

Transport Committee

Oral evidence: [Intercity East Coast rail franchise inquiry](#), HC 891

Monday 16 July 2018

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Members present: Lilian Greenwood (Chair); Ronnie Cowan; Paul Girvan; Huw Merriman; Grahame Morris; Luke Pollard; Iain Stewart; Graham Stringer; Daniel Zeichner.

Questions 123 -320

Witnesses

I. Martin Griffiths, Chief Executive, Stagecoach Group; Neil Micklethwaite, Commercial and Business Development Director, Stagecoach Group; Jo Kaye, Managing Director, System Operator, Network Rail; and Rob McIntosh, Route Managing Director, London North Eastern and East Midlands, Network Rail.

II. Polly Payne, Director General of Rail Group, Department for Transport; Beatrice Filkin, Intercity Market Lead, Department for Transport; and Simon Smith, Director for Policy, Operations and Change in Passenger Services, Department for Transport.

Written evidence from witnesses:

- [Network Rail](#)
- [Department for Transport](#)

Examination of witnesses

Witnesses: Martin Griffiths, Neil Micklethwaite, Jo Kaye and Rob McIntosh.

Q123 **Chair:** Welcome and thank you for coming along this afternoon. For the record of our proceedings, can you introduce yourselves?

Jo Kaye: I am Jo Kaye. I am the managing director of the system operator part of Network Rail.

Neil Micklethwaite: I am Neil Micklethwaite. I am the commercial and business development director for the rail division within Stagecoach Group.

Rob McIntosh: I am Rob McIntosh. I am the Network Rail route managing director for the London north eastern and east midlands route.

Martin Griffiths: I am Martin Griffiths. I am the chief executive of Stagecoach Group.

Q124 **Chair:** Thank you. This is a question to Martin and Neil. We know that the east coast franchise has failed three times. I know it was not Stagecoach each time, but there seems to be a theme of overbidding in each of the cases. Do you accept that you, Stagecoach, with Virgin, overbid for the franchise?

Martin Griffiths: It is disappointing that the franchise terminated early in the circumstances that it did. We put together what we thought was an ambitious plan. It was ambitious. It was about transformation for the east coast main line, driven by more passengers and more revenue to deliver additional premium to the Government.

Operationally, I am proud of all the things we have done, but clearly it is disappointing. The bid was put together at the back end of 2013 and 2014, and we regret that the passenger numbers we forecast have not materialised. Hindsight of course is a wonderful thing, and if we had our time again, given everything that we know now, we would look at it differently.

We used the best economic indicators that were available to us and Government at the time; a wide array of experts were available to us and we have a track record of 20 years of operating railways in the UK. In partnership with Virgin, we have transformed the west coast main line, with the sort of passenger and revenue growth that we have seen there.

Q125 **Chair:** Do you think there was a failure to understand that east coast and west coast are fundamentally different markets, different sorts of franchise?

Martin Griffiths: No. There was always a recognition that they were different markets. A whole series of factors have come together since the bid was put in that, with hindsight, we did not see, and that has been disappointing, but I do not think it was just that they were different



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markets. Clearly, that was understood. A whole lot of sensitivities were run, and the Department for Transport, as well as complimenting me individually and the team corporately for the best bid they had ever seen, evaluated it as a financially low-risk bid at the time.

Q126 Chair: It might have been a good bid, but you did not deliver on what you promised. Would you ever realistically have been able to deliver the nearly £3 billion in premiums that you set out in your bid?

Martin Griffiths: When the bid was put together, Madam Chair, it was with the intention of doing that. There is absolutely no incentive at all to overbid or to overestimate. Reputationally and financially, it has been very disappointing for us as a group, and for Virgin as our partner; absolutely.

Of course, it was a bid predicated on a number of assumptions that were to drive the premium. Indeed, the way the bid was put together and the way the franchise was specified, the Government could have got more than that. They could also have got less. Actually, the one thing that was probably sure is that they would not have got £3.3 million, because, in a contract that should have gone on for eight years, a number of things were going to change, and the contract had the ability to vary that depending on those changed circumstances. We find ourselves now in a position that is, as I said, not what was envisaged at the start.

Q127 Chair: Let me clarify. You are saying you do not think you overbid. You think it was realistic to deliver £3 billion of premiums over the life of the contract.

Martin Griffiths: We are now in 2018. Back then, in 2013-14, when we put it together, there was no incentive to overbid. It was put together in good faith, but at high cost, with some of the best advisers around and our own experience of bidding. Clearly, with the benefit of hindsight, I am disappointed at the way things worked out, but I do not think we can sit here now and say we would have made a different decision back then. At the time, we were confident in the projections, based on everything we knew at that time.

Q128 Chair: If you had put in a more conservative bid, do you think you would still have won the franchise competition?

Martin Griffiths: The franchises are competitively tendered. It would be for the Department for Transport to look at the bids they received and the evaluation of those. I cannot comment on that.

Q129 Chair: Did the way the Department structured the franchise, or the ITT, encourage you to make over-ambitious bids?

Martin Griffiths: Clearly, there was an element of understanding their evaluation process, and the premium that was offered was an important part of that, but I go back to my statement that there is no incentive to overbid. The reputational and financial damage to our group has been



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very significant. On this one contract, Stagecoach Group will have lost about £200 million. To put that into context for the Committee, that is about a fifth of our current market capitalisation. The penalty has been very significant for us.

Q130 **Chair:** You have only been held to delivering the premiums you promised, and actually, because you left the contract early, you will not have delivered taxpayers the full premiums they were expecting to receive.

Martin Griffiths: If I could correct you, we did not leave the contract early. That was a decision for the Government.

Q131 **Chair:** The contract has ended early.

Martin Griffiths: It was the Government's choice to do that, with us having satisfied the contract operationally and financially, and I am very comfortable that we did; we fulfilled all the obligations that were set. When the Government passed transfer of risk at the time of the contract, they knew what risks they were taking. We accepted those risks. It did not work out for us as we had hoped, but we honoured our contract in full.

Q132 **Chair:** But you would not have been able to honour your contract in full through to the original date set, would you? You would not have been able to pay the £3 billion-worth of premiums.

Martin Griffiths: That is what I am saying. The Government understood the risks that they were transferring to us. That is the model. The Government accepted that, in circumstances where the bid did not materialise—we regret that it did not; clearly, that is disappointing—to the extent that there was a shortfall, on this particular contract, there was no risk-sharing of downside, macroeconomic or any other, so the operator took the financial risk, but that risk was capped at an agreed amount when the contract was signed. They have not always done it that way and they will not do it that way in the future, I suspect, but we have honoured our contractual obligation in full.

Chair: No question. We will ask more questions about why you did not get your sums right.

Q133 **Iain Stewart:** Again, the questions are to Martin and Neil. You said that you based your projections, in good faith, on the best advice on assumptions you made about the duration of the franchise. Can you tell me a bit more about what assumptions were wrong, in the light of day?

Martin Griffiths: In the light of day, the thing that did not materialise was the growth in passenger numbers and therefore the growth in revenue. The big intercity franchises in this country have a very high fixed cost, and there is a very regulated service and output that you have to deliver. Everybody understands that when they bid, so on a franchise like this you have to deliver the revenue line. We have done extremely



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well, actually; we have outperformed the long-distance market, but we just have not made the sort of revenue and passenger numbers that we had assumed we would make when we put the bid together.

There are a whole range of factors. We have a very different economic and political outlook right now. We went into, and are still in, periods of the lowest fuel prices we have seen in a long time. We are seeing structural changes in the market, in terms of people's propensity to travel both for employment and for social purposes. I am encouraged to see that the Department is recognising that as well. In Peter Wilkinson's evidence to the Public Accounts Committee, he acknowledged that; we are seeing the lowest rail revenue growth since the period of privatisation, for a whole lot of factors that have come together, and that is impacting the whole industry, so it needs to be looked at. Fundamentally, our revenue projections and our passenger numbers were lower than we had hoped.

Q134 Iain Stewart: Was there one particular causal factor for that lower number? Also, to clarify, you had growth in both passenger numbers and revenue; it just was not as much as you were anticipating.

Martin Griffiths: Yes.

Q135 Iain Stewart: Of all the factors, was there one in particular?

Martin Griffiths: No. It was all the factors I have said. The infrastructure was also a contributing factor, which I am sure we will come to. What we had assumed on the performance of Network Rail in that period was less than had been assumed as well, but that was dealt with through normal industry mechanisms.

It was all of those factors. It is difficult to pinpoint one, but I am confident that the majority of the things that happened were outwith our control. All the things we said we would do, all of those that were bid, were put in: the management initiatives, the product itself, the upgrade of first class, the upgrade of standard class, the upgrade of the food offering, the extra seats and the extra destinations. What gave me great encouragement as we left the franchise in the last few weeks was that the revenue growth, while still below what we had assumed, is coming through strongly, and I am confident that the benefit of those initiatives will be there for the future franchisee.

Q136 Iain Stewart: What steps did the Department take to challenge the robustness of your assumptions when awarding the franchise?

Martin Griffiths: That is probably a question you have to ask them in terms of their approach to their evaluation, but, based on my experience over many years, they have a robust review process; they have highly paid and qualified advisers to help them; they clearly have the benefit of other franchises and what they are seeing in the industry; and, as I said, they evaluated our bid as financially low risk as part of that process.



Q137 **Iain Stewart:** You would say they have to take an equal share of the blame for the numbers being wrong.

Martin Griffiths: It is not a question of blame. At the end of the day, the numbers did not come through. That is disappointing. Rather than use the word blame, I think they have to accept the portion of the risk that was for them. To the extent that those numbers did not come through, they understood, or should have understood, the risk that that left with them.

Q138 **Iain Stewart:** It was fairly clear that in the period between the franchise being awarded to you and you taking over the franchise the numbers were going to be wrong from day one. Did you at any point seek to rebase the contract?

Martin Griffiths: It has been very clear for a number of years—probably going back to when franchises did not have as long a gap from bid and award to actual commencement—that the Department's policy is that they do not rebase. We see it in other jurisdictions, but the Department for Transport's policy is not to rebase, and we understood that.

Q139 **Iain Stewart:** You did not even attempt to approach them about it.

Martin Griffiths: It was raised with them by us and by the wider industry, and it was part of the discussion on Richard Brown's review on franchising back in 2012-13, but the Department's position is that it does not rebase. As a bidder, you understand that. You have to accept that risk.

Q140 **Iain Stewart:** You do not even say, "It is worth our while to do this on a one-off basis."

Martin Griffiths: That would not get traction under their current policy.

Q141 **Iain Stewart:** Moving forward, do you think there should be processes for renegotiating contracts mid-period? When changes have happened in the basic economy or the market, do you think there should be that flexibility in the franchise?

Martin Griffiths: I am on record as saying that I think the bid should be rebased to the start point. I think you should start with the actual revenues, but, again, that is not Department policy. I am encouraged, as we go forward, that the Department is now looking at the sharing of macroeconomic risk, and I go back to the fact that they did not do that to any meaningful extent on this franchise. We knew that when we signed it, so we accept our contractual responsibilities for that, and we have honoured them. But, if you go back to Richard Brown's review on franchising, he made it very clear that risks should best sit with those able to manage or absorb them. In terms of macroeconomic risk, his firm view was that that should sit with Government. We took all of the risk—macroeconomic, management initiative and everything else on this franchise. As we go forward, I would expect to see that change.



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Q142 **Chair:** Can I check this? You just said those numbers did not come through—revenue and passenger numbers. It almost sounds like you do not accept any responsibility for the outcome. Surely, as the franchisee, you were responsible for meeting the revenue and the passenger growth. That is why it is in the private sector.

Martin Griffiths: Yes. I did not want to give that impression. I am very disappointed and regret that our numbers did not come through. It was our bid; we put it together. I was trying to explain to you the background. You asked me why it had happened. There is no debate. It was our bid, and we stood by it at the time, as I said. It was ambitious, and it was all about fundamental transformation of the east coast main line. It was our bid, so I am not trying to not have responsibility for it. I was trying to give you an explanation of some of the reasons why it did not come through.

Q143 **Chair:** What were the assumptions you made that changed? You made reference to Network Rail's part of what they delivered over the period you were running the franchise.

Martin Griffiths: There is a point of principle for me. I want to be very clear. At no time have I or, to my knowledge, anyone else said that any failure of Network Rail's infrastructure upgrade or capability is responsible for the early termination of this franchise. That is not true.

Q144 **Chair:** What I said was that, in your evidence—

Graham Stringer: But Richard Branson said that.

Martin Griffiths: No, he did not say that.

Q145 **Graham Stringer:** I have the quotes in front of me. Branson said that.

Martin Griffiths: What Richard said it would come to was that there would be changes going forward that the infrastructure was not going to be delivered around what we had assumed in our bid for changes that would impact from 2019 onwards, but I want to be absolutely clear: the performance—

Q146 **Chair:** I was not asking you about that. Earlier, when you were answering Iain's questions, you made some reference to Network Rail's performance, and obviously you would have received compensation from Network Rail when the infrastructure was not available, as is normal. Can I check whether you believe that Network Rail's performance over the period when you were running the franchise impacted on your revenue or passenger numbers?

Martin Griffiths: Yes, it did, significantly.

Q147 **Chair:** How significantly?

Martin Griffiths: As we exited the franchise, we had a claim against Network Rail for £72 million. My understanding is that liability was accepted, but the quantum was not accepted, for what we call sustained



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poor performance. That sustained poor performance dated back to a period even before we took over the franchise, when it was previously operated by DOR. We had an obligation, from a taxpayer and a Government point of view, to pursue that claim. That claim has passed on to the new operator and it will be for them to decide what to do with it.

Q148 Chair: Do you believe that Network Rail's poor performance, in terms of delivering the day-to-day operation of its infrastructure, impacted on your revenue or passenger growth, other than the part that is compensated for in the normal way from Network Rail—that £72 million? Do you think that you had greater costs as a result of its poor performance than the amount you are due in compensation?

Martin Griffiths: No. That claim was to try to put right what we thought was due to us during that period.

Q149 Chair: The amount that you would have lost as a result of Network Rail's poor performance in delivering the infrastructure, or when things went wrong, has been covered by the compensation that is payable in the normal way.

Martin Griffiths: Yes. There are three mechanisms—schedule 4, schedule 8 and sustained poor performance. Schedule 4 and schedule 8 are settled in the normal industry course. There can be a dispute at any point in time, but, as the franchise went on, we got better at agreeing those. Sustained poor performance, as I said, is in addition to that and was liability-accepted, in terms of my discussion with the chief executive of Network Rail, but the quantum was not accepted. That £72 million was outstanding when the franchise ended.

Q150 Chair: If you had received the £72 million, would you still have used up your parent guarantee or not?

Martin Griffiths: We would have gone on for a bit longer but the parent guarantee—that is the point I was making, I am sorry, when I interrupted you—was only a factor in the whole range of issues that meant the franchise terminated earlier, but we would have gone on longer.

Q151 Ronnie Cowan: I want to come back to the point you made about macroeconomic risk. You stated that the Brown review recommended that franchises should only be responsible for the risks they can manage. Do you agree with that?

Martin Griffiths: As a principle, yes.

Q152 Ronnie Cowan: In the real world, do you agree with that?

Martin Griffiths: Yes. This type of contract has a fixed-cost base and therefore you are very revenue dependent, so it is very difficult for us to take responsibility for all the macro factors that impact the revenue base. That is what Richard Brown was saying.

Q153 Ronnie Cowan: In the process of this franchise, where was that



macroeconomic risk spread? Did you say you took it all on?

Martin Griffiths: We took it all, yes. There was no risk-sharing of any downside with the Department from the bid on this franchise—none.

Q154 **Ronnie Cowan:** How was that split between yourselves and Virgin?

Martin Griffiths: Between ourselves and Virgin, we took 90% of it and Virgin took 10% of the parent company guarantee. That was, effectively, the way we did it. That was the Government's protection for their downside. In other franchises, they have risks shared where it has been a macroeconomic risk, and we used to have things called cap and collar and revenue support. They did not have that on this franchise.

Q155 **Ronnie Cowan:** Does anyone have anything to add?

Neil Micklethwaite: On the macroeconomic risk, since we put the bid in nearly five years ago, a number of things have changed, as Mr Griffiths said. This is a very discretionary-based franchise in terms of the travel; only about 3% of it is season-ticket based. At the time we put the bid in, car fuel prices were about £1.40 at the pump and not long after they were closer to £1, so the car became more attractive. We have also seen that GDP did not do what we expected it to do at the time. A lot of highly skilled consultants and professionals were part of the process of not predicting how GDP would turn out, and how average weekly earnings have not grown as we expected, due to a lot of political and economic uncertainty.

Q156 **Ronnie Cowan:** You said that when you bid for the contract you did not overbid, but, in taking on that macroeconomic risk, were you not in fact loading the bid?

Martin Griffiths: It was our bid. We made assumptions at the time that of course we thought were deliverable, but clearly we also took into account that the risk transferred to us was capped at a certain amount. That was how the Government structured this particular contract. That is how they wanted to do it on the east coast main line franchise that they let at that time. Yes, we knew that potentially there was downside risk, but that risk contractually for us was set at our parent company guarantee plus some bonding that we had to put up.

Q157 **Ronnie Cowan:** I am a bit confused, to be honest with you. You are saying that you did not think the risk should be transferred to you in the first place but you then took on the risk as part of the bid.

Martin Griffiths: No. Let me be clear. There would be no point in having the private sector there in the first place if we did not take risk. We should take risk, absolutely. We are taking risk and we took a lot of risk—significant risk. I have highlighted what the impact has been on our group. I think you were asking where the different baskets of risk are that would impact a railway like this.



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The majority of passenger and revenue growth on a franchise like this is impacted heavily by what is happening in the economy, GDP, the wider political outlook, and, as Neil said, what is happening to wages. On this particular franchise, we have seen the lowest period of low fuel prices in over a decade, which I do not think people saw. Those things impact significantly on a discretionary travel railway like this one.

Q158 Ronnie Cowan: Surely any private business is taking on those same risks.

Martin Griffiths: Yes, but remember that this is a very specific contract. The point I was making is that this is a highly regulated, output-based contract. Let me make it simple for you.

In theory, if I carried one passenger or 100,000 passengers, my costs are the same. It is exactly your point. I remember sitting down with a very significant politician explaining this about the rail franchise. If you are in the real world—if you want to call it that—and you are a house builder and demand drops away, what do you do? You cut the supply. On these types of contracts, you cannot; the supply is fixed, so the revenue is extremely important. That is why, on some of these contracts, the Government have shared in the macro risk. On this particular one, they decided not to. They went for a parental guarantee to protect what they saw as their downside. That is how they structured it.

Q159 Ronnie Cowan: Were they right to do that?

Martin Griffiths: That is a question you should ask them. My view is that they have done exactly what they were entitled to do under the contract. They have enforced the contract absolutely to the letter. I have to respect that.

Q160 Ronnie Cowan: If you had not taken on the macroeconomic risk, would the franchise have failed?

Martin Griffiths: That would depend, but if, hypothetically, we had the FRM that is now being suggested, it is likely that the franchise would not have failed.

Q161 Daniel Zeichner: When you were making the bid, what did you think you were bringing to the franchise that would make it work better?

Martin Griffiths: We brought 20 years of experience, a transformation on both South West Trains and Virgin West Coast where I think we are all extremely proud of what we have done—the product, new trains, staff, development and brand. All those things were part of a vision for a pretty old and tired railway, but which had incredible staff.

One of my biggest disappointments is that I promised them a vision; I promised them an eight to 10-year vision because they needed that. This will be their fourth change of ownership, and I think the vision is still sound. It will happen. This will be a fantastic railway. It is all set up for that. The new trains will come in over the next two years and they will



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deliver big time on that. It is disappointing that we will not be there to do it. We brought all of that to bear.

Q162 **Daniel Zeichner:** But that was not enough to make the difference. The reason I ask is that one of my colleagues raised a point that the previous operator ran very popular loyalty schemes and that kind of thing. You changed those things, and that may not have worked.

Martin Griffiths: I am aware of the previous loyalty scheme. We had a different loyalty scheme, but I believe that we were doing all the right things. Our passenger satisfaction was at an all-time high for that railway and outperforming the rest of the sector at 92%. That is not me; that is independently judged. Our customers thought we were doing something right, and that was before we got to the transformational stage of the railway with the new trains that will come in from 2019.

Q163 **Chair:** Jo, you have just heard in the evidence about the complaint of sustained poor performance from Network Rail, and that there was a claim for £72 million. Can you give us your take on that? Why was there a dispute about the quantum that Network Rail owed Virgin Trains?

Jo Kaye: Apologies, Chair, but I think my colleague Rob is best placed to answer your question on sustained poor performance.

Rob McIntosh: Yes. That is within my part of the organisation rather than Jo's. First, the sustained poor performance threshold is a mechanistic trigger, which is the breach, and therefore why Mark Carne, our CEO, would agree in principle that there is an entitlement. You then move into a discussion about how you quantify that entitlement.

The entitlement is in two parts: any cost incurred by the operator over and above what was not recompensed through schedule 8 is one aspect; the second aspect is any consequential loss in revenue. We have been working with colleagues in Virgin Trains for the best part of a year and a half to try to agree what we think is a reasonable valuation. We are obliged to do that under our obligations for managing taxpayers' money. Colleagues in Virgin Trains East Coast provided us with the information in so far as they could, to allow us to form a quantum. We could never get to the point of agreeing what that quantum would be. We, therefore, had to take steps to refer it to adjudication.

Q164 **Chair:** Who is it being adjudicated by?

Rob McIntosh: It is being adjudicated by an independent QC.

Neil Micklethwaite: But that claim has now transferred from Virgin Trains East Coast as part of the transition to London and North Eastern Railway.

Martin Griffiths: On all of that, any value goes back to the Department and the taxpayer.

Chair: We are going to look a little further at infrastructure



enhancements and Network Rail performance.

Q165 **Graham Stringer:** Going back to your projected profits, I understand you made some growth—4% over the period of the franchise and you had projected 10%. Isn't 10% rather a heroic assumption?

Martin Griffiths: Are you talking about revenue growth?

Graham Stringer: Yes.

Martin Griffiths: I go back to my comments to the Chair at the beginning. Clearly, with the benefit of hindsight, we can all sit here and say that looks aggressive now. Back then, based on how the industry had been performing, what we had seen in the past and what we had done on Virgin West Coast over many years, and with all the initiatives that were there to back it up, we were all comfortable as a management team, our advisers and the Department that it was deliverable.

Actually, the growth we got outperformed the market, which is great testament to the team we had and the things we did. As we were coming out of the franchise, that revenue growth had been accelerating over the last three or four months, so there were a lot of really positive things that had come through. It is just disappointing that what we had assumed in the bid was a higher number.

Q166 **Graham Stringer:** Going back to the little exchange we had before, I have a quote here from Richard Branson on 5 January, in essence, blaming Network Rail for a loss of £100 million. He said that Network Rail had cost his business £100 million because they had failed to upgrade.

Martin Griffiths: I am not sure of the precise context, or Richard's wording. I have tried to explain my position on it. I hope I have made that clear. There was a claim about sustained poor performance that related to the period we have been in, but that was only part of a whole range of issues that meant this contract terminated early.

Richard is right though. We contend very strongly that, going forward, had we still been there, the contract would have had to change, because a lot of the revenue growth and passenger numbers from 2019 onward assumed there was to be infrastructure that would drive new services, new destinations and faster trains. Some of that either will not happen or will be delayed. He may have been mixing the two, but I am very clear on the distinction.

Q167 **Graham Stringer:** You are clear on it, but I think he was talking in the past tense and explaining why things had gone wrong. He also talked, as you have talked, about the improvements and investment you have made. He put a figure of £140 million on that. Is that accurate for the investment in trains and other improvements?



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Martin Griffiths: The £140 million was the commitment at the outset of the franchise. When the contract was terminated early, we had invested £75 million of that £140 million.

Q168 **Graham Stringer:** So that figure he was using was not accurate either. In the written submissions we have had from you and Network Rail, there is a slight difference in what has come through. Can you tell us what had not been delivered, if anything, to the date that the franchise was terminated?

Martin Griffiths: Again, just to establish the principle, we have never said that anything material had not been delivered to that point. We could split hairs and say that there were one or two things that were either slightly late or had not happened, but, in the scheme of it, everything that was due to be delivered to the point of termination had been. Our issues were about the future.

Q169 **Graham Stringer:** But you had some difficulties with Network Rail that were not about investment. They were about performance over that period of time.

Martin Griffiths: Day-to-day performance, yes.

Q170 **Graham Stringer:** Would one of the two Network Rail representatives like to comment on your performance over the period of the franchise?

Jo Kaye: In terms of enhancements?

Q171 **Graham Stringer:** No; just basic performance and running the railway.

Rob McIntosh: I use the line myself and have done for a number of years. I am very acutely aware of some of the performance issues that we have had and the effects on passengers and the travelling public. We work very closely with all operators on the east coast main line to try to improve our performance every day.

The way we measure performance, as I am sure you are aware, is a composite measure in the industry—PPM—as we go through this control period. It is a complex matter. Network Rail's performance over the duration of the franchise, from when it started until autumn 2016, began to get worse. We saw that our performance was degrading. We took steps to turn that around and we have seen a continued period of improved Network Rail performance from autumn 2016 right through until about February this year, when we were badly affected by the quite harsh end to the winter.

Since then, we have seen performance decline again, but in recent periods I am pleased to say that we have begun to see performance, in terms of Network Rail infrastructure, stabilise and improve. Over the last year, the Network Rail contribution to the performance gap has been 55%, with the operators taking 45%. That is operators, not just LNER, or VTEC as was. Within that, 66% of the delay causes are associated with



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our infrastructure and 34% to external events, of which we have seen a particularly difficult upturn in recent months.

Q172 **Graham Stringer:** You said you did not sign off or validate the infrastructure assumptions in the bid process. Is that unusual?

Rob McIntosh: That was the norm at the time. We would not sign off the infrastructure assumptions.

Q173 **Graham Stringer:** Do you think that was a major failing? It seems to me that, if the Department, which effectively owns Network Rail, even though it is a different structure, is agreeing to a bid with certain assumptions in it, the people who are going to make that investment should be involved. It strikes me as very odd.

Rob McIntosh: I completely agree. If you are dependent on significant infrastructure interventions and commercial dependence in a tender, the entity accountable for delivering those should endorse them. Why it was not done at the time is probably a question best put to the Department. What I can say is that going forward, and working closely with colleagues on franchises on this and the east midlands franchise, we are very much more sighted on what is going into the franchise specifications before they go out to tender. We will be sighted on what goes into them when the franchisee bidders respond.

Q174 **Graham Stringer:** And the Secretary of State has guaranteed that for all future franchises, has he?

Rob McIntosh: I have a letter from one of his officials saying that I will be invited along to the investment committee hearing when they determine who is going to win the east midlands franchise. I expect the Department to look at me as the Network Rail responsible person and say, "Can you agree to and sign off the assumptions for Network Rail in this franchise?"

Q175 **Graham Stringer:** Can I ask Stagecoach whether the Department validated your infrastructure assumptions in the bid?

Neil Micklethwaite: We signed a franchise agreement openly with the Department for Transport in December 2014 that was in accord with the invitation to tender that had been put out much earlier that year. That contract had a transformational timetable for May 2019 that was predicated on a number of infrastructure enhancements being delivered by the end of 2019. Those infrastructure enhancements were in the Office of Rail and Road's final determination for control period five, so we were entitled to rely upon that information in that regulated document. It enabled us to develop a timetable that was in accord with the invitation to tender that was then subsequently contracted on. The transformational timetable was only capable of being delivered by all those enhancements being fulfilled.

Q176 **Graham Stringer:** I think I understand that. Are you saying that, in



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effect, it was a validation of your assumptions that there was a draft timetable, as opposed to the Department explicitly saying, "This investment is going to take place"?

Neil Micklethwaite: We had a contracted timetable in the franchise agreement that was in accordance with the official invitation to tender, so as far as we were concerned we had a contract to deliver that particular timetable. That could only be delivered with enhancements that would have been fulfilled.

Q177 **Graham Stringer:** I just want to be clear. It might be splitting hairs, but they did not actually validate the assumptions of the investment. It was an assumption made because there was a timetable.

Neil Micklethwaite: You would have to ask the Department that particular question, but we have a contract that said the timetable would be operated from May 2019.

Q178 **Chair:** Can I check one of the issues with you, Neil? In making your assumptions about the infrastructure enhancements, you were looking at what was in control period five. Is that right?

Neil Micklethwaite: That is correct; yes. We had an obligation under the invitation to tender to look at the enhancements that were going to be delivered at the end of control period four, and those that were going to be delivered in control period five.

Q179 **Chair:** Fairly early in control period 5, we saw the Department get into all sorts of bother and we had the Hendy review, which led to a significant scaling back of a number of things in control period five. Did you have any discussions with the Department at that point, because you knew that enhancements had been cut back?

Neil Micklethwaite: At the time we submitted our bid, in June 2014, according to the East Coast Programme Board, which was the board established to determine the priorities and the deliverability of the enhancement schemes, they were still on time. We took over the franchise in March 2015 and the Hendy review started in November 2015, if I recall, with the final enhancement delivery plan in March 2016. We started conversations with the Department around the future in terms of the infrastructure enhancements not being as we expected them to be at the time of the Hendy review, late 2015 or early 2016.

Q180 **Chair:** You started having discussions with the Department at that point about the fact that you would not be able to deliver all the things that you had promised in your bid, because the underlying assumptions had then changed. Is that right?

Neil Micklethwaite: That is correct.

Q181 **Chair:** For the future—not specific to this line—obviously we are not going to have enhancements within the five-year control period process. They are going to be in the new pipeline. How will you, as an operator,



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know what enhancements are going to happen, given that they are not set for five years ahead but are dealt with in the pipeline process?

Neil Micklethwaite: Rob mentioned the early infrastructure assumptions document that we are now seeing as part of the franchise bidding process. They are formal documents that will be part of the competition of which we choose to be part. That will give us much more clarity. However, one of the key things we want to continue to see is much closer alignment between the invitation to tender in the franchise agreement and Network Rail's planned enhancements, so that they are all fully transparent and in alignment. The infrastructure assumptions documents that we are starting to see are a step towards that.

Q182 **Chair:** If you are doing a bid, say, for the east midlands franchise, how many years does that franchise run for?

Neil Micklethwaite: It will be eight years.

Q183 **Chair:** Would you know what enhancements are planned in the whole of that eight-year period? Would you have some idea? How does it work?

Neil Micklethwaite: We have sight of what is in the document. Rob mentioned the infrastructure enhancement document. We have sight of that documentation, which is part of the suite of documents we will see as part of the competition of what the planned enhancements are over the forthcoming years.

Q184 **Chair:** Rob and Jo, if they have sight of what is in the next eight years, how realistic is that? Presumably, those things will not all be agreed, knowing how your new enhancements pipeline works. On what basis are bidders bidding?

Jo Kaye: As you rightly said, the separation of enhancements from the rest of Network Rail's funding means that there is a difference in how that will need to be managed going forward. My expectation is that enhancements that are committed to delivery, and have passed through that final stage gate we talked about in the pipeline process, will be very clearly obvious to bidders in the infrastructure assumptions document.

There will need to be a change mechanism in franchises to deal with enhancements committed for delivery after the franchise has been let. That is a natural consequence of adopting a pipeline approach. There will be a mix of certainty in the short term for things that are committed, but for things that are much earlier in the pipeline process there will need to be a mechanism by which outputs of franchises are amended to take account of them.

Chair: We can ask the DFT later about how they are going to deal with that. We want to look at what is happening now on east coast and what is going to happen in the future.

Q185 **Paul Girvan:** The Secretary of State announced that the management of the east coast franchise would be transferring to the operator of last



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resort. I do not necessarily like that term, but it says an awful lot. He said that it would be until the new introduction in 2020.

According to what you have already stated, passengers seem to be very happy with what has been happening—the improvements. There are reports stating that there is a high level of satisfaction with what is going on. Is there going to be an impact on that? Was there consideration when it was going forward of how it would impact on the passengers? Ultimately, that is who we really care about—the passengers in this operation. How is the management going to be dealt with?

Martin Griffiths: I am on the record as saying that I was both surprised and clearly very disappointed with his decision. I felt that we had put forward a compelling case for continuity for passengers. That is really what matters. However, the Secretary of State made a different choice. I have no option but to respect his decision on that. It is a question for him and his officials to make sure the passengers are protected.

Q186 **Paul Girvan:** Do you think that the Department properly accounted for those risks when removing operational control from the franchise, from VTEC?

Martin Griffiths: I think you will have to ask them that. I assume they have done a full evaluation process of the two options. He was very transparent. He said there were two options available to him—to go with a continuity non-profit position with us, or to go with the operator of last resort, and he chose to do that. I have to respect that decision. It is probably best to ask them what the basis was for them being comfortable that that was the right decision.

Q187 **Paul Girvan:** When does the transition take place?

Martin Griffiths: It has happened.

Q188 **Paul Girvan:** It has already happened.

Martin Griffiths: Yes, it happened on 24 June.

Q189 **Paul Girvan:** It is too early in the process to evaluate how it is going to run out.

Martin Griffiths: Yes. If it gives you comfort, I am very confident in the staff we had and the team we left behind. They will do a good job. They worked very hard to do a seamless handover. The passengers were at the forefront of what we did, so I am confident it will be all right. I travelled on it this morning and they were very good.

Paul Girvan: You would say that. Thank you.

Q190 **Huw Merriman:** From 2020, the partnership will see Network Rail and the franchisee operating under one roof. We had expert witnesses who came before us saying that this would be the last network where you attempt a model such as the one I have just described. I understand that both Stagecoach and Network Rail are supportive of that partnership



proposal. Can I ask both organisations why you support the proposal?

Martin Griffiths: I believe, and have passionately believed for a long time, in the management of a joined-up railway. We tried to do that with South West Trains and the alliance. I cannot comment on this proposal because I do not know what it is, but as a principle do I believe in a strong partnership and a joined-up management team between train operations and infrastructure and signalling? Yes, I do. It is the right thing to do.

Rob McIntosh: Martin is absolutely right. It is the right decision to put track and train under single leadership and provide a single point of accountability for passengers and the stakeholder.

The reason people say the east coast is not the best place to do that is the multi-operator nature of it. It is a large piece of railway that we have to operate, and I have a large number of customers. What people are concerned about is that the day-to-day operations become affected by this, and what would be called regulating policy—whose train gets to go first, on a particular day in a particular situation—starts to get clouded by that.

That can be addressed by work we already have in place. We have policies agreed with all operators on the route as to whose train will go in front of whose train in a particular set of circumstances. We have those in place. We have had to work very hard on those for the timetable changes that took place quite recently. The answer to this problem is that we have very clear and robust regulation policies to which the industry has to adhere when my staff on the ground have to make the decisions day in, day out.

Q191 **Huw Merriman:** How will you deal with the conflict of interest point? I understand that the Wessex route is a previous example. That fell apart because of segregation of finances, but, as you say, for this particular line you have a whole series of customers with open access, yet you will also be part of the operator structure. How will you deliver for your customers?

Rob McIntosh: The east coast partnership proposals would not allow Network Rail to deviate from the track access codes and the codes that are in place in the industry. They are enshrined in how we work. We already have rules in place that do not allow Network Rail to show any prejudicial behaviours, and that will be baked into the east coast partnership.

Q192 **Huw Merriman:** That leads to the obvious question, which is that, apart from looking like the right thing to do—we hear a lot about the joined-up approach—what more is this going to do that is not currently already being done on the other routes? As you say, by your very nature you are unable to favour one operator over another. What more can you do beyond what you already do with all the other operators?



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Rob McIntosh: We are still working closely with colleagues in the Department about what the future partnership should look like. There has been some conversation today about where commercial risk, and so on, would lie. It is at the heart of what we do in the east coast partnership that commercial risk needs to lie with the entity in the partnership best placed to take that risk, and for that risk and that commercial construct to deliver the best possible outputs for the passengers. That is what needs to be different for the east coast partnership.

We also need to use it as an opportunity to better integrate the planning and execution of the service changes that are planned over the short term in the franchise, and the long term of the east coast main line.

Q193 **Huw Merriman:** Do you think there will be enough time to implement it by 2020? It sounds to me as if the announcement has occurred before the detail has been set out, which is not unusual for this place. What you have just described sounds as if that is the case. Do you think there will be enough time to bottom out the detail by 2020?

Rob McIntosh: The aspect that will take time is the actual procurement of the franchise, whatever it looks like. It is important that we spend time now getting the model right, to make sure that we get the right result. The procurement duration, which the DFT will manage, will determine whether 2020 is achievable or not.

Q194 **Huw Merriman:** Would Stagecoach be looking to bid for this new east coast partnership?

Martin Griffiths: I do not think it is a question we can answer today. I do not even know what the proposition is. Let's wait and see what emerges in franchising policy more generally and the east coast partnership. I cannot answer that.

Q195 **Huw Merriman:** There is nothing at the moment such that you would say, "There is absolutely no way we would bid." Perhaps I should reverse the question. Is there anything that you know now which would stop you bidding?

Martin Griffiths: There are some of the things we talked about earlier about what is going to happen with franchising. Risk allocation is equally as relevant to something on the east coast partnership as to other opportunities. We just need to wait and see what emerges. It has all been a bit raw, and it is not a question for today.

Huw Merriman: In a way, that takes me to a few more questions on franchising.

Chair: Luke has a couple of extra questions.

Q196 **Luke Pollard:** Following up Huw's point, do you think that past performance on a specific franchise should be taken into account if you are rebidding on that franchise? Do you think that the fact it was taken off you should count as part of the marking scheme on any future



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franchise, should you bid for it?

Martin Griffiths: We have been running railways in this country for 20 years. I think I can confidently say that every railway we have run, we have handed back in a better state than we inherited it, and we have done a lot with it. This railway had a contractual issue, which we have talked about; it was nothing to do with the staff or the operation. All of that came through. Although it is disappointing, I am very clear that at no point did we walk away or hand in the keys. We honoured our contractual obligations in full. When the Secretary of State made his decision, we respected that.

If people want to judge, that is the message I will give. We have run railways really well. We ran this one really well. We honoured our obligations in full. I have explained what the model was and the risk transfer. People should look at that. If you have operational challenges on railways, yes, I would expect people who are awarding franchises to look at that.

Q197 **Luke Pollard:** That sounds like a very good example. In a new franchise, the staff TUPE over anyway. It is effectively the management that changes with any change in franchise. As you have had the franchise taken off you by the DfT due to failure to deliver what was promised, do you think the validity of previous bids should be taken into account on this franchise and future franchises if the DfT is giving them out?

Martin Griffiths: I stand by what I said. We have honoured in full our contractual obligations. There is a process that the DfT goes through. You have to have a passport to bid for franchises, to make you a good and valid operator. We are that; we continue to be that; and I fully expect us to continue to participate in UK rail going forward.

Q198 **Luke Pollard:** There will be an awful lot of people watching this who will be slightly confused by your answer. It seems to me, from your answer, that you are claiming that nothing has been done wrong, when in fact yet another franchise on the east coast has failed. You yourself say that as a company you have lost £200 million, yet you seem to not be apologetic or to rule out a future bid for this franchise. An awful lot of people who travel on that train service want to see an operating railway, and will be flabbergasted by the fact that you do not seem to reflect the enormity of the failure of the franchise and how that should rule you out of any future franchise on that line.

Martin Griffiths: There are two things. There is an operational issue, where we have performed extremely well. As we said, customer satisfaction is high. We delivered on all the new services that we put in. We have dramatically changed the product. The railway is all set up for the future. I am genuinely disappointed and sorry that we will not be there to see it through, but the Government let a contract with risk. They transferred risk to the private sector. We accepted that risk, for better or for worse, as did the Government. For a whole lot of circumstances that



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we have gone through, we are in a different place than we were. That is disappointing but it happens. I believe we have acted with integrity in honouring what we were asked to do in terms of passing that contractual risk to us and then accepting it.

The Government knew what they were doing when they did that too. The Government have taken £200 million of private shareholder capital. Until the point of termination, we were delivering 35% more premium payments on a monthly basis than before we inherited it. That is the model. People might not like it—they might not even agree with it—but on this franchise that was what we were asked to do, and the Government understood the risks that they were taking. The staff did a great job, and the passengers told us that we were doing a really good job. That has been measured in the passenger satisfaction that we got.

Q199 Chair: I have a couple of questions about the partnership that is going to operate from 2020. Martin, you said that you did not know what the partnership was going to look like. In relation to the deep alliance or the joined-up railway on South West Trains, what did that deliver in terms of a better railway?

Martin Griffiths: It actually did a lot of good things. We got a single chain of command. There was one management team. We took a lot of day-to-day disruption and incident management down significantly. One of the questions was about conflict of interest. We managed that; there was no conflict of interest. We managed the other customers on the line well.

What happened subsequently with South West Trains has been disappointing, but it was a railway that was performing well for such a big, complicated business. It was an alliance that we broke up for different reasons. What we were asked to do at the time was difficult to integrate completely, financially. That was to be part of a new franchise bid. There were many positives that came out of the joined-up management approach to South West Trains.

Q200 Chair: You think it was very positive, but it was still scrapped.

Martin Griffiths: Because we could not agree some of the financial sharing. It is back in history. The new management of Network Rail at that time had a different view from the previous management. That is on the record. David Higgins was a massive supporter of it. Mark Carne was less supportive of it. If the chief executive does not support it, it is more difficult to take it forward.

Q201 Chair: Do you know how the issues that you found on South West Trains are going to be resolved on the new east coast partnership?

Martin Griffiths: Not at the moment, no.

Q202 Chair: Rob, do you know how those issues will be resolved? There are a whole load of other issues because obviously the east coast main line has



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a lot more operators on it than the Wessex route.

Rob McIntosh: I do not think we have got to the point of understanding how they are going to be resolved. We absolutely understand what those issues are though. We have not got through the detailed work of what the partnership will do. I am very pleased with the way the Department have listened to the feedback from guys on the South West Trains alliance who came to the expert advisory group and shared some of the stuff that Martin has just talked us through about what needed to be put right.

At the heart of this is the extent to which you align the balance sheets of the two organisations, how deep you want to take that and therefore how you commercially incentivise them to work together. Those are some of the discussions that are still ongoing with the Department.

Q203 **Chair:** How can we know whether this is the right option for the east coast main line when we do not know what it looks like?

Jo Kaye: I am afraid we cannot answer that. That is a question best directed to departmental colleagues. As Rob has said, we have been involved in picking up the lessons from previous arrangements and being clear about the important issues from Network Rail's perspective, but we are not yet at the point of having a complete partnership model to talk about.

Q204 **Chair:** So we cannot know at this point. It might be.

Jo Kaye: I am afraid you will have to ask departmental colleagues.

Chair: Huw, you wanted to ask some wider questions.

Q205 **Huw Merriman:** On franchising, I would like to get the views of the team— from Stagecoach in particular. Obviously, there have been a number of changes. There is perhaps a bit more rigour in the franchising system in terms of Network Rail's review and so on, but we also see fewer bidders coming forward. Mr Griffiths, do you think franchising is in a better place now than perhaps where it was when the Brown review reported in 2012?

Martin Griffiths: The private sector and franchising has delivered many positive things over the years, but it is not perfect. The very fact that we are sitting here again tells us that not everything is right. Sometimes a franchise will fail. I said earlier that I took comfort from the evidence that the Department gave to the Public Accounts Committee that it is considering 50 or so different areas to look at the franchise model to try to improve it and take it forward. We must learn lessons, the east coast being one of them, but equally with what is going on in other parts of the railway at the moment, and we are not short of issues that I know you have been debating.

I would hope that out of that will come a model that can continue to evolve, be sustainable and deliver the benefits that passengers rightly



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expect and deliver good value for the taxpayer. We have some work to do. It is important that we go back and look at some of the principles Richard Brown raised and challenge ourselves, and we are starting to see some of those emerge in new contracts that are being tendered.

Q206 Huw Merriman: Lord Adonis, who came before us as part of this inquiry, took the view that, with the exception of this particular route, the rest of the franchising system operated well. Do you share that view?

Martin Griffiths: I can look across my own portfolio; I look at 20 years of history. Most of them have been successful. The east coast, unfortunately, has had three difficult changes of ownership, but, generally, franchising has delivered. We need to look at it and evolve, and work with the Department, Network Rail and other stakeholders to make sure we come up with the best model that we can.

Q207 Huw Merriman: As to that evolution, do you think the Department has the right mix of skills required to evolve in a positive manner? I recognise that is quite a difficult question for you to answer.

Martin Griffiths: I am sure you will also ask the Department how it feels about that. I have been doing this for more years than I care to remember. I think the Department's skill set, process and capability has evolved over a long period of time. I think it is in its interest to make sure we get to the right place as well, so I am sure it will be challenging itself to do that.

Q208 Huw Merriman: One observation I have noted myself is that often we see people move from one part of the industry to another. Is there enough fresh challenge and thinking going in? Is that unfair to the Department? Has it brought people in from the outside who can really challenge existing views?

Neil Micklethwaite: If we look at Virgin Trains East Coast, that business attracted a whole bunch of new people to the industry. You can say that some were attracted to brand, but they were also attracted to some of the transformation that we wanted to achieve. For the first time in my experience of doing this for longer than I can remember, we had people coming from media and the tech sector to work in the rail industry. That is a big plus for us, hence why we have seen some of the customer transformations there.

Two hundred and fifty thousand people work in this industry, on and off, throughout the whole supply chain. It is about making sure that we are open to as diverse a range as possible across the whole gamut of the industry, whether it is an operator, Network Rail, the Department or other parts of the supply chain. It is about things like the apprenticeship scheme, of which our Network Rail colleagues and operators are big champions, to make sure we attract as many new types of people as possible so that we have as good and broad a range of skills, experience, background and diversity to reflect the customers we are serving. I think we are seeing that.



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Q209 Huw Merriman: We have talked about some of the challenges and the macroeconomic side of things, but could you give us one or two key areas of reform that you think could boost the franchise system and make it sustainable for the long term?

Martin Griffiths: We have talked about risk allocation, which is fundamental. What is the model, who bears what risk, and who is best placed to take and manage those risks? We also touched on the question of resetting it, which is relevant now. If we look at the west coast partnership, there could be 13, 15 or 17 months between a bid going in and a franchise being awarded. An awful lot of things can happen in that period. In the early days, when that was the policy, franchises were turning over much more quickly so there was much less of a gap. Those two things can definitely be looked at.

For me, the final factor, on which we have also touched, is that between infrastructure, franchise and operator we need to be much more joined up so that, if the Department is letting a franchise based on a particular specification that is dependent on certain infrastructure that is going to happen, and the operator is planning its bid around that, everybody has sight of that and is agreed on that. If for any reason that does not happen, which could have been the case here, there is then a clear methodology for making sure it can be changed and accommodated within the contractual framework so that we do not end up in dispute, or having to go "legal", or there is a default, because people disagree. If we did those three things, they would take us a long way forward.

Q210 Huw Merriman: We talked about the 2020 partnership proposal and the fact that it is not yet in place. Would you expect the Department to come to you, seeing that you have had the experience of South West Trains and also this route, to put your model of how this would work? Has it come to you yet?

Martin Griffiths: It has not yet, although it is speaking to the wider industry. Some of our people have been involved in discussion with it. As part of the exit from the alliance, South West Trains shared with it a blueprint document and the findings for that. Absolutely, it is in the interests of a company such as ours for me and my colleagues to make this right, whatever discussions and dialogue the Department has. I would hope that it would do that, because the industry on our side of the table has a lot of collective experience that I hope would be very relevant in framing whatever emerges on the east coast partnership and beyond.

Q211 Graham Stringer: I have two very quick questions. I put a very simple question to Mr Griffiths. Did the £200 million that you lost include your bidding costs, and what were your bidding costs?

Martin Griffiths: Our bidding costs, which would have been in addition to that, were £8 million or £9 million.

Q212 Graham Stringer: Was that in the £200 million?



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Martin Griffiths: No; that is in addition to it.

Q213 **Graham Stringer:** That is on top of the £200 million. Let me ask Network Rail a question that Stagecoach may also want to answer. You have said that in the process of putting track and different operators together you can deal with the conflicts. I would like you to explain that. If you have two train companies that want to bid for the same train pathway, apart from wishing for the best, I do not see how you can say that the conflict is resolved.

Jo Kaye: That is dealt with by the fact that the allocation of train paths will not be done within the partnership but within the system operator part of Network Rail, which is distinct. The allocation of train paths is already subject to a set of rules laid out in the network code. We make a transparent decision if there are competing interests and there is an opportunity for people to challenge our decision.

Q214 **Graham Stringer:** You do not actually get rid of the conflict; it is just dealt with independently.

Jo Kaye: There are existing rules to deal with that conflict; it will be done within the system operator and not in the part of Network Rail that would be inside that tight partnership.

Q215 **Graham Stringer:** That applies to goods trains as well as passenger trains.

Jo Kaye: That is correct.

Q216 **Chair:** I want to return to the question of the partnership approach. Perhaps Mr McIntosh is best placed to describe it. What is the advantage of being in some sort of partnership with one of the multiplicity of operators on the east coast main line? Given what you said earlier about the fact that there is a code on access that sets out whose train should go first, what is the benefit of being in partnership with just one of those operators?

Rob McIntosh: Albeit it is one of those operators, the east coast franchise—let us call it that—that carries a lot of passengers on the route. The new trains that are coming are transformative for a lot of aspects of the route of the east coast main line. One of the major benefits of the partnership is that it will allow us, finally, to align the management incentivisation of both management teams. Balanced score card and performance targets that are matched both within Network Rail and the train operator will give us greater benefit for teams working together. It will allow us to do some much better long-term planning for what the future of the route could be potentially in lieu of HS2 arriving.

Q217 **Chair:** Can you give me an example of the sorts of things that you might be doing in partnership with the intercity operator that you would not be doing in partnership with other users of the route?



Rob McIntosh: The east coast partnership that the DFT is seeking to put in place has a duration approaching 15 years. At the moment our investment planning on the east coast is limited to pretty much 2021, and we will be able to work with the east coast partnership beyond that to look at the investment opportunities there might be to provide a better service between that date and when HS2 arrives on the east coast main line sometime in the early 2030s.

Q218 **Chair:** Doesn't that partnership give an unfair advantage to one operator compared with other users of the line?

Rob McIntosh: No, because that is what Jo's organisation, the system operator, will protect against. The network code will also protect against any kind of preferential treatment about the allocation of those paths.

Q219 **Chair:** In thinking about what is going to happen on that line in future, it sounds like you are having a discussion with only one body when there are other open access operators.

Jo Kaye: We certainly would not be having long-term discussion with just this partnership operator; we would continue to do long-term strategic planning for the route with all operators there. The difference is that this one operator with whom we were in partnership would also have a longer perspective, whereas many franchises are much shorter term than that currently.

Q220 **Daniel Zeichner:** Mr Griffiths, when I asked the Rail Minister a few weeks ago who was in charge of the railways he struggled with that question. When you had this franchise who did you feel was in charge? Was it you?

Martin Griffiths: Of this franchise?

Q221 **Daniel Zeichner:** Overall.

Martin Griffiths: I ultimately was responsible and in charge of Virgin Trains East Coast franchise.

Q222 **Daniel Zeichner:** That is the franchise, but what about the whole operation? This seems to me to go to the nub of the problem we are having in trying to discuss these partnerships and all the rest of it. I think that in the end most people would imagine that somebody would be in overall charge. The problem is that it seems like responsibilities are shared between various competing groups, which means that ultimately you, as the boss of that group, could not actually take a decision because you would have to consider a range of others.

Martin Griffiths: That is one of the reasons I have believed in and lobbied—as has our group, for more than 20 years—to have a joined-up railway, where you have one management team and one leader who is responsible for everything in that franchise. That was what we set out to try to do under Tim Shoveller's leadership in South West Trains. As the Chair asked me, we did a lot of very good things, which, for other



reasons, we did not take further, but there are some very good and pertinent points from that that I hope will be taken forward as part of whatever emerges on the east coast partnership and beyond.

Chair: Thank you. That concludes our questions for the first panel of witnesses today.

Examination of witnesses

Witnesses: Polly Payne, Beatrice Filkin and Simon Smith.

Q223 **Chair:** Welcome and thank you for being here this afternoon. For the record of our proceedings, would you like to introduce yourselves? Perhaps we can start at your end, Polly.

Polly Payne: I am Polly Payne, director general of rail group in the Department for Transport. In case there is any confusion, we have two directors general of rail group because I job share with Ruth Hannant.

Simon Smith: I am Simon Smith. I am the director in rail passenger services in the Department for Transport.

Beatrice Filkin: I am Beatrice Filkin. I am the intercity market lead for passenger services.

Q224 **Chair:** Thank you very much. I am delighted to hear that we have job share high up in the civil service; that is very positive.

I noticed that you heard some of the previous evidence. On the east coast main line, three operators have now walked away or been forced off the franchise. Is there something inherently wrong with this franchise that makes it vulnerable to default?

Polly Payne: I do not think there is anything inherently wrong with the franchise. I think it is fair to say that this is a franchise that has a much smaller proportion of its revenue coming from commuters than other franchises, which means that possibly it has a more volatile revenue stream. I think the three circumstances in which this franchise has finished early have been quite different.

Q225 **Chair:** What responsibility does DFT accept for this third failure on the east coast main line?

Polly Payne: I think DFT's primary goal when letting this franchise was to look after both the taxpayer and passengers. I would say that we managed to achieve that. We had parent company support of £165 million as well as a performance bond of £21 million. They are relatively high levels. The point of having those is to ensure that, if we get into the kind of circumstances that we did get into, passengers and the taxpayer are protected, and we believe they were.

Q226 **Chair:** The Secretary of State has said that he thinks Virgin overbid for this franchise. Did the Department actively encourage over-ambitious



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bids for this franchise?

Polly Payne: The Department did not actively encourage over-bidding. The Department does encourage ambitious bids to get maximum revenue for the taxpayer and to deliver ambitious increases in services for passengers. When we do franchises, we look at the balance between that ambition and protecting taxpayers and passengers from the risks. That is what we are looking at.

As the Brown review said in 2013, it would not be a good franchise system if we never had franchises running into problems. That would probably show we were being under-ambitious and not delivering for the taxpayer and passengers, so it is a difficult trade-off. It is probably worth saying that since franchising began we have had 52 franchises, of which four have ended early.

Q227 **Chair:** But three have ended early on this line. Do you not feel that within DFT this is a failure when the franchise collapsed within three years of its start date?

Polly Payne: We would rather that had not happened, and with hindsight the bid was probably too ambitious. However, we feel that we managed to protect taxpayers and passengers, as Martin said. I think Virgin and Stagecoach have worked very well during the handover. The handover went smoothly; it happened on 24 June. Martin travelled on it today. As he said, I think passengers are seeing a really good service. Another point, on which I totally agree with Martin, is that VTEC did run this service well; it did have high passenger satisfaction—it was 90% or so—and produced additional services for passengers.

Q228 **Chair:** But it is not going to be able to continue to run the service and deliver the level of premiums anticipated. Do you not think that the Department must have failed in its analysis of the bid for it to collapse within three years? What went wrong in that stress-testing within the Department?

Polly Payne: With hindsight, absolutely, the forecast premiums were not achieved. In particular, passenger revenues and numbers have been lower across the railway than we and industry predicted, and that led to the forecast premiums not being achieved.

Q229 **Chair:** Why do you think they have not been able to achieve the premiums they promised just four years ago?

Polly Payne: It is a combination of factors. In part, we think that something structural is happening, so that passenger numbers have not been increasing as fast as they had been in the previous decade. That is due to a number of different factors. We have been analysing it. There are macroeconomic factors, fuel prices, and changing work patterns and passenger habits.

Q230 **Chair:** Do you think changing work patterns had a major impact on this



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franchise, as opposed to on commuter franchises?

Polly Payne: That is very fair. The impact is less on this franchise, although there are some commuters on it, than on others.

Q231 **Chair:** Looking at the key reasons why this franchise has not performed as well as anticipated and the DFT did not pick that up, what are the factors that not only the operators failed to anticipate in their bid but the DFT failed to pick up in terms of its sensitivity? For example, one of the issues raised was about changes in macroeconomic performance of the wider economy. When National Express had to hand back the keys, we went from GDP growth of about 2.4% to a massive slump and recession. In the past three years we have seen a fall in GDP growth, but certainly not negative GDP. Did you not anticipate that things might change slightly?

Polly Payne: The forecasts are only as good as the assumptions and modelling on which they are based. We definitely anticipated that we would not be coming out with exactly the numbers we had. Probably one of the main factors that changed was our assumption about fuel prices. Mr Smith may be able to add to that.

Simon Smith: We have done some analyses to try to look at what revenue was expected to be in Stagecoach's bid and how it has turned out. There are three roughly similar-sized areas in that. We thought Virgin and Stagecoach's bid was quite ambitious at the time we received it, so we expected at the time we evaluated it that revenue would be lower than they forecast. They had attributed quite ambitious growth to certain initiatives, including things like their marketing and pricing strategy and so on. We thought they would get some of that, but we did not think they would get all of it.

There have been some macroeconomic changes, of which the largest by quite a significant margin is fuel prices. Current fuel retail prices have declined by 41% since 2014 when the bid was submitted. That is a really significant decline in real terms. That was not projected at the time. That has been driven mostly by a reduction in global oil prices. There is a third part, but it is not clear to us what drove that. There may be wider changes so that economic growth is not feeding through to additional rail demand growth in quite the same way as in the past. We have a lot of ongoing work to establish better and make sure we fully understand the relationship between rail revenue and economic growth.

Q232 **Chair:** Government can obviously have an influence on car fuel prices. Was concern raised by DFT with colleagues in Treasury that this change would impact people's propensity to choose to use public transport rather than private car?

Simon Smith: The largest driver of the decline in retail car fuel prices, although a part of that comes from the fuel duty freeze, is the drop in global oil prices rather than Government policy.



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Q233 **Chair:** But Government policy can respond to things outside their control. Is that a conversation that you are aware is happening with officials in the Treasury?

Simon Smith: I am not aware of that, but obviously Government have wider objectives in terms of setting fuel duty than simply the impact on rail revenue.

Chair: Sure; absolutely. We are going to come on to other questions.

Q234 **Ronnie Cowan:** Picking up the last point, surely fuel prices are dropping across the United Kingdom, so why are the other franchises not failing as well?

Polly Payne: It probably had more impact on east coast and possibly west coast, because, if you are a commuter coming into central London, the fuel price might not make a huge difference to whether you bring in your car, whereas if you are travelling from London to Edinburgh it might make a bigger difference. I think there is more movement when it is long-distance travel.

Q235 **Ronnie Cowan:** I move to a different topic. The Department in its submission said that franchise failure does not necessarily matter provided it is managed in the right way. Is that not saying that it got the wrong messages?

Polly Payne: I do not think so. If you go back to the Brown review—and we would agree with this—Richard Brown was very clear that in a well-functioning, good franchise system you sometimes have failure. We would not want to have failure too often, but the key thing is to make sure that both passengers and the taxpayer are protected in the event of failure, and we think that in this case that happened.

Q236 **Ronnie Cowan:** So we are planning to fail.

Polly Payne: No. In any competitive private market you are planning that sometimes there is failure, but it is not something you want to have too much of; you want to protect against the consequences of it.

Q237 **Ronnie Cowan:** Earlier Mr Smith said he thought that the bid for the franchise was ambitious and the revenue would be lower. It seems that you are already in a situation where you think it could potentially fail, but you have a back-up plan anyway, so it doesn't really matter.

Polly Payne: It is not so much that it doesn't matter; it is more that we want ambitious bids because they maximise the revenue we get for the taxpayer, but we also want to ensure that, if things don't work out as we and the franchisee hope, both passengers and the taxpayer are looked after.

Simon Smith: Could I clarify what I said? We expected when we evaluated the bid that revenue growth might be lower than the bidder had assumed. We expected that possibly it might need to draw on its



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parent company support. We did not expect the bid to fail; we expected it to pay the contracted premium for the full term.

Q238 **Ronnie Cowan:** Does not the franchise failure and reletting process eat into your staff considerably in terms of time and numbers?

Polly Payne: Our staff spend a certain amount of additional time on this. The main cost is standing up the OLR and the additional consultants. That is what the £21 million performance bond is designed to cover. The costs of the change of franchise are covered by that performance bond and come out of Stagecoach's money.

Q239 **Ronnie Cowan:** What about the cost in terms of the staffing of this? Have your staff members now been drawn in to help to run this?

Polly Payne: We have a standing team that looks after the operator of last resort, and we have various directors and consultants on call-down contracts. The additional costs of those consultants and directors have been covered by the performance bonds. There has also been some additional pressure and workload on our staff, and I suppose that the extra money from the performance bond that we have not spent on consultants indirectly pays for that, so, yes, they are also paid for.

Q240 **Ronnie Cowan:** I get the fact it is paid for, but it is the additional pressure on your workforce that bothers me. What happens if another franchise goes down next week?

Polly Payne: We have about 530 staff in rail group; about 250 work in passenger services and the different areas of the franchises—whether we do a direct award. The overall work programme is constantly changing. We recruit new staff and bring people in on secondment where needed; we get additional consultancy support where needed. We try not to overburden them but at the same time give them challenging jobs.

Q241 **Ronnie Cowan:** I am not trying to be a prophet of doom here, but what happens if another franchise goes under?

Polly Payne: If we were in a similar situation with another franchise, we would mobilise the OLR in the same way that we did with VTEC. We would bring in additional consultancy support and move some people internally to support the team from other projects that had a lower priority at the time.

Q242 **Ronnie Cowan:** Is the cost of that additional consultancy support already met by the failing franchise?

Polly Payne: Assuming it has an adequate performance bond, which I hope would be in place, yes.

Chair: I think we are going to look at what has happened in the past.

Q243 **Iain Stewart:** I would like to return to the adequacy of the stress-testing that you did against the assumptions that Stagecoach and Virgin put forward. When National Express failed in 2009, the National Audit Office



recommended that robust stress-testing against significant economic shocks should be carried out. In your stress-testing of east coast, to take the oil price as an example, talk me through the range of scenarios against which you tested the bid. If you look back over the past 40 years of oil prices, they have oscillated significantly. What band of probability did you cover in stress-testing the bids?

Simon Smith: At the time of the east coast franchise competition the evaluation of the risk in the bid was based on one central case scenario. We also did a number of downside tests to understand the impact on the franchise's financial robustness. We were aware that if revenue growth turned out to be lower there was a risk that the franchise could terminate early, but the actual evaluation decision at that point was based on the one central case. For the more recent franchise competitions that are now under way we have revised our approach to evaluation. The evaluation looks at both a central case and a downside scenario, but that was not the approach at the time.

Q244 **Iain Stewart:** We have been talking about this being a franchise that has a highly discretionary element: passengers can choose other rail operators or other modes of transport. To be clear, are you telling me that you did not factor in, in your stress-testing, the kind of decline in oil price that was seen?

Simon Smith: The franchise proposition at the time was designed around the principle set out in the Brown review, which was that Government should tolerate a risk of franchise default and not seek to insure against it. As to the commercial model at the time, there was sufficient confidence in a central case scenario that the franchise would be robust, but not in a downside. The mechanisms set up for the franchise included a GDP mechanism. Therefore, in the event of economic shocks, if there had been a recession in the early years, the franchise would have been protected through the GDP mechanism, and there was not something like that covering oil prices.

Q245 **Iain Stewart:** I appreciate that you are now reassessing the risks for current and future franchise awards, but, reading between the lines of what you have said, you are admitting that the stress-testing was not sufficiently adequate.

Simon Smith: It was undertaken in accordance with the rules of that competition at the time.

Q246 **Iain Stewart:** I am saying that the rules of the competition did not include a sufficient stress-testing of risk—that is my question—and we are now learning the lessons from that.

Polly Payne: I think the focus at the time was more on ensuring that we had the proper protections in place if something were to go wrong rather than looking at the great wide range of things that could have gone wrong. That is why we had a considerable amount of PCS—parent company support—on this franchise. Arguably, we could have looked at



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other factors in more detail in addition to the stress-testing we did, but we focused our effort more on ensuring that we looked after passengers and the taxpayer, which is the other way of doing this.

Q247 **Iain Stewart:** I accept looking forward that that will now happen, but I can only conclude—other members of the Committee can form their own views—that there was a failure on the part of the Department that this stress-testing was not done in the way it should have been.

Polly Payne: With hindsight, we might have focused more on fuel prices.

Q248 **Iain Stewart:** I use fuel prices as one example; there were other considerations. It was also clear that in the period between the franchise being awarded and Virgin and Stagecoach starting operations the numbers had gone awry. They were basically starting on day one from a position behind and would have to play catch-up. Do you accept that?

Polly Payne: That was a risk the franchisee would have been aware of and would have taken and priced in.

Q249 **Iain Stewart:** But you accept that from day one they had to start from a basis that was not factored into the franchise.

Polly Payne: On day one they were starting from a different place from the one they had forecast, but that was a risk they were aware of.

Q250 **Iain Stewart:** If you accept that you knew from day one that the numbers were wrong, why were you not more proactive in managing the situation?

Polly Payne: I think we were proactive in managing the situation. We talked to Virgin from the beginning about their financial situation; we continued to review that throughout the franchise. We ensured that the OLR was ready. We did due diligence and were sure that we had time to mobilise it, should it be needed. We were also very clear throughout with VTEC about the different roles and responsibilities and where we were. That was the role we had at that point.

Q251 **Iain Stewart:** But you were not at any point considering rebasing the franchise. We were told very clearly by the previous panel—I do not know whether you were present to hear it—that that was never an option available.

Polly Payne: That was not the basis on which the franchise was tendered, and that would have been a big and significant change to the franchise. The other bidders might have been unhappy had we made that much of a change to the franchise that early on.

Q252 **Iain Stewart:** But did no one say, “Hang on. The changes are outwith the parameters of risk that we assessed”? No one had the foresight to say, “Hang on. We might need to rethink this.” Was that conversation ever had with Ministers or other officials?



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Polly Payne: I do not think the changes were outwith the parameters of risk; I think they were within it. From the moment the franchise started, Ministers were aware that the forecasts were not being met and that was a risk, and we continued those discussions with Ministers all the way up until the end of the franchise.

Q253 **Iain Stewart:** Did you consider any other options for changing the scope of it without changing the franchise itself, or any other means by which you could have tried to keep this franchise on track, if you pardon the pun?

Polly Payne: We did not consider changing the terms of the franchise. I think I would have seen it as letting VTEC off its contractual obligations. We ensured that it stuck to those contractual obligations. It had signed a contract in full knowledge of the risks it was taking on. As Martin said, it knew the risks it was taking on; we knew the risks we were taking on. We had a limited liability contract in which it was very clear who would pay what in those circumstances; Stagecoach and Virgin had £165 million of parent company support and we ensured that they paid that.

Q254 **Iain Stewart:** At what point did you evaluate that the parent company bond would not be sufficient?

Polly Payne: It was a slow process; we kept an eye on it and we were hoping that the revenues would pick up, as did Stagecoach. We knew when it took on the franchise in March 2015 that the revenue was lower than it had expected. In June 2017 Stagecoach made a statement and set out its expected losses. In November 2017 the Secretary of State made his statement in which he first talked about the east coast partnership. On 5 January 2018 the last PCS was drawn down, and on 30 January 2018 there was an event of default and at that point we knew that it was months until the franchise would probably fail.

Q255 **Iain Stewart:** I am trying to get a clearer picture. On day one of this franchise you knew that revenues were significantly lower than had been expected when the franchise was awarded. At that point did you think there was a significant risk that the parent bond would not be enough?

Polly Payne: We thought that might be the case.

Q256 **Iain Stewart:** But no one at that point said, "Hang on. We need to rethink this."

Polly Payne: No. At that point we thought we had the right mechanisms in place such that if we continued in this way and the parent company support got used up, which we thought was a risk, we would deal with that in a way that looked after both taxpayers and passengers. We did not feel that we should be going outwith the contract and give VTEC easier terms, no.

Q257 **Luke Pollard:** To continue the theme of Iain's questions about what the Department's impression was of this bid on day one, we heard some



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positive feedback from Mr Griffiths on the first panel about the Department's feeding back to Stagecoach about the quality of the bid. I think the phrase he used was "the best bid they had ever seen." You are now telling us that on day one of the bid you had serious concerns about elements of it and you were expecting them to be lower than the bid had said. The Secretary of State at the time Virgin and Stagecoach were awarded this contract said, "I believe Stagecoach and Virgin will not only deliver for customers but for the British taxpayer as well." It seems that we have a very mixed picture here of very positive feedback, inflated PR and a lot of very official behind-the-scenes concern about the bid. Could you help clear that up, because it seems that what the public are being told is a very different story from what officials had concerns about?

Polly Payne: I do not know exactly when that comment was made to Mr Griffiths, or by whom, but I think that when VTEC won the franchise in 2014 it was nine months before it started.

Simon Smith: It submitted the bid in June 2014 and won at the end of November of that year.

Polly Payne: It took over the franchise in March 2015. I think the deterioration in the revenue had happened over that period, so, when the positive statements you are talking about were made, that was at the point it won the bid rather than the point at which it took over the franchise, and by that point we had seen that the revenues had declined.

Q258 **Luke Pollard:** This is a familiar story that we have heard from a number of train operating companies across franchising in general. Having regard to the difference in the state of play between when bids are made and the reality when franchises are taken over—for instance, not having enough drivers, which was something that GTR spoke about when it first took over the franchise—do you think that the period between bids being won and bids being delivered upon when the company takes over is too long, with too much potential for macroeconomic change, differences in operating procedure and different staffing levels kicking in, and that that is a structural flaw in how franchises are awarded?

Polly Payne: We are letting franchises for seven to 10 years and you are talking about a period of months. So, if you are letting a franchise that could go up to 10 years-plus, having too great a focus on what happens in that initial six to nine months would possibly be unbalanced.

Q259 **Luke Pollard:** I agree with you, but what seems to be being argued here is that there was a very large change between the franchise being awarded and being delivered, be it fuel prices, macroeconomic change or whatever, and that destabilised the entire franchise from that point.

Polly Payne: We should not overstate the change that happened by the beginning of the franchise. Absolutely, revenues were not where it was hoped they would be. Absolutely, VTEC was aware of that, as was the DfT, but I do not think at that point it was a question of, "We are definitely going to run out of PCS by a particular point." It was the



beginning of a warning and the beginning of problems, and everyone hoped that that situation would reverse. We hoped that the passenger incentives Martin talked about would increase the revenue and passenger numbers. We did not know what would happen to fuel prices; we did not know what would happen to GDP. So, it was more that warning bells had been rung rather than we knew that there was a dire problem and that the franchise would end when it ended.

Q260 Luke Pollard: Do you think there is sufficient transparency and accountability about concerns that officials in the Department may legitimately raise within the building, but that parliamentarians trying to scrutinise the process, or members of the public whose taxes pay for it, ultimately, via ticket prices, should know about? From what I have heard here, you seem to be armed with a lot more concern and detail that could give more accountability of how the Government run these trains if more was published.

Polly Payne: I have two comments. First, hindsight is a wonderful thing. At any time we have many risks and concerns, and various areas that we are keeping an eye on. Some crystallise; some do not. With hindsight, we now know that this was the beginning of something that would end the franchise. At the time, we thought it was a risk. We did not know that it would happen. We should not overstate that.

There is a reasonable amount of transparency. For a start, companies have to post their results. For instance, in this case, in June 2017 Stagecoach made a statement that was very clear about the level of losses at that point. We have regular publications on passenger numbers, and regular publications of many other statistics. We do not immediately flag up all the risks we see, but we try to be reasonably transparent.

Q261 Luke Pollard: I am trying to be helpful and propose something that will enable a greater degree of confidence in the franchising system, because I have to say that Virgin, Stagecoach and GTR are doing more to build the case for public ownership than any Labour politician is at the moment. Is there a point between contract award and the franchise takeover when it might be worth publishing a statement on whether anything has changed between what was bid and where they are now?

It seems to me that on this franchise and on others there has been an element of change between those two dates that has brought that into question. Is there a way of the DFT updating some of the assumptions or the operating parameters that it has agreed, or, if the world changes between those two dates, to ensure that, when a franchisee takes over, the way they are operating, and the assumptions the DFT is working under that may or may not be different from when it was awarded, are in the public domain? Do you think that is something that might shed some value and have some credibility in building trust in the franchising system?



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Polly Payne: We can consider it, but it is worth saying that during that period there is a huge amount of due diligence being done by the incoming owner of the franchise, so they will be lifting every stone, looking in every corner and doing their due diligence. We can think about that.

Luke Pollard: If they are, and if, as a Department, you are as well, it might be fruitful to publish what lifting up stones has produced, because there seems to be a gap between expectation and delivery on this one, and on the GTR franchise in the past, that might be worth looking at, to avoid the reality gap that we might have seen.

Q262 **Chair:** Can I double-check? What date was the contract awarded?

Polly Payne: The contract was awarded in November 2014.

Beatrice Filkin: In November, yes.

Simon Smith: It was the end of November.

Polly Payne: I am sorry I do not know the exact date.

Q263 **Chair:** The new franchise started in March.

Polly Payne: In March.

Q264 **Chair:** At that point in March, were you aware that it was unlikely that Virgin and Stagecoach would be able to deliver on the full terms of their contract?

Simon Smith: No, we were not. We were aware at that point that the revenue was a bit behind where they had projected it would be, but we were not expecting at that point that it would fail, that it would terminate early. Revenue growth carried on being well behind the bid level in the time beyond that, and that is what ultimately led to the early termination of the contract.

Q265 **Chair:** Did you tell Ministers that there was a risk that it would not deliver the revenue that it was predicted to deliver over the course of the franchise?

Polly Payne: I was not in post at that time, but Ministers would have been told that, yes.

Q266 **Chair:** When the Rail Minister said on 2 March 2015 that more than £3 billion would be returned to taxpayers, how confident should she have been in making that statement?

Polly Payne: That was the contractual agreement. I am sure that was the best estimate we had at that point. We would have known there were risks around that.

Q267 **Chair:** She would have known that there were risks that that statement would not prove to be correct.



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Polly Payne: No, I do not think she would have known that the statement would not have been correct.

Q268 **Chair:** But there were risks.

Polly Payne: She would have known that there were risks, but these are always forecast premiums; there are always risks around these premiums.

Q269 **Chair:** You said earlier in response to other questions that there was a problem in that the contract was awarded and by the time the franchise started you already knew that there had been a slow-down in revenue growth, or that it was not starting from the point that was expected, but you believe that it is reasonable for Ministers to still make that claim, at that point, knowing that the risk had got significantly greater than it had been.

Polly Payne: I think we knew that revenues were less than had been expected and therefore the risk was greater. As to whether it was significantly greater, obviously we did not think it was so significantly greater; we did not feel that the expected premiums could still be described as £3.3 billion or we would not have made that statement.

Q270 **Chair:** In considering the level of risk that you thought appropriate to allow in this franchise, you talked about passengers and taxpayers. When the Secretary of State announced the award of the franchise, he said it would deliver massive benefits for passengers, taxpayers and staff. A number of the staff who work on east coast will now have worked for a number of different operators and have the uncertainty that brings. To what extent did you consider the impact on staff in allowing a level of risk that has led to a contract failure after just three years?

Polly Payne: All the staff have been TUPE-ed over with the same terms and conditions. We were very concerned about reducing concerns that staff might have. We were very sure in our communications that we always thought about the staff, and we were very clear with them that they would be TUPE-ed, that their terms and conditions would continue. It is worth saying that, under our franchise system, staff quite regularly move operating group, possibly not as regularly as this. They are relatively used to that if they have been working on the railways for a long time. There is a very well-known process for how that happens and, as I said, they keep their terms and conditions; they keep their various arrangements.

Q271 **Chair:** Do you not think that constantly changing operator, particularly if it has been a number of times and you work on the east coast, creates a level of uncertainty for staff?

Polly Payne: I should think there is a level of uncertainty, but we have done our best to reduce it to its absolute minimum. As I say, at the end of the day, they are TUPE-ed over; their employment rights are protected and they keep the same terms and conditions.



Q272 **Chair:** Given what you said, which is that you were almost willing to allow a degree of risk because it did not matter, as you had a parent company guarantee to protect the position of taxpayers, it does not feel to me that a great deal of consideration was given to the impact on staff of having a change of employer after just a few years, some of them possibly having been through this twice already.

Polly Payne: I am sorry if I gave that impression. The reason I did not mention staff is that I am aware that they are protected; their terms and conditions—their rights—are protected. While I absolutely take the point about uncertainty, we did take that very seriously, which is why we were very clear and had in the front of our mind in our communications that both passengers and staff might be feeling concerned about the uncertainty, so we did everything we could to try to reassure them.

Q273 **Daniel Zeichner:** The Brown review recommended that franchisees should only be responsible for the risks they can manage. In a way, this discussion seems to me to have hinged on the extent to which you can separate the external risks. We live in a very volatile period in the world at the moment. Perhaps in a period of stability this could work. I was thinking, for instance, of the Greater Anglia franchise in my area where it was awarded around the referendum time, a period of extreme volatility leading to sudden change. Why did the Department not implement the Brown review recommendation to only apply to the franchisee the risk that they could actually manage?

Polly Payne: We did implement the Brown recommendations, and we have refined how we have implemented them, but if you are talking about macroeconomic factors—

Daniel Zeichner: Yes.

Polly Payne: At the time of VTEC, and at the time of Greater Anglia, we had the GDP mechanism, which is a risk-share mechanism, such that when GDP changed, and that impacted revenues out of certain bounds, the Department took some of the risk and the franchise took some of the risk. With commuter franchises, there was also a central London employment similar risk share, but more recently we have moved to an FRM, which is a different kind of risk share.

Q274 **Daniel Zeichner:** What is an FRM?

Polly Payne: Simon can explain the detail.

Simon Smith: The Brown review recommendation was that we offer protection on exogenous risk, as it described it, whereas the franchisee should take endogenous risks, initiatives that are within their control. That is what we sought to implement on east coast, and we provided protection on the main exogenous risk. However, it is quite difficult in reality to completely separate endogenous and exogenous risk, because, if revenue turns out lower than expected, it is not immediately obvious whether the bidder's initiatives have returned less than expected or



whether perhaps the relationship between economic growth and revenue has changed over time as the economy changes. That is why we adopted the forecast revenue mechanism in our more recent contract.

The forecast revenue mechanism, in effect, shares revenue variation risk outside a nil band either side of the bid revenue, usually 4%, and if revenue varies by more than 4% from the original bid forecast, 80% of that risk is covered by the Department. At the same time, if revenue support becomes payable under that mechanism, contractual incentive mechanisms start to apply, so the franchisee still has a strong incentive to deliver a good service for passengers, a high-performing service, and to grow revenue.

Daniel Zeichner: I am trying to look as if I fully understand the answer.

Simon Smith: I am sorry.

Q275 **Daniel Zeichner:** It is not your fault. You are trying to set up an extremely complicated set of mechanisms, and it seems to me that there is a fundamental problem with all this, which is that as the world changes you are trying to keep up all the time. Doesn't it rather suggest that this is a chimera? You are trying constantly to deal with stuff that you cannot predict, which means there is a fundamental flaw in the whole process, doesn't it?

Polly Payne: The world absolutely is changing all the time, and with our contracts we try, as Brown set out and as Simon explained, to ensure that risks are, to the extent that we can do so, allocated to the person best able to control and manage them, and that the amount of risk and the amount of reward and the balance is right in the contract. Once the private sector has signed a contract, if things change in unexpected ways, I am afraid there is a certain amount of risk that they have taken on, and we make sure that they are held accountable to whatever they have agreed contractually to take on.

Q276 **Daniel Zeichner:** If we are back here in two or three years' time after the next iteration of this, are you saying that you think you have now reached a point where, for the next set of potential changes, you have a system that will capture that? For instance, it is easy to imagine that in the next few years the economy could be bumpy.

Polly Payne: I hope we have a system where risks are allocated in a sensible way and at the same time taxpayers, passengers, and indeed staff, are protected, and that we, through the process, manage to have ambitious contracts that have a good return for taxpayers, but at the same time do not have such a level of risk that it cannot be managed.

Q277 **Daniel Zeichner:** You will not be surprised to hear that some of us who have been through the PFI arguments, transfer risk, and all the rest of it over the last 20 or 30 years, are becoming increasingly sceptical about whether this is desirable or actually doable. Do you still think it is doable?



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Polly Payne: You can definitely have contracts with a balance of risk between the public and private sector and a balance of reward between the public and private sector, and we try to do that as well as we can.

Q278 **Daniel Zeichner:** Given, as we have been hearing, all the costs of managing this process, the transfer costs, the bid costs and all the rest of it, what is the evidence of the benefits that all these costs are worth while?

Polly Payne: We have had franchising for 20 years. During that time, passenger numbers have doubled to over 1.7 billion journeys a year. That is a very quick rate of growth, and faster, to the extent you can compare, than other countries that have not had franchising. We now have one of the safest railways in Europe. We have one of the highest levels of passenger satisfaction in Europe. Over £6 billion of private sector investment has gone into our railways, and that includes over 7,000 new carriages since 2011, so there is private sector investment going in. As I said, we have had 52 different franchises let in the 20 years-plus of franchising, and we have had four problems. As has been pointed out, three of those were on east coast, but four out of 52 does not seem an unreasonable level.

Q279 **Daniel Zeichner:** How many do you think are at risk at the moment?

Polly Payne: At the moment, we have around 20 franchises out, and we are keeping an eye on all of them.

Daniel Zeichner: I am not sure that answers the question, but never mind.

Q280 **Chair:** Are there any franchises that you have identified as being of concern?

Polly Payne: We obviously have to respect the commercial information we get. We cannot share that detailed commercial information, but I think we can reassure the Committee that we keep all our franchises under review. We look at their financial returns and, should there be any problems, we would, in the same way as we did with VTEC, mobilise the OLR and make sure that we had contingency plans that looked after the passenger, the taxpayer and, to the extent we can, the staff.

Q281 **Chair:** Without stating which franchises you might have concerns about, do you have contingency plans for any of the current franchises that are operating?

Polly Payne: The OLR is a small team of people in the rail group. It is always primed to look after any problems if problems happen, and, if appropriate, we would mobilise them.

Q282 **Chair:** When did they start mobilising to take on responsibility for the east coast main line?



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Simon Smith: We were doing some preparatory work for that in the autumn and then—

Q283 **Chair:** Can you be a bit more specific than autumn? We are used to politician answers. What does that mean?

Simon Smith: It was a relatively low level of work, in around the last three months of the year, to make sure that we had all the information we would need about the business, to start a mobilisation process if required. Then, further to Stagecoach exhausting its parent company support at the start of this year, and the technical event of default occurring at the end of January, the project to mobilise the operator of last resort ramped up to a more intensive project.

At the height of that project, in the month or two before takeover, we would have had probably about 30 full-time staff working to prepare the takeover. In effect, the project has gradually ramped up over the past few months as we got closer to a possible termination date.

Q284 **Chair:** Is any of that early preparation work under way in relation to any other franchises at present?

Simon Smith: We cannot discuss, as it is commercially sensitive, the financial position of any individual franchise.

Q285 **Chair:** I am not asking you to.

Simon Smith: We can reassure the Committee that we do not have any franchise at short or medium-term risk of financial default.

Q286 **Luke Pollard:** I realise that you have to choose your words very carefully, and I appreciate that you are trying to navigate difficult questions and answer appropriately. You said financial default. Are any franchises under operator of last resort preparation for anything other than financial default at this stage?

Simon Smith: We do not have any plans. Our operator of last resort team is constantly looking at all the franchises that we have to understand the range of risks around them, but we are not mobilising the operator of last resort.

Q287 **Chair:** Are any other franchises currently eating into their parent guarantee?

Polly Payne: We cannot comment on particular franchises. That is commercial information and, under the Railways Act, we are not allowed to discuss the commercial information we get from franchise holders.

Q288 **Graham Stringer:** Before I move on to infrastructure, do you have the power in all franchises to liquidate them effectively?

Polly Payne: If there is an event of default, I do not know whether liquidation is a term we would use.



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Q289 **Graham Stringer:** I do not mean just financial default but lack of performance that is not financial.

Beatrice Filkin: The contracts are all slightly different, but they all come with their own range of remedies, and we would have to take unilateral action to terminate them should there be a significant type of default.

Q290 **Graham Stringer:** So you have the power in every single franchise to finish it.

Beatrice Filkin: For different causes, but, in principle, yes.

Q291 **Graham Stringer:** How much does it cost the Department to run a single franchise assessment?

Polly Payne: Is this running a franchise competition?

Q292 **Graham Stringer:** Yes. How much does the whole process, from beginning to end, from putting it out to tender to awarding it, cost the Department?

Simon Smith: Our adviser costs are typically in the region of £5 million on a franchise transaction and, in addition, we have our own staff costs, but that cannot be quantified in a simple way.

Q293 **Graham Stringer:** Why can't it be quantified?

Polly Payne: To give a ballpark figure, the number of staff working on franchise competitions varies considerably depending on the size of the franchise, but our franchise competition team is usually between 10 and 30 people, and they are working on that franchise for two to three years. I would have thought the total cost would rarely go over, including the consultant costs, £15 million. It is that order of magnitude, but that is some mental maths, so apologies if it is not quite right.

Q294 **Graham Stringer:** Yes, I accept that we are in ballparks, not in precise figures. I realise there are legal difficulties because of the contracts, but I was slightly surprised at your answers about no franchises being in difficulty, because the Secretary of State has said on Northern and Govia Thameslink, I think, that he is prepared to abort them, to get rid of them.

Polly Payne: Yes, that is correct.

Q295 **Graham Stringer:** There are two at least.

Polly Payne: With both GTR and Northern, we are at the moment looking at whether they have performed to their contract, and, as you know, with GTR in particular, we have a hard review happening at the moment. We do not know what that hard review will show yet, but if it shows that they have triggered an event of default, or they have been outwith their contracts such that they can be terminated, that is a possibility, and in that case we would mobilise the operator of last resort.

Q296 **Graham Stringer:** You were here for the last session. Network Rail did not sign off the infrastructure assumptions, and we have been told that



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that will be changed in future bids, but why was it the case this time? Why didn't Network Rail—

Polly Payne: Network Rail did specialist infrastructure reports. They did not sign off, because we are the franchising authority. We had specialist infrastructure reports that were considered by the evaluating team in the Department for Transport who made the bid decision. That way of working has increased, so now we actually have people from Network Rail who sit as part of the competition teams. We are evolving that, but there were specialist reports.

Simon Smith: Although we introduced the process of Network Rail formally signing off the infrastructure assumptions since the east coast competition, Network Rail was closely involved throughout the specification stage of the franchise. We had a regular train service steering group where the Department, the Network Rail routes and the Network Rail central planning team were all represented. That was there right the way through the process of development of the specification. We have improved our working arrangements with Network Rail since, but we worked with them at the time as well.

Q297 **Graham Stringer:** In retrospect, were there any problems caused by the fact that they did not formally sign it off, although they were involved in the process in some way?

Simon Smith: I do not think so, no. The franchise specification reflected the best view at the time of the infrastructure that was expected to be delivered on the east coast. Clearly, subsequent to the franchise competition, we had the Hendy review and the changes to the enhancements programme that have resulted in changes of expectation around when some of the projects will be delivered.

Q298 **Graham Stringer:** You heard the exchanges between Network Rail and Stagecoach, where there seemed to be more agreement than there was in their written submissions. Would you like to make any comments either on their written submissions or on what you heard this afternoon?

Polly Payne: I am probably clarifying when it is already clear in your minds, but there are different bits of the infrastructure.

Q299 **Graham Stringer:** Yes. There seem to be no disagreements about the first stage and then disagreement about the second and third stages.

Polly Payne: Possibly. From our point of view, as you say, there seemed to be little disagreement about any poor performance payments, although there were still discussions about quantum. In terms of the renewals, there were significant renewals undertaken and then, in terms of the enhancements, which is where I think possibly there had been some slightly different ways of expressing it, we are clear that the package of enhancements promised under the Hendy review will be delivered, and that continues to be the case.



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As Simon says, some of them may not be exactly to the time or in the manner that was expected when the franchise competition happened, but that is partly because of the Hendy review and partly because in all these big enhancement projects, as you would expect, as the enhancements go through the pipeline, we investigate the detail of what is proposed and ensure it is value for money. Plans change slightly during the process.

Graham Stringer: Can I make one comment? You have been admirably clear in your answers, but I take issue with what you say about safety being related to franchising. After Railtrack had killed people, the public sector paid a large amount of money for train-protection warning systems, and that is primarily what has made the railways safer, not the franchising system.

Q300 **Chair:** Can I check the issue about enhancements and how the process will be dealt with? In other inquiries, we have asked about the rail network enhancements pipeline and have been told that there is not a view that it will be published information, so how will you provide information about what enhancements are envisaged in the long term, given that we do not now have a five-year process for enhancement?

Polly Payne: When we run a competition we will be as clear as we can about where the different enhancement projects are in the pipeline. We will be clear about when they are fully agreed projects to be delivered. When they are at an earlier stage in the pipeline we will give clarity. As part of the franchise, we will have certain enhancements that the franchise assumes. If those change, for whatever reason, the franchisee will be compensated for that. There will be other enhancements—and this has happened already—which, should the franchisee wish to assume that and add services on, they can, but that is at their own risk. I think we will continue with that kind of system.

Q301 **Chair:** It sounds like an extra layer of complexity in the franchise agreement.

Polly Payne: It is complex, but you are trying to project the enhancements forward for the next eight to 10 years and what will be delivered. Obviously, we are working on those continually; we are learning and we are refining. At the same time, you want to have a contract where you hold people to their obligations, and yet you are fair if things change on the enhancement side for which they are not responsible. It is a bit complex, but it is a complexity that needs to be there so that we can run enhancements in the best way and for the best value for money, and run a franchising system in the best way.

Q302 **Chair:** Effectively, will it require a renegotiation if there is a change in the enhancements, or will you somehow have written in what your expectation is of the impact on revenues and passenger numbers?

Polly Payne: We already have a contract change process, and Simon can help you with the technical detail on that.



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Simon Smith: I think “negotiation” is perhaps too strong a word to describe what happens. When a bidder submits a bid, and if they are successful, we contract the financial model and set of models that they have submitted. If an infrastructure project ran late and that meant they could not deliver the uplift to revenue, or whatever else that they were expecting from that, then we would adjust the model accordingly. It is a bit more mechanical than a negotiation. The franchise payments would be adjusted generally by the amount that the bidder assumed that it would profit by the enhancement.

Chair: Thank you. I want to move on and look at the interim and future operating arrangements.

Q303 **Daniel Zeichner:** As we have heard, there is going to be a transitional period until the east coast partnership using the operator of last resort. Given that we have heard from the passengers’ perspective that the railway was operating rather well at the moment, was it really in the interests of passengers to have this bridge before the east coast partnership? What was the thinking behind doing that?

Polly Payne: When Stagecoach and Virgin had drawn down all their PCS, which was in January, we had two options for continuing the railway. One was a direct award to Virgin Stagecoach to continue the service and the other was the operator of last resort. We did a full analysis, and we have published our analysis of those options. It was a very finely balanced decision, but we thought—well, the Secretary of State decided—that the OLR was the best way forward.

Q304 **Daniel Zeichner:** What was the advice that you gave to the Secretary of State?

Beatrice Filkin: We did a lot of detailed analysis on the three measures that the Secretary of State asked us to consider: particularly the interests of passengers, the taxpayers and the investment in the wider infrastructure of the railway. The options were very finely balanced. Effectively, what we were saying was that it would have been appropriate to consider either of these two options for your next steps.

Q305 **Daniel Zeichner:** From the point of view of the passengers, we have already heard that there was not a problem with sticking with the existing operator. How did it become a balanced decision? It does not seem very clear to me.

Beatrice Filkin: The assessment showed, as you are absolutely right to say, that the passengers were being handled appropriately at the moment, and we also thought that LNER—the operator of last resort—would be able to continue to serve the passengers.

The analysis on value for money, which is our test to get round the taxpayers, also suggested that it would be very finely balanced between the two options, suggesting neither would particularly be likely to deliver



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significantly more returns to taxpayers. Similarly, we thought both options could protect the investment in the railway.

One of the areas in the railway was about the roll-out of the east coast partnership. Our judgment of our assessment was that the OLR would probably enable a slightly more incremental roll-out of the east coast partnership. That came down to being one of the key factors for the Secretary of State to choose, with the operator of last resort being the more appropriate choice in this instance. That was not to say that VTEC also could not have done a reasonable job.

Q306 **Daniel Zeichner:** In the end, it was the transition to the east coast partnership that was probably the key deciding factor.

Beatrice Filkin: Yes.

Q307 **Daniel Zeichner:** That also seems slightly odd to this Committee, in the sense that we have heard from previous rail industry experts. Iryna Terlecky told us that it seemed completely counter-intuitive to experiment with the partnership approach on the east coast main line. For the reasons we have already heard, it is one of the most complicated areas, with many operators, open access, freight and all the rest of it.

Given that we have heard that the one previous example did not work, why on earth would one come up with this approach, and on this particular railway?

Polly Payne: As the Secretary of State has announced, the principles behind the east coast partnership are that we bring track and train together. I think the industry experts you have heard from have fully supported that. We should have a joint team with a single leader. We should have a long-term regional brand. We should have a greater infrastructure role for the train operating companies; and we should have employees at the heart and that they share the success of the railway. Those are the principles that the Secretary of State has set out.

Those principles and the idea of partnership can be—and I think the Secretary of State would like them to be—applied across the railway. This is a franchise that is coming up. It will be re-tendered, and so he wanted to apply these principles to this franchise when it came up. It will be taken forward in that way.

Q308 **Daniel Zeichner:** But the question remains, as others have said, if you are going to start testing out this kind of process, why test it on the most difficult place?

Polly Payne: There have been elements of testing out already in a number of different ways. For instance, we have the west coast partnership franchise being tendered at the moment, with a partnership element. We have various alliances that are already happening in different ways. Scotrail at the moment has an alliance. This is building on things. It is quite an evolutionary approach.



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The other thing is that under OLR we have already moved to this longer-term regional brand, which is LNER, so we would expect that brand to continue with the east coast partnership.

Q309 Daniel Zeichner: With the multiplicity of different partners involved, what evidence do you have that this can work, basically?

Polly Payne: As I said, the main problem that the east coast partnership is trying to solve is that on an increasingly congested railway a small infrastructure problem can lead to significant problems for passengers, as we have all seen unfortunately. As to evidence for the east coast partnership and bringing together track and train to try to solve this problem, there is a certain amount of academic evidence, including from Mizutani, who is an expert in this. You look at both the McNulty report and the Shaw report. They have also supported bringing together track and train, as do most of the industry experts to whom you will have spoken.

We have also learned from Scotrail and the experience of SWT, to which Martin was referring. We have had the two main people who were part of that coming and talking to our experts group.

We have small examples. For instance, we have Network Rail and Virgin frontline staff working on West Coast. They had something called the “perfect day challenge”. They managed through this to get the best-ever day that they have had on West Coast.

Following on from the Gibb report on Southern, we brought together into a single control centre both Network Rail and the operator. We have a lot of different evolutionary evidence that bringing together track and train in this way can really work. I think the east coast partnership is going to be the next evolution of this. We are then hoping to add in some other elements—for instance, the employee success and bringing in employees at the heart of it.

Daniel Zeichner: I wish you luck with it.

Polly Payne: Thank you.

Q310 Chair: Following on from that question from Daniel, given what you have said about South West Trains and Scotrail, why East Coast? The reason why there was an alliance on South West was specifically because you had quite a lot of coterminous situations between the Network Rail management and an operator—and the same on Scotrail. We know that East Coast is one of the most complex lines used by a multitude of different operators. Why would you choose to try it out next on that line rather than somewhere else?

Polly Payne: Partly because there is the opportunity that we are going to be re-letting that franchise.

Q311 Chair: But this was announced before it had been announced that the



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franchise was going to collapse.

Polly Payne: It was announced in November, but at that point, although the Secretary of State did not explicitly say so, we were expecting the PCS to be used up. We just did not know when, and we obviously did not want to say anything that might be market sensitive. I think it is partly that it is a good opportunity. Also, sometimes, the most testing circumstances really are the proof of concept. If we can sort out the concerns for the east coast partnership, which I very much hope we can do, around having a number of operators using a single line on this, then it will be even easier on other franchises. I think it is almost a good test case, because if we can do it here we really can show that the concept works.

Q312 **Chair:** The idea is that you choose the most difficult place to do it because, if it works there, it will work everywhere else. Some people might say, given your record on running successful franchises at DFT, that that was not a great decision.

Polly Payne: But, as I have tried to set out, we are not starting from, "We have never done any of this before and we have no experience." There is a whole host of experience to build on and there are bits of this happening already. We would be hoping to build on all of that, add to it and test it in challenging circumstances, yes.

Q313 **Chair:** It is hard to see an example of where it has been seen to operate really effectively. Would that not be fair?

Polly Payne: I am not sure that is fair. I think the experience of South West Trains was positive. There were some concerns at the end in particular about financial alignment of financial incentives. I think we have learned from that. Our thinking is that we would not be hoping to have a single balance sheet or do anything very complicated in that way because of that experience. We would be looking more at trying to incentivise management incentives, KPIs and balance score cards. I think we have learned from that positive experience.

Scotrail has been a positive experience. Some of the frontline experience of West Coast has been positive. There is a positive experience to build from.

Q314 **Chair:** We will be watching closely. In relation to the wider franchising system, we have already had some discussion about other franchises and the extent to which they might be struggling to meet their obligations set out in their franchise contracts. I appreciate it is difficult, and I think it is fairly common knowledge that other franchises are facing challenges, not least because of the wider issues you have talked about, such as the downturn in passenger numbers.

Is there an intention to try to manage the franchises to ensure that they do not fall into similar circumstances on East Coast, or do you regard it as a sort of hands-off approach from the DFT and just go, "Well, if that



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happens, the system is set up to allow failure"? What is the approach?

Polly Payne: I think it is a little bit of both. As Simon set out, in our new franchises we have the FRM mechanism and we have a new FRT. Simon can maybe talk you through those if that would be helpful. That is to help ensure that we have probably an even better risk-reward balance in the future. Also, we would be trying to ensure that, if problems do happen, we are adequately equipped to make sure that the passenger, taxpayer and staff are looked after. At the same time, we also remember the Brown review and remember that we should not be trying to take risk entirely out of the system. I think it is a balanced approach.

Q315 **Chair:** Do you want to add anything, Mr Smith?

Simon Smith: All I can add to that is that we very closely monitor the financial and operational performance of all our franchises, and we will always ensure that there are appropriate protections in place. An inevitable consequence of the changes that we have made to the franchising model for the three competitions that are under way at the moment is that the risk of default is reduced, because the risk assessment at bid evaluation stage is more rigorous and looks at a downside case as well, and then through the forecast revenue mechanism we have changed the way that we allocate revenue risk. There will be less risk of default under the new franchises that we will let, but there will always be some risk in the franchising system. We will continue to monitor our franchises closely and make sure that we have appropriate contingency plans in place.

Q316 **Chair:** I understand why you are not in a position to tell us, because of commercial confidentiality, about which franchises are drawing on parent company guarantees, but I would ask that you write to the Committee with that information. We do not have to publish all details of evidence submitted to us.

Luke, did you want to ask something?

Q317 **Luke Pollard:** I want to ask a similar question about the future bidding for the east coast partnership, as I asked Stagecoach earlier, about whether the Department would consider allowing any of the companies that have previously bid and failed on the East Coast to rebid for any future franchises. Does the Department have a policy on what would be the acceptable level of failure that would mean that they could be included, or do you have a policy at all that says, "If you get to this stage, you cannot participate"? Or is it just, "Yes, a free-for-all. If you still have a passport, you can still go in"?

Polly Payne: The policy is that if you have a passport you are eligible to bid, but I would not describe that as a free-for-all. The criteria for holding a passport are rigorous and they would look at a number of factors. Yes, the criteria would be whether you have a passport, and if you have a passport you are eligible to bid in our competitions. But that is not a free-for-all.



Q318 Luke Pollard: As part of the bidding process, do you think it might be appropriate to look at whether past performance on that particular franchise, or franchises in general, should be taken into account? I am aware that there are an awful lot of facts and figures, scheduling and timetabling that has to be put together in a franchise bid. Do you think past performance on that franchise should be taken into account in assessing a bid?

Polly Payne: Beatrice might be able to add some detail because she helped with the passport review that Stagecoach and Virgin went through. On past performance, if you have run a train company with a very low performance level and significant problems in the service that you have provided to passengers, that could be—if it is significantly bad—a reason for taking the passport away. There are a number of different reasons.

Q319 Luke Pollard: You have performance against the metrics of consumer satisfaction and those elements, but you also have performance against contract levels and how much money you are returning to the Exchequer, and whether you have fulfilled your promise that you made in your contract at the start of your franchise when you get to the end of the franchise. I am just trying to understand whether that is a component in any decision making or whether that is not being included in any future franchise.

Polly Payne: Virgin and Stagecoach paid every penny and upheld all their contractual obligations. If they had not, then absolutely we would not see them as fit to hold a passport.

Beatrice Filkin: Could I perhaps add something? The termination of the contract is one of those types of trigger events that makes us go back and look at their individual passports. We take that very seriously and assess whether we think that they are a reliable partner to continue to do business with—or to consider doing business with—in the rail industry. We have carried out that review and we are now finalising a rerun of that review following the actual termination. They provide us with plenty of evidence and we provide our own evidence from our commercial teams to consider whether they have learned from the approach to bidding; whether they have indicated that they have changed their approach to bidding; and whether, when they were in that contract, they did everything they could to deliver against their contractual commitments.

As you would expect, we have to abide by the procurement legislation, which suggests that we have to act proportionately. We look at that evidence and say, "What is the proportionate action to take? Have they given us evidence that they have acted as a reliable person to do business with?", which they have in this case.

Q320 Luke Pollard: That is only in the passporting process rather than in the franchise process. Effectively, what you are telling me is that there is no restriction to stop either Virgin or Stagecoach bidding for this franchise



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when it gets re-tendered.

Polly Payne: As long as they continue to hold a valid passport after the review, or after any other future reviews, if there are future events, then, yes, that is the case.

Luke Pollard: Thank you, Chair.

Chair: Do colleagues have any further questions? No. Thank you for giving evidence today. That concludes our session.