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Dear Maureen

I thought that it might prove useful to provide an update on progress in respect of rail refranchising.

As you are aware, I took the decision last year to permit the continuation of the current ScotRail franchise to March 2015 so that I might have the opportunity to review and assess the implications of the findings and recommendations of the Laidlaw Inquiry and the Brown Report and still provide sufficient time to operate an effective procurement exercise.

Laidlaw Inquiry

The Laidlaw Inquiry made a number of recommendations regarding the handling of the West Coast refranchising. Its key findings, which were widely exposed in the public arena, are as follows:

- The governance process was inadequate;
- The procurement programme was unrealistic;
- The DfT had deviated from its own rules and that it was the failure of DfT to apply its financial model correctly which ultimately lead to the issue of the inappropriate level of the Subordinated Loan Facility (i.e. the bond required by a parent company to support a failure of the franchise); and
- The subsequent collapse of the procurement of the West Coast franchise.

There is no question here of complacency; however, it is true to say that I had put in place many of the structures that Laidlaw recommends specifically to ensure that we would operate a successful procurement exercise. You will recall that we have staggered the procurement of the Caledonian Sleeper and ScotRail franchises in order to manage the strain both on ourselves as well as that of bidders. This also maintains the option as a prudent contingency to re-incorporate the Sleeper into the main franchise if I am not satisfied with the quality or value of sleeper bids.



Our procurement programme is regularly reviewed with clear oversight of a governance structure which includes a board, comprising internal and external representatives, as well as independent monitoring through Gateway Reviews. Laidlaw identified a shortfall of specific technical expertise in the DfT. I recognised the need to draw in additional industry expertise and early last year authorised the appointment of legal, technical and financial advisors to augment the internal core procurement team.

I have concluded that the approach that we have taken in Scotland has addressed the findings identified by Laidlaw.

Brown Review

The Brown Review makes a number of positive recommendations as to the changes necessary to improve the DfT franchising programme. Importantly, Brown recommends that individual franchises should be treated according to their characteristics.

I have reviewed the key recommendations in the context of the ScotRail and Caledonian Sleeper franchises and in the main the approach that I have adopted aligns with Brown's recommendations. However, it is worth noting that there are four aspects on which we differ:

- I disagree with Brown's conclusion that there ought to be a greater emphasis on an output-based specification for franchises, particularly in how that would relate to ScotRail. My contention is that we need to specify a number of inputs such as timetable, fares and performance measures to ensure no degradation of service levels and to boost patronage on lightly used and rural routes. Without specifying these as inputs there would be a possibility that inadvertently we would not achieve our objectives in respect of modal shift, social inclusion and supporting peripheral or vulnerable communities;
- I do not consider that the recommendation that during periods of potentially sustained disruption caused by major works it might be more appropriate to operate a management contract instead of a franchise applies for ScotRail. It is my contention that by continuing to incentivise the franchisee to grow (or at least maintain) revenues there will be increased effort to address in a positive manner the potential for disruption. Such an approach was adopted by ScotRail in its handling of the works on Paisley Canal electrification, where through positive and imaginative planning and implementation there was a substantial reduction of disruption to passengers. I am of the view the same will be manifest with EGIP, in part because our re-scoping of works reduces the potential for disruption but predominantly because the operator will wish to ensure the maintenance of its revenues through continuing patronage;
- I disagree with the mechanism proposed by Brown to adjust GDP forecast risk and its impact on passenger revenues between franchisee and Government, as I believe that this has been developed predominantly for premium franchises which serve the south-east of England. It is my view that the ScotRail franchise, which is and will continue to be heavily subsidised, is not substantially affected by GDP changes because passenger revenue as a proportion of total franchise turnover is low. If it were the other way round, as is the case in London-focussed franchises, then there might be a case for adopting the approach recommended, though it is noted that, as applied by the UK Government, in seeking to address GDP risk for the West Coast franchise it added complexity to that exercise; and

- I also disagree that at the Pre-Qualification Questionnaire (PQQ) stage of procurement that the suitability of potential bidders should be based simply on an assessment of their historic abilities. Such an approach is restrictive and at odds with my objective for wider participation and innovation. Whilst I acknowledge that reference solely to historic evidence may simplify matters for bidders and the evaluation process it does constrain our ability to test innovative thinking in advance of the Invitation to Tender (ITT). Accordingly, I have taken the view that the requirement for innovation outweighs process expediency (but importantly will not compromise the delivery of a successful procurement exercise).

In summary, my approach is consistent with the majority of Brown's recommendations. Where we differ the reasoning is sound, defensible and reflects Scotland's particular needs and interests.

Procurement programme

I have set out below our Procurement Programme. The first activity will be the placement of a notice within the European Journal inviting bidders to come forward. Once bidders have come forward a Pre-Qualification Questionnaire (PQQ) will be issued so as to enable the identification of those potential bidders that are most capable of undertaking the Caledonian Sleeper franchise. This will be done by assessing the technical and professional ability and financial standing of potential bidders. The Notice and the PQQ are to be published/issued in the first full week of April.

Date	ScotRail	Caledonian Sleeper
Spring 2013		Issue OJEU Notice, Bidders Submit PQQ
Summer 2013	Issue OJEU Notice, Bidders Submit PQQ	Issue ITT To Bidders
Winter 2013		Bidders Submit ITT Response
Spring 2014	Bidders Submit ITT Response	
Summer 2014		Notify Winning Bidder
Autumn 2014	Notify Winning Bidder	
March 2015	Commence Franchise	Commence Franchise

I would be content, should the committee so decide, to provide evidence or indeed make officials available to explain in more specific terms the detail of the procurement programme.

Kind regards



KEITH BROWN