HOUSE OF COMMONS

ORAL EVIDENCE

TAKEN BEFORE THE

TRANSPORT COMMITTEE

RAIL FRANCHISING

TUESDAY 15 JANUARY 2013

RICHARD BROWN CBE

Evidence heard in Public Questions 1 - 48

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Oral Evidence

Taken before the Transport Committee

on Tuesday 15 January 2013

Members present:

Mrs Louise Ellman (Chair)
Sarah Champion
Jim Dobbin
Karen Lumley
Karl McCartney
Lucy Powell
Iain Stewart
Graham Stringer

Examination of Witness

Witness: **Richard Brown CBE**, Chairman, Eurostar International Ltd, gave evidence.

Q1 Chair: Good afternoon, Mr Brown. Welcome to the Transport Committee. I understand that you would like to make some opening remarks.

Richard Brown: Thank you very much for inviting me today. As you know, in early October I was asked by the Secretary of State to review the Department's rail franchising programme, looking particularly at the way risk is assessed and how the bidding and evaluation processes work, and then at how to get competitions going as soon as possible. As you know, my report was published last Thursday. I spoke to a very wide range of people across the industry and was supported by commercial, financial and legal advisers, and a small team from the Department itself—a secretariat. I got a lot of information from the Department—in fact, everything that I asked for at any point. It is also important to say that I spoke fairly extensively with Sam Laidlaw and Ed Smith during and at the end of their inquiry, and also with the National Audit Office about its separate inquiry.

I have attempted to make my recommendations as helpful and practical as possible. I also recognise that quite a lot of what I said is probably not very comfortable reading for the Department. There were four main things that I looked at: first, how you structure franchises and allocate risk; secondly, how to procure franchises, and, in particular, how to get a stronger voice for passenger needs into the process; thirdly, how franchises are managed once they have been let, and, in particular, how to get more of a partnership relationship between the Department and the franchisees; and finally, and most importantly, how the Department should set about strengthening its capability to take forward franchising.

The only other thing that is worth mentioning is that you will have seen that several paragraphs in chapter 8 of my report have been redacted. This was because the information in them, which was about the paused franchises, was potentially stock market sensitive. I understand that it is the Government's intention to publish those when they announce how they will take forward the paused franchises. I think that is probably all I can usefully say for the moment.

Q2 Chair: Thank you, Mr Brown. I think the report is very interesting. It is also very constructive and forward looking, but there are a number of areas we would like to ask you about. In some, we just have queries about what you mean and would like to understand a bit better where your thinking is, and there are some we may be querying. At the beginning of the report, you say that your main conclusion is that “the rail franchising system is not broken”, and you point to a number of rail’s successes. However, it is also the case that the franchising system has been changed a number of times since it was introduced because of problems that arose. Looking at the rail system as a whole, there are undoubtedly successes. However, the McNulty report points to a 40% efficiency gap between our rail service and some other European rail services. Of course, there are current concerns about fare levels. In that context, why are you so clear that the franchising system is not broken?

Richard Brown: The point I was trying to make is that franchising is an important part of the architecture of the industry as a whole, and the industry as a whole—as, I think, the Committee acknowledged in its most recent report—has enjoyed considerable success over the last few years. Over the last 17 years, since privatisation, passenger numbers have been growing faster in the UK than on any other major European railway. We now have the second safest railway in Europe, which is a huge improvement on where we were 10 years ago. Passenger satisfaction has improved a lot, although there is still scope to do better. The same applies to things such as punctuality. It seems to me inconceivable that the industry could have achieved those improvements if franchising were broken and fundamentally flawed. That is not to say that there is not scope for significant further cost reduction, as McNulty set out, and to improve services still further, but my strong conclusion is that there is success and we should be looking to build on it, and there is no need to go down the road of changing fundamentally the way the industry is structured.

Q3 Chair: Your report also talks about alternatives to franchising, or management contracts. With some specific exceptions, which you have named, you favour franchising rather than management contracts. Can you tell us where you see the benefits or disbenefits of both those approaches to both passengers and taxpayers?

Richard Brown: The principal difference between what some people call a concession or a management contract and a franchise is whether the concessionaire—the contractor—is taking revenue risk. On London Overground, the revenue risk is held by Transport for London. The franchisee or concessionaire is delivering the train service and investment paid for by TfL, on its behalf, and has a series of quality criteria. So the principal difference is around revenue risk. I said that, if you want to go down that path, the franchising organisation—in that case, TfL—has to have the capability to market the services and to collect revenue. Ideally, it should have its own ticketing system. That is not the case for the large majority of franchises. Potentially, concessions have a role, but I do not think that applies to the majority of heavy-rail franchises.

The other point is that there is no doubt that giving franchisees revenue risk, so that they take the benefits of revenue growth, subject to their bid offer, is a strong incentive for them to go out and attract more passengers and to make sure, particularly on the more commercial franchises, that they are delivering what passengers want. If they were not, fewer passengers would be using them. On most franchises, I think there are quite strong reasons for keeping revenue risk and, therefore, the franchise model, but it does not need to be universal.

Q4 Chair: You pick out the Thameslink, Southern and Great Northern franchise as ones where a management contract could be used. Why did you decide that?

Richard Brown: The principal issue there is that massive investment is going into the Thameslink project, as you know. Of course, there will be a major programme of new trains to be introduced into service, so there will be huge change and huge disruption to passengers. During that disruption, you want the franchisee to be focused principally on delivering that project and on working with Network Rail and other partners to do so—worrying slightly less about potential revenue losses and more about how to minimise the disruption to passengers during that period. I did say more of a management contract, because I think you want to keep a degree of incentive on revenue on the franchisee—for the taxpayer's benefit, if nobody else's. However, given the degree of disruption on Thameslink, it would be very difficult to structure a franchise in the conventional way.

Q5 Iain Stewart: I would like to follow on directly from the Chair's questioning about franchises as against concessions. Elsewhere in the report, you talk about the desirability of having further devolution of powers, particularly in large urban areas. Do you see potential for having a franchise model for inter-city and inter-regional services, but, increasingly, a management contract-style model for major urban/conurbation rail services?

Richard Brown: I would put it slightly the other way round. For the major conurbation rail services, where you have a passenger transport authority in place whose role is to develop public transport in that conurbation, you have a situation where you could let concessions, but they would need to be pretty focused on that conurbation.

I will give you a specific example. Centro, the West Midlands PTE, is quite keen to see Birmingham rail services devolved. That would be a new franchise, because it would need to be stripped out of London Midland. However, the current northern franchise covers a lot of areas that are not within PTE boundaries. You would need either to split it up into a lot of smaller pieces, which I am not sure would be such a good idea, or to have some sort of hybrid, probably. Only where you have a passenger transport authority or the likes of TfL do you have the conditions where a concession can work sensibly. I think that is the point.

Q6 Iain Stewart: The reason I ask is that, when we were conducting our research for our Rail 2020 inquiry, one of the lessons I drew from our visit to the continent was that the inter-city market is very profitable, on the whole, but the commuter-based services tend to require a degree of subsidy. That is why I am exploring the option of having a bi-mode that allows us to have better rail services. If we can get a compromise situation where there is a travel-to-work area that crosses a PTE boundary, do you not see that that has some potential?

Richard Brown: I think that the difference is more in how you specify the franchise and evaluate bidding. Certainly, with an inter-city franchise, which is more profitable and commercial, as you say, you can rely more on the revenue the franchisee earns from passengers as the incentive to make sure they deliver the right level of quality to passengers. For the less profitable, heavily subsidised franchises, the fare box is less of a direct incentive, so you need to reinforce it with stronger quality measures and, probably, by giving a higher weighting to quality when you evaluate the bids, as I have recommended. At the moment, no appreciable weighting is given to quality in the bids, which I think needs to change.

Q7 Chair: Would you be concerned about fragmentation, if there were a lot of devolution and splitting up into smaller franchises?

Richard Brown: I have not recommended splitting things into a lot of smaller franchises. What I have said is that I think we should stop the process that has slowly but steadily happened since privatisation of having fewer, larger franchises and look for opportunities to create new franchises. I have mentioned the Birmingham and Centro area as one. What Transport Scotland is doing in creating a new franchise for the sleepers is a very good idea. However, having lots of smaller franchises would be a mistake, because rail services need to be co-ordinated. For example, the northern PTEs are very keen to integrate

TransPennine Express more with the northern franchise, for the principal reason that they will share the same infrastructure for the trans-Pennine electrification and a lot of the investment in capacity increases for the northern hub. They want to be able to make the best use of those capacity increases by co-ordinating the two franchises. Setting up lots of smaller franchises would go absolutely against that desirable objective.

Q8 Graham Stringer: You say that the franchising system is not broken, yet at every stage of experience of franchising different Governments have changed the system. It does not seem to me that they have ever been able to transfer the risk properly in the long term. The east coast franchise is one example; the risk has come back to the public sector after four or five years. Can you expand on why you think it is not broken? We have had long franchises, short franchises and a move to longer franchises. Now you are recommending medium-sized franchises, if I may put it like that, with the possibility of extensions. Doesn't it all indicate that there is still a problem that is not solved?

Richard Brown: I have tried in my report to go back and look at the evolution of franchising since it started to try to address that specific question. Franchising is now, of necessity, a fairly complex process, because these are very big contracts. I do not think many people quite appreciate just how big they are. I mention in the report that the gross value of the west coast main line, for instance, over its 13-year term, would have been well in excess of £20 billion. That is a huge piece of Government procurement. Effectively, although I have not used those words, I have also said that one size does not fit all. You used the term medium-sized franchises. I have said that franchises should never be for less than five years but that they could be for 15 years. The key thing is to learn from the experience we have had. We have now had a lot of experience, and, based on that, we have a rather better idea of the way forward and of what does and does not work.

Q9 Graham Stringer: Aren't there two different potential solutions that you have not mentioned? One would be a hybrid system between a concessionaire and a franchisee with a profit-share arrangement. The real worry is that these franchisees will walk away with super-profits or will walk away because they think they are going to make losses. Isn't a way of capturing their commercial acumen but not running the risk of super-profits just to profit-share?

Richard Brown: I quite agree. One of my recommendations is that there should be a profit-share arrangement in every franchise, to guard against precisely that thing, but, equally, to incentivise the two partners. The Department needs to be an equal partner in these franchises, on behalf of the taxpayer, with the franchisee. If it is a profit-share arrangement, there should be a greater incentive to work together to continue developing the performance and value of the franchise during its term, not just at the point at which it is let.

Q10 Graham Stringer: I turn to the second point. We all want best value for the taxpayer in this—not just value, but as much money as possible coming into the Exchequer. I have read your report and do not really see any comparison or estimate of what would happen if the operator of last resort were given the opportunity to compete in the franchise market. Obviously, the operator of last resort is wholly publicly owned. Why didn't you consider that?

Richard Brown: It is quite difficult to give consideration to that because, while there is an operator of last resort, it has no capital and is taking no risk. Effectively, because it is publicly owned, the risk is being retained 100% by taxpayers. The point of franchising—and why I recommend continuing with it—is that you pass risk to the private sector but make sure that the risks you pass to the private sector and the franchisees are risks that they can manage and to which they can, therefore, add value. With Directly Operated Railways—the operator of last resort, or whatever you want to call it—it is still publicly owned, so you have achieved no risk transfer at all.

Q11 Graham Stringer: But you might be capturing the profits for the public sector. It is a good benchmark, isn't it? I suppose the real question I am asking is, if you want to say—as you have said is your conclusion—that the franchising system is not broken, you need something to compare it against; you need a benchmark. Directly Operated Railways could be that benchmark, but you have not really examined that point.

Richard Brown: In its previous report, the Committee itself made the point that there was a need for greater transparency and a much clearer picture of where somebody is going and where profit is flowing. I entirely agreed with that. If you have a number of franchises, in effect, each one is a benchmark for the others. As I read the recommendation in the Committee's latest report, it was trying to get a better degree of benchmarking as well as an understanding of the financial flows. It is better to have 17, 19 or 21 benchmarks rather than just the one of Directly Operated Railways. I am not saying that you should not include Directly Operated Railways, but why not get a number of benchmarks?

Q12 Graham Stringer: That is a very good point. If you are saying that Directly Operated Railways should be a benchmark, as I read your report—I have not had it long—it did not come out as clearly as that.

Richard Brown: It did not; I acknowledge that, yes.

Q13 Graham Stringer: My final point is about the record of the railways since privatisation. It has been good, when you look at the different parameters, but is not some of the good record to do not with franchising but with the fact that our motorways are very heavily congested?

Richard Brown: If you look at it strategically over many decades, there was a period—particularly in the '50s, '60s and '70s, when the motorway programme was being taken forward and motorways were being built—of massive modal switch away from rail on to the roads. Generally, we as a country are not building motorways now. What you are seeing is natural growth in travel. Rail is now taking a higher share of that natural growth. One has to look at these things over decades.

Q14 Sarah Champion: I thought that your report read really well and gave very clear recommendations, which was great. I was very interested that in it—and also in your answer to Mr Stewart's questions—you spoke of quality. In paragraph 1.17, you say, "Bids should also be explicitly scored on their proposals for improving service quality for passengers and their approach to management." You recommend that a weight of 20% to 40% should be attached to quality in the final evaluation. I really welcome that and think it is a great step forward. However, as the national passenger survey is based on opinion rather than hard fact, how would you actually operate that? What sort of system do you envisage being put in place to capture those data?

Richard Brown: You are quite right, in the sense that the national passenger survey asks passengers to score and rank on a whole series of different quality criteria, but that is all you do in any opinion and customer feedback survey. At the end of the day, what passengers think about the service is pretty important. I think most people, both within and outside the industry, now recognise that the national passenger survey is a pretty authoritative account of what passengers think. It correlates with the physical performance franchise by franchise, so it provides quite an authoritative and objective benchmark. I have recommended that it should be deepened, because one of its few shortcomings is that in most cases it does not go below franchise level. To take one example, the quality of services on the west coast between Scotland and London would probably be rated rather differently from that of those between Birmingham and London. Ideally, in order to reflect what passengers really think, you want those scores to come in route by route. We as an industry now have a good tool and should use it much more actively, as I have said, both when evaluating bidders and what they are offering and then monitoring the performance of franchises once they have been let.

Q15 Sarah Champion: If it became clear from such surveys that the quality was not meeting expectations, do you think it would be possible to put in sanctions and what would you suggest they be?

Richard Brown: I did suggest—it is more in the detail of a later chapter—that you could set benchmarks for particular aspects of quality. The current southern franchise provides an example of that. If the franchisee falls below certain benchmarks on the NPS scores, it has to invest a certain amount—it used to be called a passenger dividend—in improving facilities for passengers. To the franchisee, that appears like a fine, but the money is being spent directly on trying to improve services to passengers, so it is not going outside the industry or being taken away from passengers. That mechanism could usefully be applied more widely on other franchises.

Q16 Lucy Powell: I return to the west coast main line specifically. Obviously, we have lost a lot of time, as well as money, in terms of much-needed investment in this important line. Do you think that the new time frame that has been set for refranchising the line is realistic?

Richard Brown: I think it is realistic. It is quite ambitious, but it is very important for passengers and for the supply industry, in particular, to get the process restarted. If you select overgenerous time scales, there is a risk that they will get complacent and not drive it forward. I am comfortable—and I think the Department is comfortable—that those time scales are achievable, but they will have to move fast. However, they need to move fast to restart the three paused franchises and, as I have said, to announce what they are going to do with the rest of the programme.

Q17 Lucy Powell: I totally agree that they need to move fast, but the worst thing that could happen would be for us to have another disaster with it; that is more important than the speed of it. Have you had assurances from the Department? Do you personally feel that it could, should and will be done in that sort of time frame?

Richard Brown: I have not personally had those assurances, but I think the Secretary of State said to you last week that he would be announcing how he intends to take forward the three paused franchises within the time scales that I suggested—by the end of February.

Q18 Lucy Powell: We have not heard back from him yet. He alluded to the fact that he would announce that at the same time as your report, but that has not happened.

Richard Brown: My understanding is that he has accepted that particular recommendation. It is not as if nothing has been going on for the last three months. Since the cancellation process, there have been people in the Department working on how to restart the programme, so of course it is possible.

Q19 Chair: Do you think it is feasible for him to do that within the time scale? It is a short time scale if he is going to take account of any of your recommendations, isn't it? It does not give him very long.

Richard Brown: I have made specific recommendations as to how the three suspended franchises should be restarted. They have been redacted because, as I said, it is stock market-sensitive information for the companies that are bidding and for the incumbents. I think it is not just important but feasible for them to announce how they will take those forward within that time scale.

Q20 Karen Lumley: Do you think that it is possible in the time scale to bring in outside commercial help?

Richard Brown: That is the other priority that I hope I made pretty clear in the report. The Government need to strengthen their capability urgently. That is not news—Laidlaw said exactly the same thing in his report. I have just made a number of more detailed suggestions about how to do that. I hope that over the next month or two they will be making announcements of a series of appointments, because they need to bring in some additional expertise to strengthen the teams that are already there.

Q21 Karen Lumley: Is there lots of that expertise out there? I have no idea.

Richard Brown: Franchising is a form of procurement. Many other organisations—both Government Departments and private sector organisations—do this sort of thing. There is plenty of expertise out there. There is a particular challenge for the Department, as there would be for any Government Department, in getting those sorts of people to come and work within a civil service structure. It will have to take some difficult decisions about terms and conditions and pay and give reassurances that people will be given the headroom to deliver what the Government want. However, that is not different from any other Government Department.

Q22 Karl McCartney: Thank you, Mr Brown, for coming in and for your report and the work that you have done. I would like to drill down into the future for franchising. Incumbency is a very strong card to have in anybody’s hand in various different facets of society, but certainly if you have won a franchise. Under your recommendations, with franchising lasting up to 15 years, do you think we might not see that many free and open procurement processes and we might end up with a 21st-century version of GWR, LMS and so on?

Richard Brown: No, I do not, because I have recommended that, more normally, you would have an initial franchise term of seven to 10 years, with a pre-contracted extension. That extension would be granted only if the franchisee were delivering what it is that it was contracted to deliver, which gives some protection against complacent incumbency, shall we say. Secondly, I have said that one of the things that need to be strengthened is franchise management, after the franchises are let, and that in the detail of that the Department needs to be a lot firmer with incumbents about releasing information during the bidding process.

Q23 Karl McCartney: A lot more proactive?

Richard Brown: It must be firmer and more proactive about the electronic data centre that has opened up, to make sure that everybody has all the information they need at the start of the bidding process and that it does not dribble in during the process. You need experienced procurement people to make sure that that happens.

Q24 Karl McCartney: So you believe that new entrants to the market may well take it upon themselves to enter the bidding process and that it will not just be left to incumbents? As I said, it is a big bonus to have been running the part of the railway concerned beforehand.

Obviously, if they are making a good job of it, most of them will want to carry on doing what they are doing, I would think.

Richard Brown: Taking a strategic look at it, it is very important that the Department look to encourage a continuing, healthy franchising market. That means encouraging new entrants to come in. There has been a relatively recent new entrant in MTR from Hong Kong, for instance, an experienced, quite big, well-resourced company. We should welcome it, but we should have a situation where it is possible, feasible and desirable to get in further new entrants, because you will get people dropping out over time or further mergers taking place, as I pointed out.

Q25 Iain Stewart: I have one factual question on your point about pre-contracted continuation in paragraph 4.7. I have a lot of sympathy with your argument there. Do you envisage a train operating company being able to walk away at that break point? Would it not be obliged to continue if it had already met the performance criteria?

Richard Brown: No, I envisage that it would not be able to walk away, because otherwise you would get back to the risk that it would bid over-aggressively in that franchise term, take its profits in the first term and walk away.

Iain Stewart: Okay. I just wanted to clarify that.

Richard Brown: That is quite an important part of my package to try to deter over-aggressive bidding but still encourage ambitious bidding. We want the bidders to be ambitious, because that will deliver best value to taxpayers in the long run.

Q26 Chair: How does what you have just said fit with your other statement that the "Government should tolerate the idea that a franchise may default"?

Richard Brown: The principal issue is that there have been suggestions that the capital that the Government asks a franchisee to put at risk—for the west coast, it would have been the subordinated loan facility; I have suggested that it would be a parent company guarantee—should potentially reimburse the Government for lost premium, or whatever, if the franchisee walks away. I do not think that is realistic, because the cost of the amount of capital that would be involved would be uneconomic. Therefore, you have to accept that, in the extreme, there will be occasions—essentially, we have had three out of the 47 franchises that have been let so far—where the franchisee defaults, walks away and sacrifices its deposit, if you like. You have to accept that that will happen, because the cost of insuring that it will never happen is uneconomic. Essentially, the Government would be buying an insurance that they would not normally otherwise buy. Insurances cost money, in one way or another. In this case, they would be paying a higher margin to the franchisee.

Q27 Chair: But you would not want to give the bidders an impression that they could leave things if it did not work out?

Richard Brown: There is a balance to be struck in how much capital you are asking the franchisee to put at risk. It needs to be a deterrent to walking away so that the franchisee does not walk away except in extreme circumstances, where it is otherwise about to go bust. However, if you set it at a level that makes sure that there is no loss to Government, you will be paying a significant extra premium or higher margin to the franchisee. There is a balance to be struck. If you are asking private sectors bidders to bid, the nature of the private sector is that, from time to time, you get failures. The important thing is to plan for that. In all three cases where that has happened, while there has been a great deal of uncertainty at the time, at the end of the day, no member of front-line staff has ever lost their job, no trains have been cancelled and no passengers have been unable to travel, because their tickets have been honoured. In each case, the transition to DOR went quite smoothly, so the situation is not as disastrous as it might first appear.

Q28 Chair: Are you concerned that the changes that you are suggesting might lead to that happening more often? It is true, if it happened only three times, that it was dealt with.

Richard Brown: No. My point is that you should not try to eliminate it altogether. If anything, the changes I have proposed would reduce the likelihood of that happening because, compared not with the west coast franchise but with earlier franchises, the bidders would be expected in the parent company guarantee to put up more money at risk proportional to their bids. You would be asking them to put their money where their mouth is, if you like, in terms of the ambition of their bids. That will probably be set at a higher level than it was for earlier franchises, so it should actually deter default. However, I am at pains to stress that it will never eliminate it.

Q29 Sarah Champion: Perhaps linking the last few questions, in paragraph 3.12, you say, “The franchising authority and the franchisee need to develop a partnership relationship.” Do you think that there is capacity for that sort of relationship within the Department?

Richard Brown: I think that it needs to be worked on, but it needs to be worked on equally on the side of the industry and franchisees. Some very encouraging progress is being made within the industry—for instance, with the Rail Delivery Group, where all the main franchisees and Network Rail are working together closely to deliver the McNulty regime. So partnership and collaborative working are becoming much more the norm within the industry. The industry needs to hold out a helping hand, if you like, to the Department to say, “We would like to adopt this approach with you as well,” but it takes both sides to operate an effective partnership, doesn’t it?

Q30 Sarah Champion: I would rather it were the other way round. Rather than the industry leading the Department, should it not be the Department leading and supporting the franchisees?

Richard Brown: My point is that both sides have to come to the table looking to operate in a partnership spirit. We should not expect one side to take the lead, particularly when that party—the Department—has quite a big task ahead to strengthen its capability and bring in new people. The industry should be looking to help with that, rather than wait for the Department to make the first move, if you follow me.

Q31 Sarah Champion: In your opinion, from your research, does the Department have the potential to scale up within the quite short time frame we are looking at?

Richard Brown: Yes, it does. It needs only a small number of additional experienced people to come in, because there are a good number of very good people in the Department. One of the other, more detailed issues is that the people who are working on franchising need to be given the chance to focus entirely on that, rather than other jobs, and to be left in position throughout the term of a franchise competition. Changes of people during the term are dangerous. There also needs to be the ability to pass on the experience of one competition to the team doing the next competition, and so on, so you are building capability with each successive franchise. That is the thing that has not happened with the most recent franchises.

Q32 Chair: If flexibility and change are built into the franchises, is that unfair on bidders who are excluded, who might have been able to change what they propose?

Richard Brown: It is important that it is not done in a way that is unfair. The point about flexibility and change during the franchise term is that from time to time the Government side will inevitably want to change some key component of some of the franchises. Electrification is a very good example. The Government and future Governments may well decide to electrify additional routes on top of those that have been committed. That could affect an existing franchise within its term. They will want to negotiate, via the change mechanisms, effective change to the terms of the franchise to allow that to happen. That is in the interests of passengers and taxpayers. It is important that the franchisee is encouraged to come forward with other proposals during the course of the franchise term, not just to deliver what it promised at the time of the competition and to sit back once it has delivered all of that and let the thing run through. That is the purpose of the change mechanisms. I do not think that needs to be at all unfair at the bidding stage.

Q33 Graham Stringer: Accepting that there needs to be more expertise in the letting of franchises, you say that this can be done in one of three ways. Do you have a preference between those three alternatives?

Richard Brown: If I had, I would have made a clear recommendation. There are some complex issues around financial management, financial delegation and legal issues. The Department has to decide how it is going to structure all of its rail activity, in policy as well as franchise letting. I have not made a recommendation really because I think there are a number of other factors I am not competent to rule on. I said these are medium-term options. The absolute priority is to bring in some additional people quickly and to strengthen the organisation as is, in order to restart the three suspended franchises and to get the rest of the programme going again. As I have said, the options I have set out are slightly more medium term.

Q34 Graham Stringer: In assessing the three alternatives—accepting that there is complexity at the moment—what criteria do you think the Committee should look at if and when the Government choose one of those three alternatives? How will we know which is the best of them?

Richard Brown: That is a good question. I have said that, whatever happens, it needs to be a discrete organisational unit. The accountability of that unit, so that it is absolutely clear who is delivering and managing the franchise programme, is a very important criterion. That is trying to build on the lessons from Laidlaw. The other important criterion is probably which one of those will be best at keeping the sort of capability and quality of experienced people to run this programme on an ongoing basis. Those are the two things that I would say should be the key criteria.

Q35 Graham Stringer: That is interesting. Do you think that your recommendation for the continuation of franchising, though in slightly different form, is the end of the other form of competition that we could have on the railways—open access for other train operators?

Richard Brown: I have not looked at open access, because it was fairly clear from my terms of reference that I was to look at franchising. My understanding is that there is no intention to do other than continue to encourage open access, but I have not looked at that as an alternative model, to be quite honest.

Q36 Graham Stringer: How much damage do you think has been done to the industry out there by what has happened on the west coast main line? Is the capacity within the industry still there to bid for the franchises that are coming up in the near future?

Richard Brown: I do not think that there has been any damage to capacity for bidding. The teams are largely still there, waiting to restart, and champing at the bit to get on with it. That is not to say that damage has not been done. The damage is more in the area of confidence in the industry, particularly in the supply chain and among investors in some of the supply chain companies. In my report, I mentioned that we have to understand that these days a lot of these companies operate internationally, or are even owned overseas, and they have continuous choices as to where to put investment and resource. That is where the damage needs to be repaired most quickly, to rebuild confidence in the wider industry and investment community.

Q37 Graham Stringer: There are two questions that immediately follow from that. I accept that one is how; you made that point in a couple of paragraphs in the report. Secondly, is it possible to quantify the damage that has been done? In terms of the financial costs, the compensation to the bidders is relatively easy to quantify—we have had different estimates from the Secretary of State—but is it possible to quantify the damage that has been done by the loss of confidence in both the national and the international industry?

Richard Brown: The honest answer is that I do not think you can quantify it. The more important question is, how do you minimise it? The way to minimise it is to get the process restarted and for investors in the wider supply base to see that the process is going forward again. One way of reducing the damage in the longer term will be to spread out the refranchising programme, as I have recommended, because that will make it much easier for bidders to resource their bids and will reduce their bidding costs, because they will not be drawing on a limited resource base in relatively short periods of concentrated bidding.

Q38 Graham Stringer: You do say that in the report, but I do not think you state there whether or not the industry should be consulted on the scheduling of bids. Do you think that it should?

Richard Brown: Yes, I think it will be quite important to consult the existing franchisees on the key issues coming up that should lead to a prioritisation of which franchises are let at which point. At various points, I have said that the Department should consult with bidders, in particular, before it finalises the ITT, to make sure that the ITT is clear, is delivering what Governments want and is structured in a way that gives bidders the opportunity to add real value in their bids. I have not said formally that they should consult on the programme, but I think they would be foolish not to take account of the industry's views.

Q39 Chair: You talk about imbalance and asymmetry between the bidders and the Department. How can that be addressed? If there are going to be more smaller franchises and more local authorities are going to be involved, will that make the imbalance worse?

Richard Brown: On the contrary, I think that, over time, having other authorities such as West Midlands PTE or some of the northern PTEs also procuring franchises will actually increase the resource base among the procurers—on the public sector side. The point about asymmetry is that these are big contracts and that, over time, bidders have evolved their approach to bidding and have pretty sophisticated, experienced teams. Some of the individuals have been doing this since franchising started 17 years ago. That is quite a sharp contrast with the Department, which has not been refreshing its capability in the last few years—in effect, since it took over the Strategic Rail Authority—to make sure that it is bringing in new, experienced people to refresh the teams and to compensate for people who have left for various reasons over the intervening years.

Q40 Chair: Why do you think our rail system is so popular with foreign bidders? We have a lot of companies—sometimes owned by other countries—running our rail. What do you think the attraction is?

Richard Brown: It is for the same reason as with the rest of our economy, which is very open to international companies coming here either to operate or to buy our companies. We have, probably, the most open economy certainly in Europe. Other countries find that very attractive.

Q41 Chair: How are we going to get more entrants as bidders? How can it be made more appealing to more people?

Richard Brown: As I said, one thing that the Department needs to bear in mind—this is perhaps a slightly longer-term consideration—is how to ensure a healthy franchising market. That can be done by having a variety of franchise sizes, so that a new entrant might bid for and, hopefully, win a smaller franchise to build experience of the UK system; having more franchises rather than fewer; and making sure that the capital requirements are proportionate and not excessive, so that you are not creating unnecessary barriers to entry. MTR is a good example. The fact that it has come in indicates that the current structure is probably about right. The key point is that we must not let it slip from that.

Q42 Chair: Could you expand a bit on your report in relation to anonymising the bidders? You say that they should be anonymous while the technical evaluations are being made and not after that. I am trying to relate that to what happened on the inter-city west coast. How would it have applied there?

Richard Brown: The argument for anonymisation is that it gives you a totally objective evaluation of bids, and no prejudices and feelings about one company or another that people may have can come into play in evaluating and judging which is to be the winning bid. I think it is quite desirable, particularly when you are doing the more technical early evaluation of bids, that you should be looking at what people are promising and saying, rather than allowing your judgment to be affected by what you already know.

When it comes to the decision makers, I think it is quite important that you know the identity of bidders, because that will lead you to ask more probing questions about what they are saying and whether you really believe it. From my experience of procurement, I have to say that complete anonymisation right through the chain is a mistake, but it has value at certain points in the process. As Laidlaw pointed out, there were one or two instances where the Permanent Secretary himself became aware of the identity of one of the bidders and excluded himself from further decisions. Clearly, that can’t be sensible, can it?

Q43 Chair: Taking past performance into account is another issue you raise. How would you assess that? Suppose there had been a problem and it had to do with the way Network Rail was dealing with the line, but the company was being blamed. How would you assess things in that case or where some difficult situation was going on?

Richard Brown: I think that is a two-step process. At the point of shortlisting bidders—the pre-qualification process—I have described the process as essentially backward-looking. Principally, that means looking at the track record of the bidders and their capability to deliver that particular franchise, because we are getting quite a wide range of different franchises that will require different skills going forward. The second area of track record—this is one of the important points about my proposal to have pre-contracted extensions—is, clearly, that you only get an extension if you have developed the track record in the first part of the franchise. It comes in at various stages.

Q44 Chair: You say in your report that, if somebody does default and walk away, they should not be excluded from other contracts. Is that right? Have I read that properly?

Richard Brown: I did not think that I had passed comment on whether or not they should be excluded, but, if somebody defaults, that would certainly be a pretty important thing to take account of, were they to apply to bid for a new franchise. One would need to look very closely at why they defaulted and whether or not the situation, the management, the ownership or whatever had changed since then.

Q45 Chair: So you would have that as something to be known about and part of the consideration, but not as an automatic exclusion?

Richard Brown: I think it would be foolish to make it an automatic exclusion, but it would be a very important thing to take account of.

Q46 Chair: You also say that the franchisees should form alliances with and work with Network Rail and others. How do you see that working?

Richard Brown: In franchising terms, I see it as a two-step process. I have suggested that, when a franchise is being competed for, the bidders should give a first cut, if you like, of what they think they could achieve in terms of cost saving—because this is principally about cost savings and the McNulty agenda—in alliance with Network Rail. Expecting Network Rail to have tentative alliances signed up with three or four different bidders would be a poor use of its resources, so it would be an initial estimate of what the bidders could achieve. Once the franchise has been let, the franchisee should be strongly encouraged to enter into an appropriate depth of alliance with Network Rail. The profit-share arrangement that I propose would ensure that, if they delivered savings in excess of bid, the Government and taxpayers would take their share of those benefits during the term of the franchise. Assuming those cost savings were ongoing, Government would, of course, enjoy the full benefit of them when the franchise came to its full term and was re-let.

Q47 Chair: So there would be a financial incentive for them to work together with other sectors of the industry?

Richard Brown: There needs to be, and it is appropriate to have, a direct financial incentive for the train companies to look with Network Rail for greater savings in infrastructure costs. The franchisees should also see the cost impact of some of the things that they are asking Network Rail to do, which they do not see at the moment. That is a shortcoming of the current excess charging structure.

Q48 Chair: That is an interesting area to develop. Thank you very much, Mr Brown. You have clarified some issues and given us some thoughts on other areas. Thank you very much indeed.

Richard Brown: Thank you for the opportunity.

Chair: Thank you for coming so soon after publication of your report. It is appreciated.