House of Commons

Committee of Public Accounts

Reform of the rail franchising programme

Twenty-first Report of Session 2015–16

HC 600

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The Committee of Public Accounts

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Summary

The last time we discussed rail franchising was in 2012, in the wake of the collapsed competition for the InterCity West Coast franchise. We are encouraged that, since then, the Department for Transport (the Department) has strengthened its capability to let franchises, but there are still gaps in its ability to then manage the contracts effectively. The Department's increased focus on the passenger experience is also welcome, but it is unclear when passengers themselves will actually see the benefits. Furthermore, the Department has not yet developed the partnerships with operators that are required to support innovation, improve efficiency and improve services for passengers. Successful rail franchising depends on strong interest from the market and effective competition but there are barriers to entry to the UK market and the possibility that current participants in the market may drop out. Any reduction to the current level of competition is a major risk to securing value for money for the taxpayer.

Perhaps the biggest challenge facing the Department is to manage the complex interdependencies between passenger rail franchises, the infrastructure that train services run on and the introduction of new fleets of trains to the network. Uncertainty about infrastructure work has resulted in delays to franchise competitions and the Department will have to rely on potentially expensive changes to franchises during the life of contracts. The Department's role is to provide a strategic lead for the complex rail system but it has not yet shown that it has embraced this role. It needs to provide a coherent strategic vision and stronger leadership to ensure that the investment decisions it makes now do not result in increased costs in the long term.

Introduction

The Department for Transport (the Department) is responsible for awarding franchises in England and Wales to private sector companies to run passenger rail services. In October 2012, the Department cancelled its competition for the InterCity West Coast franchise, having discovered errors in the procurement process. The Department also paused three further franchise competitions. We and the National Audit Office published reports on the events that led to the cancellation of the InterCity West Coast competition and made recommendations for the Department to implement to protect value for money. The Department also commissioned its own inquiry into the collapse of the West Coast competition, as well as a wider review of passenger rail franchising - the Brown Review. In March 2013 the Department launched a revised rail franchising programme of 15 competitions over an eight-year period. To maintain the provision of train services and to facilitate a staggered programme of competitions, the Department also planned to make 2 short-term, single tender actions (direct awards). Since the launch of the programme the Department has awarded 5 franchises through competitions and has made 11 direct awards.

Conclusions and recommendations

1. **It is not clear when passengers are going to see the promised improvements in service quality.** The Department has increased its focus on improving passengers' experience through the rail franchising programme. It reassured us that, whereas franchises were previously won largely on price, it now attached significant value to, for example, cleanliness, safety and security at stations, and wifi access. But the Department could not tell us when passengers would see the benefits of its new approach to rail franchising. On capacity—providing enough seats for everyone—the introduction of new trains on some routes has helped. The Department acknowledges that one of its core challenges within the franchising programme is to keep pace with rising passenger numbers.

   Recommendation: ***The Department should set out clearly and transparently by autumn 2016 what benefits it expects passengers to see from each franchise and by when.***

2. **There is a real risk to value for money if market interest in operating rail franchises declines any further.** The number of bids the Department receives for franchise competitions has reduced, on average from 4 to 3, since the restart of the franchising programme in 2013. The Department acknowledges the risk that some of the nine transport companies that currently run rail franchises may drop out of the market, but was unclear about how it plans to retain their interest. The Department has been trying to attract new entrants to the market by, for example, reducing the cost of pre-qualification for franchise competitions, but has had limited success. Despite the significant barriers to entry to the market, the Department does not currently have a plan to adjust its procurement approach in the event that levels of interest in a franchise falls to a level where competition would be ineffective.

   Recommendation: ***The Department should develop alternatives to its current commercial approach so it is well placed to deliver value for money if market interest falls to a level where intense competition cannot be guaranteed. The Department might benefit from looking at other markets where competition has been limited, such as the energy market, to see if it can learn lessons which may help in the future.***

3. **The Department has made relatively poor progress in building up its franchise management capability.** We acknowledge the steps the Department has taken to improve its franchise letting capability since the collapse of the 2012 Intercity West Coast competition. However, the Department's capability to manage franchise contracts has not noticeably improved. The Department is committed to strengthening its franchise management, but around 7% of positions in franchise management teams remain vacant. We recognise that building contract management capability is a challenge across Government, but it is surprising that the Department has not been able to attract more of the right people, despite having the flexibility from the Treasury to pay more additional allowances to high calibre experts.

Recommendation: ***The Department should fill its remaining vacancies with appropriately qualified individuals as soon as possible. It should provide us with an update on its progress in filling these vacancies and its use of flexibility to pay experts market rates by June 2016.***

4. **The Department is not doing enough to develop partnerships with operators that facilitate innovation and improve services for passengers.** Train operating companies have concerns that the Department takes too rigid an approach to letting and managing franchises, which stifles innovation and reduces efficiency. The Department says it is moving to an approach that gives operators more flexibility—with more onus on operators to explain what benefits they will deliver for passengers and then set out for themselves how they will achieve that. The Department has previously been too focused on over-specifying the detail, and in turn constrained any flexibility for the operators to be more innovative. The Department is reviewing its franchise contracts to seek ways to enable more flexible working with operators, and acknowledges that it has not made best use of flexibility available to it under the current standard franchise contract.

Recommendation: ***The Department should set out the specific steps it is taking to encourage innovation both during the franchise letting process and during the life of the franchise to secure greater passenger service benefits from operators, and better returns to the taxpayer.***

5. **The scale and uncertainty of planned infrastructure improvements is delaying franchise competitions, and will result in contractual changes, which will come at a cost.** The Department has delayed competitions for a number of franchises, including Transpennine Express, Northern and InterCity West Coast. Such delays mean that the department could be running more competitions simultaneously, straining both its own resources and those of potential bidders. On the Great Western franchise, uncertainty about the timing and specification of the electrification programme resulted in significant delays to the competition and a second non-competitive 'direct award'. The franchise will not benefit from the value that competition can bring for up to six and a half years. The Intercity West Coast franchise could go the same way unless the Department gains greater certainty about the plans for the development of Euston Station as part of High Speed 2. The Department considers that Sir Peter Hendy's review of Network Rail's infrastructure programme provides greater certainty in the short term. However, the Department is still largely reliant on making changes during the life of franchises to manage uncertainty about the impact of infrastructure projects on franchises. There is also a risk that the incumbent operator will hold the upper hand in any negotiations to change contracts, which would increase costs to the Department.

Recommendation: ***The Department should capture and apply learning from its experience of letting and managing franchises during this time of uncertainty, while building on the Hendy review to develop greater certainty about infrastructure requirements.***

6. **The Department's lack of a coherent strategic vision for the rail system presents a risk that it will make decisions now that prove costly in the future.** The Department is responsible for the overall strategic development of the rail network, rail policy, funding and the regulation. However, we are not convinced that it has a coherent vision for the rail system. The Department's position at the centre of the complex rail system means that it is ideally placed to enable the integration of the infrastructure improvement programme, rolling stock replacement and rail franchising. However, following the reclassification of Network Rail as a public sector organisation, the Department is only now putting in place governance processes to oversee both infrastructure work and franchising.

Recommendation: ***The Department needs to provide a coherent strategic vision and stronger leadership to ensure that the investment decisions it makes now do not result in increased costs in the long term.***

1 Reform of the franchising programme

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 work to reform the rail franchising programme.[1]

2. In October 2012, the Department cancelled its competition for the InterCity West Coast franchise, and paused three further franchise competitions. Following that episode, the previous Committee of Public Accounts and the National Audit Office made recommendations to improve, for example, senior level oversight, governance and assurance, and commercial and project management capacity and capability. The Department also commissioned its own inquiry into the collapse of the West Coast competition, as well as a wider review of passenger rail franchising (the Brown Review).[2]

3. In March 2013 the Department launched a revised rail franchising programme of 15 competitions over an 8-year period. One of the recommendations of the Brown review was that the Department should establish a staggered programme of competitions and limit the number of competitions it runs each year. In order to do this the Department decided to award a total of 12 short-term, single tender actions (direct awards) to incumbent operators. This means that a number of franchises operate without the benefit of competition for longer than expected.[3] Since the launch of the programme the Department has awarded 5 franchises through competitions and has made 11 direct awards.[4]

4. The Department has acknowledged the problems that led to the collapse of the competition for the InterCity West Coast franchise in 2012, and there are early signs that it has improved its management of passenger rail franchising. It has increased its capability to let franchises, including the appointment of a well respected and experienced Senior Responsible Owner for the programme. The Department's Passenger Services team, which is responsible for letting and managing franchises, is better resourced, partly through the appointment of 9 staff using flexibility agreed with the Treasury to pay technical and commercial professionals more than would usually be paid to civil servants. The Department has also improved its engagement with the companies that run passenger rail services.[5]

5. The Department has increased its focus on improving passengers' experience through the rail franchising programme. It told us that, whereas franchises were previously won largely on price, it now attached significant value to aspects of passenger service quality including cleanliness of trains, safety and security at stations, and wifi access on trains.[6] In addition, on the Northern franchise, the government has specified that the operator of the franchise will be required to introduce new trains to replace the fleet of 'pacer' trains that are particularly unpopular with passengers. The Department told us that the main

1 C&AG's Report, *Reform of the rail franchising programme*, Session 2015–16, HC 604, 24 November 2015
2 Q 1; C&AG's Report, paras 1.1–1.5
3 Qq 1, 19, 65; C&AG's Report, paras 1.14, 2.2
4 At the time of our evidence session on 2 December 2015 the Department had made 10 direct awards and awarded 3 franchises through competitions, since restarting its franchising programme in 2013. On December 3 the Department announced a direct award for the West Midlands franchise and on 9 December it announced the award of the Northern and Transpennine Express franchises following competitions.
5 Qq 1, 17, 115; C&AG's Report paras 6, 1.5–1.10 and Appendix 3; [Ev X letter from Peter Wilkinson to Chair December 10 2015]
6 Qq 107–109; C&AG's Report, paras 3.8–3.11

reason for this decision was the view of Ministers that passengers' experience of the pacer trains was poor and that the trains were not compatible with the government's overall vision for the northern powerhouse, and regeneration and connectivity in the north of England.[7]

6. The Department told us that it will take time for franchises to develop, but it could not tell us when passengers would notice improvements in service quality. The exception is increased capacity on routes benefiting from the procurement of new trains which are able to carry more passengers.[8] The Department acknowledges that one of the biggest challenges it faces is to increase capacity to provide seats for everyone at a time when passenger demand is growing at around 4–5% per year across the network, with higher increases in some areas.[9]

7. The Department monitors crowding on trains by measuring the number of passengers that are travelling in excess of defined capacity levels. The Department told us that it takes account of this forecast growth in demand as part of the franchising programme, and that rail investment programmes such as the Thameslink programme will makes a significant contribution to increased capacity on major commuter routes into London.[10]

7 Qq 47–51
8 Qq 107–110
9 Q 113
10 Qq 84, 107–114

2 Commercial and contract management

8. Passenger rail services are, on the whole, provided by the private sector. Achieving value for money from the rail franchising programme therefore depends largely on the effectiveness of the Department's engagement with the market and on its contract management. This includes generating sufficient market interest to enable effective competition and result in high quality bids, and having the commercial and contract management capability to work with operators to get best value for passengers during the life of franchises.[11]

9. There are signs that the level of interest from the market in rail franchises is dwindling. The Department has received three bids for each of the first five franchise competitions it has completed since the franchising programme was restarted in 2013. The previous 10 competitions received an average of four bids.[12] The Department told us that the quality of bids it has received has been high. However, by its own measure, the Department requires at least three bids per competition to create competitive tension and increase the likelihood of receiving high quality bids.[13]

10. The 15 franchises that the Department is responsible for letting and managing are currently run by nine owning groups. Some franchises, such as the InterCity East Coast franchise which is run by Virgin and Stagecoach, are run jointly by two of those nine owning groups, and some owning groups run multiple franchises.[14] The Department has been trying to attract new entrants to the market. For example, the Department has attempted to reduce the cost of pre-qualification for franchise competitions, by issuing a 'PQQ passport', which means that bidders do not have to submit the same information to pre-qualify for every competition.[15] In addition, the Department told us that it is reviewing the size of franchises to make them more attractive to new entrants and the Department has met with four international rail operators about entering the UK market. It expects two or three of those operators to enter the UK market in the next few years.[16]

11. The Department has had limited success so far in attracting new market entrants. Each of the five completed franchise competitions have been won by operators who already run franchises in the UK. We were encouraged, however, that the Department takes steps to limit the benefit of being the incumbent operator and level the playing field when a franchise is re-let. Of the five franchises awarded so far through competition, three have resulted in a change of operator.[17]

12. The Department told us that there is always a risk that one of the current participants will decide not to remain in the market. The Department has analysed the current market and identified a number of potential reasons why levels of competition for franchises could fall further, including increasing opportunities in European markets and the lower cost

11 C&AG's Report, para 3.1, 3.19–3.21
12 Q 1; C&AG's Report, para 3.21
13 Qq 83; C&AG's Report, paras 3.21–3.23
14 C&AG's Report, para 3.20, Figure 5
15 Q 65; C&AG's Report, para 3.23
16 Qq 66–68, 71; C&AG's Report, para 3.20
17 Qq 56–62,

of bidding to run bus operations.[18] However, the Department was not clear about what it is doing to retain interest from current operators. In addition, the Department could not tell us how it would adjust its procurement approach in the event that levels of interest in a franchise fell to a level that resulted in ineffective competition. The Department might do this, for example, by introducing more negotiation and dialogue with bidders between the evaluation of bids and award of the franchise.[19]

13. We noted above that the Department has improved its capability to let franchises. However, transport owning groups consider that the Department's capability to then manage franchise contracts has not noticeably improved. The Department told us that its focus since it restarted the franchising programme in 2013 has been on letting franchises and that it is now looking to improve its franchise management capability. This is particularly important because, as the Department stated, it is important to continuously improve benefits for passengers and taxpayers through the life of a franchise.[20] In addition, the Department anticipates that it will have to negotiate significant changes to franchises in the future, which will require strong commercial skills. Seven per cent of franchise management posts are currently vacant and 11% are filled by interim staff.[21]

14. Train owning groups have also expressed concerns that the Department takes too rigid an approach to letting and managing franchises. In particular, owning groups felt that that the large number of committed obligations in franchise contracts results in a rigid approach to contract management which can be inefficient and limit innovation.[22] The Department told us that it has recently taken steps to develop stronger partnerships with operators to encourage innovation. For example, the Department told us that, with the Greater Anglia franchise, the most recent franchise that it has put out to for tender, it has tried to tell operators less about how to run their businesses and instead to specify the outcomes that it expects operators to deliver for passengers. The Department is also reviewing its standard franchise contracts to seek ways to enable more flexible working with operators. However, the Department acknowledges that the challenge is more about developing better relationships with operators, and that it has not made best use of flexibility available to it under the current standard franchise contract.[23]

18 Qq 64–65; C&AG's report, para 3.22
19 Qq 64–65; C&AG's report, para 3.24
20 Q 92; C&AG's Report, paras 9, 3.15–3.18
21 Qq 3–12, 41; Evs [letter from Peter Wilkinson to Chair, December 10 2015]
22 Q 89
23 Q 87, 93–95; C&AG's Report, paras 3.15–3.18

3 Oversight of the rail system

15. The Department is responsible for the overall strategy for the development of the rail network. It controls the main levers in relation to policy, funding, the award of franchises and the regulatory regime. Following the reclassification of Network Rail as a public sector organisation, the Department is ultimately accountable for Network Rail's programme of infrastructure improvements, as it is for the development of the High Speed 2 programme. As such, it is ideally placed to enable the integration of infrastructure improvement programme, rolling stock replacement and rail franchising. The Department told us that the single biggest issue it faces is to ensure that the relationship between the Network Rail's improvement programmes and franchising are managed effectively.[24]

16. The Department told us that it has put in place mechanisms to help it manage the interfaces between High Speed 2 and the rest of the rail system, and make informed judgements. However, the Department does not yet have a similar governance structure for the wider network which brings together train operating companies and Network Rail. The Department told us it would be putting in place more robust governance arrangements to manage these interdependencies.[25]

17. We sought clarification of the Department's policy on rolling stock procurement. On the one hand the Department told us that its procurement of trains for the Thameslink and Intercity Express programmes is not the Department's current practice and that it now intends to leave the procurement of trains to operators through the franchising process. On the other hand, the Department also told us that in some cases, such as where very large train procurements are required, Government might procure trains itself.[26]

18. The scale and complexity of infrastructure improvement projects currently planned or underway, and delays and cost increases to Network Rail's programme are creating uncertainty for the franchising programme. The Department told us that very few parts of the railway system are not being touched by significant infrastructure change. The Department has had to employ a number of approaches to managing uncertainty, including to delay competitions for franchises such as Transpennine Express, Northern and InterCity West Coast.[27] These delays are likely to result in the Department carrying out more competitions simultaneously, which would put a strain on resources in the Department and amongst bidders. The further delay to the Intercity West Coast competition, for example, has resulted in the Department planning to begin four franchise competitions during an eight month period. Delays to franchise competitions can also result in the need for additional direct awards, which mean that passengers and the taxpayer miss the benefit of competition for longer.[28] On the Great Western franchise, uncertainty about the timing and specification of the electrification programme resulted a second direct award, which means that the franchise will not benefit from the value that competition can bring for up to six and a half years. The Intercity West Coast franchise could go the same way unless the Department gains greater certainty about the plans for the development of Euston Station as part of High Speed 2.[29]

24 Q 99; C&AG's Report, paras 1–2, Figure 3
25 Q 99
26 Qq 43–44
27 Qq 1, 35, 43 and 46; C&AG's Report, paras 13, 1.16, 4.8
28 Qq 19–20; C&AG's Report, paras 1–16-1.18, Figure 3
29 Qq 34–39, 52; C&AG's Report, para 2.6–2.7,

19. Another approach the Department adopts is to manage change during the life of the franchise. The Department considers that there will be significant amounts of change that it will have to instigate as specifications and timetables for infrastructure improvements change. In such negotiations there is a risk that the operator could hold the upper hand, resulting in higher costs to the Department. The Department was not able to tell us what it expects the cost of contractual changes to be, and acknowledged that it needs to develop robust information on which to base its negotiations with operators when changes to franchises are required.[30] The Department considers that Sir Peter Hendy's review of Network Rail's infrastructure programme provides greater certainty in the short term but there are clearly still significant risks to be managed.[31]

30 Qq 41–43, 46, 92; C&AG's Report, para 13, 4.7–4.10
31 Qq 35, 126

Formal Minutes

Wednesday 3 February 2016

Members present:

Meg Hillier, in the Chair

Mr Richard Bacon	Stephen Phillips
Deidre Brock	John Pugh
Kevin Foster	Karin Smyth
Nigel Mills	Mrs Anne-Marie Trevelyan

Draft Report (*Reform of the rail franchising programme*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 19 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Twenty-first 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 8 February 2016 at 3.30pm

Witnesses

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

Wednesday 2 December 2015 *Question number*

Philip Rutnam, Permanent Secretary, **Bernadette Kelly**, Director General, Rail Executive, and **Peter Wilkinson**, Managing Director, Passenger Services, Department for Transport Q1–126

Published written evidence

The following written evidence was received and can be viewed on the Committee's inquiry page. RRF numbers are generated by the evidence processing system and so may not be complete.

1 Department for Transport (RRF0001)

2 Rail Executive Passenger Services (RRF0002)

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