



# Government Response to the Brown Review of the Rail Franchising Programme

Presented to Parliament  
by the Secretary of State for Transport  
by Command of Her Majesty  
July 2013

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# Foreword

In January this year I welcomed the publication of Richard Brown's independent review of rail franchising, and his broad endorsement of the Government's overall strategy for franchising set out in the Government's March 2012 Command Paper *Reforming our Railways: Putting the Customer First*.

I promised that his thorough examination of the issues and recommendations for improving the franchise model following the cancellation of the InterCity West Coast competition would receive very careful consideration.

Six months on, I am pleased to publish this response broadly accepting those recommendations and reporting on the good progress we have made in implementing them.

This response provides the industry with the clarity it needs about the high-level principles we will be applying in future. It will enable the industry, including potential new entrants, to engage confidently with the Department for Transport in the opportunities ahead, helping to deliver better services for passengers, better value for the taxpayer, and a thriving rail industry.

A handwritten signature in black ink that reads "Patrick McLoughlin." The signature is written in a cursive, flowing style.

**The Right Honourable Patrick McLoughlin MP**  
**Secretary of State for Transport**

# Introduction

1. Richard Brown's review of the rail franchising programme<sup>1</sup> published in January this year concluded that the successes of Britain's railways since privatisation were unlikely to have been delivered if franchising was fundamentally flawed. Our railways are successfully carrying more passengers, more safely, on more and newer trains, more of which arrive punctually and with better station facilities and improved levels of passenger satisfaction. However his report also set out a number of detailed recommendations on how the fundamentally sound model of franchising needed to evolve to provide a robust blueprint for the future.
2. The recommendations of the Brown Review proposed:
  - an early restart to a sensibly-paced refranchising programme;
  - improvements to the way we specify franchises;
  - changes to the commercial proposition;
  - strengthening and simplifying the bidding and evaluation process;
  - improving the way we manage franchises; and
  - strengthening the Department for Transport's organisation and capability to manage franchising in future, echoing similar recommendations in the report of the Laidlaw Inquiry.<sup>2</sup>
3. The Government has carefully considered all of the Review's recommendations. This report sets out the significant progress we have made in the last six months in implementing the vast majority of them. In particular, we have:
  - announced plans for the three franchise competitions that were paused following the cancellation of the InterCity West Coast competition (January);
  - published a revised rail franchising programme and Prior Information Notice setting out clear objectives for that programme (March);
  - set up a Franchising Advisory Panel (April);
  - agreed the first short-term contract since that programme was announced (c2c Rail Limited, in May);
  - held a UK Rail Opportunities Day to stimulate interest amongst existing and potential new entrants to the rail franchising market (May);
  - published a Franchise Procurement Process Map (April) and a more detailed Franchise Competition Guide (June); and
  - appointed a new Director General for Rail and Franchising Director in DfT (January) and implemented a new Rail Group structure (June).

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<sup>1</sup> <https://www.gov.uk/government/publications/the-brown-review-of-the-rail-franchising-programme>

<sup>2</sup> <https://www.gov.uk/government/publications/report-of-the-laidlaw-inquiry>

4. Work on a number of the Review's recommendations is complete. For others we are clear about the direction of the changes we plan to make, but – recognising their complexity - there is further work to do to elaborate on the detail. We are committed to publishing further information about the policy changes we will be making in the next few months. This will be both in forthcoming individual franchise Invitations To Tender (ITTs) and in the Rail Franchising Overview (RFO) document that is now planned to be published later this year. Each ITT, and our implementation of the Review's recommendations, will be tailored to the particular features of that franchise opportunity. The RFO will be a practical guide to rail franchising. It will describe the industry's structure, the responsibilities of each of the principal industry organisations and the arrangements for procuring and managing franchises.
5. The Government endorses the Review's conclusion that restarting the franchising programme on a sound footing is vital to maintain the momentum towards greater cost efficiency in the rail industry. The Government set out plans in the March 2012 Command Paper<sup>3</sup> *Reforming our Railways: Putting the Customer First* for the rail industry to reduce the cost of running the railway by up to £3.5 billion per year (or around 30%) by 2019. If this can be achieved, it will allow us to reduce the burden on taxpayers and put an end to above inflation regulated fares rises while continuing to expand capacity on our rail network. We will continue the drive for greater Train Operating Company and wider industry efficiency through the new franchising programme.

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<sup>3</sup> <https://www.gov.uk/government/publications/reforming-our-railways>

# 1. Restarting the programme

- 1.1** The Brown Review recommended that the franchising programme be resumed as soon as practicable to enable the Government to drive improved value from contracts and to allow franchisees to support the major programme of industry investment planned in the coming years. The Government accepts these recommendations and has completed the actions necessary to restart the programme on a sustainable footing.

## Franchising powers

- 1.2** The Review recommended that as a first step the Secretary of State restate how he plans to exercise his franchising power under section 26(1) of the Railways Act 1993, given the passage of time since the statement was last issued in March 2008. The statement is required to include his policy on:
- when it is likely that an invitation to tender will be issued; and
  - when it is likely such an invitation will not be issued, and how he proposes that the selection will be made in such circumstances.
- 1.3** Following a consultation in the spring of 2013, and taking into account the views of consultees, we published a revised statement of policy on 26 March.<sup>4</sup>

## Decisions on the paused competitions

- 1.4** The Review made recommendations on the way forward for the three franchise competitions that had been paused following the cancellation of the InterCity West Coast competition in October 2012: Essex Thameside, Great Western and TSGN. We announced decisions on the way forward for all three competitions on 31 January, within the timescale the Review had recommended.

### Essex Thameside

- 1.5** We announced that the competition would resume, as the Review had recommended, with a revised Invitation to Tender (ITT) to be issued to the existing shortlisted bidders this month, and with the new franchise now proposed to start in September 2014. The Review recommended that this should be on the basis of a 10 year term with a 5 year continuation period subject to applicable legal requirements. However our review of the applicable legal requirements concluded that it was necessary to retain the 15 year term prescribed by the OJEU notice.

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<sup>4</sup> A report on the consultation and the revised policy statement can be found at <https://www.gov.uk/government/consultations/railways-act-1993-section-26-policy-statement>

## Great Western

- 1.6** As the Review had recommended that the then current proposition for the Great Western franchise was not the right one, we announced the cancellation of the Great Western competition.

## TSGN

- 1.7** We announced that the competition would resume with a revised ITT to be issued to existing short-listed bidders. The new franchise is planned to start in 2014, and is expected to be more of a management-style contract – all as the Review had recommended.

## New franchising programme

- 1.8** The franchising programme has been restarted, accepting the Review's recommendations on how to make the programme more resilient and providing greater transparency to the industry.
- 1.9** On 26 March the Government announced a revised franchise schedule<sup>5</sup> that provides for a steady flow of franchises to the market. We will be entering into short term contracts to ensure that major competitions can be scheduled at a time that encourages competition from potential bidders. The new schedule is broadly based upon a rate of 3–4 competitions per year. This will enable the Department for Transport, bidders and the supply chain to deploy a steady level of resource, thus helping to reduce industry bid costs. A Prior Information Notice<sup>6</sup> (PIN), covering the whole franchise programme, was published on the same date, and we have committed to updating the PIN annually.
- 1.10** The programme has adopted the recommended 24 month franchise competition timescale for new competitions. This will initially be treated as a minimum duration, with more complex franchises allowed longer. The competition processes will be regularly reviewed and we will seek to reduce the time and resource required to deliver a competition.
- 1.11** We concluded the first short-term directly awarded contract under this new programme in May (to c2c Rail Limited to continue to operate the Essex Thameside franchise until the new long term franchise starts (expected September 2014)).
- 1.12** In taking forward negotiations with current operators on short term contracts we will look to negotiate further passenger benefits, which will ensure the best deal for taxpayers.

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<sup>5</sup> <https://www.gov.uk/government/publications/rail-franchise-schedule>

<sup>6</sup> <https://www.gov.uk/government/publications/prior-information-notice-for-rail-franchising-from-2013>



## Encouraging new entrants to the market

- 1.13** The Review noted that it was important to foster a healthy range of potential franchisees and ensure an active appetite for bidding, including maintaining the attractiveness of the programme to new entrants. The Review noted a number of factors that would impact on the attractiveness of the programme to new entrants including capital requirements (see Chapter 3), the ease of entering the market initially, and the size and number of franchises on offer.
- 1.14** The Government agrees with this conclusion. As noted above, as a first step we set out on 26 March our plans for future competitions. Publication of these plans was welcomed by the industry and potential bidders as providing a new level of detail that could help forward planning by bidders and suppliers. This was followed, in June, by the publication of a Franchise Competition Guide<sup>7</sup> setting out in more detail our processes and how to get involved.
- 1.15** To encourage wider interest in the franchising programme we held a successful UK Rail Opportunities Day at the QEII Conference Centre in London on 22 May, and plan to publish a comprehensive guide to franchising – the Rail Franchising Overview – later this year. We will host further industry days in the future to encourage dialogue with new entrants and provide more detail about upcoming opportunities.

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<sup>7</sup> <https://www.gov.uk/government/publications/franchise-competition-process-guide>

## 2. Specification of franchises

- 2.1** The Government broadly **agrees** with the Brown Review's recommendations about the way in which franchises are specified.

### Devolution

- 2.2** The Review observed that where franchises have previously been devolved the experience has been very positive. The Review recommended that further franchises should be devolved to local control and that these may include additional inner suburban services within London.
- 2.3** The Government agrees, and welcomes the Review's support for the principle of devolution, a key element of the Government's important localism agenda. In November 2012 we published a summary of responses<sup>8</sup> to a consultation on rail decentralisation undertaken earlier in the year. We confirmed our willingness to see an appropriate form of decentralisation introduced where it was sensible to do so, subject to resolution of a number of issues prior to entering into any decentralisation agreement. The propositions would, in particular, need to demonstrate that they have a business case and have widespread support from within the areas affected by the proposal.
- 2.4** With our agreement, 'Rail North' (a consortium of Transport for Greater Manchester, South Yorkshire PTE and West Yorkshire PTE) and Centro (West Midlands PTE) are developing detailed propositions for Ministerial consideration later in the year. We have also recently announced<sup>9</sup> that we will devolve part of the West Anglia franchise to the Mayor of London.
- 2.5** We continue to have a dialogue with the Welsh Government on their interest in assuming further responsibilities in relation to the provision of franchised rail services in Wales.

### Franchise objectives

- 2.6** The Review refers to franchising objectives in two different contexts. First, it highlights a set of specific challenges facing the rail industry, which franchising should help to address. The Review recognises that these industry-wide challenges call for the franchising programme as a whole to have a clear set of long-term objectives. The Government fully supports this. Such objectives will provide a

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<sup>8</sup> <https://www.gov.uk/government/consultations/rail-decentralisation-devolving-decision-making-on-passenger-rail-services-in-england>

<sup>9</sup> See p19 in <https://www.gov.uk/government/publications/investing-in-britains-future>

consistent and transparent direction of travel for the industry, taxpayers and passengers.

- 2.7** We consider that the proposed objectives set out in the Review are consistent with our past and future approaches to rail franchising. To provide clarity, the PIN published in March 2013 included our aims for the franchising programme. We plan to use these programme objectives as a reference in designing franchising agreements and also in developing our expectations of bidder behaviour and values. This will be taken forward in individual franchise procurements and contracts.
- 2.8** The Review also noted the need for each individual franchise competition to have its own set of objectives which reflect its specific requirements and address particular challenges. We fully support this recommendation and recognise the value of such clarity in assisting bidders in understanding the nature of exactly what we wish to procure for the passengers of each railway route.
- 2.9** In line with previous practice, we will develop specific objectives for the franchise competitions which are currently in their early stages of development. Along with the detailed franchise specification, these objectives will give bidders further direction as to where to focus their efforts and resources at bid stage and throughout the life of the franchise.

## Use of management contracts

- 2.10** The Review considered the case for widespread use of management contracts or operating concessions, where the franchising authority takes the revenue risk rather than the franchisee. The Review rejected this case, but did concede that there may be a better case where a franchisee is facing major and sustained disruption due to infrastructure works. The TSGN franchise was cited as being likely to be most suitable for such an arrangement.
- 2.11** We broadly accept this recommendation. The presumption is that in normal circumstances the risk around protecting and growing revenue is best left with the franchisee. In the case of the TSGN franchise, we accept that the Government is best placed to take much of the revenue risk given the large scale disruption planned over the next few years. In conjunction with pre-qualified bidders we are currently developing the specification, ITT, evaluation process and franchise agreement documents that will give effect to this revised approach.

## Output-based specifications

- 2.12** The Review welcomed moves towards more output-based specifications in recent franchise competitions. It recommended that the Department engage with bidders on a franchise by franchise basis to agree the framework for specifying train services, capacity and crowding standards, in a way that gives flexibility to bidders but which also recognises the need for Government to protect essential service levels for passengers.

**2.13** We agree with this recommendation and have begun engagement with Train Operating Company owning groups to develop revised approaches to specifying train services, crowding standards and capacity. We will seek to give bidders as much flexibility as possible in each future competition, in order to encourage increased efficiency and franchise value by allowing bidders to propose more innovative solutions. While every franchise is significantly different and requires a bespoke specification, the new approach will continue to safeguard essential levels of service and comfort for passengers, and realisation of the benefits of Government investment.

## 3. Commercial proposition

- 3.1** The Brown Review made a number of important recommendations on the nature of the commercial proposition in rail franchises, in particular on the transfer of risk, capital requirements, and franchise term. The Government **accepts** the principles on which these recommendations are based. Much of the detail of our revised approach on these and other commercial matters will be set out in proposals for individual franchise competitions. We also aim to provide further detail in the RFO.

### Risk transfer

- 3.2** The Review recommended that franchisees should be responsible for the risks they can manage and should not be expected to take exogenous revenue risk. The report set out a proposed mechanism by which Government would retain some elements of exogenous revenue risk (eg of GDP fluctuations). The Review recommended that the risk proposition be tailored to each franchise.
- 3.3** We agree with the principles set out in the Review and are currently analysing the implications of implementing a revenue risk sharing mechanism along the lines of that envisaged. As recommended, any mechanism will need to be tailored to the specific nature of each franchise and the risks which it faces. We are examining the revenue risk sharing options with a view to developing an approach to be used in the East Coast franchise competition, although we note that the successful bidder in the Essex Thameside competition will bear full revenue risk.

### Capital requirements and cross-default

- 3.4** The Review recommended that capital requirements be set at a level to create financial robustness, deter default and provide Government with protection up to a reasonable limit in the event of any default, without creating inappropriate burdens on the industry. It also set out a number of detailed proposals as to how these protections and disciplines could be achieved. The Review also recommended that the requirements should be clear to bidders when the ITT is issued.
- 3.5** We are undertaking a thorough review of the approach to capitalisation in franchise bidding, taking account of the findings of the NAO,<sup>10</sup> Laidlaw and Brown reviews. As recommended, we intend to move in future to a capital calculation which bidders will be able to determine in advance of bid submission. This will mean that the amount of capital required will be transparent and the calculation will be objective.

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<sup>10</sup> <http://www.nao.org.uk/report/lessons-from-cancelling-the-intercity-west-coast-franchise-competition/>

- 3.6** We intend that a portion of the total amount of capital will be backed by a bond provided by a financial institution of a certain minimum credit quality, and the whole amount will need to be supported by a parent company guarantee. We intend to implement our proposal for future capital requirements in the Essex Thameside franchise, for which the competition has resumed.
- 3.7** The Review concluded that a cross-default provision creating an event of default if another franchise agreement held by the franchisee or an affiliate is terminated should not be necessary, if appropriate requirements are set for parent company support and bonding as part of the capital requirements. This recommendation remains under consideration and we will provide an update in the RFO.

## Franchise term

- 3.8** The Review recommended that the franchise term should be determined by the circumstances and size of each individual franchise, usually consisting of a 7–10 year initial term with pre-contracted continuation, subject to agreed franchise criteria being met, of a further 3–5 years. The Review also recommended that the Department should be able, at its discretion, to extend a franchise by 26 four-week ‘reporting periods’ (in other words, approximately two years), as an alternative to the 7 reporting period (approximately six months) pre-priced extension included in recent contracts, in order to give the Department flexibility in planning the franchise programme.
- 3.9** We agree with these recommendations, including in relation to discretionary extension by 26 reporting periods.

## Profit sharing

- 3.10** The Brown Review recommended that there should continue to be an arrangement under which Government shares in the franchisee’s profits above an appropriate level. The Government agrees. A graduated profit share arrangement will continue to be included in future franchises.

## Partnership and alliancing

- 3.11** The Review recommended, as part of incentivising franchisees to play their part in achieving industry efficiency improvement targets, that franchise agreements should give sufficient freedom to facilitate the development of effective alliancing agreements with Network Rail. The Review also recommended that Government and the relevant regulatory bodies should work collaboratively with industry to pursue alliancing; and that a full review of the track access charging regime should be undertaken in advance of Control Period 6 (which commences in 2019), to ensure that the infrastructure costs to which franchisees are exposed more closely reflect the true cost imposed on Network Rail by train operations.

- 3.12** We agree with these recommendations, and welcome the Review's endorsement of the policy direction on alliancing set out in the 2012 Command Paper. Working closely with the Office of Rail Regulation (ORR), we have already successfully facilitated the launch of the Wessex Alliance between South West Trains and Network Rail. This Alliance, which recently celebrated its first anniversary, demonstrates how cultural change can be facilitated through removing the barriers to partnership working.
- 3.13** The objective of alliancing is to achieve operational efficiency through alignment of goals and incentives at a local level, so the model used in Wessex may not be appropriate elsewhere on the network. It is for Network Rail and operators to own the solutions and their delivery. We want to facilitate alliancing and other forms of partnership working where proposals deliver a benefit to passengers and taxpayers, and are compatible with the existing legislative framework. Bidders for future franchises will therefore be invited to work with Network Rail to develop proposals for bespoke partnership working, tailored to the requirements and circumstances of the route, including the extent to which the route is used by more than one operator.
- 3.14** We will work with the Rail Delivery Group to continue to support the development of alliances and other types of partnership working, in both new competitions and existing franchises. We will work with Network Rail to ensure that all bidders during competitions have the information necessary to understand and develop partnership opportunities and set out in their bids how they will work with Network Rail to contribute to improved industry cost efficiency.
- 3.15** We will also, for new franchises, consider partially exposing train operators to changes in Network Rail's track access charges occurring at future regulatory reviews in order to incentivise them to work with Network Rail to reduce infrastructure costs – as stated in the 2012 Command Paper. Finally, we will also engage with the ORR, which is taking forward a long-term review focusing on charging in the period beyond 2019.

## Bidder-proposed investments

- 3.16** The Review recommended that investments that are proposed by bidders during the franchise bidding process should be contracted, but with provisions that allow the franchisee to replace the proposition in their bid with an alternative which achieves the same outcome but in a more efficient or better way.
- 3.17** We fully accept the principle underlying the Brown recommendation. The Government has legal requirements to ensure benefits that were given credit in evaluation are delivered. However this needs to be balanced with our aim to maximise flexibility during management of the franchise, and to avoid hard-wiring schemes which could later be improved, or are no longer needed as a result of unforeseen macroeconomic or other events.
- 3.18** Guidance for bidders on contractualisation will be published as part of the ITTs for bidders on Essex Thameside and TSGN. Further improvements are being considered for future franchises.

## Change during the franchise term

- 3.19** The Review recommended that improved flexibility and change mechanisms should be built into each franchise agreement to ensure agreements are capable of accommodating beneficial changes proposed by the franchisee and Government-initiated changes.
- 3.20** We agree with this recommendation. We had already introduced new provisions for all future franchise agreements under which if a franchisee proposes a change which benefits its financial performance, and that change would normally trigger a payment adjustment clawing back the benefits, the franchisee can retain a portion of that benefit to the extent that rewards it for improving efficiency, and incentivises it to propose further such changes.
- 3.21** The Review also recommended that the Government return to a No Net Loss/No Net Gain (NNLNNG) mechanism for any changes it seeks to initiate.
- 3.22** We believe it is important to retain a structured approach to in-life financial change and do not therefore accept the recommendation that we should revert to the old style NNLNNG provisions. We have however developed a revised change mechanism, for inclusion in some future franchise agreements, which achieves outcomes more akin to a NNLNNG adjustment. We will continue to work with industry to address any ongoing concerns and simplify the process where possible.
- 3.23** The Review further recommended that Government take measures to enhance the effectiveness of the existing residual value provisions.
- 3.24** We agree with this recommendation. Franchise agreements let in recent years have contained provisions aimed at incentivising long term investments proposed by the franchisee during franchise life. We recognise that these have been poorly utilised historically, and are developing a guidance note explaining the circumstances in which such proposals will be considered and the mechanisms available to ensure the franchisee receives the appropriate benefit either during or at the end of the franchise. We will keep under review the need for further action.

## Financial model

- 3.25** The Review recommended that a single template financial model should be maintained by the franchisee and used to implement all adjustment and agreed change mechanisms; and that the template should be developed in collaboration with interested parties.
- 3.26** We agree that the more similar bidder financial models are, the easier it will be for the Government to identify and understand the differences and similarities between the propositions. However we consider that there are limits as to the degree of standardisation that is practicable. We currently issue a set of output templates which bidders are asked to populate with the outputs from their models. These templates are as generalised as is feasible across franchisees, and are used as the basis for implementing all relevant adjustments and changes. However some variety between them is inevitable, to reflect individual characteristics such as fleet types and routes. For each franchise competition we will consult with bidders on the format and content of the relevant templates.



## 4. Procurement process

- 4.1** The Brown Review concluded that the franchise procurement process needed to be more focused, transparent and disciplined, in the interests of both bidders and the franchising body. The Government **accepts** this recommendation, and has already taken a number of steps. We published a high level process map<sup>11</sup> in April outlining the end-to-end process, including stages of engagement and overall governance. This was followed by a more detailed Franchise Competition Guide published in June.

### Market information

- 4.2** The Review recommended that the Department regularly seek to inform the market about upcoming competitions through the issue of Prior Information Notices (PINs) and engage early with stakeholders to inform the production of a draft ITT.
- 4.3** We published a PIN in March that provided potential applicants with details of the revised franchising programme and have committed to updating this PIN annually to include an updated schedule and more detailed information on the Franchising Programme. We will engage with potential bidders early in the process when developing the specification and tender documentation. As set out in the Franchise Competition Guide, we intend to publish more detailed information on the commercial proposition in each OJEU notice. This will enable potential bidders to make an early decision as to whether they wish to bid for the franchise.

### Simplicity of documentation

- 4.4** The Review recommended that documentation and bidding requirements be simplified wherever possible. We are reviewing all bidding documentation and will seek to remove any unnecessary details and requirements that are set out in the documentation. We will ensure that each ITT has clear instructions to bidders that will enable them to understand what the Government is seeking to buy. This is an ongoing activity and will be addressed through each franchise competition.

### Streamlining the ITT

- 4.5** The Review recommended that ITTs should not require bidders to supply evidence relating to basic competence where this has been tested at pre-qualification, standard industry process descriptions, or evidence of compliance with processes tested by other bodies. We will in future structure ITTs in a way that focuses more

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<sup>11</sup> <https://www.gov.uk/government/publications/franchise-competition-high-level-process-map>

closely on key objectives, and will not seek detailed information on non-essential areas, or areas that are already adequately covered by pre-qualification or other industry processes. The main results of this will be reflected in the structure of the TSGN and East Coast ITTs. We will continue to test our proposals with the market and keep them under review.

## Pre-Qualification Questionnaire

- 4.6** We are implementing the Review's recommendation that the Pre-Qualification Questionnaire (PQQ) should be backward looking only. The sections of the PQQ seeking the organisation's vision for the new franchise and evidence of past performance measured against aspects of the European Foundation for Quality Management (EFQM) Excellence Model 2010 will be replaced by an assessment of technical and professional ability. The updated PQQ will be used to rank and shortlist bidders who can demonstrate they have an appropriate financial position and technical ability to deliver the contract. The PQQ will only request information which the Government intends to use in the evaluation of responses.

## Data site

- 4.7** We are implementing the Review's recommendation that the electronic data-site for each competition be opened once bidders have been short-listed. We have reviewed and consulted the industry on the Department's data-site system. We have developed a generic data-site structure which provides clear instructions on what information is required. This will enable a level playing field for all bidders. The incumbent will be required to populate the data site in good time prior to the pre-qualification stage and the data-site will be opened once bidders have been short-listed. This should reduce the number of clarification questions and will enable bidders to use their time more effectively.

## Assessment of financial robustness

- 4.8** The Brown Review reiterated that the Department should undertake a test of the financial robustness of bidders' proposals so that it can satisfy itself that the bidders' proposals do not pose unacceptable probabilities of default. The Review also recommended that, to support a transparent process, the variables to be used and assessment process should be set out in the ITT along with the acceptable implied probability of default.
- 4.9** We agree that the ability of a bidder to deliver the premiums in the bid (or to meet its costs with the subsidy payments received) over the course of a franchise, is of great importance. Previously, we made an adjustment to the Net Present Value (NPV) of premiums/subsidies in the bid, in order to reflect any revenue support which a bidder might require during the life of the franchise. We also sought, post bid, to secure parental funding guarantees of value equal to the level we viewed as necessary to ensure that the premiums/subsidy commitments could be met.

- 4.10** The ability of a franchisee to meet its financial projections will continue to be assessed as part of the financial evaluation of a bid, although, as explained in the section on capital requirements above, this will not involve the requirement for additional funding after a bid has been submitted. Alternative methodologies for assessing and mitigating financial risk are currently being developed, and an update will be provided in the RFO.

## Assessment of quality and deliverability

- 4.11** The Brown Review recommended that franchise bids should be explicitly scored on their proposals for improving passenger quality and their management of the workforce, and that an appropriate weighting should be given to the overall quality of the bid. The Review proposed that quality should be judged on a range of factors, including proposals for investment in staff, commitments to deliver passenger satisfaction survey results, the strength of the bidders' approach to managing the franchise, and their approach to developing partnerships and alliances.
- 4.12** The Review recommended that the Department's assessment of bid quality takes account of the bidders' delivery plans. This requires the Department to test the credibility of bids, and assess whether bidders can deliver the requirements and successfully achieve the outcomes they are projecting.
- 4.13** The Review also recommended a significant role for the National Passenger Survey in franchising, and highlighted that this would require some boosting of sample sizes.
- 4.14** We are making significant changes to franchise procurement in light of these recommendations. Initial changes will be implemented in the ITTs that will shortly be issued for Essex Thameside and TSGN, with further changes to the structure of evaluation to follow for later franchises.
- 4.15** The Government accepts the recommendation that points be given for quality and/or deliverability and that these should play an explicit role in award. In future, franchise evaluation will award all bids a score for non-financial elements of the bid, which will be used along with price in awarding the franchise. The Department will publish clear, transparent instructions to bidders for each franchise which set out how bids will be evaluated and how points are awarded.
- 4.16** The Department intends that the scoring criteria will reflect different priorities on each franchise, in line with the Review's recommendations. The credibility of bidders' plans to deliver the operational and contractual requirements (deliverability) will form an important part of the scoring criteria in all future franchises. The scoring criteria will also be designed to work with the franchise specification to secure good quality for passengers and good outcomes for taxpayers across the range of areas highlighted in the Review, including passenger satisfaction, innovation, good management of the franchise and partnership with the Department and the wider industry. The key quality outcomes that we are seeking from the industry were set out in the March PIN.

**4.17** The Government accepts the recommendation of the Review that it should contract targets from the National Passenger Survey in future franchises. New franchises will require franchisees to achieve clear levels of passenger satisfaction based on the National Passenger Survey. The Department is working with Passenger Focus, who design and administer the Survey, to make the appropriate changes to sample size or survey methodology for each franchise and is considering mechanisms to ensure that appropriate passenger benefits are delivered.

# 5. Franchise management

- 5.1** The Brown Review emphasised the importance of effective management of each franchise in order to deliver value for taxpayers and passengers, and made a number of important recommendations to that end. The Government **accepts** the Review's recommendations on this matter. Those concerning the Department's capability are addressed in the next chapter.

## Simplifying the franchise agreement

- 5.2** We undertook a thorough review of the template franchise agreement in 2010–2011, resulting in a number of reductions to the contractual provisions. As recommended, we will continue to review and remove any unnecessary details and process as part of the document development process for each franchise competition. We are currently working with the Rail Delivery Group to identify areas where provisions can be clarified or removed without detriment to either party.
- 5.3** We have strengthened the franchise agreement provisions concerning the obligations on the incumbent at franchise re-letting. In the event that we believe an incumbent is failing to meet its obligations with regards to information provision for the competition we can require them to appoint, or appoint directly ourselves, appropriate suitable resource at the franchisee's expense.

## Guidance on franchise management

- 5.4** We accept the Review's recommendation that the Department publish guidance on our approach to franchise management and intend to do so this summer. This guidance will provide operators and potential operators with a greater understanding of the Government's approach to effective and rigorous franchise management, so that both parties can identify and work towards common goals within a long term partnership designed to maximise commercial value.
- 5.5** The publication will cover the Government's statutory obligations and general approach to franchise management, including how it looks to protect taxpayer investment, best serve passengers' needs, and grow the long term commercial value of franchises and railway assets. It will address how we will approach compliance monitoring, in order that the appropriate level of assurance can be maintained without adding unnecessary cost or bureaucracy. It will provide guidance for franchisees on how they can benefit most from their relationship with the Department, including use of specific contractual mechanisms in the franchise agreement such as Protected Proposals.

## 6. Organisation, governance and capability

- 6.1** The Brown Review made a number of important recommendations on strengthening the Department's organisation, governance and capability to deliver rail franchising, and consideration of wider structural options. The Government largely **accepts** these recommendations. Work to implement them is in many cases complete and in most others well underway.

### DfT organisation

- 6.2** As recommended by the Review, a Franchising Director has been appointed in the Department for Transport and is responsible for specifying and procuring all rail franchises. He is the Senior Responsible Owner (SRO) accountable for delivering the programme as a whole. Supporting team members in the Franchising Directorate and a strengthened Programme Office are now dedicated full time to programme delivery. Clear reporting lines have been established and committee meetings have new terms of reference that will be regularly reviewed.
- 6.3** Three project teams have been established for the current live franchise competitions (Essex Thameside, TSGN and East Coast). As the Review recommended, each franchise competition now has a dedicated Project Director responsible for leading the delivery of each stage of the competition. This is a senior civil service role supported by a discrete team fulfilling finance, specification, procurement and project management activities.
- 6.4** The team will be established at the beginning of each project to ensure an effective delivery of the competition. The project teams will be supported by a programme office, procurement unit and a design team. This will ensure that the right level of resources and systems are in place, there is consistency through each competition, and that lessons learned are captured and carried forward for future competitions. Further detail is set out in the Franchising Competition Guide. Project Directors have also been appointed for two subsequent projects and their teams are currently being recruited.
- 6.5** As recommended, the teams responsible for day-to-day management of franchises and franchise procurement remain co-located. They are now located within a newly established Rail Group, led by the Director General for Rail, which covers all aspects of rail policy other than development of High Speed 2.

## Structural options

- 6.6** As part of the Government's recently announced<sup>12</sup> drive to improve the delivery of significant infrastructure projects, the Department will bolster its commercial capability in rail franchising. We agree with the Review's recommendation that consideration should be given to where franchise procurement and management are located. Recognising the importance of this issue, the Department has already begun the work recommended, looking at the three options identified by the Brown Review: the central Department, an Executive Agency or a new body at arm's length from the Department. Whatever the structure, decisions would remain under Ministerial control with the franchising team led and staffed by professionals with appropriate commercial experience and skills. By December this year, the Department will conclude its evaluation of the options and set out plans for the future location of these functions so as to ensure the optimal management and delivery of the Government's rail franchising programme.
- 6.7** The Review also considered, but did not recommend, passing responsibility for rail franchising to the ORR. The Government agrees that responsibility for rail franchising as a whole should not be passed to ORR as there are few, if any, synergies to be gained. However, as we set out in the 2012 Command Paper, the Government considers that there are clear benefits to be gained from moving towards a simpler regulatory structure. Following a joint consultation with ORR on this subject and conclusions published in March 2013,<sup>13</sup> the ORR has taken on from the Department new responsibilities for train operators' maintenance of, and compliance with, passenger complaints handling procedures and disabled peoples' protection policies. The conclusions also include a commitment to improved joint working between the Department and ORR on how the operational performance of the whole rail industry is monitored and reported. The ORR is also taking on a greater role in respect of monitoring and reporting whole industry efficiency and value for money. Both these commitments will improve the comparability of information provided to passengers and the informed commentary available to explain it. The Government will keep under review the option of transferring additional functions to ORR in the future.

## Governance and assurance

- 6.8** The Review concluded that the Department needed to establish a clear governance and assurance framework for each franchise competition, with clear and purposeful reporting lines and committee compositions. The Department set out its initial thoughts on this in its response<sup>14</sup> to the Laidlaw Inquiry in December last year. Since then further work has been carried out to implement such a framework.
- 6.9** We have strengthened governance and assurance both within rail franchising and more widely across the Department by revisiting the composition and constitution of the bodies involved in decision making. We have reviewed the role of the Department's Board and its sub committees and have revised the Terms of

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<sup>12</sup> See p68 in <https://www.gov.uk/government/publications/investing-in-britains-future>

<sup>13</sup> <http://www.rail-reg.gov.uk/upload/pdf/dft-orr-statement-180313.pdf>

<sup>14</sup> <https://www.gov.uk/government/publications/response-to-the-report-of-the-laidlaw-inquiry>

Reference as appropriate. Following the establishment of Rail Group, we have developed a Rail Group Governance Framework which aligns with the principles established for governance and assurance processes being rolled out across the Department. Terms of Reference have been established for the Rail Board and the Terms of Reference for its sub-committees have been reviewed to ensure they show clear reporting lines and confirm that roles and responsibilities are clearly communicated. The wider review of the Department's governance also addressed the extent and limitations of delegated authority held by committees and individuals. The Rail Group's governance and assurance processes will be kept under regular review in the light of experience and as we grow our capability.

- 6.10** The Review recommended that, as part of the independent assurance framework, consideration be given to setting up a small Franchising Advisory Board to give support and guidance to the Department as well as wider reassurance to bidders and the wider industry. We have established the Franchising Advisory Panel,<sup>15</sup> chaired by Richard Brown, which has been meeting regularly since April.
- 6.11** The Review also made a specific recommendation that, once decisions are being considered by senior governance bodies, the anonymisation of bids was not desirable. The Department has undertaken a review of its policy on anonymisation of bids in concert with the Cabinet Office. The review concluded that there is no significant advantage in using an anonymised bidding approach, and that there are risks which on balance outweigh the benefits. The Department has therefore concluded that it will no longer use bidder anonymity in its contracting activity.

## Capability

- 6.12** The Review highlighted the need for the Department's franchising organisation and capability to be strengthened urgently to match that of the bidders' teams.

### Recruitment and capability plan

- 6.13** The Review recommended that the Department bring in a range of experienced individuals, with senior level experience in areas such as procurement and commercial negotiation, finance and programme management, noting that franchise management capability is as important as the franchise letting process. It also noted that Department needs to ensure that it has sufficient external advisers to support the procurement process and the final negotiation stage of the competition.
- 6.14** We agree with these recommendations, and recognise that ensuring that there are the right internal resources and external support in place is an ongoing process which will need to continue to monitor.
- 6.15** The Department is working to ensure that there is the right mix of skills, experience and knowledge in Rail Group required both to deliver each franchise competition and to manage the franchises. Following the recommendations made by the

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<sup>15</sup> It has been titled a Panel rather than a Board as it has an advisory and assurance, rather than decision-making, role in relation to the franchising programme. Details of the membership and terms of reference can be found at <https://www.gov.uk/government/policy-advisory-groups/rail-franchise-advisory-panel>



Laidlaw Inquiry, the Department completed a skills review in January to inform the allocation of resource to each team. The Department has prioritised roles and vacancies within its Rail Group which are being filled through a combination of internal moves, interim consultants with specialist skills, as well as through recruitment and capability development.

- 6.16** External technical, legal and financial advisors have been appointed for the competitions for Essex Thameside, TSGN and East Coast. The Department has developed a strategy for procuring and appointing technical, legal and financial advisors for future competitions as they become live and will continue to keep this area closely under review.
- 6.17** We agree with the Review's recommendation that the Department should draw up a capability plan which demonstrates how this initial injection of outside experience and skills will be used to develop and grow its own organisation as the programme progresses. The Department is developing a learning and development strategy with the objective of further developing the capability of the in-house franchising teams.

### **Programme management capability**

- 6.18** The Review specifically recommended that the Department's programme management capability needed to be greatly strengthened. The revised franchising programme ensures that the number of simultaneous franchise competitions in progress is kept to a manageable number. In addition to the project capability in each individual dedicated franchise project team described above, the programme-level functions in the new Franchising Directorate are being substantially strengthened.
- 6.19** It will be possible over time for franchise teams to move on from one franchise competition to the next, acquiring skills and experience of the process and building capability along the way. Planning is already in hand on how to give effect to this in practice.
- 6.20** A number of interim professionals are being employed on medium-term contracts to help provide the necessary skills and expertise. This will continue until suitably-qualified permanent staff are appointed.

### **Management of responses to clarification questions**

- 6.21** The Brown Review specifically recommended that sufficient capable resource should be in place to manage actively the commercial dialogue with bidders. The Department has reviewed its processes and systems for handling clarification questions (CQs) and has developed and implemented a robust CQ handling process that is integrated into a single system alongside the data-site and evaluation tool. This will enable bidders to track the status of CQs and will ensure that CQs cannot be misplaced or go unanswered.

# Annex A: Index to the Brown Review recommendations

**A.1** The table below identifies the specific recommendations relevant to each section of this Government response.

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