**Transport Committee**

The Transport Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Department for Transport and its associated public bodies.

**Current membership**

- **Lilian Greenwood MP** (Labour, Nottingham South) (Chair)
- **Jack Brereton MP** (Conservative, Stoke-on-Trent South)
- **Ruth Cadbury MP** (Labour, Brentwood and Isleworth)
- **Robert Courts MP** (Conservatives, Witney)
- **Ronnie Cowan MP** (Scottish Nationalist Party, Inverclyde)
- **Steve Double MP** (Conservatives, St Austell and Newquay)
- **Paul Girvan MP** (Democratic Unionist Party, South Antrim)
- **Huw Merriman MP** (Conservatives, Bexhill and Battle)
- **Grahame Morris MP** (Labour, Easington)
- **Graham Stringer MP** (Labour, Blackley and Broughton)
- **Daniel Zeichner MP** (Labour, Cambridge)

**Powers**

The committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the internet via [www.parliament.uk](http://www.parliament.uk).

**Publication**

Committee reports are published on the Committee’s website at [www.parliament.uk/transcom](http://www.parliament.uk/transcom) and in print by Order of the House.

Evidence relating to this report is published on the [inquiry publications page](http://www.parliament.uk/transcom) of the Committee’s website.

**Committee staff**

The current staff of the Committee are Gordon Clarke (Committee Clerk), Ed Faulkner (Second Clerk), James Clarke (Committee Specialist), Nerys Davies (Committee Specialist), Andrew Haylen (Committee Specialist), Deborah Courtney (Senior Committee Assistant), Michelle Owens, (Committee Assistant), Estelle Currie (Senior Media Officer) and Oliver Florence (Media Officer).

**Contacts**

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Appendix 1: Government Response

What went wrong with the franchise?

We recommend that the Department clarify, in detail, exactly what its current and future approach to macroeconomic risk-sharing is, in doing so, it should make clear how it has implemented the relevant Brown Review recommendations. (Paragraph 25)

We are happy to clarify the Government’s approach to macroeconomic risk sharing and how we have implemented the Brown Review recommendations.

The Government recognises the need to ensure that franchising remains attractive to bidders while securing value for money for taxpayers. For this reason, the Department continues to develop its franchise specifications based on the principle outlined in the Brown Review, that risk should be borne by the party best able to manage it. As noted by the Committee, the Government has already taken steps to amend its approach to reflect changing circumstances, including the introduction of the Forecast Revenue Mechanism (FRM) in current competitions.

FRM provides for risk sharing between the Department and the Franchisee against the full range of revenue risks. This means that risk is shared across a wider range of factors than the targeted mechanisms that provide risk sharing against unexpected changes in Gross Domestic Product (GDP) and/or Central London Employment (CLE) levels that have been used in some previous competitions.

With FRM, financial support is available to a Franchisee if revenue drops significantly below the level that was ‘bid’ in the competition. If revenue does fall below the levels agreed, normally 4% lower than the bid level, then the Government would make support payments to the Franchisee if the Franchisee opted to trigger support. If revenue were to exceed the bid revenue by more than the agreed threshold (both thresholds are symmetrical so it would match that for support payments), then the Franchisee would be required to make payments to the Government.

Details of the specific FRM thresholds for each franchise competition are contained within the Invitation to Tender (ITT) documents. The ITT also contains details of Contractual Incentive Mitigations (CIMs) that will apply for each competition, which would be applicable where FRM risk-sharing is triggered. CIMs are designed to align operator’s incentives with those of the Department, for example, to ensure that the operator undertakes appropriate revenue protection and marketing activities, and to maintain incentives to improve operational performance and service quality. These ensure
that the Train Operating Company continues to focus on passenger service and growing revenues when share or support is payable and ensure revenue risk is not solely transferred to Government.

We recommend that the Department for Transport clarify exactly what role Network Rail now have in the bidding process and recommend that, if it is still not the case, their relevant representatives have formal sign-off of any bids prior to a successful bid being decided. More generally, we would like to see much closer alignment between the invitation to tender in the franchise agreement and Network Rail’s planned enhancements. The DfT has responsibility to ensure all parties to the franchise bid process are aligned and have equal and accurate sight of what infrastructure upgrades are planned. (Paragraph 36)

We are pleased to clarify Network Rail’s role in the franchise bidding process. Network Rail (NR) already plays a highly integrated role in the franchise process. The Department works closely with NR to develop the train service requirement and seeks formal agreement from NR on aspects of the Invitation to Tender (ITT) that affect NR, including the train service requirement. Where the Department specifies train services that would require the completion of infrastructure enhancements, the Department provides an Infrastructure Assumptions Document (IAD), approved by NR.

NR formally reviews all franchise bids and provides DfT evaluators with a detailed specialist report covering critical areas such as the bidder’s approach to timetable development. DfT also requires bidders to provide evidence of the level of support that NR has for their proposals. As franchising authority, the department is solely responsible for determining the outcome of the bidding process, in accordance with the procurement rules.

We recommend that the Department outline how it will specify future infrastructure enhancements in the invitations to tender and what change mechanisms it has in place and whether they can cope with any uncertainty arising from the enhancements pipeline proposals. (Paragraph 37)

We are pleased to provide this information. Since the East Coast franchise competition, the Department has improved its process to provide franchise bidders with clear assumptions about the delivery of new infrastructure. Where the Department specifies train services that would require the completion of infrastructure enhancements, the Department provides an Infrastructure Assumptions Document (IAD), approved by NR. Where appropriate, the franchise agreement includes a change mechanism to ensure the operator is able to deliver an acceptable level of service to passengers whilst not being financially disadvantaged for late delivery of infrastructure in the IAD. Franchise bidders are also free to propose additional services that may require additional infrastructure. In such circumstances, the Department expects bidders to provide evidence that it has robust plans to enable delivery of that infrastructure.
Interim operating arrangements

We recommend that the Secretary of State outline the exact timescale for the interim operator and clarify exactly how operational and investment risks will be managed until the longer-term Partnership arrangement is in place. We are not aware of the existence of formal obligations and targets for the operator of last resort for the Intercity East Coast franchise. (Paragraph 45)

The Government disagrees with this recommendation. As announced by the Secretary of State to the House of Commons on 16 May 2018, the Operator of Last Resort (OLR) will prepare the ground for the line to be transformed into the East Coast Partnership (ECP). The creation of the ECP is an evolutionary process, not a single date. The process has already started with the creation of LNER.

LNER has been set up as a Public Corporation and operates in the public sector as a commercial enterprise. LNER’s operational and commercial risks and opportunities are managed by the company in the same way as other Train Operators in the private sector. The company has a contract with DfT, the Services Agreement, which is a proxy for a normal commercial Franchise Agreement.

The Services Agreement is in place between the Department for Transport (as the Franchising Authority) and both DOHL (DfT OLR Holdings Limited), and London North Eastern Railway Limited (as shareholder and operator respectively) to contract services from 24 June 2018. This uses the baseline Franchise Agreement for competed franchises and sets out the obligations and targets for the operator in a manner such that it is managed in the same way as any other franchise operator. The Services Agreement will be published in the Public Register alongside copies of all Franchise Agreements in due course, once the process of redacting has been completed.

Due to the need to preserve commercial confidentiality and a predictable environment in which rail companies can operate and invest with confidence, certain information is redacted from Franchise Agreements available on the Public Register.

Public Register copies of all Franchise Agreements and Train Service Requirements (or Service Level Commitments) are available on the GOV.UK website. The Public Register copies of all Franchise Agreements contain full schedules of operational performance targets including PPM, cancellations and capacity benchmarks. Any change or variations to Franchise Agreements are updated on the Public Register.

We recommend that whenever the operator of last resort arrangement is invoked, the DfT should revise and publish obligations and targets for the operation of the failed franchise by the operator of last resort, in order to provide passengers, taxpayers, Parliament and industry certainty of its business plan, strategy and development plans. This should be done within six months of assuming responsibility for a franchise. (Paragraph 45)

The Government partly agrees with this recommendation and revises obligations and targets as a matter of course, and keeps the delivery of these under close scrutiny. However, due to commercial confidentiality, the published Agreements will often need to be redacted. On East Coast, for example, LNER has entered into a Services Agreement with the Department. As stated above, a redacted version of this Agreement will be placed
on the GOV.UK website. LNER does not propose to publish their business plan, much of which will be commercially confidential, as it will set out details of how the company plans to deliver its contractual obligations under the Services Agreement. The company will be fully involved in the wider development of the ECP, details of which will be announced in due course. The ECP will be the vehicle that sets out the longer term plans for development of the business and services on the East Coast Main Line.

**The East Coast Partnership**

We recommend that any review of franchising should consider what change would be needed to the financial and regulatory framework to make partnership working a viable and sustainable model for operating the railway in the future. We recommend that the Department set a timetable for publishing the detail of how it expects the East Coast Partnership will work.(Paragraph 54)

The Government partly agrees with this recommendation. The Rail Review, as announced on 20 September by the Secretary of State, will consider all aspects of the rail franchising system including leveraging the commercial model to ensure improved services for passengers and taxpayers, and more effectively balance public and private sector involvement and the roles and structures of all parts of the industry, looking at how they can work together more effectively to reduce fragmentation, improve passenger services and increase accountability. More broadly, the Review, which will be led by independent Chair Keith Williams, will consider the commercial model for rail, including the future approach to franchising or alternatives and how these align with the wider industry structures and framework.

With regards to the recommendation that the Department set a timetable for publishing the detail of how it expects the East Coast Partnership to work, the creation of the ECP is an evolutionary process. The process has already started with the creation of LNER. As announced by the Secretary of State to the House of Commons on 16 May 2018, the OLR will prepare the ground for the line to be transformed into the East Coast Partnership.

Before experimenting with this Partnership, we recommend the Secretary of State lay out in detail how the new approach will work and conduct a proper assessment of its feasibility against those plans. This assessment needs to demonstrate that his proposal will offer better value for money for the taxpayer and better outcomes for passengers than other ways of operating. We recommend the Secretary of State review his decision to go ahead with this partnership based on the findings of this assessment. (Paragraph 55)

The Government disagrees with this recommendation because the approach on East Coast will be developed by NR and LNER in the context of the independently chaired East Coast Partnership Board; proposals will, therefore, be developed by people with a real understanding of the railway. Proposals, where necessary, will need to go through the respective decision-making processes of NR, LNER and DfT, to ensure delivery of the Government’s objectives and value for money for the taxpayer.
Wider franchising issues

We recommend the Department outline what mechanisms it has available for franchise change and renegotiation. We also recommend that it keep the Committee informed about any franchises that look likely to default on their contracts and whether it is resourcing the operator of last resort to take over any of these franchises, and find a way to brief Parliament on the de facto reality on the railways. (Paragraph 62)

We are happy to outline the mechanisms the Department has available for franchise change and renegotiation and we have done this below. The Government disagrees that it should keep the Committee informed about franchises that may default on their contract due to the sensitive nature of this information and this is explained in more detail below.

The Franchise Agreement for each franchise sets out the circumstances in which the agreement can be varied, although there are legal procurement risks and value for money considerations which constrain substantially the use of these provisions. Furthermore, in most cases franchisees are protected against the financial consequences of a variation.

The Secretary of State can unilaterally vary the core services that the franchisee is required to deliver and a significant number of other contract terms. The parties can also vary any other term of the contract by agreement in writing. A variation of the contract, either unilaterally by the Secretary of State or by agreement, will be a ‘Change’ under the Franchise Agreement. The Franchise Agreement sets out a process for making consequential changes to the contract to address the financial and performance consequences of the ‘Change’ which will be triggered in the case of any ‘Change’, provided that it has a financial consequence (including when aggregated with other ‘Changes’ occurring in the same year) over a certain threshold.

In addition to these ‘Changes’, the Franchise Agreement defines a number of other events which, if they occur during the franchise term, will be ‘Changes’. These include certain changes to the regulatory track access charging regime and changes instructed by the Secretary of State to the percentage by which the Operator can increase regulated fares.

Particular Franchise Agreements may include ‘Change’ events specific to that franchise. For example, in the Great Western franchise agreement there will also be a ‘Change’ if there is a change to the delivery dates of the Intercity Express rolling stock from that set out in the Franchise Agreement. In the TransPennine Express and Northern franchise agreements there are assumptions about the dates for the delivery of particular infrastructure projects set out in an ‘Infrastructure Assumptions Document’. The East Coast franchise agreement which terminated in June 2018 had a Change assumption concerning the availability of train paths to the Franchisee from May 2020.

Public Register copies of all Franchise Agreements are available on the GOV.UK website.

The Government understands the desire the Committee has to be informed about any franchises that look likely to default, however under the Railways Act we are prohibited from giving out confidential information that we have received as part of the franchising process. The financial information concerning franchises is highly commercially sensitive. We can assure the Committee that we monitor Train Operating Companies
closely to ensure delivery of services for passengers and value for money for taxpayers. The Secretary of State provided timely updates to Parliament when VTEC defaulted and we would endeavour to adopt a similar approach in the event another franchise defaulted.

The Department has put appropriate resources in place to manage the risks associated with all private sector franchises. This includes the maintenance of an internal team who are supported by a team of specialist advisers.

**We recommend that the Department revisit its approach to franchise failure, which should be embedded in how they assess the risk and feasibility of each bid. (Paragraph 63)**

The Government disagrees with this recommendation because the Department has already developed a more robust procedure for assessing the risk and feasibility of each franchise bid. As noted by the Committee, the Department presented evidence that it has strengthened its Financial Robustness Test (FRT) when assessing bids. The implementation of the strengthened FRT operates alongside a process of risk adjustment, so that the test is based on bids which are adjusted to reflect the Department’s reasonable view of the most credible financial outcome.

The FRT assesses the financial robustness of bids based on a central scenario, and if it is forecast to fail at any time during the core contract term, it is automatically eliminated from the bidding process. The FRT now also assesses the financial robustness of bids in a downside scenario. This tests the ability of a bid to remain financially robust should forecast passenger revenue be lower than expected. The downside scenario applies a greater reduction to a bid’s expected revenue where, as part of the test, there have been significant risk adjustments in order to determine the most credible financial outcome. This further discourages unfeasible bids.

The changes to the FRT were introduced to ensure that, while still encouraging ambitious bids, Government does not encourage bids that are unrealistic or unsustainable.

These new measures have been incorporated into the current franchise competitions and will provide more robust tests of the franchises’ long term viability.