identify who they are and how much they are being paid?

Mark Russell: We can definitely write you a letter on that.

Chair: Thank you very much. Mr Rutnam, you have added single-handedly a number of bingo words to our bingo cards, which we will be selling to the civil servants behind you before Christmas for charity. Thank you very much indeed for coming along and explaining the rationale behind the Eurostar sale and getting into the issues around High Speed 1 and High Speed 2, which are particularly interesting to the Committee. As you know, we have looked at those before, and we will be having you back—particularly Mr Russell and Mr Kingman—on future sales of assets by the Government, because that is obviously of great importance to the taxpayer. Thank you for your time.