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The Committee of Public Accounts

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Summary

We are deeply concerned that the Department for Transport's management of two of its most important franchises has been completely inadequate and could be indicative of wider weaknesses in its contract management capability. Passengers on the Thameslink, Southern and Great Northern franchise have suffered an appalling level of delays and cancellations since the franchise started in 2014. At one point, less than two thirds of trains arrived on time. This totally unacceptable state of affairs which caused misery for passengers was due to a catalogue of failures by the Department, Network Rail and the operator, Govia Thameslink. The Department was too ambitious about what could be achieved, and it overlooked the poor condition of the infrastructure of the rail network. The Department was also ambivalent about the risk of industrial action and neglected to engage constructively with rail unions. The Department failed to see, or chose not to see, the perfect storm of an ambitious upgrade programme coupled with plans to increase driver controlled operation of trains. While there has been some improvement recently and there are signs that Network Rail and Govia Thameslink are now working together more effectively, we remain sceptical that this will address the serious and deep-rooted problems we have identified. On the East Coast franchise, the Department has failed to learn the lessons from previous failures of the franchise, and has again allowed the operator to promise more than it could deliver. The Department will have to put in place new arrangements for running train services. We are concerned that the Department could terminate its contract with VTEC yet still give the operator the opportunity to run the franchise again in the future. The issues we have found with the East Coast and TSGN, and the small pool of potential bidders in the market, highlight the broken model of franchising.

Introduction

The Department for Transport (the Department) awards franchises to run rail services for passengers to private sector companies. The Thameslink, Southern and Great Northern (TSGN) franchise, which operates services in South East England, is the largest of the Department's passenger rail franchises and is also tasked with supporting delivery of the Thameslink Programme to improve services for passengers. The current operator, Govia Thameslink, started operating services on the franchise in September 2014. Since then, performance has been poor: 146,000 trains were cancelled between July 2015 and March 2017, and more trains have been delayed on this franchise than any other.

The East Coast franchise covers intercity routes between London King's Cross and Yorkshire, the north east of England and Scotland and is run by Virgin Trains East Coast (VTEC). The franchise started in 2015 and had been due to run until 2023. In February 2018, the Department announced that VTEC's contract to operate the franchise would end some five years early. Passenger numbers have not increased as much as the operator assumed when it bid for the franchise, meaning that VTEC will not be able to continue to pay the Department the amount it is contractually required to run the franchise.

Conclusions and recommendations

1. **Passengers have suffered unacceptable levels of disruption due to the Department's inability to effectively balance the trade-offs between short-term returns to taxpayers and sustainable improvement of passenger services.** The Department had complex priorities for the franchise: to maximise the number of services for passengers, modernise practices on the railway and support the Thameslink programme, and to do all of this while operating on a congested and unreliable network. The Department's failure to manage these competing aims meant that the priorities and incentives of the operator and Network Rail were not adequately aligned in the interests of passengers. In the first three years of the current Thameslink, Southern and Great Northern franchise, services delivered by Govia Thameslink were the least punctual on the whole rail network, causing misery for many passengers. Network Rail told us that the increasing number of trains using the railway meant that knock-on effects of any problems are greater than they used to be, and that until recently it was 'virtually impossible' to get enough time to do the required amount of maintenance work, since the operator runs trains, as part of its franchise agreement, throughout the night on parts of the network. It now recognises the need to spend £900 million to ensure that the network can accommodate the increased number of train services that will be delivered by the Thameslink Programme. In its written evidence to the Committee, ASLEF points to a lack of communication between Network Rail and train operators that results from the lack of alignment between control periods and franchising schedules and more successful collaboration would be mutually beneficial. Network Rail and Govia Thameslink told us that they are now working together much more closely, and that this has led to a 38% improvement in the reliability of the railway infrastructure coming out of London Victoria station.

   Recommendation: ***From the next franchise it awards onwards, the Department should ensure that the priorities and incentives of Network Rail and the franchise operator are aligned to serve the passenger. These incentives should be embedded in contracts, rather than relying on good relationships between individuals.***

2. **The Department turned a blind eye to the potential level of industrial action on the Thameslink, Southern and Great Northern franchise, a particular lack of foresight given that it already knew that passengers were at risk of disruption from the Thameslink programme.** The Department recognised that the Thameslink programme is probably the most complicated upgrade it has ever attempted on the live UK rail network. It told us that it wanted the operator to focus on delivering the programme rather than maximising revenue. In spite of this objective, and alongside other ambitious elements such as increasing the number of services, the Department allowed bidders for the franchise to propose increasing the proportion of driver-only operation (also known as driver-controlled) trains, although it knew that there had already been some industrial action relating to the introduction of driver-only operation. The Department told us that it expected this to cause some disruption for passengers, although it admitted that it had not discussed its plans with the rail unions. The RMT told us that no specification for any franchise has ever been shared with them and that extending Driver Only Operation was not in the public consultation for the Southern routes. ASLEF also assert that the

Department accepted GTR's driver only operation plan but did not fully evaluate the possible effects on passengers of industrial action, nor did it ask GTR to do so. The Department asserted that the large-scale and long-term industrial action was responsible for the worst levels of disruption, including the period when fewer than two thirds of trains arrived on time. The way the Department designed the franchise meant that the operator did not have the usual incentives to maintain performance levels for passengers as it did not benefit from rising passenger revenue. Whilst the Department seeks to heap blame on the unions, it must acknowledge that its own decisions and lack of constructive engagement have played a large part in the dismal service for passengers.

Recommendation: ***The Department should reflect on the lessons from TSGN about the level of change that can be achieved on any one route. Where it does anticipate change, it should ensure the franchise operator has robust risk management plans in place which take into account how other elements of the broader rail system have the potential to improve or harm delivery of passenger services. It must ensure it engages with all key stakeholders including rail unions, as an open and honest dialogue is in the best interests of passengers.***

3. **It is unacceptable that the Department agreed to disregard the terms of its contract and settle the level of fines Govia Thameslink will pay for future poor performance before knowing whether Govia Thameslink was performing well or not.** The Department told us that it had considered cancelling its contract with Govia Thameslink Railway in early 2017 because performance for passengers was so poor. Instead, in July 2017, the Department agreed a settlement worth £12.4 million with the operator for the period between September 2015 to September 2018 to compensate for actual and expected poor performance. It said that a settlement would benefit passengers more because using the performance regime available within its contract with Govia Thameslink would have required management time spent 'arguing over a huge number of detailed claims' instead of focussing on improving performance. Govia Thameslink agreed that it was time to 'draw a line and move on'. The Department asserted that it made a good decision in settling for performance in future as Govia Thameslink will pay more under the agreement than it would have done if the Department had enforced the terms of the contract. However, the standards expected of all public services dictate that penalties should always be determined by the actual level of performance. Settling on the basis of future performance means the Department has fewer levers available to it to manage Govia Thameslink's performance if it does not improve. The Department told us that if performance deteriorated, it could always find Govia Thameslink in breach of the contract. This is not a credible threat, since the Department has already decided once that it could not use the performance regime in the contract.

Recommendation: ***The Department should write to us by September 2018, explaining how it has reviewed its approach to performance management of rail franchises, in order to reduce the risk that performance regimes break down in practice and to set clear expectations for protecting passengers and taxpayers if alternatives to the contracted regime need to be found. It should also set out how it held Govia Thameslink to account between September 2017 and September 2018, and how it will do so after the current agreement ends.***

4. **We are concerned that the Department still does not have a good enough understanding of what causes passengers to choose to travel by rail, given how central this is to making the right decisions for passengers and taxpayers.** The East Coast franchise has now failed for the third time, and yet again it has failed because the operator's passenger growth forecasts were wildly wrong and created a serious gap between predicted revenue and reality. The franchise previously failed in 2006 and 2009. In 2011, the previous Committee found that the Department had not been rigorous enough in questioning the previous franchise holder on its over-optimistic assessment of the business, and did not test bids against a range of different scenarios. As we were reminded in a written submission from the National Union of Rail, Maritime and Transport Workers (RMT), this story bears some of the hallmarks of the collapse of the previous East Coast franchise in 2009. The RMT also argued that the slowdown in passenger journeys between 2010–2013, precisely at the time when bidders were preparing their bids, did not support the expected increase in passenger numbers. The Department told us that this franchise is 'perhaps more volatile than others', but also said it had identified 50 or 60 factors that affect the behaviour of passengers and demand across the network, such as the relatively low cost of petrol and increased flexible working. It recognises that accurately predicting demand is extremely important both for itself and for the rail industry. The Department told us that it wants bidders to be ambitious about what they offer passengers. However, Stagecoach was clear that bidders would only put forward ambitious proposals if the level of risk they were asked to take on was acceptable. In written evidence to the Committee, ASLEF argue that train companies are encouraged to overbid because the highest bidders generally win. ASLEF also say that the government pushes for ambitious improvements such as increased capacity and more and faster train services which has led to unrealistic contractual demands and unachievable promises being made. The resulting problems and delays have had a knock-on effect on train operators. Companies appear to be aware of this, leading to fewer and fewer potential operators interested in bidding for franchises. Stagecoach told us that its failure to forecast passenger demand accurately means that it will lose about £200 million from the East Coast franchise, which is equivalent to about 20% of the company's current value. But ASLEF also point out that when operators are forced to hand back the keys and the process of refranchising begins, it is ultimately the taxpayer who incurs the cost. Franchisees bid too much and the public sector pick up the pieces.

Recommendation: ***The Department must take urgent action to improve its understanding of what causes changes in passenger demand, and use its understanding of these factors to model a range of likely outcomes before awarding franchises. It must write to the Committee before it awards any more franchises to explain the improvements it has made.***

1 The Thameslink, Southern and Great Northern Franchise

1. On the basis of a report from the Comptroller and Auditor General, we took evidence from the Department for Transport (the Department), Network Rail and Govia Thameslink Railway (Govia Thameslink) on the performance of the Thameslink, Southern and Great Northern (TSGN) franchise.[1] We also took evidence from the Department, Network Rail, Stagecoach and Virgin Trains East Coast on the recent announcement that the East Coast franchise would end early, which is covered in Part Two of this report.

2. The Department for Transport designs, lets and manages franchises which operate most passenger rail services in Britain. Since September 2014, Govia Thameslink has operated the TSGN franchise. The franchise operates services in the south-east and east of England and is the largest of the Department's 15 franchises. In 2016–17, there were 321 million journeys on TSGN services.[2]

3. The TSGN franchise was designed to support the delivery of the Thameslink programme, which aims to increase capacity and reduce overcrowding throughout London and the South East through introduction of new trains, which run more frequently, and infrastructure works costing £5.5 billion. The franchise also intended to increase passenger services and modernise practices on the railway. Network Rail, which is funded by the Department, is responsible for maintaining and improving the rail network, including delivering the infrastructure elements of the Thameslink programme. We reported on the progress of the Thameslink programme earlier in the year.[3]

Passenger disruption

4. Passengers using the TSGN franchise have suffered a sustained period of disruption, which started almost as soon as Govia Thameslink started operating trains on the franchise. Over the first three years of the franchise, Govia Thameslink trains were the most delayed on the whole rail network.[4] Between July 2015 (when Govia Thameslink took over responsibility for Southern train services) and March 2017, 146,000 services, 7.7% of scheduled train services were either cancelled or more than 30 minutes late. This does not include trains which were cancelled in advance because Govia Thameslink expected significant disruption.[5] Less than two thirds of trains arrived at their destination within five minutes of their scheduled arrival time during one particularly bad four week period between November and December 2016.[6] The Department said that it aims to balance services for passengers and a good outcome for taxpayers in the form of franchise payments. However, in the case of the TSGN franchise, the Department asserted that the franchise is on course to deliver for the taxpayer even though passengers have experienced

1 Report by the Comptroller and Auditor General, The Thameslink Southern and Great Northern rail franchise, Session 2017–19, HC 528, 10 January 2018
2 C&AG's Report, paras 2–3
3 Committee of Public Accounts, Update on the Thameslink Programme, Twentieth Report of Session 2017–19, HC 466 23 February 2018
4 C&AG's Report, Figures 2 and 3
5 C&AG's Report, Para 1.12
6 C&AG's Report Figure 2,

serious disruption.[7] Up to September 2017, the Department received £760 million from Govia Thameslink, which is approximately the amount of revenue it expected when it awarded the franchise.[8]

5. The Department admitted that it had not achieved a good balance between maximising capacity (by running more trains) and making sure that the rail network was able to recover from disruption.[9] It specified a minimum number of train services that operators were required to run in its tender document for the franchise, but also encouraged bidders to suggest how they could provide additional trains from December 2015 and December 2018. After the Department received bids, Network Rail informed the Department that it had significant concerns about the service timetables which all the bidders proposed to operate, including Govia Thameslink's proposals, which it believed did not comply with its timetable planning rules and did not allow enough time for engineering work.[10] The Department told us that it relies on normal industry processes taking place after it awards the franchise to make sure that promised timetables can be delivered.[11] However, the NAO found that it was possible that the demands placed on the network by the actual 2015 timetable contributed to the disruption experienced by passengers.[12]

6. Network Rail accepted that the condition of the rail infrastructure has deteriorated to a point where it is basically not reliable, and that this caused about 13% of the delays passengers suffered between July 2015 and March 2017.[13] Carrying out maintenance work overnight is the least disruptive for passengers. However, Network Rail told us that until recently, it was 'virtually impossible' to carry out necessary maintenance work overnight as trains run through the night on some parts of the TSGN network. We queried whether Network Rail and Govia Thameslink had the right incentives to work together in the interests of passengers, as they have different stakeholders, objectives, targets and budgets. Network Rail accepted that this had been an issue, since until recently Network Rail and Govia Thameslink used different targets to monitor performance. Both organisations told us that they were now working together very well, although there are still times when their objectives come into conflict.[14] Network Rail told us that Govia Thameslink has agreed to make changes to its timetable so that Network Rail can carry out more work overnight. Network Rail also told us that reliability of the infrastructure on routes out of Victoria has improved by 38% because it has been able to 'get in and maintain [the infrastructure] in a more effective and efficient way'.[15]

7. We heard from Network Rail that the Thameslink programme means that it is even more important to improve the reliability of the infrastructure of the rail network as the programme is designed to allow 24 trains an hour to pass through the central London 'core' section. Each train has to arrive at the 'core' at 'precisely the right moment'. Any problem would have a knock-on effect throughout the railway, potentially delaying a number of trains.[16] Network Rail plans to bring forward £900 million of spending to replace old and

7 Qq 162,193
8 Qq, 193
9 Q 163
10 C&AG's Report, paras 3.6–3.7
11 Q 157
12 C&AG's Report, Para 3.8
13 Qq 144, 148
14 Qq 200–203
15 Q155
16 Qq 149–150

dilapidated parts of the rail infrastructure earlier than it had intended. Network Rail told us that renewal of the network was expensive and so it generally tried to keep the existing assets in use for as long as possible, but the increasing cost of maintenance and falling reliability of the infrastructure mean that it is necessary to carry out this work now.[17] Govia Thameslink agreed that long closures such as the planned closure of the Brighton Main Line for a week in both October 2018 and February 2019 are incredibly disruptive. We asked Govia Thameslink and Network Rail to explain how they will reduce the impact of these works on passengers. Govia Thameslink told us that it is still developing its plans, but that it will seek to use replacement bus and rail services to reduce the impact of closures on passengers, and is considering offering passengers financial compensation.[18] Network Rail told us that it believed giving passengers plenty of notice and explaining the benefits of the work it was doing would reduce the number of complaints.[19]

Managing industrial relations

8. The Department told us that the Thameslink programme is "probably the single most complicated upgrade we have ever attempted on the live UK rail network". It designed the franchise in a way which would, in its view, minimise the risk of disruption to passengers. This included awarding a single franchise covering the routes most affected by the Thameslink programme and not requiring the operator to take on the risk that revenue is not as high as expected (as is the Department's usual practice) to avoid incentivising it to focus on maximising revenue at the expense of supporting the Thameslink programme.[20] However, the Department did allow bidders to propose increasing the number of 'driver-controlled' or 'driver-only operation trains, where the driver is responsible for opening and closing the train doors.[21]

9. The Department told us that the worst period of passenger disruption was caused by an extensive period of official and unofficial strike action in response to the expansion of 'driver controlled operation'.[22] RMT began industrial action in April 2016 and called 38 strike days between April 2016 and November 2017. ASLEF, the train drivers' union, called six strike days between December 2016 and November 2017, and formally introduced overtime bans for 64 days in total between December 2016 and July 2017. Between July 2015, when Govia Thameslink took over the running of the full franchise, and March 2017, around 56,000 (38%) of all cancellations were due to issues related to train crew availability.[23]

10. Both the Department and Govia Thameslink told us that they did not anticipate that their plans to increase the number of driver-controlled trains would result in a significant amount of industrial action taking place.[24] The Department told us that it was aware that there had always been some industrial action relating to the introduction of driver-only operation and that it expected 'a certain amount of disruption' when it awarded the franchise. However, it told us that it did not expect or forecast the level of industrial action in response to the Thameslink franchise in part because 'driver-controlled operation' was

17 Qq 144–148
18 Qq 136–140
19 Q 138
20 Q113, C&AG's Report, paras 1.6–1.8
21 Q114
22 Q114
23 C&AG's Report, paras 1.13, 2.6
24 Q117

already in use on 60% of services run by the TSGN franchise. The Department asserted that it had tried to discuss bidders' proposals with the relevant trade unions before letting the franchise but that its offers of communication were not readily taken up. Govia Thameslink also told us that the risk of industrial action 'crystallised in a way that we had not foreseen'.[25] The RMT told us that no specification for any franchise has ever been shared with them and that extending Driver Only Operation was not in the public consultation for the Southern routes.[26]

11. The Department structured its contract for the TSGN franchise in such a way that Govia Thameslink does not retain the revenue from passenger fares. It accepted that this meant that Govia Thameslink potentially had less incentive than normal to avoid industrial action as its income would not change even if passenger revenue fell, or if compensation was due to passengers.[27] The Department told us that it designed the contract in this way to incentivise Govia Thameslink to focus on delivering the Thameslink programme and that its decision was not driven by expectations around industrial relations.[28] It also told us that while the Department shouldered the risk that revenue could fall, the consequences of the risk that performance was not good enough was the operator's responsibility.[29]

12. The Department and Govia Thameslink stressed that they still believe that there are advantages to driver-controlled operation and that it was at least as safe as other methods of operation. The Department believes that it allows trains to move off more quickly, as the driver does not need to communicate with the guard. Govia Thameslink told us that it believes that the second member of train crew can now assist passengers more easily as they are not required to be in a certain place to open and close doors, and that customers have noticed the improvement.[30]

Managing performance

13. Govia Thameslink's contract with the Department contains performance measures, such as targets to limit the number of delays and cancellations. Penalties are charged if Govia Thameslink does not meet these targets. However, the franchise contract, like other contracts the Department has with train operators, defines industrial action as a 'force majeure' event, which means that the operator is not usually responsible for poor performance caused by industrial action.[31] The Department ultimately decided that much of the disruption in 2016 and 2017 took place for reasons outside Govia Thameslink's control. As a result, in spite of the significant disruption to passengers, Govia Thameslink has only paid £12.4 million in performance payments, to cover the period from September 2015 to September 2018.[32]

14. The Department told us that Govia Thameslink's performance for passengers was so poor that it considered cancelling the contract in early 2017. It ultimately decided that the right thing to do for passengers and taxpayers was to continue to manage and deliver the plan set out in the franchise agreement. The NAO found that the usual approach

25 Q 134
26 RMT Union (RFU0002) para 4
27 C&AG's Report, paragraphs 1.7–1.8
28 Q 129
29 Q 130
30 Qq 118–122, 178
31 C&AG's report, paragraphs 2.10 and 2.13
32 C&AG's report. Paragraphs 2.15, 2.17–2.18.

to determining responsibility for delays and cancellations did not work, because Govia Thameslink made significantly more claims for 'force majeure' events once industrial action started. Each of these claims had to be resolved individually. The Department decided that the amount of 'force majeure' disruption meant that it did not have sufficient legal grounds to terminate the contract.[33]

15. In July 2017, the Department agreed a £12.4 million settlement with Govia Thameslink. Govia Thameslink agreed to accept the Department's analysis of how much disruption was down to 'force majeure' circumstances in the year to September 2016 (which meant that Govia Thameslink owed £2.4 million in performance payments) and to pay £5 million a year to settle its obligations for the two years to September 2018. The Department also agreed with Govia Thameslink that this money would be spent on measures aimed at improving services for Govia Thameslink passengers.[34] Govia Thameslink told us that it agreed to pay penalties up front because it 'took a view, after a long and protracted industrial dispute, that [it] needed to draw a line and move on'.[35]

16. We asked the Department to explain how agreeing fines in advance of services that had not yet been delivered was in the best interests of taxpayers and passengers. It asserted that using the performance regime available within its contract with Govia Thameslink would not have benefitted passengers because of the amount of management time which would have been spent 'arguing over a huge number of detailed claims' instead of focussing on improving performance. The Department told us that it believed it had made a reasonable assessment based on the worst case scenario of disruption, and that subsequent improvements in performance meant that a penalty based on actual performance would be lower. It told us that Govia Thameslink will pay more under the agreement than it would have done if the Department had enforced the terms of the contract.[36] It does not currently believe that any further fines will be required after September 2018.[37] Govia Thameslink agreed that operational performance was rising and asserted that passenger satisfaction was now rising as a result.[38]

17. The Department said that it could still find Govia Thameslink in breach of its contract if performance deteriorated. This is not a credible threat, since the Department has already decided once that it could not use the performance regime in the contract. The standards expected of all public services dictate that penalties should always be determined by the actual level of performance. Settling on the basis of future performance means the Department has fewer levers available to it to manage Govia Thameslink's performance if it does not improve.[39]

33 C&AG's report, Paras 2.15, 2.17, Figure 13
34 C&AG's report Para 2.18
35 Q 169
36 Qq 188, 190
37 Q192
38 Q135
39 C&AG's report, Para 2.22

2 The East Coast franchise

Early termination of the East Coast franchise

18. The East Coast franchise operates services between London, the north-east, Yorkshire and Scotland. Since 2015, it has been operated by Virgin Trains East Coast, which is a 90% subsidiary of Stagecoach and 10% owned by Virgin Group.[40] The franchise was intended to last until March 2023, and as well as running passenger rail services, was supposed to manage the introduction of a fleet of new trains procured by the Department under the Intercity Express Programme.[41] In June 2017, Stagecoach announced that it expected to incur losses from operating the franchise and stated that it was in discussions with the Department for Transport about the terms of its continuing operation of the franchise.[42] In November 2017, the Transport Secretary announced that the franchise would become a public-private railway and that the franchise would terminate in 2020 to enable this change.[43] However, in February 2018, the Secretary of State for Transport announced that the East Coast franchise would end in 'a very small number of months' as Virgin Trains East Coast had breached a financial covenant in its contract with the Department.[44] The Department told us that it 'cannot be absolutely sure at this stage' exactly when the franchise will end. This will nonetheless be the third time this franchise has ended earlier than intended. The franchise previously failed in 2006 and 2009. The Department considers that passenger demand on this franchise is more volatile than others.[45]

19. The failure of the East Coast franchise is the result of a failure by Stagecoach and Virgin Group to accurately forecast the amount of money Virgin Trains East Coast would earn from operating the franchise because the passenger growth forecasts were wildly wrong. Stagecoach told us that the franchise had been 'impacted by an unprecedented combination of macro-economic and other factors'.[46] The Department and Stagecoach agreed that forecasting passenger demand is more challenging than simply making sure that suitable economic forecasts are used. Stagecoach told us that there have been fundamental changes in the economy and passengers' perceptions about travel since 2013 and 2014 that called into question the reliability of traditional methods to forecast rail revenue and rail passenger numbers'.[47] As we were reminded in a written submission from the National Union of Rail, Maritime and Transport workers (RMT), this created a serious gap between predicted revenue and reality, a story which bears some of the hallmarks of the collapse of the previous East Coast franchise in 2009.[48] The RMT also argued that the slowdown in passenger journeys between 2010–2013, precisely at the time when bidders were preparing their bids, did not support the expected increase in passenger numbers.[49] The Department told us that it has identified between 50 and 60 factors which impact the growth in passenger demand, including changes in working patterns towards more

40 Q 1
41 Department for Transport, New East coast Mainline franchise confirmed, 10 December 2014
42 Stagecoach Group, Preliminary results for the year ended 29 April 2017, 28 June 2017
43 Department for Transport, Strategic vision for rail, 29 November 2017
44 Secretary of State for the Department for Transport, Chris Grayling MP, Rail update, 5 February 2018
45 Q 1, 91
46 Stagecoach (RFU0001), para 2
47 Qq 15, 23
48 RMT Union (RFU0002)
49 RMT Union (RFU0002), Paragraph 12

flexible working and a reduction in the number of people commuting five days a week into London. It told us that the relatively low cost of petrol has also increased competition between rail transport and long-distance coaches and cars.

20. Stagecoach told us that, before taking into account the payments it promised to the Department, Virgin Trains East Coast will make a profit of around £260 million this year. However, since revenue has not grown by as much as expected, the payments due to the Department mean the operator has made a loss of about £200 million to date.[50] This is equivalent to approximately 20% of the current value of Stagecoach Group, which told us that this was 'a very, very significant and painful experience'.[51] Stagecoach told us that the franchise would end early because it and the Department anticipated that the franchise would breach a key financial ratio at some point in the next twelve months and that under the contract, the parent company was only obliged to provide £165 million to support the franchise if it made losses.[52] We queried why it was not willing to put more money in to keep hold of the franchise, as Stagecoach stated publicly last year that it expected it to be profitable after 2019. Stagecoach told us that 'the trading position has deteriorated even further since this time last year', and that it no longer expected the contract to be profitable.[53] The Department and Stagecoach both told us that they believed that to date, Virgin Trains East Coast and Stagecoach had met their obligations, including running passenger services and paying the Department premiums, in full.[54]

21. The Department told us that it is currently evaluating what options are available to it to maintain train services after the current franchise ends. This includes considering operating the services on the East Coast franchise itself, or contracting Stagecoach to keep running services on a not-for-profit basis. We questioned why a private company would be interested in such an arrangement. Stagecoach told us that there had been no detailed discussion about it running services on a not-for-profit basis and that it was right to question why a private company would be interested in this arrangement.[55]

22. The Department and Stagecoach agreed that in contracting with the private sector to deliver public services, it was important to make sure that the risks sit with the organisation which is best able to manage them. The Department told us that it wants bidders to be ambitious about what they offer passengers.[56] However, Stagecoach was clear that bidders would only put forward ambitious proposals if the risk transfer was acceptable.[57] It asserted that on the East Coast franchise, all of the risk sat with Virgin Trains East Coast as operator, including risks they were not best placed to manage, such as the risk that the economy does not perform as well as expected at the bidding stage.[58]

50 Qq 28, 33, 39–40
51 Q 28
52 Qq 6–7, 80
53 Qq 31–32
54 Q 5, 98
55 Qq 43–44
56 Q 91
57 Qq 19, 38, 43, 91
58 Q 38

23. In 2011, the previous Committee noted that the high proportion of business and leisure travel on the East Coast franchise meant that it was particularly susceptible to changes in the economy and recommended that the Department should always test franchise bids against a range of different economic conditions.[59] The Department told us that it now tests bids against 'a very pessimistic view of the economy' but that it only started doing this in 2015, after it let the East Coast franchise. It also told us that it has put in place a new risk sharing model intended to shelter operators from 'the worst excesses of economic change'.[60] It was keen to stress that it did not believe the franchising system as a whole is failing, and that passenger demand is still growing, albeit at lower rates than previously.[61]

59 Public Accounts Committee, The InterCity East Coast Passenger Rail Franchise, 39th Report of Session 2010–12, HC 1035, 9 July 2011

60 Q95

61 Qq 91, 94

Formal minutes

Wednesday 18 April 2018

Members present:

Meg Hillier, in the Chair

Bim Afolami
Sir Geoffrey Clifton-Brown
Caroline Flint
Gillian Keegan
Shabana Mahmood
Layla Moran
Anne Marie Morris
Bridget Phillipson
Gareth Snell

Draft Report (*Rail franchising in the UK*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 23 read and agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-fifth 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 23 April 2018 at 3.30pm

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 26 February 2018

	Question number
David Horne, Managing Director, Virgin Trains East Coast and **Martin Griffiths**, CEO, Stagecoach Group Plc	Q1–90
Bernadette Kelly, Permanent Secretary, **Peter Wilkinson**, Managing Director, Passenger Services, Department for Transport, **Mark Carne**, Chief Executive, Network Rail and **Charles Horton**, Chief Executive Officer, Govia Thameslink Railway Ltd	Q91–212

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

RFU numbers are generated by the evidence processing system and so may not be complete.

1 ASLEF (RFU0003)

2 RMT Union (RFU0002)

3 Stagecoach (RFU0001)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2017–19

First Report	Tackling online VAT fraud and error	HC 312 (Cm 9549)
Second Report	Brexit and the future of Customs	HC 401 (Cm 9565)
Third Report	Hinkley Point C	HC 393 (Cm 9565)
Fourth Report	Clinical correspondence handling at NHS Shared Business Services	HC 396 (Cm 9575)
Fifth Report	Managing the costs of clinical negligence in hospital trusts	HC 397 (Cm 9575)
Sixth Report	The growing threat of online fraud	HC 399 (Cm 9575)
Seventh Report	Brexit and the UK border	HC 558 (Cm 9575)
Eighth Report	Mental health in prisons	HC 400 (Cm 9575) (Cm 9596)
Ninth Report	Sheffield to Rotherham tram-trains	HC 453 (Cm 9575)
Tenth Report	High Speed 2 Annual Report and Accounts	HC 454 (Cm 9575)
Eleventh Report	Homeless households	HC 462 (Cm 9575)
Twelfth Report	HMRC's Performance in 2016–17	HC 456 (Cm 9596)
Thirteenth Report	NHS continuing healthcare funding	HC 455 (Cm 9596)
Fourteenth Report	Delivering Carrier Strike	HC 394 (Cm 9596)
Fifteenth Report	Offender-monitoring tags	HC 458 (Cm 9596)
Sixteenth Report	Government borrowing and the Whole of Government Accounts	HC 463 (Cm 9596)
Seventeenth Report	Retaining and developing the teaching workforce	HC 460 (Cm 9596)
Eighteenth Report	Exiting the European Union	HC 467 (Cm 9596)

Nineteenth Report	Excess Votes 2016–17	HC 806 (Cm 9596)
Twentieth Report	Update on the Thameslink Programme	HC 466
Twenty-First Report	The Nuclear Decommissioning Authority's Magnox	HC 461
Twenty-Second Report	The monitoring, inspection and funding of Learndirect Ltd.	HC 875
Twenty-Third Report	Alternative Higher Education Providers	HC 736
Twenty-Fourth Report	Care Quality Commission: regulating health and social care	HC 468
Twenty-Fifth Report	The sale of the Green Investment Bank	HC 468
Twenty-Sixth Report	Governance and departmental oversight of the Greater Cambridge Greater Peterborough Local Enterprise Partnership	HC 896
Twenty-Seventh Report	Government contracts for Community Rehabilitation Companies	HC 897
Twenty-Eighth Report	Ministry of Defence: Acquisition and support of defence equipment	HC 724
Twenty-Ninth Report	Sustainability and transformation in the NHS	HC 793
Thirtieth Report	Academy schools' finances	HC 760
Thirty-First Report	The future of the National Lottery	HC 898
Thirty-Second Report	Cyber-attack on the NHS	HC 787
Thirty-Third Report	Research and Development funding across government	HC 668
Thirty-Fourth Report	Exiting the European Union: The Department for Business, Energy and Industrial Strategy	HC 687
First Special Report	Chair of the Public Accounts Committee's Second Annual Report	HC 347