HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Rail Franchising in the UK, HC 689

Monday 26 Feb 2018

Ordered by the House of Commons to be published on 26 Feb 2018.

Watch the meeting

Members present: Meg Hillier (Chair); Sir Geoffrey Clifton-Brown; Martyn Day; Luke Graham; Anne Marie Morris; Lee Rowley; Gareth Snell.

Sir Amyas Morse, Comptroller and Auditor General, Adrian Jenner, Director of Parliamentary Relations, National Audit Office, Lee-Anne Murray, Director, NAO, and Richard Brown, Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-212

Witnesses

I: David Horne, Managing Director, Virgin Trains East Coast and Martin Griffiths, CEO, Stagecoach Group PLC

II: Bernadette Kelly, Permanent Secretary, Department for Transport, Peter Wilkinson, Managing Director, Passenger Services, Department for Transport, Mark Carne, Chief Executive, Network Rail and Charles Horton, Chief Executive Officer, Govia Thameslink Railway Ltd.

HOUSE OF COMMONS

Reports by the Comptroller and Auditor General

Update on the Thameslink programme (HC 413)

Reform of the rail franchising programme (HC 604)

Crossrail (HC 965)

Examination of witnesses

Witnesses: David Horne and Martin Griffiths.

Q1 **Chair:** Welcome to the Public Accounts Committee on 26 February 2018. We are here today to take evidence on two major troubled franchises. Rail franchises are something the Committee has looked at a great deal in the past, and we have been raising concerns about them for some time.

Today we are looking at the National Audit Office's Report on the Thameslink, Southern and Great Northern franchise, which does not need much introducing because passengers have had a very poor service on it. It is a particular style of franchise—in fact, we have so far not really discovered two franchises that are on exactly the same footing. We are also here to look at the Virgin Trains East Coast service—VTEC. That franchise has collapsed for the third time, this time ending five years early.

We will have two panels in front of us today. The first is the owners of the east coast franchise. We have, from my left to right, Martin Griffiths, the chief executive officer of Stagecoach Group plc, which is the 90% owner of VTEC, and David Horne, the managing director of Virgin Train East Coast Limited, which is, by mathematical deduction, a 10% owner of the franchise.

We have obviously seen huge publicity about the franchise collapsing for the third time. The obvious question to ask you both is why your forecasts on passengers and revenue were so wildly wrong, and why you therefore feel obliged to give up the franchise five years early.

Martin Griffiths: Just one thing for the record: Virgin Trains East Coast is a 90% subsidiary of Stagecoach Group. David is the managing director of the subsidiary of Stagecoach Group. For the record, 10% is owned by Virgin Group.

Chair: Thank you for the clarity.

Martin Griffiths: Thank you for inviting us. We will do our very best to answer your questions and, I hope, help with your deliberations. I start by saying that this is a complex matter, but to the extent that we have responsibilities and obligations, we absolutely accept those.

Q2 **Chair:** My question was why you got your forecasts so wildly wrong for the franchise.

Martin Griffiths: We start back in 2013, when these bids were put together. We could probably spend the whole time going through what has changed in that period. Lots of things have changed, but fundamentally, we signed a contractual position with the Government—with the Department for Transport. We accept our responsibilities under that contract. Just for the record, the franchise has not—

Q3 **Chair:** But you are walking away from it, so you got the numbers wrong, didn't you?

Martin Griffiths: Just to be clear, we have never walked away from it.

Q4 **Chair:** You are negotiating your way out of it.

Martin Griffiths: No. We continue to fund the business to the extent that we are obliged to. We signed a contract. A risk share between us and the Government was part of the procurement of that franchise. We are doing all the things that we were expected to do when we signed that contract, and the business continues to run and trade. We have to work out the contractual structure going forward at a period in time.

Q5 **Chair:** Just to be absolutely crystal clear, you will not be running this once you have negotiated with the Government to exit. You have decided to give up the franchise early.

Martin Griffiths: No; we are honouring our contractual obligations under the franchise. It is really important that we make that distinction. The Government had obligations under this contract and we had obligations under this contract. I accept that our forecasts, for lots of different reasons, have not come through. We would have liked passenger growth to be greater than it has been over the last three years. That is unfortunate. I am disappointed about that, but to the extent that we have contractual commitments to fund the franchise, we have done that, up to a level agreed with the Government. Once we reached that funding commitment, the risk was then with the Government. That was the franchise model that they put in place for this contract. You actually alluded to it at the beginning: you said each contract has been different. This contract is different from how the Government have procured rail franchises in the past and, encouragingly, is probably different from how they will procure franchises in the future.

Q6 **Chair:** But you have had to put in the parental guarantee money—the £165 million.

Martin Griffiths: Yes, we have.

Q7 **Chair:** That caps your liabilities. Has that been a factor in your going? If you go, you have to pay that £165 million and you are not liable for a penny more.

Martin Griffiths: We are committed to putting in the £165 million. That was what we agreed to do at the time the franchise was let. You asked about the model. I hope the Committee would acknowledge that we have had quite a change since 2013-14. The economic outlook, the political outlook and a lot of other things have impacted rail. We have seen the lowest growth rates in UK rail since privatisation. From our point of view, contractually, we have had to accept that, but no risk share was put in place on this franchise that has recognised the macroeconomic factors that have changed. The Government decided to take a big guarantee from us to secure the continuity of the franchise up to £165 million, and that is what we did.

Q8 **Chair:** Let me put it differently to you before we get to Mr Horne. You bid a certain amount. One could argue that you overbid massively for this contract in order to secure it, on the basis of certain passenger numbers, leaving yourselves little wriggle room if the passenger numbers went down. Why did you get your forecasts so wrong? Or were you gambling on passenger numbers staying static? Did you not allow for or contemplate any situation where passenger numbers went down?

Martin Griffiths: There is no incentive to overbid. We would not all be here talking about it if—believe me when I talk about the time and energy in this situation. Nobody approached these bids with the intention of trying to overbid or overestimate what they might achieve. The forecasts were put together based on the best economic outlook data that was available from the Government and the OBR at that time.

Q9 **Chair:** Mr Griffiths, if you were so pitch perfect on the bid and you were not overbidding, why are you not able to continue to run it because passenger numbers have gone down? They have got no capacity to—

Martin Griffiths: Clearly, with the benefit of hindsight, things have changed, and we accept that. We accept responsibility for that.

Q10 **Chair:** Which gets me back to my original question: why were your forecasts so out? Why did you not plan for any significant variation, or even a degree of variation, in passenger numbers? I tell you what, tell us this: what was your tolerance level for passenger number variation when you bid for this, percentage-wise, plus or minus?

Martin Griffiths: We were bidding a high percentage of passenger revenue growth, based on the trends that had been seen in the previous periods at that time, based on all our own experience of—

Q11 **Chair:** So in your planning you did not contemplate passenger numbers going down at all.

Martin Griffiths: We ran many, many sensitivities, put them together and worked through what would happen and the scenarios that would emerge. A whole series of things have come together now that were not foreseen at the time, which we have had to deal with.

Q12 **Chair:** So you didn't plan for the worst-case scenario; you planned for continuing growth, in summary.

Martin Griffiths: We ran a whole lot of downside sensitivities, as did Government, who we believe evaluated our bid very robustly from both a financial and an operational delivery point of view.

Q13 **Chair:** The Department provides data to the franchisees to look at, in terms of determining things. Did you rely on that data, or did you do your own market analysis of what was likely to happen to passenger numbers?

Martin Griffiths: It is a combination of both.

Q14 **Chair:** Were the Government's figures robust, when you compared them with the figure that you calculated?

Martin Griffiths: If you take the economic forecasts back in 2013 and 2014, you don't need me to tell you that those have changed quite substantially since then.

Q15 **Chair:** What about passenger numbers? The Department has put in some quite considerable work into passenger numbers and trends, and provides a handbook for you. Were you relying on that, or did you do your own?

Martin Griffiths: There is an industry standard of forecasting rail. We have seen fundamental changes since 2013 and 2014 that would question the reliability of the traditional way we have forecast rail revenue and rail passenger numbers—that has changed.

Q16 **Chair:** I am sure we will come back to that. Mr Horne, I said that your forecasts were wildly wrong, but it does seem that there has been a real difficulty here. What was your involvement in determining how to bid and how many passengers you would forecast for this line?

David Horne: Good afternoon. To be clear with you on that question, I was appointed managing director of this business just before we took over the business—I was appointed in December 2014 and we launched the business in March 2015—so I was appointed after the bid had been secured and the contract signed. At the time of the bidding process, I was involved in running another company.

Q17 **Chair:** Is part of your role to encourage more passengers to use Virgin Trains East Coast?

David Horne: Absolutely. We took over in March 2015 and we have had a very clear and admittedly ambitious plan to improve the service, transform the service and grow the passenger services on the back of that.

Q18 **Chair:** Improving the service was one of your main drivers to increasing passengers. Were there any other aspects?

David Horne: It was. We supported the revenue growth projections with a significant amount of investment, and that is really in three phases. The first phase, which we have delivered over the last three years, has been about improving the existing trains, running more services with the existing train fleet, and improving other elements of the customer service. The second phase is about the delivery of the new train fleet, which is coming later this year. Both of those things—based on the experience of both Stagecoach and Virgin elsewhere—had delivered significant revenue growth on other routes. So we felt that we could place a lot of confidence in the model that we adopted at the time of the bid. As I think Mr Griffiths has mentioned, other things have since happened in terms of the wider economy.

Q19 **Chair:** At board level—I don't know which of you sits on which board of which part of the organisation—were there any discussions about the potential risks to passenger growth? Did anybody call out and ask, "What if we don't get this passenger growth? Have we got enough tolerance in our bid?" Or, indeed, did you, Mr Horne, when you took over and were looking at the day-to-day costs of managing this contract—this franchise—and continuing it running?

Martin Griffiths: Absolutely. I will take that because, as I said, I am ultimately responsible for the Stagecoach Group bid. Yes, at bid level, steering group level and, ultimately, Stagecoach board level, there was a lot of discussion about the bid, the forecasts, the revenue assumptions and what happens if certain things don't work out. If the macro-economy is different, is there a risk share? What is the ultimate liability or the tolerance for risk that the group would have? That was a very robust process. Part of that was agreeing with the Government the contractual framework, which said, "We are prepared to take risk"—there is risk; you won't win franchises if you don't take risk—"but is the risk transfer and the risk allocation acceptable to us?" Back in 2013 and 2014—again, a very different time—we concluded that the risk was acceptable for us and we pushed ahead with the contract.

I would just echo what David said. David's team are responsible for driving forward the business and, against the background, it has been extremely challenging. His management team and our staff have done an excellent job, and we are growing. Many businesses in the last five years have not seen growth, but our railway has grown; it is just not growing at the rate we had hoped or anticipated when we put the bid in— not even when the contract started, but when we put the bid in.

Q20 **Chair:** Okay. Let us go back to when you put the bid in. You have talked about a massive change in the economy, but there were still shocks apparent at that time, and it seems that nobody either in Virgin Trains East Coast or Stagecoach or in the industry was calling that out. In hindsight, do you think you could have got the franchise for cheaper than your bid?

Martin Griffiths: Hindsight is a wonderful thing. Of course, if we could go back today to that time and look now and see what has happened, you would bid less. You would not take the position that we did. But all of the evidence we had at the time, from the testing we had done, the customer interviews we had done and 21 years of running railways in this country on South West Trains and East Midlands Trains, and what we have done with Virgin on transforming the west coast main line—as recently as 2006 that railway had 14 million passengers a year, and Virgin Trains West Coast will do something like 34 million passengers this year. We have seen significant passenger growth on the back of what of what was expected on the economy, customer experience improvement, new investment and new trains. It was a bid that was ambitious, but it was a transformation—

Q21 **Chair:** It was ambitious, but it was also—you say that hindsight is a wonderful thing, but you knew when you bid that it had failed twice before.

Martin Griffiths: Yes, we did.

Q22 **Chair:** So what particular cautions did you take in bidding for this franchise, knowing that it had failed twice before? Surely that was a big, bold warning sign that it was not a simple franchise to run. I'm not suggesting that you thought it was simple, but it was going to have its own complications.

Martin Griffiths: It is not a simple franchise, but I go back to: it was a business transformation project. This was to be eight years, plus potentially options to go further. It was to introduce a whole new fleet from later this year or early 2019, which was absolutely to transform and revolutionise public transport on the east coast main line. And we will do that—or somebody will do that.

It will be a fantastic project; it is just that the first three years of operating have been below what we would have expected. That is despite a significant capital investment programme. All the customer experience—the customer on-board experience and the station experience—and first class has been upgraded. For those of you who use it, I hope you see that. So everything that traditionally you would have put into driving growth on a railway has been done, and then some. We have got growth; we just have not got the growth that we had anticipated back in 2013.

Q23 **Gareth Snell:** Mr Griffiths, you can't see what I can see, which is one of our colleagues shaking her head at the idea that the service has improved on the east coast main line. I have got the train a couple of times, but I take the west coast main line. You have just explained how everything with the west coast main line seems to have gone well and passenger numbers have grown, but earlier on you said that part of the reason you have not seen the growth in passengers on the east coast main line was because of macroeconomic problems and wider economic circumstances. So how is the east coast economy any different from the west coast economy in terms of driving passenger growth?

Surely, the only people to blame when people are not getting on your trains are the company that provides the service. The idea that somehow there is this wider set of forces that means that passenger levels have been subdued on the east coast main line, when every other franchise across the piece is experiencing an increase in usership, suggests that you are out of kilter and it is not the public who are at fault.

Martin Griffiths: It is absolutely our responsibility. But, to be clear, Virgin Trains East Coast has outperformed the sector over the last three years in terms of growth. The railway has seen the lowest growth rate since privatisation, and Virgin Trains East Coast is part of that. So when I talked about the historical experience on west coast, that was in a different period of time. In the period leading up to the bid, we had seen substantial growth. In the last three years, rail revenue growth across the UK has collapsed. That is to do with the economy. That is to do with political uncertainty. We have had some terrible high-profile incidents in places like Manchester, which you will clearly all be aware of, and a fundamental change in people's perception about travel.

Q24 **Chair:** Can I just probe that? How does political uncertainty stop someone getting on a train and going somewhere? I don't understand the connection.

Martin Griffiths: The whole economy—

Chair: You mean economic uncertainty? That is different.

Martin Griffiths: When we bid for the franchise, nobody foresaw two referendums—one in Scotland. We did not foresee the Brexit referendum, with two general elections. All of these things. I can take you to other parts of our business—

Q25 **Chair:** I have to say that you got a lot of business with a load of MPs travelling up and down to Scotland for the referendum.

Martin Griffiths: We are in a very different place. That is my point. So Virgin Trains East Coast has outperformed.

Q26 **Gareth Snell:** I think it is a baffling excuse, frankly, that two referendums stopped people getting on the train.

Martin Griffiths: I just said it is relevant; it is part of the whole wider debate.

Q27 **Gareth Snell:** How? This is what I do not understand. How exactly—in fact, don't worry about that question, because it is so baffling and such a throwaway comment that it's not even relevant to what we are discussing. What I do want to know is this. You have said that the east coast main line is outperforming every other franchise and it has had record growth. How have you not been able to sustain the programme of activities that you had planned to do if you are the most successful, in terms of growth, out of the franchises?

Martin Griffiths: One of the most successful. As I said, everything is relative to what you bid. We assumed that we would have higher growth rates than we have achieved, and we take full responsibility for that. Contractually, that was a risk, and we have accepted it. It is disappointing. I am disappointed for our staff and for our shareholders; I am disappointed it has not worked out. But that is where we are.

Just to be clear, our risk—you asked about the model. When we signed this contract on this franchise, the Government stress tested this bid as well. The way the Government dealt with the risk allocation was this. You asked what we did; we presume the Government—I am sure you will ask them this—did all this evaluation as well. But what the Government then asked for, to protect the taxpayer in the scenario that these forecasts did not come through, was this. The Government asked us to write at that time the single biggest guarantee that had ever been given on a rail franchise.

Q28 **Chair:** It was £165 million.

Martin Griffiths: It was £165 million. Our total losses on this contract will be about £200 million; that is about 20% of the market capitalisation of Stagecoach Group at the current time. That is a very, very significant and painful experience for our company.

Q29 **Chair:** Clearly, walking is less painful than staying with the contract, or you wouldn't have walked—let go.

Martin Griffiths: Can I just go back to this? We are honouring our contractual position—absolutely. We are funding the business. We are doing everything that we were asked to do.

Q30 **Chair:** You are honouring it, but you were expecting to run the franchise, as you said, for a minimum of eight years, with a possibility of extension, so this is well out of kilter with your plans when you bid for the franchise.

Martin Griffiths: Of course.

Q31 **Chair:** And you said only last year that you expected the franchise to be profitable by next year—by 2019—so why is it that you are prepared to pay that Government guarantee of £165 million but not prepared to put money into keeping the franchise going until it is profitable? Or do you disagree with what you said last year?

Martin Griffiths: No; there is no doubt that the trading position has deteriorated even further since this time last year.

Q32 **Chair:** So you do not now think it will be profitable by 2019?

Martin Griffiths: No.

Chair: That is very clear; thank you.

Q33 **Sir Geoffrey Clifton-Brown:** Can I just try to examine for a minute why the franchise is not as profitable as you thought it was? Is it because you are getting lower passenger numbers? Is it because people are buying cheaper tickets? Or is it because your costs are more than you thought they were going to be?

David Horne: Can I take that question? It is absolutely a matter primarily of revenue. If you go back to the time of bidding—to 2014-15—the inter-city sector, across the whole rail network in the UK, was growing at about 7.5% in terms of passenger revenue. So far this year, from April 2017 to now, the sector has been growing at only 1.2%. Across the sector, passenger revenue numbers are still growing, but at a much lower rate than they were at the time of bidding.

We have also seen an impact in terms of the price that people are prepared to pay. It is fair to say that people are under more financial pressure than was expected. We are certainly seeing that the market is shifting more in terms of the lower-cost fares that people are looking for. We have responded to that as best we can by running more services so that we can offer more cheap fares—at weekends, for example—and we are seeing some good growth on the back of that, but it is a different position from what it was at the time of bidding.

Q34 **Chair:** Mr Horne, I just want to cut across Sir Geoffrey. You are one of the companies that has pioneered early booking and cheap fares.

David Horne: We have.

Q35 **Chair:** So, in a way, are you not hoist with your own petard? You have promoted advance booking and cheap fares, and people are now, you are saying, buying too many of those, so that has been damaging your—

David Horne: It is a mix. When you are running a business like this, it is a mix between the volume strategies, the extra passengers that you attract by cheaper fares, and the fares that you can expect business customers, for example, to pay. Clearly, the focus has shifted in terms of affordability. People have less discretionary income than they used to, which has made the revenue challenge a bit greater. As a business, we have been responding to that as best we can by, for example, running more services and improving them where we can.

Q36 **Chair:** Have you done an analysis of how business passengers, walk-up fares and expensive tickets have dropped off? You talk about the balance changing, but have you done an analysis of what percentage drop there has been?

David Horne: I don't have that figure to hand. We can certainly follow that up.

Chair: If you can provide it, that would be helpful. The Department has got its handbook, and clearly passenger numbers dropping overall is an industry-wide issue.

Martin Griffiths: We can provide that.

Chair: That would be very helpful.

Martin Griffiths: We have experience of running other railways. This is not just inter-city; commuter franchises are also seeing this.

Chair: We would be very interested in that, because it is something we want to probe.

Martin Griffiths: We have that.

Chair: Our sister Committee is interested, too.

Q37 **Sir Geoffrey Clifton-Brown:** Let me try to test your bidding process against where you are at the moment. You have told us today that you are running 34 million passengers. What did you predict in your original bidding process? Where did you think you would be at the moment in your original bidding process?

Martin Griffiths: I can't remember right now off the top of my head, but we were certainly looking, in these early years, for a minimum of high single-digit revenue growth, and we have been getting low to middle single-digit growth. In those three years, we were significantly behind what we hoped for, for the reasons we have alluded to.

Q38 **Sir Geoffrey Clifton-Brown:** How will this affect your bidding process in the future? I don't know whether you are going to be bidding for this franchise in 2020 or not, but if you were, how would you approach the bidding process?

Martin Griffiths: There are two things. There are lessons to be learned here for all people. We have responsibilities, but there are lessons to be learned by various stakeholders—the Department, Network Rail and us principally—about how we approach bidding, the risk transfer and the risk allocation. Bids are set at a point in time in the economic cycle. You asked me about that. You can only form a view based on the evidence, the trains and the data you have at that point in time. Clearly, if you were bidding tomorrow, you would have a much more cautious outlook because of what you are seeing at this point in time.

I think the Government recognise that the model they procured on for this particular franchise is perhaps not fit for purpose. I know you have looked at Richard Brown's review from 2012. I am a great believer that risks should sit with those best able to manage them, and he said that macroeconomic risk should largely sit with Government. On this franchise, there has been no risk share, so all the risk—macroeconomic, initiative and all of that—has sat with us, the operator. We accepted that contractually, but I don't think it has worked. One of the reasons we are here is that it clearly hasn't worked out as any of us intended. I think there needs to be some time for reflection about what the rail franchising model needs to look like as we go forward.

Q39 **Sir Geoffrey Clifton-Brown:** Just to try to work out where we are going to go from here, you are going to negotiate your way out of this, because you have come up against your £165 million guarantee. Is it likely either that the Government will pay you to run it until 2020, or that they will take it over themselves? In any case, are you likely to be bidding for it in 2020?

Martin Griffiths: The Secretary of State made an announcement in the House of Commons a few weeks ago, and he clearly flagged that the contractual position on the railway needed sorting. Again, I would reiterate that the railway generates a high cash surplus. This is a very strong railway that will generate something like £260 million cash profit this year.

Q40 **Chair:** We are talking about east coast?

Martin Griffiths: East coast will generate something like £260 million. The issue is the contractual structure below it—in other words, the payments to Government—which was part of the bid structure we have talked about. Going forward, the taxpayer will still get an incredible amount of value out of this franchise, whether we are running it, the Government are running it or somebody else is running it.

In answer to your question, the Secretary of State has made it clear that he wants to evaluate his options. I believe we can demonstrate that it is still best value for us to deliver the next stage of the growth that David alluded to, which is the new trains coming in. It would be very disruptive to change that now. But that will be a decision the Secretary of State will have to make when he sees the different options evaluated to him. We will obviously co-operate with him. He has made it clear that if we were to continue to run it, and we understand this, it would be on a not-for-profit basis through to 2020, but if we met certain key milestones around, I think, things like passenger satisfaction and delivery of new trains, we would look at whether there would be an exit fee payable. He will measure that against bringing the railway back to be run in house. On your question about—

Q41 **Chair:** Can we unpack that comment? There is a discussion going on that if passenger satisfaction hits a certain bar and things like the delivery of new trains—I won't ask you to detail everything in that, because obviously it is under discussion—you could forgo your exit fee. Is that the £165 million?

Martin Griffiths: No. To be clear, there is everything we are contractually committed to under this contract, but it is not actually that. There is the £165 million, the performance bond and the net assets. The Government—

Q42 **Chair:** Can you just be clear about what you mean by the exit fee and what ballpark, if not precise, figure you are talking about?

Martin Griffiths: To be honest, we have not really discussed that. I am not ducking the question. I only saw that when you saw that, three weeks ago when the Secretary of State announced it. There is ongoing discussion about what that structure might look like.

Q43 **Sir Geoffrey Clifton-Brown:** The final bit of that question was, are you likely to be a bidder in 2020?

Martin Griffiths: Stagecoach Group has been operating and bidding rail franchises in the UK for 21 years. We take it very seriously. This has been an unfortunate experience, but I believe passionately in the railway. We all do. As long as the contractual structure and—coming back to this—the risk allocation are right, I would like to think that we will continue to bid for UK rail franchises.

Sir Amyas Morse: I want to make sure I have understood properly what you have said, Mr Griffiths. If I understood what you were saying there, in the event that you were to run the railway up to the end of the current franchise period on a not-for-profit basis, I think you mentioned that there might be space for you to get an exit fee if you hit a series of performance targets—a return of some kind if you were highly successful. Is that what I heard you say?

Martin Griffiths: Really, there has been no detailed discussion about that, other than what the Secretary of State for Transport said in the House of Commons. He was very clear that it would be not for profit through the life of the remaining contract, but he would want to talk to us about certain deliverables and if we hit them there would be a discussion about whether there would be some very small compensation for that.

Q44 **Chair:** Why would you want to run a railway not for profit, Mr Griffiths, given that you are a private company with shareholders who expect you to make profits?

Martin Griffiths: That is a very valid question, and that is why, until I understand what the Government might mean by that proposition, it is difficult for me to comment. You are right: we are a private company, we have shareholders to answer to and they would rightly ask exactly the same question as you, "Is this the right thing for us to be allocating our management time to?" Until I see the details of that I cannot absolutely comment.

Q45 **Chair:** One could say that it might preserve some of your integrity as a company to continue to run it. There might be some reputational benefit. Is that something that would be considered?

Martin Griffiths: Absolutely. As I said, we are not in any way shirking where we have responsibility here. We have not asked for any special favour, and we have not been given any special favour. We are seeing through the contract and the Government are pursuing the contract, as I would have expected them to do.

Q46 **Chair:** But you cannot be proud that this has happened.

Martin Griffiths: No, I am not. I am very disappointed. It has been a very painful experience. But when we sign contracts we honour them. Through the depths of the recession we honoured them. We have never shirked our responsibilities. This is where I feel that there are other parties with responsibilities here as well—

Q47 **Chair:** We are going to get on to that in a moment.

Martin Griffiths: We expect everyone to be responsible under the contract, and we will be too. We accept that.

Q48 **Anne Marie Morris:** At what point did you begin to realise that there was a problem and that you were not going to get the results you had expected? How did you monitor exactly how this contract was going? If you realised earlier that there was a problem, what did you do about it? What steps did you take? Every business can always adjust; businesses have to.

Martin Griffiths: I knew about this a few weeks after we got in.

Q49 **Chair:** A few weeks after you got the franchise?

Martin Griffiths: After we started. I knew we had a problem.

Q50 **Anne Marie Morris:** And what did you do then?

Martin Griffiths: I have been talking to the Department for Transport about it for over two years.

Q51 **Anne Marie Morris:** But what about your own internal organisation? Did you not look at what it was you were trying to deliver?

Martin Griffiths: Of course. I think the management team and the staff have done an incredible job, against a very difficult backdrop, to drive up the revenue and manage the costs, recognising that this was a key business transformation. We have known for a long time that it was going to be a difficult experience, but I feel that we have done a good job.

Q52 **Anne Marie Morris:** But if you knew it was going to be difficult, I would find it helpful to hear from Mr Horne exactly what you did. It was a transformation project. You knew it was going to be difficult. What were the things—you discovered this very early on—that you put in place, to try to make the best of this? The sense I get is that you just carried on and at the end of the day threw in the towel.

Martin Griffiths: I disagree. I will let David answer the question, but the last thing we have done is throw in the towel. We have been working extremely hard at everything that was within our control, to maximise the business.

Q53 **Chair:** Mr Horne, you arrived just at the point at which Mr Griffiths said you knew it was going wrong, so perhaps you had some contribution to the discussion, which you could explain to Ms Morris and the Committee.

David Horne: Yes, indeed. The point is that at the beginning of a franchise there is a lot to do anyway, so we were very focused on delivering the transformation that we had set out in the bid. But when we realised that we also had a bigger job to do in terms of revenue growth, we reviewed our revenue strategy. To give you a couple of examples, we formed a separate group to look at our long-term commercial strategy. We had the immediate management team focusing on the next year and then we had a separate team looking at 12 months-plus. Over the last three years, they have come up with a new long-term commercial strategy to drive revenue in the context of the circumstances in which we now find ourselves.

Q54 **Anne Marie Morris:** It sounds to me like you have separated out the transformation bit from the profit bit. It seems to me that if you had worked them together, there might be a success story coming out of this.

David Horne: We have worked very hard to make the best of the situation we have found ourselves in and the challenging circumstances we have been in. For example, some of the new services that we have launched in the past year are the response to that. We have started to run services that were not envisaged at the time of bidding and are not franchise commitments, but we have introduced those services, because we are confident that they drive revenue growth. The experience we have had on the east coast main line is that where we have run additional services, there has been revenue growth on the back of them. For example, last May we introduced extra services between Leeds and London, and we introduced a whole package of services just in December, which bring the Saturday service up to the same level as other days in the week. Those are examples of the actions that we have taken in response to the commercial and revenue situation that we found.

Q55 **Anne Marie Morris:** What was the transformation vision that you originally had? You are painting more of a picture of economic challenges—"How are we going to sort out the profitability issue?" Looking at what passengers will pay, you do a tweak here, a tweak there and a new service there, but what was the overall vision for the transformation? That is not really coming through.

David Horne: At the time of bidding, the business development team reviewed the existing offer and we considered that in the three or four years between the franchise start and the new trains arriving we could do an element of transformation with the existing trains through investment. We have invested £74 million over the past three years to improve the service. The interiors of the trains have been completely refurbished with new interiors and we have invested something like £13 million or £14 million in improving the reliability of the very old fleet that we are running at the moment. That has delivered results. We know that has delivered some benefits, but clearly the revenue growth in aggregate has not been as much as was expected.

Q56 **Anne Marie Morris:** I am still not clear about what your overall transformation vision was. I hear about what you have done, in terms of refurbishing this and that, but—

Chair: Just list them for us. There are the new trains.

David Horne: We have the new trains that are coming.

Martin Griffiths: Sixty-five state of the art new inter-city high-speed trains are coming, starting from next year. That will completely change the whole fleet on the east coast main line.

Q57 **Chair:** Answer Ms Morris's question. What else? We have had it in bits, but let us have it all in one list.

David Horne: The new trains will enable the operator to significantly increase the number of trains that the franchise operates and reduce journey times.

Q58 **Chair:** We are getting into detail again. Ms Morris is right in saying that we have had little bits and pieces about what you might improve; you have talked about improving the existing rolling stock, but the long-term vision was new trains, which would mean faster and more efficient services.

David Horne: Faster journey times; more capacity, so passengers are able to get a seat; new services to places that do not have regular services at the moment, so the likes of Braford, Lincoln, Middlesbrough and Sunderland—new services.

Martin Griffiths: This is an old railway. It's really tired. It is remarkable that it has got this far. The whole business plan here was to absolutely revolutionise it between now and 2023, and to create something that will be completely different from a customer point of view and much more valuable from a taxpayer point of view. That will happen; the investment is coming through that will drive that. What we started with, and even what we have today, will be a completely different proposition by the time we are through to 2022-23. It was a complete transformation of the railway.

Q59 **Sir Geoffrey Clifton-Brown:** Mr Griffiths, you gave a rather surprising answer to my colleague about when you knew that you were in trouble over this franchise bid. You said it was fairly soon after the in. What had actually changed in such a short space of time?

Martin Griffiths: To make sure you understand the process here: we started putting this bid together at the back end of 2013; the shortlists were around the beginning of '14; the invitation to tender came out in March '14; we put a bid in in June '14; and we were told that we were going to be awarded the contract six months later, in December, with the franchise to start the following March. We all know that bidders are on risk from the time you submit your bid—you are on risk for revenue.

This was also an unusual franchise—it is a bespoke contract—but the Government actually sold this business. Normally, it is an operating contract that they let, but because of the history and because it had been part of Government, they sold the business, so we "bought" a company. It was buyer beware—if you buy things from the Government, you take your chance and you don't get many warrantees. By the time we got hold of it and opened the lid up, the revenue base that we thought we were inheriting was actually lower than we had assumed when we started. Again, contractually that was our position and I have accepted that.

Q60 **Chair:** How could that be the case? Was there no open book approach to it?

Martin Griffiths: No. You don't reset.

Q61 **Chair:** So you didn't know the revenue issues until you actually took—

Martin Griffiths: Not fully, until you are fully taking charge of the business. There clearly were signs of things starting to slow down—we run other railways. But it got much more pronounced thereafter. As I said, the base we inherited was lower than we had assumed when we bid.

Sir Amyas Morse: I am asking to make sure I have understood what you are saying. You are saying that the volume figures up to the time of the bid turned out to be wrong.

Martin Griffiths: No, what I am saying—

Sir Amyas Morse: More or less, you said, "When we had a look at it, we realised that the figures were lower than we thought." Is that not right?

Martin Griffiths: What I said is the annualised revenue run rate was less than we had assumed it would be when we took over.

Sir Amyas Morse: Just be clear: you were making this bid in just normal commercial practice. Were you not allowed to do due diligence?

Martin Griffiths: Yes, you were, but I go back to my timeline. You put the bid in in June, and you didn't get told whether you had won the franchise until December—so that's six months. The contract didn't start until the following March—that's nearly nine months. You already have nine months of history. We know this—this is the way the model works and the way the Department procures franchises: the bidders are on risk for that period for what happens in the business.

Q62 **Chair:** Do you think that is too long a time?

Martin Griffiths: Yes I do.

Q63 **Chair:** How quickly do you think, practically, that could be done if you were running the Department?

Martin Griffiths: I would reset it. It would be a leveller for all. It does not change the competitive position because it takes everybody back to the same starting point: your bid and your growth. That is what they do in the rest of Europe. The chief executive of Arriva, who is relatively new to the UK, does not understand why that does not happen.

Q64 **Chair:** So basically, at the point of award, you just reset.

Martin Griffiths: You reset. Again, why is it important on this franchise? It is highly geared. These are low margin and fixed cost. I will make this very simple. I am exaggerating, but whether I had to carry one passenger or thousands of passengers, the costs would be the same. I have high costs, so it is all about revenue. If your revenue base is lower than when you start—those of you who are mathematicians can do the compounding. If you need to grow 8% off a lower base, you are already significantly underwater. That is why you asked me. I knew as soon as I looked at it. That in itself would not have been insurmountable, just to be clear. It was a challenge, but all the other things that we have talked about on top of that have made it more difficult.

Q65 **Gareth Snell:** Mr Griffiths, you said that you would expect a very small exit fee for hitting KPIs even if you were running not for profit. I wonder whether you can tell me how small you think "very small" is. I imagine we might have very different ideas about that. Secondly, given that you have essentially bought yourself out of responsibility for the remainder of the contract, do you honestly believe that you are entitled to even £1 more of taxpayers' money?

Martin Griffiths: First, I have not bought my way out. I have honoured my contract. I keep going back to this: the Government set the risk transfer on this.

Chair: We have got that.

Martin Griffiths: I am doing what I was expected to do. Secondly, we get no subsidy at all on this franchise. This is premium payments to the taxpayer; this is not a subsidy railway. We are paying the Government for the right to operate.

Chair: I think Mr Snell was talking about the exit payment.

Q66 **Gareth Snell:** Yes, the exit payment. You said, "Very small." What do you consider to be very small? Do you honestly believe, given the way this franchise has been run and the amount of work that is now going into keeping it aloft, that, even if you do run it not for profit and meet those passenger satisfaction levels, you should be entitled to any public money at all?

Martin Griffiths: Just to be clear, the franchise will continue to generate significant value for the taxpayer going forward.

Gareth Snell: Yes, you have said that three or four times.

Martin Griffiths: Well, I think it is important.

Gareth Snell: My question was very simple.

Martin Griffiths: We need to see what the Department wants to do. The Chair rightly said that, ultimately, our shareholders are going to ask us, "What should we do?" We go into that with a sense of realism about where we are at. We want to try to maximise the best for passengers and taxpayers going forward, so we need to sit down and understand what the Government want to do there, recognising that the business, and what is right for passengers and taxpayers right now, is at a very sensitive stage. We are about to go into this period of huge transformation—massive transformation—and the last thing we should be doing is disrupting all that. On what the ultimate commercial return to the shareholders will be, if any, we will sit down and be realistic with the Government about that. The Secretary of State has made it clear that he will be very transparent about which option he pursues, and we will have to work through that with him.

Q67 **Chair:** Is that a bid to keep running the franchise on a different basis? Are you keen to carry it on?

Martin Griffiths: Look, we have put in a lot of time, effort and capital, and it has been a painful experience, but I believe passionately in what we are doing. This will be a great railway. I like to think that we can continue to take it to the next stage if the Government choose to do that with us as a partner.

Q68 **Chair:** At the beginning, Mr Griffiths, you talked a lot about macroeconomic circumstances and changes to the economy, yet you have just talked about the bidding process and the fact that it is not reset at that six-month point when the contract is awarded. Which was the bigger of those problems that you laid out? Was it the economic circumstances or the fact that, at that reset point, you did not have the—

Martin Griffiths: The reset point, as I thought I said, would not have been insurmountable in its own right. The other things that have emerged are more significant.

Q69 **Chair:** Mr Horne, Sir Richard Branson has made a number of statements about Network Rail's infrastructure being a key factor, in his view, in the challenges to this franchise. Do you share that view?

David Horne: It is certainly an issue that we needed to talk to the Department about. At the time of bidding for this franchise in 2014, everybody was expecting the suite of enhancements that Network Rail are delivering on the east coast main line to be delivered by 2019, including Network Rail. There are public documents from 2014 where Network Rail said that these things would be delivered by 2019. The Department procured the trains and encouraged each of the bidders to come up with timetables to take advantage of the new trains and the infrastructure enhancements. We did that, and our franchise agreement and the premiums are predicated on the basis of both the new trains and the infrastructure enhancements. What has happened since is, the dates for completing some of those infrastructure enhancements have been delayed. That is another thing we have been in discussion with the Department about, as well as working with Network Rail to ensure that the enhancements are delivered.

Q70 **Chair:** Mr Horne, how long have you worked in the rail industry?

David Horne: Twenty-one or 22 years.

Q71 **Chair:** Have you ever known a rail project deliver on time?

David Horne: I have, actually.

Q72 **Chair:** Okay. Give us an example.

David Horne: Actually, if you take some of the work that Network Rail has been doing on this route, some of it has been delivered on time; other elements have not been delivered on time.

Q73 **Chair:** But you must acknowledge that an awful lot of rail projects—if it is not all of them—do not deliver on time. It is a very high percentage. I suppose I have to return to Mr Griffiths at this point. Although it is not a defence of anything Network Rail has not achieved, it is not something you could have factored in when you were bidding, to think, "Where is the risk or potential for time lapse?" That can happen in a project of this size, with all the guarantees made by the Department and Network Rail. You must have built in some for potential slippage, because that often happens.

Martin Griffiths: Let me try to explain it this way. We were told to assume, as part of the bidding process, that a whole fleet of new trains would be procured and delivered by 2018-19. On the back of that, infrastructure would be provided and funded by—

Q74 **Chair:** Basically you trusted that.

Martin Griffiths: It is not just trust; we were entitled to rely on that, because that meant there would be more trains per hour, faster train journeys, more destinations, more revenue and more premium. I do not know whether Network Rail made those decisions, whether the Treasury made them or whether the Department for Transport made them, or Peter Hendy's review—I do not know. But, at the end of the day, you cannot change the inputs and expect to get the same outputs.

Q75 **Chair:** We appreciate that. But in any other business, where there are a number of variables, especially in third parties—

Martin Griffiths: But this is hundreds of millions of pounds. You could never have priced that back in. This is a fundamental change to the franchise contract.

Q76 **Chair:** Did you have any conversations with Government about the surety of those deadlines and figures, given the track record in the rail industry—

Martin Griffiths: At the time, or since?

Chair: At the time of bidding.

Martin Griffiths: Well, no, because at the time you were—

Chair: Because you had to take it or leave it.

Martin Griffiths: At the time it was clear, and we were clear—as were the other bidders—what you were to assume.

Q77 **Chair:** So you could take it or leave it.

Martin Griffiths: Yes. The Government's specification for the franchise was very clear as to what was going to happen. There was a very detailed specification that they wanted to be delivered.

Q78 **Chair:** Mr Horne, when is Virgin Trains East Coast going to run out of money and hand back the keys to Government?

David Horne: I think that depends on the economy and on our revenue trends going forward. So we do not have a projection giving us a specific date at the moment. I think the Secretary of State said something in the House of Commons, but that was clearly his view. We are just working hard at the moment, looking after our customers and looking after the business at the moment.

Q79 **Chair:** Mr Griffiths, you may have answered this earlier, but can we pin down how much money you will have lost by the time you walk away from this franchise?

Martin Griffiths: Over £200 million.

Sir Amyas Morse: Sorry—you didn't really just say that you don't have a projection forward for when you are going to cross the break-even? Of course you do. Come on.

David Horne: We have some projections, but this is a business which is quite volatile, so I cannot give you a specific date. Even if I could—

Sir Amyas Morse: Even if you wanted to.

Q80 **Chair:** At some point the coffers are going to run dry.

Martin Griffiths: As part of your franchise obligations, you have to give a forward-looking ratio analysis, and that is looking forward what we call 13 rail periods. So, based on where we are at now, and us putting in all our contractual commitments, at some point in that next 12-month period that ratio would be breached. I believe that is what the Secretary of State was alluding to, so we need to sit down and reset the contractual structure.

Now, as David said, there are a lot of variables—not revenue and cost. You asked about Network Rail as well. We have some contractual day-to-day issues with Network Rail we have to resolve as well. And these are quite significant numbers.

Q81 **Chair:** Just to be absolutely clear for anyone watching who is a passenger or a taxpayer, you are not just going to run out of money one day and walk away; you are going to keep that negotiation going with the Department for an ordered handover.

Martin Griffiths: There is no mechanism. People always go on about you throwing the keys back.

Chair: I am just being absolutely clear—

Martin Griffiths: There is no mechanism for handing back the keys.

Q82 **Chair:** So, just to be absolutely clear, you are responsible for it until there is an alternative.

Martin Griffiths: Correct.

Chair: Okay. Can I ask about the future of the staff at Virgin Trains East Coast, Mr Horne? What is going to happen to them? Are they going to be TUPE-ed over to any future provider?

David Horne: Yes, they would be. That is what happens in this situation, and the Secretary of State's section 30 duties provide for that.

Q83 **Chair:** Will you be poaching the best of them to go and work for Virgin Trains elsewhere?

David Horne: I am not expecting to, no. They perform very important roles in the business and are a very talented team.

Q84 **Chair:** What about you two, Mr Griffiths and Mr Horne? Where are you going to end up as a result of losing this franchise? Mr Horne, first of all—you are the managing director.

David Horne: We are in discussions with the Department for Transport to deliver the business up to the East Coast Partnership in two years' time. At the moment, we are very focused, I am very focused, on running the business today and on putting arrangements in place for the next two years, so we can deliver the new trains successfully.

Q85 **Chair:** But after two years, will you be—

David Horne: I have certainly not given any thought to what I will be doing in over two years' time.

Q86 **Chair:** Okay. Mr Griffiths, do you get a bonus payment this year?

Martin Griffiths: I don't decide my bonus payment; bonus payments are for shareholders and remuneration committees. I think we can safely assume, in the light of what has gone on this year—even if they gave me one, and I wouldn't think they would, I would not be expecting or taking a bonus this year.

Q87 **Chair:** You won't take one. So if you are offered a bonus, you will refuse it.

Martin Griffiths: Yes; I wouldn't take a bonus this year.

Q88 **Chair:** Mr Horne, do you get offered a bonus as the managing director?

David Horne: Sorry?

Chair: Do you get offered a bonus—awarded a bonus?

David Horne: Yes, I do.

Q89 **Chair:** And do you expect to get one?

David Horne: I don't expect to get one this year, no.

Q90 **Chair:** Would you give it back if it was offered?

David Horne: I would, actually, in this case.

Chair: Thank you for your candour. That is heartening to hear; maybe it is a small heartening point in what is not a good example of railway management. We and our sister Committee are interested in looking at what is happening with franchising. We don't have time with you to go into the issue about different franchising models, but as a Committee we are constantly looking at that, as is our sister Committee. Thank you for coming and for your candour. We remain concerned about this matter and will continue to keep a close eye on it, but thank you very much indeed.

Examination of Witnesses

Witnesses: Bernadette Kelly, Peter Wilkinson, Mark Carne and Charles Horton.

Q91 **Chair:** Welcome. You may take your jackets off if you wish, but you probably don't want to. Before we get into the main session—we are really talking today about the Thameslink franchise with Govia—I want to replay some of the questions, Bernadette Kelly, that we have just asked about the east coast main line. This is the third time we have seen a failure of this franchise. Doesn't it rather underline that the system of franchising is bust—the fact that you can't manage to let a contract that sticks on the east coast main line?

Bernadette Kelly: It is true that this is the third time we have seen this particular franchise fail. I think that reflects some of the particular characteristics of this franchise that make it perhaps more volatile than others. We are not seeing franchise failure elsewhere in the system in anything like that regard, so I don't think it proves that the system as a whole has failed. I would say it is a significant challenge in this particular case, but I do not think it is proof of system-wide failure. Indeed, following the Brown review, we very consciously adopt an approach to franchising in which default is not impossible, and we do that because we are trying to drive the right amount of risk allocation through the system; also, we are trying to incentivise train operators and bidders to be ambitious in the services that they offer to passengers.

Q92 **Chair:** What about the issue of passenger numbers, which we have seen dropping overall? Our previous witnesses were saying this is a major contributor to their walking away. Do you think that your methodology in the Department and across the industry is now bust in terms of predicting passenger numbers, or is it just bad luck?

Bernadette Kelly: I think what we have seen in the last two or three years is an unexpected decline in passenger numbers after a long period of sustained growth. I think we were seeing 5% year on year for a very significant number of years. As I say, we have seen a decline, although there are some signs that that may be starting to pick up a little as well. It is always hard to be absolutely confident in these sorts of forecasts, and of course over the past couple of years we have also seen, across the economy, forecasts generally proving not to be right—including, for example, the OBR's own forecasts of growth in the economy.

Q93 **Chair:** What kind of analysis are you doing of passenger numbers to ensure that you are seeing what is happening? There has been a view that it may be because people are working more from home and they are not commuting or buying a season ticket for the whole week because they are working or travelling fewer days. Have you done any detailed analysis of passenger behaviour to back up those sorts of assumptions?

Bernadette Kelly: We have done a lot of detailed analysis, as you would expect, because this is extremely important to us—as has the industry, in fact, because it is critical to them as well. I might ask Mr Wilkinson to describe in a little bit more detail some of the work we have been doing.

Q94 **Chair:** I have not introduced the witnesses because we were mostly focusing on Ms Kelly, but Peter Wilkinson is the managing director of passenger services at the Department for Transport. Mr Wilkinson, do you want to expand a bit on that?

Peter Wilkinson: Thank you very much. As Ms Kelly has said, we are doing a lot of work to understand the factors that are causing a significant drop-off in the underlying rate of growth. It is important to remember that we are still seeing growth on the railway; even at the levels of 1% or 1.5% that is still tens of thousands more journeys being taken on this railway and in the country. Keeping this in proportion is important. However, there are a number of structural changes taking place. We have identified about 50 factors driving changes in growth in demand on rail in this country, so there is no single magic bullet answer to this question.

In fact, the Committee and the NAO in the 2015 Report rightly identified that we needed to think more flexibly about the commercial model we have with the industry, to take account of potential changes in demand for rail. That is something we took very seriously when you recommended it, and we have begun already to make changes in the franchising model so that it is able to adapt to and cope with those kinds of changes in demand.

Q95 **Chair:** Can you give us some precise examples of what you are doing or what you have learned from that so far about what is affecting revenue and passenger numbers?

Peter Wilkinson: For example—forgive me, these are two technical points—we have put into recent specifications two quite important technical changes that mean we have the option to exclude a bidder that in our central forecast is clearly demonstrating an over-ambitious bid. We apply a downside risk adjustment. We take a very pessimistic view of the economy and apply that downside, and we look at whether a bid will survive under quite a severe downside scenario. That is technology that was not in the bidding in the franchise design process prior to 2015.

We have also put in a different kind of risk-share model. We were very reliant on a GDP risk-share model until recently. We have adapted that, in line with the conclusions that I think you were coming to in the 2015 Report, to put in a forecast revenue mechanism that still leaves incentive with the market to go out and chase revenue and grow patronage on the railway, but shelters them from the worst excesses of economic change.

Q96 **Chair:** Okay. But in terms of passenger trends, we heard for instance from previous witnesses that cheaper journeys are becoming more popular but there is a downturn in more expensive season tickets. Is that something you have done detailed analysis of? Can you give us examples of that and the other—how many factors did you say? Sorry, I've forgotten.

Peter Wilkinson: Between 50 and 60.

Q97 **Chair:** Yes; 50 or 60 factors is quite a lot. Can you give us some examples of some of those 50 or 60?

Peter Wilkinson: There is no doubt that people are not commuting in the same numbers that they were, five days a week into London. That is a change in working pattern that is fairly recent. It is connected to flexible working in both the public and private sectors, increasingly. That is one very important change that is taking place. The long-term relatively low cost of petrol has undoubtedly had an impact on longer-distance travel, particularly on those routes like the east coast where it is a very competitive market. There are several railway companies competing on that railway, but they are also competing with long-distance coaches and with cars. Those are the sorts of issues we are looking at.

Chair: That is an interesting challenge for the Department for Transport. We do not have time to go much more into that particular bit. Bernadette Kelly, there is talk—we heard it then from Mr Griffiths—about potentially running this franchise again. We understand that Stagecoach are also bidding for another franchise. How can you, in all conscience, think that it is okay for them to be considered as a bidder for another franchise when they have got it so badly wrong in their numbers and the running of the east coast one?

Bernadette Kelly: It is important to remember that what has gone wrong is entirely a failure by Stagecoach to forecast their revenues correctly. The performance for passengers on this railway remains very good indeed; it is one of the highest performing parts of the rail network. Passengers are not suffering as a consequence of what is currently happening on the east coast. However, Stagecoach got their assumptions about revenue badly wrong and, as a consequence, they are paying the price for that. As the Secretary of State has made clear, we will hold them to every penny of their contractual obligations to the taxpayer on this. That is a very significant cost that we will be holding them to account for—nearly £200 million in total—but they will have fulfilled all their contractual obligations; we will hold them to every penny and letter of those.

Q98 **Chair:** There may well be a cost to the taxpayer in setting up a new vehicle or letting the new franchise.

Bernadette Kelly: There may be a cost to the taxpayer in running a process, true. Obviously we will now be running a new competition to determine who runs this railway from 2020, and we will need to deal with that. As I said, what we can hold Stagecoach directly to account for is the full extent of their financial and contractual obligations to the taxpayer, and that is exactly what we are doing.

Q99 **Chair:** How much will the competition likely cost?

Bernadette Kelly: I cannot give you a precise figure.

Q100 **Chair:** A ballpark, a range?

Bernadette Kelly: A ballpark cost of a full competition?

Peter Wilkinson: A full competition costs the Department something in the region of £600 million; but the process that we are going through immediately, in terms of a potential operator of last resort or a potential short-term contract with an incumbent, would be considerably less than that.

Q101 **Chair:** Briefly, it is only fair to turn to Mark Carne, who is the chief executive of Network Rail. We asked about Sir Richard Branson's comments that Network Rail was to blame for some of the poor services. What is your response to that?

Mark Carne: We have delivered all the infrastructure that was required so far and, as Mr Griffiths said, the failure of this franchise was entirely down to their inability to predict the revenue forecasts.

Q102 **Chair:** So there were no delays or problems.

Mark Carne: No—in fact we delivered the power supply upgrade, which was the big project that we were meant to deliver, bang on schedule, you will be pleased to know.

Q103 **Chair:** So nothing that Network Rail did on that line was behind schedule.

Mark Carne: No, we have delivered all the projects that we said we would deliver.

Q104 **Chair:** Finally, Bernadette, when will the Secretary of State announce the option and what will happen with this franchise?

Bernadette Kelly: There is further intensive work going on at the moment to determine at what point it is appropriate to end the current arrangement with Stagecoach. I think that the Secretary of State has talked in the House about that possibly taking a small number of months, but we cannot be absolutely sure at this stage. We are also doing extensive work on both the options that the Secretary of State has identified, one of which would be a short-term arrangement with Stagecoach and the other of which would be to bring this in to the operator of last resort. That work is going on now to assess options in parallel. I cannot give you an exact date; I expect it to be within the next few months.

Chair: Okay. We may write to you in a couple of months to find out whether that few months is up or not. We will keep an eye on this. I know that our sister Committee, the Select Committee on Transport, is interested in keeping an eye on this too, as you would expect.

Moving on to our formal second panel, although three of you have already had a bite—

Q105 **Sir Geoffrey Clifton-Brown:** Can I just ask one question? Mr Carne, in view of your very firm answers that none of your infrastructure relating to the east coast franchise was late, when Mr Griffiths was hinting that he was going to seek some compensation for late delivery of your infrastructure, are you saying that there is no case whatsoever for any compensation?

Mark Carne: No, I do not believe that was what Mr Griffiths was referring to. That is a separate issue about the overall performance of the railway, where there is an outstanding commercial claim that we are debating with them and is unrelated to the delivery of infrastructure.

Sir Geoffrey Clifton-Brown: Sorry. Thank you for that clarification.

Examination of Witnesses

Witnesses: Bernadette Kelly, Peter Wilkinson, Mark Carne and Charles Horton.

Q106 **Chair:** I now want to formally introduce our panel for the second part of our session, which is looking at the Thameslink, Southern and Great Northern rail franchise. The witnesses are, from my left to right, Charles Horton, who is the chief executive of Govia Thameslink Railway, which runs the contract on a management basis for the Government and, indeed, for passengers. Mark Carne, as I said, is chief executive of Network Rail. This is not quite your last hearing with us, Mr Carne, as I think you are with Network Rail until September. Since you came in front of us last you have announced that you are leaving.

Mark Carne: Yes, indeed.

Q107 **Chair:** Do you have plans about what you will do when you go?

Mark Carne: I am sure that I will have lots of things to do, but I am not yet in a position to discuss that.

Chair: I am sure we will ask you that at your valedictory, when you come again, as I know you no doubt will. I am sure it will not be your last hearing in front of us. Then we have Bernadette Kelly, the permanent secretary at the Department for Transport, who we heard from just now, and Peter Wilkinson, who is the managing director of passenger services at the Department for Transport. First of all, I have to turn to you, Mr Horton. What do you have to say to long-suffering passengers on Southern, who are affected by the franchise that you have been running?

Charles Horton: For the disruption that has happened to passengers in the past, I have apologised to those passengers on many occasions, but I would observe that the challenge we are meeting is to transform one of the busiest and most congested parts of the UK rail network. We have seen unprecedented growth on this part of the railway network and we are leading a transformation programme, which has a number of elements. The first—

Q108 **Chair:** Forgive me, but in the time that we have we are not going to go through all the elements. I do need to turn to what happened over the weekend, with Redhill station facing dangerous overcrowding. I think you have apologised publicly for that. Would you like to say what happened there and why such chaos reigned? I would have thought that it was entirely predictable.

Charles Horton: We had engineering works yesterday at Redhill station. It was slightly unusual, because we had all lines stopped on the Brighton main lines. All four lines were not operating. We had a plan to operate buses from Redhill to destinations south of Redhill, including Gatwick airport. We found that the road congestion and the difficulty of getting buses to circle around the routes we had planned meant that we were unable to get sufficient buses to Redhill station to allow the passengers to move in reasonable time. I have apologised absolutely for that. That is very regrettable.

As a result of those very disappointing and bad conditions for customers yesterday, we are doing two things. First, we have had an urgent review today of our plans for next weekend and the weekend after, when we have similar engineering works, and we are putting in place revised plans as a result of those reviews and the lessons learned from today. We are working closely with Network Rail on that. Secondly, we are making it clear to passengers who suffered such inconvenience yesterday that we want them to get in touch with us. We will be giving them compensation. Where people have suffered further losses as a result of being in queues for such a long period of time, we will ensure that they are not out of pocket as a result of that.

Q109 **Chair:** So if someone missed their flight, you will pay for that?

Charles Horton: We will ensure that people are not out of pocket for things such as missing flights because they were in queues for long periods of time—yes.

Q110 **Chair:** Okay. Is there a cap on how much you will pay people?

Charles Horton: We will look at every case on its merits. Obviously, we will want to ensure that people give us some evidence for what they have been doing, but we will look very generously on those claims.

Q111 **Chair:** That sounds great, but just to be acidic for a moment, it takes quite an infrastructure in an organisation to deal with a lot of claims such as those and to process them. Have you got that infrastructure in place or will you buy it in from somebody?

Charles Horton: We have an arrangement with our outsourced customer call centre where people can get in touch with us. We also have a team within our head office, which is leading the process of looking at these claims and so our head office team are ready to receive those claims. Indeed, we have started dealing with some of those already.

Q112 **Chair:** So you are promising that it will not be the same next weekend?

Charles Horton: We are going to make sure that it is not the same next weekend.

Q113 **Chair:** Okay. If I was a coach driver in the area, I would be quids in, wouldn't I? I suspect they will all be in touch with you.

Bernadette Kelly, this was a very complicated franchise and it was made even more complicated by the way the Department chose to let it, adding in a lot of modernisation into one place. Do you have anything to say to the passengers who have been suffering on that line over recent months?

Bernadette Kelly: First, it is the case that passengers have suffered sustained disruption on this franchise in recent years. Mr Horton has rightly apologised for that, and the Department has required the company to pay penalties for that poor performance. But I think it is important to put this into perspective. You talked about the scale of change, but this was a franchise designed to deliver the Thameslink improvements, which is a truly massive transformation project for the rail industry, comprising a huge infrastructure upgrade, combined with the introduction of several new train fleets and extensive timetabling changes. That is probably the single most complicated upgrade we have ever attempted on the live UK rail network. That was bound to bring some challenges in this franchise, which we designed precisely to mitigate and manage those challenges, with a single franchise to reduce the number of interfaces and a franchise in which the Department took revenue risk so that the operator could focus on delivering the programme. Those were sound decisions. I acknowledge there has been disruption for passengers, but it is also important to acknowledge that the worst period of disruption was materially created by an extensive period of official and unofficial industrial action.

Q114 **Chair:** You brought up the strike action. Was it not foreseeable that if you were going to push for driver-only operated trains, it would cause industrial relations issues? Did you not factor that into dealing with an already very complex franchise?

Bernadette Kelly: I would make a couple of points. Obviously, industrial action on the railway is not unprecedented, and from that point of view it was clearly a risk that we thought about, but we had good reasons at the point at which we were designing and letting the franchise to imagine that it would be nothing like as significant as it has been in practice. DCO was already in extensive use across the railway, including on this franchise, before the start of the franchise. We did not demand that it be introduced. It was entirely a choice taken by the bidders in presenting their plans for service improvements for passengers on this franchise. There were perfectly good reasons for us imagining that it would be possible for the operator to introduce their plans without anything like the level of action and disruption to passengers that we subsequently saw.

Q115 **Chair:** Did the Department have any discussions with the trade unions about this aspect before it let the franchise?

Bernadette Kelly: We specifically did look, at the point at which we were letting the franchise, at the risks of industrial action. I will ask Mr Wilkinson to say a little more about the work we did to assess that risk at the time.

Q116 **Chair:** Mr Wilkinson, we are fascinated to hear what you have got to say.

Peter Wilkinson: We did try to engage with the trade unions leading up to letting this franchise that has proved difficult. We assessed the bids for the franchise—all the bids went far further than our specification in procuring additional DCO services, because on this railway 60% of the services were already driver-controlled operation. At that time, it was not seen as particularly contentious that we would extend that a little further, which is what we were talking about.

Q117 **Chair:** Was it the Department or the trade unions who did not see it as contentious? Were you talking to the trade unions at this point?

Peter Wilkinson: There had been a history of introduction of DCO on the railway over a significant number of years—going back to the mid-1980s, if I recall—without significant industrial action. There had always been some industrial action relating to the introduction of driver-only operation. We risk-adjusted our bids to take account of that, and we expected a certain amount of disruption on the railway. However, we did not expect or forecast the significant levels that we saw with this programme.

Q118 **Chair:** If you had not added in the driver-only operated trains, would it not have smoothed out some of the many complex issues you were dealing with in trying to get this franchise and this railway operating better? Why did you push for that, particularly?

Peter Wilkinson: That is a fair question. It is because the Thameslink programme is all about catering for the growth that we are seeing on this railway. We have seen over a large number of years significant levels of growth, which we continue to see today. To cater to that growth and to make sure that we were not leaving passengers at platforms, we embarked on a programme that would see a very high-density traffic railway, and a lot of train throughput in the Thameslink core. We and the industry took a view that trains that the driver had full control of—not a communications relationship between a driver and a guard in operating the doors—were the best way to achieve that, and that practice was already well established in the industry.

Q119 **Chair:** Was that because you are suggesting it would be slower to have a guard and a driver talking to each other?

Peter Wilkinson: The evidence is such, yes.

Q120 **Chair:** So it was about speed of the railway going through. What about the safety aspects? How much were they taken into account?

Peter Wilkinson: It is about the train throughput, which is what this programme is genuinely trying to achieve.

Chair: We appreciate that, with 24 trains going through—

Peter Wilkinson: On safety, driver-only operation has been safely used on the railway in this country, and in many other countries, without—

Q121 **Chair:** I know that there will still be on-board train managers, but they will not have the ability to use the doors, so what is the back-up if something happens to the driver? With an increasingly busy service on an interesting bit of the route, let us say, on which there are perhaps interesting passengers at certain times of the night, having other people on board with safety training is surely a consideration that is exacerbated by the extra number of passengers, rather than declining?

Peter Wilkinson: That is absolutely right. We are continuing to keep people on trains. In fact, there are more staff working on trains now on this franchise than there ever have been before. These are very well-staffed trains and those staff come with safety training. So there has been no attempt whatsoever to diminish the role of the second person on the train, in terms of their safety competencies and their ability to support the driver at any times of difficulty.

Charles Horton: If I may, Chair, I will explain the change that we made on the Southern network more than a year ago now. The change involved changing the operational role of the second person on the train, so that they are freed up from the task of opening and closing the doors. They are still safety trained and they are still able to deal with emergency situations on those trains. What they are not involved in is the operational tasks of opening and closing doors.

The benefit for customers of that is that those members of staff who are on board have more time therefore to interact with customers, to move through the trains, to offer assistance, to provide customers with tickets and to help customers out with their problems and issues. That is the method of working now on our Southern network. And as Mr Wilkinson said, we have more of those people on our trains now than we had under the old way of working.

Q122 **Chair:** So if you had bid for this without it being a requirement by the Department, would you still have wanted driver-only operated trains?

Charles Horton: Yes. I think it's a better method of operation, and as to your questions about safety, we believe that evidence collected over many years proves that driver-only operation is at least as safe as other methods of operation and may offer some advantages, because of the lower risk of miscommunication between two people involved in a task.

Q123 **Chair:** Mr Wilkinson, or maybe Ms Kelly, isn't it pretty clear that you wanted driver-only operated trains and no bidder could have bid without taking that on as part of the package?

Bernadette Kelly: Mr Wilkinson can comment on whether any bidders bid; I think there were different levels of DCO bid for at the time. Actually, the bid that we accepted did not have the highest level of DCO roll-out within it.

I should also say that I keep coming back to the fact that there are reasons why this form of operation is necessary on this railway. It is to do with the capacity, the throughput and the dwell times that are needed to deliver the improvement in capacity that passengers want—

Q124 **Chair:** I still maintain that, given you knew there was going to be a risk of industrial action, engagement with the people who run the trains—through their trade unions; that would be the most appropriate route—would have been a good idea. In retrospect, do you wish you had had better engagement at an earlier stage? Who is going to take that—Mr Wilkinson or Ms Kelly?

Peter Wilkinson: I wish we did have better engagement. We have tried to reach out, but that has not been readily accepted. I think we would all like a better dialogue with the trade unions. They play a vital role in this industry.

Q125 **Chair:** Those are nice words. However, you said at the beginning that you expected some industrial action. Did you see this as an outlet just to take on the trade unions and let it all out on one issue?

Bernadette Kelly: Not at all. Indeed, what I've said is that actually we didn't anticipate that this would cause anything like the level of industrial action that it has—

Q126 **Chair:** What did you base that anticipation on? Was that from conversations with union representatives?

Bernadette Kelly: We had looked, as I say, at the experience elsewhere on the railway of introducing DCO or DOO trains, where they had been rolled out relatively smoothly and with far less large-scale and long-term industrial action.

Q127 **Chair:** So had you had conversations with the trade unions at the point at which you were letting the franchise, recommending driver-controlled trains?

Peter Wilkinson: No, we had not.

Q128 **Chair:** Do you wish you had done that now?

Peter Wilkinson: As I said, we tried to do that, but those offers of communication were not readily taken up.

Chair: Okay. I am sure that others may pick this up elsewhere.

Q129 **Sir Geoffrey Clifton-Brown:** Let's just stick with that for a minute. Mr Wilkinson, you surely anticipated some industrial action, because you let a service-only type contract, which was a completely different type of franchise from whatever had been let before. So, if you didn't anticipate some industrial action, why did you let the franchise on that basis?

Bernadette Kelly: The franchise was let on that basis principally because we wanted the operator incentivised to focus on delivering the Thameslink service, rather than on driving revenue. Our expectations around the industrial relations climate were not the principal driver behind why we designed the contract and the franchise in the way that we did. Again, I am sure that Mr Wilkinson can say more on that.

Peter Wilkinson: I agree with Ms Kelly. The primary motive for the structure of the contract was to deliver the Thameslink programme on a live railway, which is a very difficult thing to do. The alternative option open to us would have been to close the railway for a very significant period of time to allow that Thameslink work to be done.

The second thing is that we had a very old fleet of trains on this railway. We have already delivered a new Gatwick Express fleet—that is already in operation—and by the end of this year, there will be an entirely new Great Northern fleet. Our class 700 series, which replaced a 40-year-old fleet, is already on the railway. An enormous amount of change is taking place on the railway, which is about modernising it and bringing it up to very contemporary railway standards. You cannot operate a railway of this nature, with this sort of density of traffic and the kind of very modern vehicles that we buy and are built in the world today—not just for us, but for other railways all around the world—in the same way that we would have operated railways many years ago. We recognise that, and we recognise that a lot of change needed to take place in this contract, which is why we structured the contract in the way we did.

Q130 **Sir Geoffrey Clifton-Brown:** Does it provide enough of an incentive to improve the performance as opposed to a conventional franchise?

Peter Wilkinson: That is a good question. When the Government took the revenue risk for this contract, we did not take away the performance risk. We put the risk for performance and cost very much with the operator. In fact, we left some measure of revenue or growth incentive and the marketing incentive with the operator as well, but as I said, we wanted the focus to be on supporting Network Rail to get the Thameslink programme done and finished on a live railway. You put a question earlier to a previous panel about whether there is experience in the industry of a programme running to time. Well, this programme has been extremely well managed and executed. The recent deadlines that have been published have been met, and I think that is in part because we have an operator that is incentivised to work closely with Network Rail to make those things happen.

Chair: That is a comfort for passengers.

Q131 **Sir Geoffrey Clifton-Brown:** Can I come to you, Mr Horton? If you look at figure 14, part of the settlement is to retain 50 on-board supervisors. Was that originally envisaged when you bid for the franchise, or was it envisaged that you would move to entirely driver-only trains?

Charles Horton: That was a commitment made subsequently. No, that was not envisaged. It was in addition to what we had originally envisaged to have.

Q132 **Sir Geoffrey Clifton-Brown:** Are they now envisaged to be a permanent feature, or are they only there for a period of time?

Charles Horton: They are definitely there for two years, but we will take a judgment on the value that we get from having on-board staff. We made a commitment that there will be an on-board member of staff on at least as many trains as we had when we started our change programme. In fact, every train that previously had an on-board member of staff on—and more—has a second member of staff on board. We have some additional staff as well, who are covering other lines of route. We are seeing the benefits of those people. It is a commitment in addition to what we originally bid for.

Q133 **Sir Geoffrey Clifton-Brown:** Is that because this railway is so busy that driver-only trains are actually proving to be quite difficult?

Charles Horton: As a method of operation, no, that is not the reason. It is because the second member of staff on the trains provides a valuable service to customers. They are able to provide information, to do ticketing and to get through the trains and provide assistance to people who need boarding and to other people who need general assistance with making their journey. Through the work that they do, they prove that they have a value to us and to our customers. Since we introduced the change to the method of working, the reaction from customers has been extremely positive. They notice the fact that our employees on trains are more visible and more able to give them assistance, because they are not tied down to the operational jobs that they were doing before.

Chair: There are more of them for a start.

Charles Horton: Yes, but they are also not as engaged in the operational tasks. Previously, they would have to be in a certain place to open and close doors at stations, but they are not in that situation now. They are much more able to move through the trains with greater ease.

Q134 **Sir Geoffrey Clifton-Brown:** May I ask a similar question to the one we asked East Coast and Mr Griffiths? In hindsight, do you think you overbid for this franchise?

Charles Horton: We put in what I would describe as a solid bid, which looked at the risks in a reasonable way. We had some exciting plans with some big improvements for customers in our bid. It is fair to say that there were two risks: the risk of operating a network that was so constricted as a result of the works that were ongoing, and the risks associated with industrial action, which crystallised in a way that we had not foreseen. Of course, we know the result in terms of the impact on our passengers and on the profits we have been able to make as a private sector operator.

Q135 **Sir Geoffrey Clifton-Brown:** Looking forward prospectively, do you now feel that you are in a position where the franchise should operate smoothly? You have largely—not entirely—overcome the single driver issue with the trade unions, although there is ongoing industrial action, is there not? You have introduced new trains and we have got Thameslink sorted out. On behalf of your poor, beleaguered passengers, are you now in a position to say that this franchise should run reasonably smoothly?

Charles Horton: Yes. As the changes that we have been making are coming through, we are seeing operational performance improving and passenger satisfaction rising. As a result, we are seeing the business returning to profitability. For example, on our Thameslink route, where we have seen the benefit of the new trains and the changes to the way in which we have been operating that railway, we have just delivered our highest level of passenger satisfaction ever. We have seen passenger satisfaction of 83%, which is the highest level of satisfaction we have ever seen since the creation of the national rail passenger survey. Passengers are starting to notice the difference. My belief is that as we continue to deliver these changes, we will start to see those improvements being noticed by customers across our network. Even on Southern, which has had its very difficult period, we saw satisfaction rising by 7% in the most recent national rail passenger survey.

Chair: It could not really go the other way, could it? Well, it would have to be pretty bad to go the other way.

Charles Horton: But still, what we have seen is passengers noticing the change and the improvements. It is our objective to continue to deliver those improvements so that passengers see continued improvements in their satisfaction.

Q136 **Chair:** Can I chip in on some of the improvements you are planning? I gather that you are planning to close a section of the Brighton mainline for two one-week stretches in October this year and February next year. Am I right?

Charles Horton: Yes.

Q137 **Chair:** And that is for Mr Carne—well, perhaps not Mr Carne personally—and Network Rail to undertake some essential maintenance. What are you going to do for passengers at that point? A whole week's closure is incredibly disruptive after all the trouble that people have been through. Are you planning to compensate passengers?

Charles Horton: We are looking at that now. We are working very closely with Network Rail first on how we can provide replacement services for customers in terms of replacement rail services and also bus services. We are looking at how we can use buses to best effect. Of course, a bus could never replace a train. Secondly, we are also looking at how we inform customers and how we give them advice and information on that. Our plan is to get that information out to customers in good time so that they can make their plans, but that detailed work is going on at the moment with Network Rail.

Q138 **Chair:** I understand, Mr Carne, that it saves Network Rail quite a lot of money doing it in these one-week stretches as compared with weekends or days here and there. That makes logical sense, but there is obviously an impact on passengers. In terms of the money that it is saving you, is there money in that pot to compensate passengers, or do you see that as Govia Thameslink's job?

Mark Carne: We always work very closely with the operator to try to find the most cost-effective way of delivering programmes. It is taxpayers' money that is funding these programmes, so we have to try to do them in the most cost-effective way. What we find is that by working closely hand-in-hand we are able to meet the dual objectives of low-cost efficient delivery of this sort of work while also looking after passengers. If we give passengers plenty of notice of the planned work and communicate effectively with them, we see that they understand why we are doing this work. We can talk about the huge closures we had of London Bridge, for example, where we shut it for nine or 10 days. With extensive communication up front, we had virtually no complaints from passengers, because they could see the benefits that they were going to get.

Q139 **Chair:** Did regular passengers to London Bridge get any compensation? I'm sorry, but I don't know the answer to that. For example, a season ticket holder using London Bridge—does anyone know the answer to that?

Charles Horton: We continued to provide the service, so the service did not change. That was at the heart of the London Bridge project and what made it enormously challenging.

Q140 **Chair:** But we are talking about the actual closure. When we visited it as a Committee, trains were running through and a number of people were travelling through. There was a period of actual closure, was there not?

Mark Carne: There were at least two periods when we completely closed the station.

Chair: Did passengers receive compensation? I don't know if anyone can answer that. Perhaps we will have to find out elsewhere.

Charles Horton: We will let you know that. I cannot recall off the top of my head.

Q141 **Chair:** We absolutely understand the logic. We know about very big projects—it is always quicker to do it in one hit if you can—but it is a problem now. Mr Carne, for the poor beleaguered passengers of Southern Railway, will the works in October and February run to time and on schedule, and what will the difference be for passengers after that work has been done? How will they see a physical change? Will they see a physical change?

Mark Carne: I would like to pick up on a point made in the previous hearing. We have 15,000 projects in Network Rail and the vast majority run to time and to schedule.

Chair: I suppose we all hear about the ones that don't.

Mark Carne: Regrettably, I get asked to come to the PAC to talk about the ones that don't go well, but we actually deliver an extraordinary number of projects bang on schedule.

Q142 **Chair:** Can you reassure the passengers on Southern that these will be two of the ones that do run on time? You are hoping.

Mark Carne: I am more than hoping; I am extremely confident, because the vast majority of these sorts of projects—these weekend closures and week-long closures—are so brilliantly planned for years in advance that we have a great track record of delivering them. Last time I was here, I promised you—or almost promised you—that we would open London Bridge on 2 January, and we did.

Q143 **Chair:** Yes, perhaps we should have given you credit for that. On these closures, what will passengers see that is different?

Mark Carne: These closures are part and parcel of the significant renewals programme that we have brought forward as a result of some of the challenges we have had on this railway. It is really important to note that the £900 million we have talked about before—perhaps I have inadvertently not advised the Committee well enough on this—is not an additional cost to the Thameslink programme. It is not an additional cost to this project. We have roughly £430 billion-worth of assets in Network Rail and we are constantly trying to get the balance right between maintaining those assets and renewing them. It is like when you have a car—

Q144 **Chair:** I think we covered this in our Report. If £900 million is being spent on essential maintenance around Thameslink, it is not—

Mark Carne: It is not about maintenance. The £900 million is basically about making a decision to shift from maintaining an old and dilapidating asset and keeping that going to renewing it with a new asset. The £900 million is not new money; it is money that we have brought forward that we would otherwise have spent in a number of years' time. That is where passengers will see the benefit. Instead of us trying to maintain an asset that is basically not reliable, we will have a new asset—

Q145 **Chair:** Just to be clear, these two weeks of closure are part of that £900 million.

Mark Carne: It is all part and parcel of our programme to renew—

Q146 **Chair:** So on their own, these two weeks of work—passengers won't come back after the October one and say, "Ah, now I see what they have done."

Mark Carne: Regrettably, I am not going to say to you that this—

Q147 **Chair:** I am simply asking whether suddenly a new bit of something will be open, but it will not—it is part of an incremental process.

Mark Carne: It is a small part of a big programme.

Chair: That is the answer to my question. Thank you very much.

Q148 **Sir Geoffrey Clifton-Brown:** Why did you allow the rail infrastructure in the south-east to get so bad that it needed this massive one-off improvement?

Mark Carne: That goes back to the same point. We are constantly trying to get the balance right between maintaining an asset that is declining in its condition with the cost of renewing it. We are trying to get the balance right as to when to do that.

It is like having a car. The older the car gets, the more you have to maintain it and the less reliable it becomes. Eventually, you make the decision that you need to change the car for a newer one. You try to defer that decision for as long as possible, because the newer car will be very expensive. We do exactly the same. We try to defer those renewals as far as possible.

What happened on Thameslink was that over the past few years, because of the intensive use of the railway to which Mr Wilkinson referred, we found that the whole system was becoming much less reliable than we had anticipated. Therefore, we took the decision to accelerate the renewals activity to try to enhance the underlying infrastructure reliability. It is important to recognise that the infrastructure causes only about 13% of the total delays. Nevertheless, we want to do what we can. That is the reason for accelerating this spend.

Q149 **Sir Geoffrey Clifton-Brown:** You put a pretty good gloss on it, Mr Carne, but wasn't it actually the case that if you hadn't done this major upgrade the whole system was in danger of collapse? It was unsustainable.

Mark Carne: The difficulty we had is that there are over 200 stations that feed into the Thameslink core and we have to get 24 trains an hour through that core. We have to present the trains together into that core exactly at the right moment.

Q150 **Sir Geoffrey Clifton-Brown:** So, if you have any problem with the infrastructure, signalling or whatever, it has a knock-on effect—?

Mark Carne: Precisely. When this programme was originally conceived, the reliability of the railway was around 93%.

Q151 **Chair:** Just remind us—it was called Thameslink 2000. So just give us an idea of what percentage—

Mark Carne: That is a distraction, Chair, if I may say so. It has taken a very long time to work out how to do this impossibly difficult project, because the challenge of rebuilding London Bridge while keeping Britain's fourth busiest station open for 55 million people a year is an incredible engineering achievement.

Q152 **Chair:** Mr Carne, we have given you credit for maintaining services at London Bridge while—

Mark Carne: But that is why it was originally Thameslink 2000, because it just took so long to think, "How are you going to do this?" And eventually, in 2007, the decision was taken to proceed with this project. At that point in time, reliability of the network was around 93%. It subsequently declined to 83% or thereabouts, because of this huge growth.

So we have recognised, "Okay, we've got to do something more in order to improve the reliability, so that we can present the trains into the core at the right frequency". I think that it was an entirely responsible action to try to prepare the network in the best possible way to deliver the services that people will need in future.

Q153 **Sir Geoffrey Clifton-Brown:** Can I examine the improvements that you were discussing with the Chairman—this £900 million of improvements? You have already carried out £300 million-worth of improvements—is that correct?

Mark Carne: We will have done by March of next year; by then, we will have invested about £300 million, yes.

Q154 **Sir Geoffrey Clifton-Brown:** Then we get to the £600 million programme, which is to be carried out in the next Network Rail period. Is that correct?

Mark Carne: That is correct, yes.

Q155 **Sir Geoffrey Clifton-Brown:** And you need access to the railway to carry out that £600 million programme. So are the poor, beleaguered passengers, as I have christened them, going to suffer another lot of delays when you start on the £600 million project?

Mark Carne: I am really pleased with the way that we have been working with our colleagues to get better access to the railway. You may remember the Gibb report of a couple of years ago—almost two years ago now—which identified that one of the big challenges that we had was that trains were running all the way through the night on bits of the network and it was virtually impossible for us to get sustained periods of access to maintain the railway.

So, working very closely with Mr Horton and his colleagues, we have now made some changes to the timetable, to give us more access in the middle of the night, so that we have been able to do more of that maintenance activity without disrupting significant numbers of passengers.

That has a huge beneficial effect. In just a few months, we have seen a 38% improvement in reliability on the railway coming out of Victoria, because we have been able to get in and maintain it in a more effective and efficient way.

Q156 **Sir Geoffrey Clifton-Brown:** You still haven't quite answered my question. With the £600 million programme, is there going to be a significant amount of disruption to the passengers on this network?

Mark Carne: There will be. Clearly, there need to be substantial periods of access in order to do the kind of track renewal activity—a lot of it is track renewal, and switches and crossings an signalling systems that we have to renew. Clearly, you have to not run trains on the line when you are digging it up.

We try to do it, wherever possible, in short bursts at night and at weekends, as we were doing at Redhill this weekend. Occasionally, it is much more efficient and much more cost-effective to have a longer duration possession, but those are very few and far between. The vast majority of the work that we do is done in a few hours, snatched every evening or every night during the week.

Q157 **Sir Geoffrey Clifton-Brown:** Ms Kelly, Mr Carne and Network Rail warned you before you let this franchise that the timetable was too tight. What account did you take of that when you were letting the contract for the franchise?

Bernadette Kelly: I will say a little but then I will hand over, if I may, to Mr Wilkinson. First, it is important to emphasise that during the bidding process there was extensive engagement with Network Rail, both between bidders and Network Rail and between the Department and Network Rail, to test the deliverability of some of the proposals that bidders were making to run train services. That is absolutely a normal and embedded part of the franchise process. We do not carry these competitions out without Network Rail being closely involved throughout.

Secondly, we did get assessments from Network Rail of all the bidders' proposals, which they variously assessed as red or amber. I think that in the case of this bidder it was rated amber, which meant that there were some quite challenging things around the timetable being proposed, but not that it was impossible to deliver. What normally happens at that point is that there is an industry process, which ensures that the train services that the bidder has promised are capable of being delivered. That happens through normal industry processes, as has been happening here.

I do not think that it is quite true to say that we were ignoring Network Rail's warnings. We were engaging with them in the normal way and then engaging with the industry in the normal way to deliver the level of service that bidders were proposing. There is always a difficult trade-off between wanting, naturally, to see bidders run as many services as possible and needing to ensure that there is the resilience and the capability for the network to be renewed and maintained, as Mr Carne has indicated. I will ask Mr Wilkinson perhaps to say more.

Q158 **Chair:** Mr Wilkinson, do you briefly want to add to that?

Peter Wilkinson: I actually do not have much to add. That was a very comprehensive answer.

Chair: That is fine. You don't have to if you don't want to. If the permanent secretary can speak for the Department, that is very good.

Q159 **Sir Geoffrey Clifton-Brown:** Can I go on? Does it make sense, Ms Kelly, to have a separate process for contracting with train operators and for deciding how to improve the rail network that they must use?

Bernadette Kelly: Sorry, is that separate from the infrastructure management? I am not sure that I understood the question.

Q160 **Sir Geoffrey Clifton-Brown:** Separate processes for contracting with the train operators—the franchise operators—and for deciding how to improve the rail network that they must use.

Peter Wilkinson: There is a fair question at the heart of what you just asked. It is about the continuity of setting objectives, in terms of improving performance on the railway through the regulatory processes with Network Rail, and the way in which we go about franchising and the obligations we put on franchise operators to improve passenger satisfaction and performance. There are tensions between those two processes; I think that is what you are pointing to, and I would very much support that point. It has been one of those crunchy issues in the industry and an area of friction that has not been optimal. Mr Carne's organisation and the Departments are working much more closely together to harmonise those processes now. In fact, Mr Carne's organisation sits in our franchising processes today to make sure our specifications are coherent in terms of the obligations placed upon them.

But the point Ms Kelly made a bit earlier is important. We do need to keep driving for a bit of ambition in this system, because the kind of growth that we have experienced—even though it has flattened off—is still there. On a railway like GTR, carrying 320 million journeys a year, you cannot be lazy about pursuing capacity. We all have to work to do that to get the best out of the system and to carry those people.

Q161 **Sir Geoffrey Clifton-Brown:** To come back to my previous question, Ms Kelly, if on your traffic light system Network Rail says that a particular timetable for a particular franchise is impossible, would you then alter that timetable to take that into account?

Bernadette Kelly: If there was a really severe level of concern at that level, we would take that very seriously. We would have done at the time when we let this franchise, and since then, as Mr Wilkinson indicated, we have actually strengthened our processes for ensuring that Network Rail is fully involved in testing bidders' proposals during the franchising process.

Q162 **Sir Geoffrey Clifton-Brown:** It is encouraging to hear that Network Rail and your Department are working closer together. Can I ask you a similar question to the one I just asked? How do you balance passenger and timetable performance with getting the maximum economic return from a franchise?

Bernadette Kelly: In our franchising, we are always looking to ensure we get the optimal balance between the best service for passengers that can be delivered and a good outcome for taxpayers. In all the decisions we take, whether about designing or awarding franchises, or about thinking about infrastructure investment, we look at both of those things. Clearly, to the extent that services are working and delivering for passengers, we expect them to deliver for taxpayers too, because you would naturally expect some correlation between passenger satisfaction, use and demand, and the quality of service that is being provided.

Q163 **Sir Geoffrey Clifton-Brown:** But with hindsight, given the potential industrial action, the scale of the works that needed to be done with Thameslink and the improvements you were requiring from the franchise, weren't they in fact overbidding? You underestimated the scale of what needed to be done with the franchise and you accepted a bid that was too high.

Bernadette Kelly: I am not sure I would say that there was overbidding in this instance. What we are absolutely learning as we go through the process of delivering the Thameslink programme is that it is important to get right the trade-off and the balance between maximising capacity and maximising the resilience of the network. I think we probably have learned some lessons over the past couple of years in that regard. Mr Carne rightly referenced the report by Chris Gibb, which identified that trade-off and the importance of being aware of and managing it.

Q164 **Sir Geoffrey Clifton-Brown:** With hindsight again, given how the whole thing has worked out, do you not feel that the experience that passengers have had to go through is completely unacceptable, and that these franchises need planning a little differently in the future?

Bernadette Kelly: Absolutely, the experience that passengers have had has not been good enough at times on this franchise. With hindsight, there are things we are learning from that, such as the point about resilience, which I just made. I would point to the importance of collaborative working between Network Rail and the operator. That is absolutely pivotal, and that is something that has deepened and grown as this franchise has gone on. There are also some important lessons about managing passenger expectations and the communication we have with passengers about projects and programmes of this scale. As we embarked on this programme, we perhaps did not understand the extent to which people would experience disruption and the importance of managing expectations and communication well, as we saw, for example, at Waterloo over the summer. That was a much more positive example of managing some very extensive disruption for passengers.

Q165 **Chair:** But, Ms Kelly, I don't know how you can positively manage it when people are sometimes taking four or five hours to get home. People gave up their jobs because they couldn't commute on this line. However well you communicate that—

Bernadette Kelly: There were extreme examples. Mr Horton has rightly apologised for them, and the company has paid penalties to the Department as a consequence of that. That is clearly true. The examples you are describing are the more extreme examples. It is important to look at the way performance is recovering now. We are now beginning to see the franchise performing in the way it was intended. Although I am in no sense making light of the severe disruption that some passengers experienced, it is important to look at the performance now to see how significantly it has improved and to see how the capacity is coming on board.

Q166 **Chair:** But you have already agreed penalties with Govia for next year.

Bernadette Kelly: We have agreed penalties covering a three-year period. Mr Wilkinson can say more about that.

Q167 **Chair:** Which doesn't sound very positive about your prospects. You talk about it getting better, but that doesn't sound very positive to me. Mr Wilkinson, do you want to explain how the penalty system works?

Peter Wilkinson: You are quite right that we have agreed financial penalties retrospectively and for the coming period because we want this franchise to be on a continuing trajectory of improvement. We have put them on a remedial plan, which sets them rigorous targets for continuous improvement to get them to a place—

Q168 **Chair:** So you are giving them some certainty about the penalties to keep them sticking with the franchise.

Peter Wilkinson: In fact the penalties that they have paid for the future are already a good value deal for the taxpayer because their rate of improvement in performance is outbidding what they have paid us, so we are able to invest that money back in the railway. If we had not done that, we could have spent an interminable amount of time trying to analyse their performance for the future. We have bought them out of that, and they have given us a healthy sum of money that we are able to invest in the railway. If we had left them in the contract without buying them out of those penalties, they would have probably had to pay less than they already have, so the taxpayer has had a good deal out of that.

Chair: I have to say that is a very positive spin on penalties.

Peter Wilkinson: May I also say it is important to listen to what passengers tell us as well? There is no question but that passengers have experienced a really torrid time on this railway, and there were no easy choices or options for the Department, Network Rail or any operator if they wanted to do this work on a live railway. However, we are now hitting levels of performance and passenger satisfaction on the Thameslink railway that we have never seen on that railway. That is because we have taken the steps—

Q169 **Chair:** And yet you are putting in penalties on a three-year future basis. Mr Horton, are you happy, as a franchisee, with that approach—that you have to pay your penalties up front?

Charles Horton: We took a view, after a long and protracted industrial dispute, that we needed to draw a line and move on. We wanted to focus on the future. We took a judgment last summer that it was right, following a negotiation with the Department, to agree upon a regime that has been put in place. What it has allowed us to do is focus on the future and on delivering the improvements that we want to see.

Q170 **Chair:** So it has kept you tied in?

Charles Horton: It has put us in a place where we can focus. We are not looking at the past or looking over our shoulder and talking about why the penalties should be organised in that way. We are looking to the future. That is what we want to do. It is so crucial this year, when we deliver huge improvements for passengers right across our network, the first big part of the Thameslink programme—

Q171 **Chair:** That's fine; we know that. But did you at any point consider just walking away from it?

Charles Horton: We have not envisaged walking away. We have stuck to our commitments. It is our job to deliver on the promises that we have made. We look forward in this franchise to delivering successful outcomes both for our business and for our customers.

Q172 **Sir Geoffrey Clifton-Brown:** I am sorry to labour the passenger, but we are here to represent the passenger. You have heard both Mr Carne and Ms Kelly talk about better passenger information, yet we still got the incident at Redhill last weekend. What can you do to improve your advance notices where the passenger is likely to be held up and delayed?

Charles Horton: Redhill is probably not a good example because that was about our inability to get rail replacement buses through a road network. On the question of passenger—

Q173 **Chair:** Buses normally travel on roads.

Charles Horton: But our difficulty was to get the buses quickly enough through the routes we were trying to get them to look after passengers.

Q174 **Chair:** So it was a logistics mismanagement.

Charles Horton: Indeed. More specifically, on passenger information, the new trains that we are bringing in on Thameslink have state-of-the-art information systems. They allow us to beam live information to those trains. They have tube information on them. We have invested heavily to put more people into our control centre to provide information, including a social media team providing Twitter updates regularly to customers. We are making other improvements with Network Rail and our stations, putting much more modern information screens on our stations, and we have improved the information throughout the core stations on Thameslink. There is a huge amount of investment going in on information, and we are changing the way in which we do things so that we can give customers better information. Those things are starting to come through in the passenger satisfaction results on information.

Q175 **Sir Geoffrey Clifton-Brown:** We have not discussed Gatwick Express today. When are you on target to meet your obligations under timetable for Gatwick Express?

Charles Horton: Gatwick Express is the most challenging of our brands to operate in terms of its punctuality and reliability. When there is significant disruption on the Brighton mainline the operational plan that we put in place involves not running the Gatwick Express in favour of running other services.

The reason for that is that the other services we operate on the line—Thameslink and the other Southern services—are available to Gatwick Express customers and allow them to make their journey on the route. What we sometimes have to do when there is significant disruption on the network is restrict the number of trains that are able to operate over that network. That is the reason why the performance of the Gatwick Express historically has not been as good, but, as Mr Carne said, the objective is to get the whole railway to run a lot better and to improve the performance of the infrastructure. As you know, we have invested substantially in increasing the number of drivers we have across the franchise. Taken together, better infrastructure, more drivers and better performance on a day-to-day basis will mean that across the network we will see punctuality and reliability of services continuing to improve.

Q176 **Sir Geoffrey Clifton-Brown:** So the closure of the Brighton main line will not affect the Gatwick Express—or will it?

Chair: The October and February closure?

Sir Geoffrey Clifton-Brown: Yes.

Charles Horton: We are working at the moment on the detailed operational plan. The area that will be unavailable to us is south of Gatwick Airport. The predominant number of people who go to Gatwick Airport are coming from London, but we are of course concerned about people travelling from Brighton and other places on the south coast, and it is likely that they will have a rail service, albeit with a more lengthy journey than they would ordinarily have. We are working, as I said, on those detailed plans. We are also looking at how we supplement that with bus services and other arrangements, as well as co-operation with other operators. Part of the mix is to see where we can work with other operators—

Q177 **Sir Geoffrey Clifton-Brown:** So they can expect better advance information of the delays that are likely to occur.

Charles Horton: Indeed.

Q178 **Sir Geoffrey Clifton-Brown:** Can I just ask you to give us an update on RMT's announcement that they will have industrial action for 24 hours on 12 March? Where have you got to with trying to settle the driver-only issue?

Charles Horton: We have done our level best to find a way of getting the RMT to talk to us and bring their dispute to an end. The changes we have introduced have been in place for more than a year. They are working well. Customers have noticed the improvement in the way in which those trains operate, but I am afraid that the RMT continues to be unwilling to come and make an agreement with us for the future.

Q179 **Chair:** Well, there are two entrenched positions.

Charles Horton: What the RMT is asking me to guarantee is that I will cancel a train when there is no good reason to cancel a train for a customer. I will not do that. It is my job to run trains for customers, and I am being asked to do something that I do not think is in the best interests—

Q180 **Chair:** To be clear, that's the sticking point?

Charles Horton: That's the sticking point. That's the thing—

Q181 **Sir Geoffrey Clifton-Brown:** How is this to be resolved, Mr Horton?

Charles Horton: Because we have large numbers of contingency ready trained to run our services and because we have the agreement we have in place to operate the services, on strike days now, when the RMT takes action, the vast majority of services operate. It is also worth noting that 60% of people covered by this dispute are now coming to work on those strike days and are working normally.

Q182 **Sir Geoffrey Clifton-Brown:** On 12 March, will your customers see disruption or will they not?

Charles Horton: The vast majority of customers will see no disruption.

Sir Geoffrey Clifton-Brown: Thank you.

Sir Amyas Morse: I want to bring you back to your deal on penalties. Do you think that it is good management practice to, instead of associating penalties with performance, just do a roll-up deal? The whole point of having the penalty regime is not that, is it? What was the real reason for doing this deal? I can see that it is nice not to have it on your plate, but what was the point of it?

Bernadette Kelly: We did a forensic analysis of a huge number of detailed returns from GTR in assessing the level of the penalty. We were also making some judgments about the value of management time focused on driving performance and the value of management time focused on arguing over a huge number of detailed claims. I should say that there is no question in any of this of our taking our foot off the pedal on performance. Indeed, we have only just in the past month agreed a further remedial plan with GTR that sets out detailed performance standards that we absolutely expect to hold it to. Again, Mr Wilkinson might like to add to that.

Sir Amyas Morse: Before he does, may I check something? What you had in place before was not driving performance. Are you saying it did not drive performance effectively?

Bernadette Kelly: No, we had in place performance metrics throughout, which we have held GTR to account for. This, as I say, is our second remedial plan, which we have just put in place to ensure that we are managing that performance extremely actively from the Department. At no point are we relaxed about the level of performance that is being delivered on this franchise. Again, if Mr Wilkinson wants to come in—

Q183 **Chair:** Did you not consider cancelling the contract?

Bernadette Kelly: We did consider that. We looked at a number of options—

Q184 **Chair:** Was anyone else willing to take it over?

Bernadette Kelly: —in the early part of 2017 to determine the best way to deliver the best possible outcome for passengers and taxpayers, but the view that we took at that time was that the sensible way to proceed was to secure a penalty from GTR and then really focus minds on driving performance for passengers. We were confident that was the best way to deliver for passengers and taxpayers.

Q185 **Chair:** Do you think the franchise has become toxic now because of all the complicated issues that we highlighted at the beginning, and because of the industrial action and the passenger misery stories across the media?

Bernadette Kelly: There has been an extremely difficult period on this franchise. What we are now seeing are sustained improvements on the franchise.

Q186 **Chair:** Did you put any feelers out to see if anyone else in the industry would be willing to take on the franchise?

Bernadette Kelly: At that point we were principally focused on the best way to secure the best outcome for passengers and taxpayers. We looked at quite a long suite of options.

Q187 **Chair:** If you looked at options and considered cancelling the contract, in order to consider that you must have had an idea—perhaps Mr Wilkinson will answer—whether there was anyone in the wings who would have stepped up and taken on this franchise. Were there people out there who might have?

Peter Wilkinson: We considered these things very carefully. We put feelers out and there were people prepared to take on the franchise. Yes, is the answer to that question, but, in the final analysis, that was not the right thing to do. The right thing to do was to quietly get on and manage and deliver the plan we bought in the first place, because it was the right plan. It is a difficult plan. We accept that. But the results coming through now bear out the fact that we made the right decision. We would not be achieving the levels of passenger satisfaction on a railway that continues to grow and returning levels of performance if we had not stuck to that plan.

Chair: Fine. We hear your position loud and clear.

Q188 **Lee Rowley:** I am interested in the penalty framework as well. You talked a moment ago about how the franchisee has overperformed to some extent during the period when this was agreed. If they had underperformed significantly and if the operation had gone off a cliff, would you have reopened these speculative penalties?

Peter Wilkinson: We would have done, yes. The reason we were confident in our judgment was we did a lot of empirical extrapolation from the previous period. We did not just pluck a number out of the air. It was a reasonable assessment we made based on past performance, and we took a view on what, if that were to carry on, they would pay in the worst cases. In fact, they have done better. That demonstrates the remedial plans are working and they are getting back on trajectory. That was our expectation. We drive these businesses very hard through our contract management processes. We do not just let plans sit on a shelf in a filing cabinet.

Q189 **Lee Rowley:** Given we are now in a world of speculative fining for things that might happen in the future, what fines do you expect to require and what fines does Mr Horton expect to pay beyond when this current fining regime ends in September?

Peter Wilkinson: I understand the sentiment behind your question. These were not speculative fines. This was a well-assessed product on the basis—

Q190 **Lee Rowley:** Fining on a number of assumptions.

Peter Wilkinson: Coming back to the question you have asked me, we would expect to exert the full contractual regime that we have with this supplier if they do not perform. That leaves us with mechanisms of breach and default if ultimately their performance is so poor. I expect, on the basis of current performance, that they will continue to improve. The job is about passengers, not operators or the Department. It is about getting this railway working for passengers. That is our primary concern and that is the thing we work for every day.

Q191 **Lee Rowley:** But you have already accepted that there is a disconnect between passenger satisfaction—because you have highlighted its significant improvement—and the operational ability of this contract to perform. It is not performing, otherwise you would not have a speculative fining—or whatever you wish to a call it—process in place, which you do at the moment. On the assumption that that continues beyond September, I presume that further fining will occur.

Peter Wilkinson: I do not agree with what you have said, unfortunately. Performance is improving because we have put a very robust penalty process in place. We have kept this operator honest to their contract and driven them hard through the contractual mechanisms that we have. Where I do agree with you is if, at the end of this particular period of remedy, their performance falls off again or does not continue to improve in the way that we would expect, we would continue to exert the financial penalties and breach conditions that we have open to us in our contract.

Q192 **Lee Rowley:** Finally, to confirm, as of right now, based on the performance that you have seen in the last few weeks or months, would you expect a set of fines to be levied beyond September 2018, whether speculatively, pre-emptively or post the fact?

Peter Wilkinson: No, I would not, because the current plans should get them back on to a trajectory of performance that should be acceptable to us under the contract.

Q193 **Anne Marie Morris:** It sounds to me that what we have here is almost—forgive me—a freebie, in that there is no penalty. Effectively, you have said, "They need more money into this contract, therefore this is how we're going to achieve it. We will effectively convert this fine into more investment for the project." I hear what you are saying, Mr Wilkinson, that if you want success at the end of the day maybe that is what you have to do, but does that not then raise the question of, first, how you incentivise if there is no real penalty, and secondly, how you are measuring the benefit of what you have done for the tax-paying public? It does not sound to me as if there is really any measure; it is just giving them more to do the job. Where is the measure that what you did was actually the right thing to do, and will deliver value for the taxpayer?

Peter Wilkinson: A totally understandable question. This franchise is delivering broadly in line with what we expected in terms of returns to the taxpayer. It has generated a net contribution to the Treasury of about £760 million. It has generated about £3.5 billion of revenue. This franchise is on course to deliver for the taxpayer. We are only halfway through this franchise. It is important to keep this franchise in context: it is a very important one, and there is a lot of change going on. We need to look at the franchise at the end to see whether it has delivered the full value for the taxpayer. I sincerely trust that it will.

In terms of the penalties, we have not given away any rights for the future. We have left the incentive with the operator to perform, because we still uphold and maintain our rights of breach if they are not delivering the trajectory of performance that we have agreed with them. We have conceded no ground. What we have done is manage to extract out of their earnings—their own margin, effectively—a penalty, which we are reinvesting in the business. I should point out as well that this franchise owner—the investors in the franchise—are some £180 million down on what they expected to earn out of the franchise. In reality, the person paying for the pain is not the taxpayer; it is the investor, and the owner of the franchise. That is rightly so. The obligation is on them to deliver and to perform in this contract.

Q194 **Chair:** Can I just make sure that we have got those figures on ticket revenue right? Can you just repeat them, and tell me which period of time they are from? If you want to write to us with them, that would be fine.

Peter Wilkinson: As I understand it, the franchise has generated, to date, £3.6 billion of revenue, and has returned to the Government something in the region of £760 million in surplus.

Charles Horton: Chair, if I could just correct the figure on expected profits, we were expecting to receive £130 million by now in profits. We have actually made a loss of £5.25 million to September last year.

Q195 **Chair:** That brings me neatly on to a point about ticket offices. I understand that often they are closed, or the machines are broken. Apparently, you responded to colleagues in the House and to passengers that it has been difficult to recruit staff for ticket offices. Is that true?

Charles Horton: There have been some local difficulties with recruitment of ticket office staff, but we have got a lot of additional ticket office staff in now. We have also made an investment of more than £8 million in new ticket machines, and we are making a further investment in our ticket machines in our ticket offices as well.

Q196 **Chair:** Given that you are making a loss, is there a connection between you making a loss and a delay in recruiting people to staff ticket offices?

Charles Horton: No; because of the way in which the franchise works, there is no direct correlation.

Q197 **Chair:** The franchise requires you to staff ticket offices.

Charles Horton: We have certain obligations around ticket office staffing—

Q198 **Chair:** So the penalty you have already paid covers the fact that you have ticket machines that haven't been working—

Charles Horton: No; that is a different part of the contract. The key point here is that we have obligations in relation to not only train service performance but a number of other operating obligations that we are required to fulfil, and for which the Department has penalty and enforcement regimes that it can use.

Q199 **Chair:** Have you had any penalties for passenger difficulties in buying tickets?

Charles Horton: Not for ticket offices. Performance is monitored extremely closely there. We certainly have a regime, for example, in relation to ticketless travel—the Department undertakes an audit of the number of people travelling without a ticket, and there is a financial and enforcement penalty regime associated with that. So we are strongly incentivised to make sure that customers have an opportunity to buy a ticket before they travel and that no one is on the railway without a ticket.

Chair: We will leave that one there for now.

Q200 **Anne Marie Morris:** May I ask Mr Horton and Mr Carne a question? One of the things that will determine whether this succeeds or not is how your two organisations work together. It was music to my ears to hear that, in terms of the actual franchise tendering process, you are both engaged. But, clearly, once the franchise has been let, there is the ongoing operational issue: you have different stakeholders, different objectives and different targets, and you are responsible and accountable to different people. So while I am pleased to hear the warm words between you, in practice how will you ensure not just that you two dialogue and work closely together, but that your organisations below you do that? As I understand it from conversations that I have had with Mr Carne about my own network in the south-west, going forward there will be a new model of close working between the TOCs and Network Rail, but I am concerned about how this will work at the operational level if you are not sharing budgets and you don't have the same targets. How will you actually make this happen in practice?

Charles Horton: Could I begin by saying that we do work extremely closely together with our colleagues in the south-east through to Network Rail? At the top of the tree there is an alliance board, where we have shared objectives to deliver certain programmes and performance outcomes, and we work very closely together as teams to deliver on those objectives and outcomes. There is a remarkable degree of alignment between our goals and objectives, and that is cascaded through our organisations so that people right at the bottom end of our organisations, facing the customers and looking after the day-to-day maintenance of operations, understand how—

Q201 **Anne Marie Morris:** How do you cascade?

Charles Horton: You can speak for Network Rail, Mr Carne.

Mark Carne: Perhaps I can build on what Mr Horton has said, because I think this is absolutely the core of the transformation that we have been leading in Network Rail. Working track and train together as one team, focused on what passengers need, is at the heart of what we need to do differently. You are quite right that there was a time when the targets that Network Rail had were sometimes very different from the targets that the train operators had. That, clearly, was not the right solution.

We now have a structure where we have a scorecard for our businesses. The targets are agreed and very often set by the train operating company, which means that we basically have shared objectives to try to achieve those things. In some cases—you referred to the Great Western route, where we have a supervisory board overseeing it—we have Transport Focus representing the interests of passengers to ensure that those scorecards reflect their interests as well. That is an emerging and maturing way of providing greater supervision for these scorecards.

The power that that then creates, in terms of the message it sends that we are all in this together, is very strong. But then you have to have the right leadership. You have to have the right leadership in the train operating company and in Network Rail, because you have to get those people to come together to say, "Right, we're now going to make this work." Today we have terrific leadership here, down in the routes, running these businesses. The degree of collaboration and commitment from those people working on the railway night and day to deliver for passengers is really exemplary. It is chalk and cheese compared with where it was a relatively short time ago. It is terrific to see.

Q202 **Anne Marie Morris:** It is, and clearly the orange army that helped us at Dawlish was very much appreciated, but you still have not answered my point. It sounds lovely, but how is it going to work in practice? You can tell me what is going to happen, but where is an example of how this has been properly cascaded and you have actually shared these objectives?

Mark Carne: Ah, I beg your pardon. Let me be very clear. In terms of the cascade, these scorecards are the basis on which every employee in Network Rail receives performance-related pay. All 38,000 employees receive an element of performance-related pay, and it is based on how well we deliver for our customers. Every employee in Network Rail can see what the targets are and how well we are doing against those targets. We report to them every four weeks on how well we are doing, which ones we are falling short on and which ones we are doing really well on. Those cover: safety, of course; the reliability of the network; financial performance, to ensure that we are making best use of taxpayers' money; the delivery of projects; our asset integrity, and of course how passengers and customers feel about the services. Those elements are in the scorecard, and they are effectively communicated to all members of staff, right across the network.

Q203 **Anne Marie Morris:** How does that work when your budgets do not allow you to have the co-operation you would like? Let me give you a parallel. We talk about health and social care. They have separate budgets. We have for many years talked about how we can integrate them so they work together. At the end of the day, my experience is that unless you actually integrate the budgets you are not going to get anywhere. There is usually a fight about who is going to spend their budget on a particular issue. It seems to me that you have the same close relationship between the tracks and the trains on the tracks, and that the two need to work together. What do you do when there is a real challenge because, for all the work you have done in terms of scorecards and all the rest of it, there is a crunch point and the right budget is not in the right place to make whatever has to happen happen?

Mark Carne: You are right: they are very different budgets, and we have different shareholders. We are still two different entities with responsibilities to our own shareholders. I would say that the vast majority of the time we actually find there is a very good opportunity for alignment and pulling together. There are some occasions when I want to shut the railway in order to do something cheaply and efficiently to restore it, and Charles wants to run trains on the railway, and we clearly cannot do both. We then have a commercial discussion about what is the right possible outcome and whether we can find a compromise agreement. But these are relatively rare. The normal contractual mechanisms in the railway work reasonably well to define these sorts of relationships.

Bernadette Kelly: It is probably worth adding, on your general point, that we have of course set out in the rail strategy our longer-term plan for evolving the model of franchising as it currently operates, precisely to deepen the alignment between track and train. My Secretary of State has been clear that he thinks that has the potential to improve outcomes for passengers. That work is under way, building on, as Mr Carne says, the hugely improved collaboration we have already seen over the past couple of years.

Q204 **Sir Geoffrey Clifton-Brown:** Ms Kelly, can we clarify this whole issue of bidding by Stagecoach on the east coast main line? You said there were no grounds to prevent Stagecoach from bidding again for that contract, but in a letter to the Department for Transport, Lord Adonis said that it would clearly be reasonable not to invite a company to bid for future franchises in circumstances where it had recently failed to deliver on a previous franchise. Will Stagecoach and Virgin be eligible to rebid for that franchise, or not?

Bernadette Kelly: What we have said in this instance is that we see no legal reason—no legal grounds—at the moment to exclude Stagecoach from bidding for this franchise. Clearly, we will keep this under review, but we see no legal grounds at present to stop them bidding.

Q205 **Chair:** Is that because of what you said earlier—that passengers have not been failed?

Bernadette Kelly: I think this turns upon the nature of the default that we are seeing. We have seen and we will see Stagecoach honour its contractual obligations in full. Clearly, that has a bearing on the judgments and criteria we may apply in determining its fitness to bid for future franchises. But, as I say, we do not have any legal grounds at the moment for preventing it—

Q206 **Chair:** If it were to bid to run the same line again, for example, which it talked about as a possibility, you could take into account what has happened when deciding whether it would make the shortlist.

Bernadette Kelly: What we would do is look at the criteria in place in determining the fitness of all bidders and assess whether anything in the circumstances here would have a bearing on that. As I say, at present we are clear that there are no legal grounds to prevent it bidding for the franchise.

Q207 **Sir Geoffrey Clifton-Brown:** Can I quickly move on to Crossrail? The Chairman, other members of the Committee and I went and had a look at Crossrail in 2016, early 2017. It all looked to be going swimmingly. The tunnels were built. There were amazing engineering feats. They were getting lots of apprentices doing engineering. It all looked to be on time and opening on budget. What has gone wrong?

Bernadette Kelly: This is a project that is now 90% complete, so it is even more advanced than when you and other members of the Committee had the opportunity to see it yourselves. It is not surprising with a project of this scale and complexity that in the final hurdles there are some challenges in ensuring that the project absolutely delivers to time, to schedule and to budget. Some of those pressures are becoming more apparent as we get closer to the end. It is not true to say that it has all gone wrong. This is and continues to be a fantastic project, and a fantastic showcase for what the UK can do in delivering really challenging, big infrastructure projects. What we are seeing is that as the project nears completion some of the pressures are growing. We in the Department and Transport for London, as joint sponsors, are absolutely holding Crossrail's feet to the fire, to ensure successful delivery of this very important and essential project.

Q208 **Sir Geoffrey Clifton-Brown:** Is it not the case that the basic engineering was exemplary and it was only when you started to install the systems that things have gone wrong? If that is the case, surely there were plenty of other comparators around the world for how to install these systems. For example, you had an explosion at Pudding Mill Lane. What has gone wrong?

Bernadette Kelly: First, I am really reluctant to buy into the "what's gone wrong" question here.

Q209 **Chair:** What has caused the delays?

Sir Geoffrey Clifton-Brown: I gather that there was a board meeting of Transport for London at the end of January, where it was said that the opening time of the Elizabeth line of December 2018 is in danger of being delayed, so something has gone wrong.

Bernadette Kelly: The company has told us that it is still firmly fixed on delivering that December '18 scheduled opening. We are holding its feet very firmly to the ground, as you would rightly expect. I do not think that it is true either to simplify this as a project where the construction has all been fantastic and the systems are more difficult. Systems and operational readiness are very complex and challenging elements of the totality of the project. We and Transport for London are holding Crossrail to account to ensure a relentless focus on seeing this through to a successful conclusion.

Q210 **Sir Geoffrey Clifton-Brown:** Sitting here today, you are absolutely confident that the Elizabeth line will open in December 2018 and on budget?

Bernadette Kelly: The company has told us that it remains confident that December '18 can be delivered. It is under pressure, but it is confident that it can deliver it. There are cost pressures emerging. Some of the records from the TfL discussions demonstrate that; indeed, Crossrail has made us aware of that. We are now challenging it very hard to manage those cost pressures. I cannot give you a 100% guarantee at this stage. I can say only that as we near the final stages of this project, everybody in Crossrail, in my Department and in TfL is absolutely focused on seeing it through to a successful conclusion.

Q211 **Chair:** Is Her Majesty the Queen scheduled to be there at the opening in December 2018?

Bernadette Kelly: I am not privy to Her Majesty's diary, but I am hopeful that she will be there.

Chair: If she were, it would be very unfortunate, would it not, if it were delayed?

Q212 **Sir Geoffrey Clifton-Brown:** I recognise a political answer when I hear one, Ms Kelly. I put it to you again: is it likely to be opened on budget? If not, how much over budget do you, sitting here today, expect it will be?

Bernadette Kelly: There are some cost pressures emerging. We have asked Crossrail for some further analysis so that we can understand exactly the nature of those cost pressures. I cannot give you a figure, because I do not have a figure in which I have any confidence. We are pushing Crossrail very hard to come up with a very robust cost estimate and to ensure that it is as close to budget as it can be.

Chair: I think we will leave it there, but we will no doubt be back to cover it. Thank you for your forbearance. We have gone on longer than we expected, but the east coast rightly took up an important amount of our time. Thank you very much for your time. The transcript will be published in the next couple of days on the website, uncorrected, and realistically, our report is now likely to be out after Easter, but I cannot guarantee that timing. We will obviously send you a copy.