House of Commons
Committee of Public Accounts

Procuring new trains

Twenty-fourth Report of Session 2014–15

Report, together with the formal minutes relating to the report

Ordered by the House of Commons to be printed 26 November 2014

HC 674
Published on 17 December 2014
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

Committee of Public Accounts

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Contents

Summary

The Department for Transport's (the Department's) decision to lead on two major train procurements itself, despite having no previous experience of doing so, was a significant break from its previous approach of leaving it to the rolling stock companies and train operators to buy trains. The Department has stated that it intends to leave some operational decisions to the market and to intervene in others. But it has not set out when these different approaches will apply, which is confusing for the industry. The Department's decision to buy the trains itself has constrained the options available to future train operating companies as they will be required to use these trains to run their services. It is open to question as to whether the negotiations with preferred bidders provided best value. It is surprising, to say the least, that Agility reduced their price by 38% after Sir Andrew Foster reviewed the issue. By buying the trains directly the Department has taken on the risk of passenger demand forecasts being wrong. If demand proves to be lower than forecast taxpayers would have to cover the costs of any financial shortfall. These two major projects also demonstrate yet again that the Department has limited capacity and capability to manage large scale procurements, and that it remains overly reliant on consultants. Whilst we welcome Hitachi's decision on Intercity Express to invest in the UK, it is extremely disappointing that Siemens will not also be manufacturing the Thameslink carriages in the UK, when the £2.8 billion contract is funded by the UK taxpayer and farepayer.

Conclusions and Recommendations

1. The Department awarded two large contracts to private sector consortia to supply, finance and maintain new trains for Intercity Express and Thameslink with a combined cost of around £10.5 billion, which will be paid by train operators. The Department has opted to lead these procurements itself, rather than have rolling stock companies finance the trains and lease them to the train operators, which has been the usual model for train procurement. The 866 new carriages procured from the Hitachi-led consortium (Agility Trains) under the Intercity Express programme will replace ageing trains on the Great Western and East Coast lines. Siemens, in the Cross-London Trains consortium, will supply 1,140 new Thameslink carriages which are needed as part of a wider improvement programme, increasing the capacity and improving the frequency of this cross-London commuter service. The contracts will run for 27.5 and 20 years respectively. The Department awarded both contracts more than two and a half years later than intended, largely because of pauses to the procurements and the challenge of securing finance for these projects during the financial crisis. The Intercity carriages are now expected to enter service between June 2017 and 2020, and the Thameslink stock between 2016 and June 2018.

2. **The Department's failure to articulate its role in the rail system has caused confusion in the rail industry.** The Department considers that in taking the lead it is best able to secure value for money for taxpayers in procurements of this scale, but it has not set out when it intends to use this approach, causing confusion in the industry. The Department believed that it should lead these procurements because of their scale and complexity, and the need for greater uniformity in the fleet which would bring economies of scale and other operational benefits. It also believed that the train operating companies did not have the right incentives to buy trains which minimised maintenance costs to Network Rail. However, the Department's role in this procurement appears to be at odds with its previous policy of transferring responsibility for procuring trains to the industry. The Department did not appear to have examined alternative ways of achieving its objectives, such as providing the train operators with the right incentives. The Department has no clearly stated rationale for the aspects of rail where it will simply set policy and strategic goals, and those where it believes it has an additional responsibility to intervene in operational decisions.

   Recommendation*: The Department needs to work with the industry through the Rail Delivery Group to clarify the respective roles and responsibilities of government and industry, and to address weaknesses in the system including the lack of appropriate incentives to achieve a high-performing network, including good quality trains and low track maintenance costs.*

3. **The Department's decision to purchase the trains leaves all the risk with the taxpayer.** By deciding to buy the trains directly the Department has taken on the risk that if fewer new trains are needed in future taxpayers would need to cover the costs of any resulting financial shortfall. The Department's decision to procure the trains itself and guarantee that they will be leased for defined periods has left it bearing the

risk that passenger numbers may be lower than predicted. The only way the Department can mitigate this risk is to constrain the options available to future train operating companies by requiring them to use these new trains to run their services rather than having the flexibility to choose trains that best fit the services they would like to offer.

<u>**Recommendation**</u>***: The Department needs to calculate the potential impact of its decision on the taxpayer and put in place plans to mitigate that impact, if demand for train services means it is not economical for train operating companies to use these trains as expected. More broadly, the Department needs to develop with the industry a rolling stock strategy, setting out what rolling stock will be replaced, when and by whom to provide certainty to the industry.***

4. **Value for money was undermined by the lack of certainty at the start of the procurement process.** The Department began the procurement of Intercity Express trains without a clear idea of how many trains would be needed, which routes they would run on and what form of power would be required. The Department's original procurement notice was for between 500 and 2,000 trains, a very wide range, and it requested bids for trains on routes which were later excluded from the procurement. In addition, the Department decided in 2009 to electrify the Great Western main line which significantly changed the requirement, as there was no longer a need for diesel trains. Its specification therefore is goldplated to handle both diesel and electrified options and this is likely to mean higher prices and higher fares.

<u>**Recommendation**</u>***: The Department, working with key partners such as Network Rail, train operating companies and rail manufacturers, should develop a long-term, integrated strategy covering infrastructure, rolling stock and franchising, so that major decisions can be taken in a logical order which provides the industry with greater certainty.***

5. **The procurement process for the Intercity Express Programme was poorly managed from the outset.** Agility Trains' offer of a large unsolicited reduction at a late stage in the procurement process, when it was the only bidder for the Intercity Express programme demonstrates that the procurement process was poorly managed and that the Department's oversight of the likely programme costs was weak. The Department selected Agility in 2009, but in 2010 the Government put the programme on hold as part of its overall spending review and commissioned a re-evaluation of the programme's value for money, including potential alternatives. Agility then submitted a revised bid with a 38 per cent reduction in price. The Department admitted that this raised questions about whether the original tender was inflated. The Department would have needed to cancel and re-run the procurement if Agility had not reduced its bid.

<u>**Recommendation**</u>***: Before starting any procurement the Department should develop its knowledge of the supply market and underlying costs to inform its procurement strategies, to determine whether bidders' proposed prices are reasonable, and to help negotiate prices with suppliers.***

6. **We welcome Hitachi's commitment to invest in County Durham so that trains are assembled in the North East and support is given to the UK supply chain.** However, we are disappointed that Siemens will not be manufacturing the 1,140 new Thameslink carriages in the UK.

   Recommendation*: The Department should be more assertive in using its powers to require information on, for example, the supply chain proposals, the use of SMEs and the employment in apprenticeships to ensure that the UK economy and UK-based industry benefit from large capital public sector investment programmes.*

7. **The Department still lacks the skills needed to manage complex procurements.** The Intercity Express Programme illustrates once again our concerns about the very small number of senior staff in the Department with the skill and experience to oversee large complex procurements, resulting in frequent changes to the senior officials responsible and a reliance on consultants to manage these programmes. This is evidenced by the fact that there have been 7 changes of Senior Responsible Officer for the Intercity Express Programme since November 2007. The Department recognises that it lacks the in-house commercial and project management skills that it needs to manage complex procurements and noted that it has proposals in hand to recruit more permanent staff and to develop commercial skills in new graduate recruits. However, the Department accepts that these will take time to develop.

   Recommendation*: The Department must develop, set out and implement a clear strategy for developing the capability needed to deliver its rail strategy and address the concerns we have raised over many years about its senior management capacity and its commercial skills.*

1 The Department's role in the rail industry

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from the Department for Transport (the Department) on its procurement of new trains for the Intercity Express and Thameslink programmes.[1] The Department has awarded contracts to two private sector consortia to supply, finance and maintain the new carriages. Agility Trains, led by Hitachi Rail, will supply 866 train carriages for the Intercity Express programme at a future cost of around £7.65 billion. The Siemens-led Cross London Trains consortium will provide 1,140 new vehicles for the Thameslink programme at an estimated cost of some £2.8 billion.[2] The contracts to supply, maintain and finance the trains will run for 27.5 and 20 years respectively. Both procurements have taken longer than expected, with the Intercity carriages expected to enter service between June 2017 and 2020, and the Thameslink stock between 2016 and June 2018.[3]

2. Previously, new rolling stock has generally been procured by train operating companies, financed by rolling stock companies who lease the trains to the operating companies. However, in the cases of Intercity Express and Thameslink the Department considered that it was best placed to secure value for passengers and taxpayers by procuring the trains itself.

3. The Department told us that it had been reluctant to intervene and manage the procurements but that it had decided to do so because of the massive scale and complexity of both procurements, which it considered were larger than any single train operating company or rolling stock company could undertake[4]. The scale of the projects was driven by the desire to have a uniform fleet for the Thameslink programme, and to have Intercity Express trains that can operate on both the East Coast and Great Western Main Lines. For the Thameslink upgrade, a homogeneous fleet allows more trains to pass through the core section of the network, increasing passenger capacity. If a number of different trains were used, it would not be possible to run as many services in peak times, because the trains would have different performance characteristics, such as acceleration.[5] However, large one-off orders risk reducing the level of competition, and hence value for money.[6]

4. The Department believed that it would not have been able to leave it to train operating companies to co-operate with each other to procure homogeneous fleets of trains,[7] and that there was a need for a 'step change' reduction in the energy used by trains, and the wear and tear on tracks.[8] It also believed that train operating companies do not have

1 C&AG's Report, *Procuring new trains*, HC 531 Session 2014-15, 9 July 2014

2 Q 50; C&AG's Report, Figure 5

3 C&AG's Report, para 1.4

4 Q 6

5 Qq 14, 19, 55, 57, 81

6 Q 63

7 Qq 12,13, 14

8 Q 6

incentives to make optimal long term decisions as their contracts are typically for seven to ten years, while trains last for up to 40 years[9].[10]

5. We asked the Department what its rationale was for intervening in the operation of the rail network. It told us it was taking a 'mixed' approach to the procurement of trains "intervening only when and where necessary" and where it thought that intervention was "going to produce better value for money". For example, the Pacer trains running on the Northern franchise are coming towards the end of their useful life, and the Department has decided to ask bidders for this franchise for proposals for replacing the trains.[11] The Department also told us that investment to increase capacity and to electrify lines would require a collaborative approach, but there was 'no simple answer' to the question about the need for government intervention.[12]

6. The Department acknowledged that the procurement of trains for the Intercity Express programme would constrain the ability of future train operating companies to configure the rolling stock to offer the best service. Train operators on the Great Western and East Coast lines will be required to use these new trains, although they will have some scope to configure the internal layout of the carriages and to have flexibility in terms of train services.[13]

7. While the Department would not accept that constraining operators' choice of rolling stock would have an adverse effect on their profitability, it did accept that the demand risk—whether passengers use them and in what numbers—would ultimately be borne by the taxpayer.[14] It will be some years before it is clear whether this risk will materialise on these lines, as the Intercity carriages are not expected to enter service before June 2017, and the Thameslink stock before 2016.[15]

2 Delivering major rail projects more successfully

8. The Department made significant changes to the specifications for the new Intercity Express trains, which delayed the procurement. These problems might have been avoided if the Department had a better understanding of the sector's infrastructure and train needs, and a clearer strategic overview of the rail network.[16] The Department went out to tender before it had decided which Intercity routes the new trains would run on, resulting in it specifying six different routes and then eliminating some. The Department agreed that it should perhaps have been clearer about its plans for electrification of routes before it drew

9 Q 53

10 Qq 7,8

11 Q 30

12 Q 106

13 Qq 15, 16, 17

14 Qq 21, 25, 26, 40

15 C&AG's Report, para 1.4

16 C&AG's Report, para 8

up its initial specifications, rather than considering electrification part way through the procurement process. It also acknowledged that its specified range of between 500 and 2,000 carriages was very broad, and it had in practice assumed that between 500 and 1,000 carriages would be procured.[17]

9. When the Department drew up its original specifications for the Intercity Express programme, the business case for electrification on the Great Western line was weak, so the Department specified that it required self-powered (diesel) trains. When electrification of parts of the line were approved in 2009, the Department had to change its specification as self powered trains were no longer required.[18] Rather than stop and retender the Intercity Express train procurement to reflect these significant changes, the Department pressed on with the procurement with its preferred bidder, Agility Trains. The Department said that before proceeding it had assessed very carefully whether these changes fell within the original boundaries of the procurement. The Department maintained that had there been better value solutions available it would have stopped the procurement. However, the Department concluded that the abortive costs of stopping and then restarting the procurement would have been around £100 million.[19]

10. We asked the Department what the Intercity trains would have cost if it had pursued a standard public procurement rather than a PFI route.[20] The Department told us that it had evaluated this option at the beginning of the procurement and that it had concluded that the PFI approach offered the best value for money. Affordability, not value for money was the key factor in the decision to procure Thameslink trains using PFI, and affordability was also a factor in the decision to use PFI for Intercity Express.[21] The Department said that the Government at the time believed that a PFI-type approach could bring significant benefits in terms of value for money, by creating incentives for the manufacturer and its funders to deliver the trains on time and to the given specification, and to maintain the trains so that they would operate well throughout the life of the contract.[22]

11. The Agility consortium reduced its price by 38 per cent when the Department changed the specification at a late stage. Such a large unsolicited reduction does not inspire confidence that the Department has managed the procurement process well.[23] The Department selected Agility in 2009, but in 2010 the Government put the programme on hold as part of its overall spending review and commissioned a re-evaluation of the programme's value for money, including potential alternatives.[24] The Department suggested that Agility made the reductions as it saw the deal as globally important. However, the Department's admission that it could not have afforded to proceed with the procurement without this reduction did little to reassure us that the price the Department has negotiated is best value for the taxpayer. That Agility was able to offer such a significant

17 Q 93

18 C&AG's Report, paragraph 2.3, Q 93

19 Qq 69, 70, 71

20 Q 32

21 Qq 33, 34

22 Q 34

23 Q 74

24 C&AG's Report, para 2.13

reduction raises questions about whether the original tender was inflated.[25] The Foster Review into the value for money of Intercity Express, commissioned by the Secretary of State in March 2010, stated that he was "*not convinced that all the potentially viable and possibly preferable alternatives to IEP (Intercity Express programme) have been assessed alongside it, on an equal footing*". In September 2010, the Department received a revised proposal from Agility Trains, to provide fewer trains with a revised design at a lower price.[26]

12. The Department admitted that it did not have a credible alternative plan in case its negotiations with Agility stalled. It could have extended the life of the existing rolling stock while it paused to rethink before going through some further form of procurement. We note that the Department considers itself extremely fortunate that Agility revised its bid and offered an unsolicited reduction in price.[27]

13. There was a lack of continuity on these two projects, with 7 changes of senior staff leading the projects in 7 years. The Department said that it would have welcomed more continuity, particularly on the Intercity Express procurement. It is worrying that on major projects like these, the Department does not have consistent personnel in charge.[28]

14. The Department has a shortage of suitably qualified and experienced staff and is still reliant on contractors and interims. It has a programme in hand to recruit more permanent staff and reduce its reliance on contractors, although it foresaw that it would always have a need for contractors and interims to help it manage peaks in its workload. It has launched a commercial fast track programme, for example, to hire in young talented people who are interested in developing commercial skills.[29]

15. Hitachi will be assembling the Intercity Express trains in the UK, but Siemens will not be doing so with the Thameslink trains. We asked the Department what attempts it had made to insist on a proportion of the manufacture of the trains being carried out in the UK. The Department told us that its focus with these procurements was on getting the lowest price and value for money, and that having obligations for trains to be manufactured in the UK would have breached European law. The Department also told us that it tries to help the UK rail supply base to develop, but that this objective is treated as separate from its procurements.[30]

25 Qq 73, 75, 76, 78

26 C&AG's Report, para 11

27 Qq 77, 78, 80

28 Qq 1, 3, 4

29 Q 94

30 Qq 36-37 and 44

Formal Minutes

Wednesday 26 November 2014

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
Chris Heaton-Harris
Meg Hillier
Anne McGuire
Austin Mitchell
Stephen Phillips
John Pugh

Draft Report (Procuring new trains), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 15 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-fourth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 1 December at 3.00 pm

Witnesses

Monday 13 October 2014 *Page*

The following witnesses gave evidence. Transcripts can be viewed on the Committee's inquiry page at www.parliament.uk/pubaccom.

Philip Rutnam, Permanent Secretary, Department for Transport; **Michael Hurn**, Director, High Speed Rail and former SRO for both Thameslink and Intercity Express programmes, DfT; and **Lucy Chadwick**, former SRO for Intercity Express (currently DG International, Security and Environment Group), DfT Q1–109

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry web page at www.parliament.uk/pubaccom. PNT numbers are generated by the evidence processing system and so may not be complete.

1 Department for Transport (pnt0001)

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2014–15

First Report	Personal Independence Payment	HC 280
Second Report	Help to Buy equity loans	HC 281
Third Report	Tax reliefs	HC 282
Fourth Report	Monitor: regulating NHS Foundation Trusts	HC 407
Fifth Report	Infrastructure investment: impact on consumer bills	HC 406
Sixth Report	Adult social care in England	HC 518
Seventh Report	Managing debt owed to central government	HC 555
Eighth Report	Crossrail	HC 574
Ninth Report	Whistleblowing	HC 593
Tenth Report	Major Projects Authority	HC 147
Eleventh Report	Army 2020	HC 104
Twelfth Report	Update on preparations for smart metering	HC 103
Thirteenth Report	Local government funding: assurance to Parliament	HC 456
Fourteenth Report	DEFRA: oversight of three PFI waste projects	HC 106
Fifteenth Report	Maintaining strategic infrastructure: roads	HC 105
Sixteenth Report	Early contracts for renewable electricity	HC 454
Seventeenth Report	Child maintenance 2012 scheme: early progress	HC 455
Nineteenth Report	The centre of government	HC 107
Twentieth Report	Reforming the UK Border and Immigration System	HC 584
Twenty First Report	The Work Programme	HC 457
Twenty Second Report	Out-of-hours GP services in England	HC 583
Twenty Third Report	Transforming contract management	HC 585