Department for Transport

Case for creation of a new public body in place of the Highways Agency

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1. Summary

1. The Highways Agency (HA) is responsible for maintaining, enhancing and operating England's strategic road network (SRN). Although consisting of only 2.5% of the nation's roads, the SRN carries over one third of all traffic and two thirds of freight. It is an essential piece of our national infrastructure, and is the single most valuable asset owned by government. In recent decades the HA has become a strategic network operator rather than a large-scale road builder: 95% of its activity is now outsourced to private sector contractors.

2. In order to deliver a network that supports economic growth, provides a better service to users and value to taxpayers, the Government has announced a package of interconnected reform measures. This document sets out the case for one aspect of these reforms: the creation of a new government-owned company within the public sector to take the role of the Highways Agency. The other elements are long term certainty of funding and plans delivered via a Road Investment Strategy including a performance specification and statement of funding.

3. Without this fundamental change to the Highways Agency and the relationship between government and network operator, the other elements of reform will not be able to take full effect. So while some of the efficiencies flow from the legislation, the new separate body is needed to achieve the full savings and benefits.

4. The creation of a legally separate company:

- is vital to the credibility of the long-term financial settlement throughout the supply chain;
- will enable a transparent process to establish a stable delivery requirement for the network that matches the financial settlement;
- will provide clear separation between the roles of government as the client and the company as the network operator, enabling the government to focus on creating a clear set of strategic outcomes and performance expectations and identifying the operator as accountable for delivering specific outcomes for its road users;
- establishes a body that will be sufficiently independent and accountable for the day-to-day management of the strategic road network to deliver faster and more efficiently; and
- will foster the cultural change to allow the company to work in a different way, that is more aligned to that of the supply market in which it operates.

5. The potential savings to the taxpayer from roads reform are estimated at £3.8bn over 10 years (on a programme rising to over £3bn by the end of the decade and continuing at a similar level thereafter), within a range of

£2.6-7.4bn that reflects different assumptions about the level of investment as well as the savings that reform can deliver. These efficiency benefits of 15% or more stem from the whole package; our qualitative assessment demonstrates why a new public body is an essential part of that.

6. These reforms, and this new public body, are important to delivering the step change in investment and performance set out in Investing in Britain's Future and Action for Roads in summer 2013. This will see investment on the SRN treble by 2020-21 to support jobs and economic growth.

2. Strategic context

7. At Spending Round 2013, the Chief Secretary announced that the Government would convert the Highways Agency into a company that was publicly-owned with end-year financial flexibility and long-term funding certainty. This message was elaborated in July with the publication of Action for Roads by the Department for Transport, and, in winter 2013, the Department completed a consultation on the following reform proposals, and the legislation required to deliver them:

- Transformation of the Highways Agency into a government-owned company.
- Introduction of a Road Investment Strategy (RIS), likely to be for five years, including the Statement of Funds Available (SoFA) to support delivery of the RIS.
- The creation of an independent road user watchdog and efficiency monitor.[1]

8. The reform measures that the Government is taking forward reflects those recommended in 2011 by Alan Cook – current HA non-executive chairman and former Post Office CEO. His report, A Fresh Start for the Strategic Road Network (the Cook Review) [2], found that these reforms could enable savings of 15-20% on strategic roads spending. The Department for Transport's impact assessment[3], presents the evidence base for these reforms and an assessment of the scale of savings they could deliver.

9. These reforms are designed to provide certainty over the forward programme investment to the roads operator and its suppliers. Publishing a RIS including a SoFA, underpinned by legislation and applied to an arm's-length body, will create confidence among suppliers over the size of the future market; this will generate potential savings by making more long-term behaviour economically viable for contractors. Secondly, to ensure that savings are delivered to the taxpayer, we must provide operational independence to the HA's successor so that its tendering processes both drive and exploit efficiency in the supply chain. This involves:

- A long-term strategic plan, giving clear sight of work to come, insulating against short-term, non-strategic changes, and allowing the

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[1] We are not proposing to create new bodies for these functions, but to use existing ones.
[2] A. Cook, *A Fresh Start for the Strategic Road Network*, November 2011, https://www.gov.uk/government/publications/a-fresh-start-for-the-strategic-road-network, (hereafter 'the Cook Review'), para 1.7, citing the IUK infrastructure cost review and the Cabinet Office's government procurement strategy as evidence.
[3] The impact assessment can be found at: https://www.gov.uk/government/consultations/transforming-the-highways-agency-into-a-government-owned-company

operator to focus on how it delivers, thereby increasing the efficiency of its operations.

- Legal separation of central government and the operator to ensure that the necessary organisation and culture change occurs and that the message to suppliers is clear: government is committed to improving the resilience and performance of our road infrastructure, and is making it more difficult for itself to arbitrarily revise its plans or funding commitment in future.
- Providing discretion to the operator to do what it takes to maximise efficiency. Some of this will flow from legal separation and incorporation; beyond that government will undertake further work on the most appropriate balance of flexibility and control for the operator.

10. The Department for Transport (DfT), together with HM Treasury, looked in detail at different options for managing the SRN and found that introducing greater independence by setting up a government-owned company was the most suitable for meeting the policy objectives. This is because:

- operational and legal independence is vital in driving the change in the relationship of the company with both Government and suppliers that will maximise the benefits of roads reform;
- creating certainty over funding and long-term plans is essential for realising efficiency savings and a key part of this is establishing a more contractualised relationship through a Road Investment Strategy (RIS) with a separate legal body, rather than an agreement with part of DfT;
- this will provide a clear message to suppliers that government is prioritising and committed to roads funding, making them more likely to adopt longer-term, more efficient behaviour;
- operational independence is vital for equipping the company to drive and extract the efficiency savings from the HA’s supply chain that certainty over the RIS makes possible;
- the funding certainty and operational independence envisaged can only be substantively achieved with clear, transparent and binding commitments on both sides, to enable a constant focus on delivery and provide the environment for a culture change;
- the establishment of a new body, delivering a transparent strategic plan set by government, will indicate a clear owner of accountability to road users and enhance customer focus; and
- the Secretary of State will be able to concentrate on developing successive performance indicators and shaping a strategic direction for the company, without needing to be concerned about the tactical management of the network.

11. At the June 2013 Spending Round, the Government set the HA the significant challenge of trebling capital investment in its network to £3bn p.a. by 2021 to support growth and jobs. To ensure delivery of this, and provide value to the taxpayer, it is now more important than ever that efficiency is improved in roads delivery.

3. Aims and outcomes

12. Our aim is to create world class national roads infrastructure, supporting economic growth, through maintaining and improving the asset, improving resilience and reliability, reducing congestion and supporting broader, sustainable development and safety goals. This requires a world-leading delivery and operations company that delivers efficiency savings, a step change in the scale and speed of investment, a better service to customers and value for money to taxpayers.

13. The key to achieving this is to create an arm's-length body that has its own legal identity, so that it can operate and contract in its own right with a funding stream that is insulated from short-term change, while leaving government responsible for the overall strategic direction.

14. The outcomes expected of this change are to:

- to add further certainty and reassurance, alongside the changes to legislation we are bringing forwards, to suppliers over the Government's plans and funding commitment for the SRN, so that they switch to long-term approaches that enable efficiency savings;
- establish a body that is operationally independent and accountable for the day-to-day management of the strategic road network; and
- allow the new company to approach network management as much like an efficient and commercial, market-driven entity as possible.

4. Consideration of options

15. In this section we show our assessment of all the options, including the status quo, which have been considered for the future of the Highways Agency.

Must this be carried out by central government?

16. The Prime Minister's feasibility study, commissioned in March 2012, examined the case for managing the SRN outside of government. It concluded that without substantial changes to the fundamental nature of the SRN this was not possible.

17. The business of governing the SRN is a 'natural monopoly'[4], operating an 'open' network that forms an integral part of a wider transport system and the economy. The business gives rise to serious safety and environmental issues and requires a very long-term approach to planning and investment. Hence the SRN must be run under a stable management framework with priority paid to the public interest, which means the business must be either publicly-owned or strictly regulated.

18. As laid out in chapter 6 of Action for Roads, we continue to examine longer-term options for reform. That chapter referred to a range of possible models for governing the road network, some of which could involve movement outside of central government. As discussed below, however, government has no intention of moving to a model that would require a new way of paying for roads. Any model implemented should leave open the option of further reform. However, this is not the reason for reform and the proposal is a much better long-term business model than the status quo.

19. In June 2013, the Government announced a major increase in investment on the strategic road network, taking effect between now and 2021. This forms a centrepiece of the Government's infrastructure programme, and is a key part of efforts to improve national competitiveness. This underlines the need for reform in the short term which will enable savings and accelerate, rather than impede, the speed of delivery.

20. In line with the Government's review of infrastructure, we intend this company to emulate best practice from comparable private sector bodies, whilst government as sole shareholder exercises pressure on efficiency and value for money through the company's governance framework. This represents the closest we can get to mirroring the

[4] The key facts about the market which lead to this characterisation are that the network has high sunk costs and low variable and fixed costs. The SRN had an estimated asset valuation of £110bn in 2013, compared to the 2012-13 net operating cost of £2.1bn (Highways Agency Annual Report and Accounts 2012/13, June 2013). This will lead to decreasing average costs to scale over a large range, a key characteristic of natural monopolies.

efficiency and incentives of commercial businesses, while retaining the capacity to ensure we can effectively protect the public interest.

Could an existing body take on board these functions?

21. The HA is a large and complex organisation with expertise unique to infrastructure in roads. It is already investing c. £1bn per annum and has an ambitious Spending Round settlement which will treble that by the end of the decade. The potential risks and costs of HA merging with any other organisation currently delivering infrastructure would clearly be tremendous and would risk jeopardising both roads delivery and the delivery of any partner body's remit.

Could the Department for Transport provide these functions 'in house'?

22. This would be a significant step backwards from the status quo in terms of providing the independence and corporate culture needed to deliver management and improvement of the strategic road network effectively. Reviews of the Agency have found that efficiency, innovation and accountability could be improved by greater independence, not less. Bringing the HA into central DfT might mean losing or obscuring a robust governance and internal controls framework, and the advantage of the Agency's CEO being an Accounting Officer, severely jeopardising delivery and value for money.

23. The successful introduction of a Road Investment Strategy with supporting legislation to provide a certain long-term budget to the roads operator is a much needed reform that will enable a step change in investment and efficiency savings. This will not come about if the SRN is managed by DfT centrally, as the lack of corporate independence for roads operation would greatly dilute the strength of the guarantee that the money will be used for roads and weaken accountability for delivery against strategic outcomes. Critically suppliers would not have the confidence that this is a genuinely new relationship and hence make the changes to their long-term behaviour needed to deliver the efficiencies.

What consideration we have made of alternative delivery models

24. Our consideration has been informed by two main pieces of work, highlighted below.

25. In his independent review of the SRN, Alan Cook looked at four broad kinds of model for reform of the network operator.

a. An 'enhanced status quo' model, which retains the Highways Agency as an executive agency of the Department for Transport (DfT), but introduces a commitment to greater funding certainty from the DfT; an outcome-based performance specification for the Agency; and a governance structure that separates the DfT's 'customer' and 'shareholder' roles in the Agency, with a stronger role for the Agency Board modelled on commercial best practice.
b. A 'contractual' model where the network manager is formally independent from the DfT, for example as a GovCo, and delivers transport services to the DfT under a performance contract based on network performance, asset condition and cost efficiency. The

Secretary of State’s role as shareholder is formally separated from their customer role and exercised through a strong independent board.

c. A ‘regulated’ model, where the network manager is subject to formal economic regulation, with the regulator determining the maximum charge which the network manager can require the DfT to provide in return for its services.
d. A ‘regional concessions’ model, where the DfT operates as a franchising authority, contracting out service provision to a mix of public and privately-owned regional franchises over fixed 10–12 year contracts.

26. Cook recommended option ii. Government noted this recommendation and undertook further evidence gathering and stakeholder engagement to formulate the proposals in Action for Roads. The department, with the agreement of No.10 and HM Treasury, has decided to set up a government-owned company, as described above. The case for this model is set out in the rest of this document and in Action for Roads. We now look at the Department’s reasons for not progressing with the other possible options in turn below.

i. Enhanced status quo

27. Implementing option i – an ‘enhanced status quo’ – would offer an opportunity for improving efficiency and delivery. Governance of the Agency and its relationship with government could be reformed to align it more closely to that of similar organisations in the private sector, including separation of the roles of ‘owner’ (seeking to make the Agency more commercial) and ‘client’ (setting and driving performance expectations) within DfT. This could enhance pressure on costs and the clarity of strategic plans respectively, enabling the Agency to undertake more efficient and autonomous delivery against outcomes. This would also be the cheapest and least disruptive reform option, and would retain greater fiscal and policy flexibility for ministers, even when coupled with a Road Investment Strategy (RIS) and statement of funds underpinned in legislation.

28. The corollary of retaining greater fiscal and policy flexibility for ministers is that, under this model, we expect it would be easier for government to revise investment plans and funding than under the other options. Even with a statutory provision which commits Government to the specified funding, we would still have concerns that in practice, many channels for the Department to micromanage operational decisions or revise the agreed outcomes and expectations would remain under an enhanced status quo. Fundamentally, the Highways Agency would remain legally as part of the Secretary of State for Transport, it would be discharging functions for which he remains directly legally responsible, and its employees would remain as civil servants. As a behavioural driver we think that there is too much similarity between this model and the status quo, which causes us to doubt that it would in practice provide for a sufficiently clear and mature client-operator relationship between the government and the Agency. The Agency would also remain within civil service frameworks that would dilute the autonomy and options of the

Board in managing its staff. These factors would both reduce the level of challenge from the Agency on decisions that affect efficiency and the achievement of long term targets and undermine the robustness and the transparency of decision making between government and delivery body.

29. This would all undermine the certainty of a RIS where performance expectations, investment plans and funding is intended to be set once over multiple years and binding on both parties from therein. Both the Cook Review and subsequent assessment by DfT, including engagement with the Agency's supply chain, has found that the key consequence of this is that the certainty underpinning investment plans would be less credible to external organisations specifically the supply chain which is key to delivering efficiencies. As our impact assessment showed, efficiency savings depend on suppliers adopting lower-cost approaches which they will only do if confident in the forward programme of investment. Previous long-term plans have not always been seen through to conclusion and there is a history of 'stop-start' in roads investment in particular, creating a difficult challenge in business confidence to overcome.

30. Under option i, there remains a significant and distinct reliance on the good will of government not to intervene in plans and funding as it has in the past. In order for suppliers to change their behaviour, which would involve some adoption of risk, they expect to see roads treated similarly to other modes, which means greater independence, much more commercial governance and a clear commitment to change by the government, rather than what might be perceived as merely a 'rebranding'. Without this, it will be difficult to realise gains in efficiency.

iii. Regulated model

31. In developing Action for Roads we considered options for further institutional reform, giving the roads operator even greater independence from government and leaving it to handle a specific remit on the management of the roads. Some models have the potential to bring private finance in to the network (as might be the case under option iii) to help support investment. Ministers ruled out establishing a dedicated funding stream for strategic roads, which would be a prerequisite for a private finance model. Any private finance option for the strategic road network would require years of lead-in time to implement, which would not allow it to meet the criteria of accelerating the roads programme announced at SR13. The reforms in Action for Roads, central to which is the creation of a government-owned company, is designed as an end point and will deliver this Government's policy objectives over the long-term without further reform. However, government will continue to examine whether there is a case for further change to the way the strategic road network is run in England.

iv. Regional concessions model

32. Option iv, long-term concessions operated by a mixture of private and public companies, was also found to not be suitable as despite the possibility of improving cost competition and providing a stable funding basis, it comes with high potential risks and less flexibility. Contractual arrangements over these timescales carry the risk that provisions might not be applied as envisaged. The inherent lack of flexibility once a contract is signed with a private sector provider means that poorly defined contracts will impact on either the public finances, the users of the system or the concessionaire. This risk would be exacerbated by the lack of experience in setting performance regimes for roads on this scale, and there would be no opportunity to evolve the system to take into account lessons learnt.

Does the service or function meet at least one of the Government's three tests?

a) Is this a technical function (which needs external expertise to deliver)?

33. Yes. At present, 95% of the Agency's spending is on services delivered by private companies. The Agency employs a wide range of technical experts whose functions are not duplicated elsewhere in central government, and which frequently have to be contracted in from the private sector at a high cost to the taxpayer. As a government-owned company, the operator would also have more ability to develop its own, tailored talent management strategy, to recruit more specialists and improve skills generally, which would lead to cheaper costs in contracts and asset management.

34. After transformation, staff at the company would not be civil servants and civil service recruitment protocols would no longer apply. This means the operator could react to business needs much more quickly by cutting many months out of the typical process for recruiting staff from the private sector. A company would also be able to depart from civil service norms in how it offers benefits and sets terms and conditions, which could lead to more effective incentives.

b) Is this a function which needs to be, and be seen to be, delivered with absolute political impartiality (such as certain regulatory or funding functions)?

35. This function does not need to be delivered with "absolute" political impartiality – the company would take high-level directions from government via the RIS and the Secretary of State will have a role as shareholder. However, it is crucial that the roads operator is given a very significant degree of separation from short-term Whitehall interference, and that it acts within more commercial incentives and frameworks.

36. Comparison with private-sector infrastructure operators shows that greater efficiencies can be achieved by firms that are not subject to short-term decision-making. The key to achieving the long-term target of 15-20% efficiency savings that Alan Cook projected in his Review is certainty over the forward programme in the RIS. To do this, it is necessary to give suppliers confidence in the pipeline of schemes and the future size of the market, so that they can make economies of scale from procuring in bulk and more efficient long-term recruitment and training strategies replacing cyclical hiring-and-firing to meet fluctuating demand.

37. Creating a government-owned company will make the roads operator a separate legal entity and an independent advocate for roads. The strategic plans and performance framework should be more effective where DfT has a more contractualised relationship with another body, rather than agreeing what it will do internally. The protection of the RIS from Whitehall micro-management is important to achieving the quoted benefits, or else suppliers will believe that plausible changes in political priorities – due to, for example, local issues around specific projects or government-wide budget pressures – may lead to work being cancelled. This could undermine the certainty of investment plans and funding. Under the system being introduced, a change to the funding by government within the RIS period would involve a formal and transparent process which we do not anticipate Ministers entering into lightly. So overall this provides a huge increase in the certainty of funding compared to the status quo.

c) Is this a function which needs to be delivered independently of Ministers to establish facts and/or figures with integrity?

38. No. But it is important that there is appropriate external, expert scrutiny and challenge of the company's costs, efficiency and performance. We are setting up an independent cost monitor and road user watchdog to undertake this.

5. Appraisal of preferred option

Benefits

Efficiency savings from funding certainty and behavioural change

39. As demonstrated in the roads reform impact assessment[5][6] institutional changes are a crucial component to enabling the full efficiency savings of roads reform, estimated at:

Table 5.1 - Cost saving benefits			
COST SAVING BENEFITS (£m)	**Average Annual (excl. Transition) (Constant Price)**	**Total Cost Saving Benefit (10 years) (Constant 2013/14 Prices)**	**Total Cost Saving Benefit (10 years) (Discounted)**
Low	£258m	£2,580m	£2,297m
High	£740m	£7,402m	£6,557m
Likely estimate	£380m	£3,804m	£3,361m

The size of the range is primarily due to sensitivities around the level of potential investment in roads post-2021 and the extent of savings possible due to reform. The Spending Round 2013 only committed spending from 2015/16 – 2020/21l. The likely estimate assumes that investment continues at a broadly similar level from 2021 onwards.

40. The impact assessment explained that these savings are estimated on the basis of all of the interconnected reform measures, with underpinning legislation, being delivered. Monetising the impact of the different reforms in isolation (e.g. the creation of a new body without a legislated commitment to funding) would not provide an accurate estimation of their respective potential value in this context, as the measures are mutually reinforcing. A qualitative assessment is given below.

41. Creating a separate legal body, with a secure funding arrangement underpinned by legislation (to build the supplier confidence required to secure the efficiencies) is fundamental to delivering these savings. We will be seeking to introduce a new arrangement with more flexibility at the micro-level, supported by a strategic controls framework. This new control framework will be dealt with separately; configuring it correctly will be very important to delivering the likely estimate of efficiencies in the table above.

[5] Please see the impact assessment for further detail on the issues facing the SRN, costs and benefits of our preferred option, risks and evaluation.
[6] The impact assessment can be found at : https://www.gov.uk/government/consultations/transforming-the-highways-agency-into-a-government-owned-company

42. It should be noted that the likely efficiency savings forecast would be additional savings to those made since 2010. As part of its settlement for the 2010 Spending Round, the Highways Agency committed to reducing costs in its major scheme programme by 20% and has achieved this, delivering £644m in savings for the taxpayer. This efficiency is now embedded in the funding settlement for SR13, meaning that most of the opportunities to improve efficiency in the pre-2010 system have been exploited already, and only significant reforms can deliver a further step change in efficiency.

43. The order of magnitude of efficiency savings envisaged will not be possible without legal separation of operator and central government to provide:

- independence and accountability over how high-level strategy is delivered;
- an environment where culture change can occur; and
- a clear signal to suppliers and stakeholders that the Government is committed to improving roads and will not revise funding certainty.

These points can be assessed qualitatively, and we take them in turn below.

Independence and accountability over how high-level strategy is delivered

44. Under the status quo, the HA has to refer decision-making at various levels to DfT, because executive agencies fall firmly within the remit and responsibility of ministers. The HA is always acting in the name of the Secretary of State, and the Minister is always responsible for its actions. In practice, this means Ministers and senior DfT officials can get drawn into operational matters.

45. A new degree of operational independence from ministers is to be achieved by appointing the new company to act as a legally separate company with functions under the Highways Act (and other relevant legislation) which take the place of the Secretary of State’s current functions in relation to the SRN. The company would have the rights necessary to fulfil the RIS (over and above the general duties and obligations that would be transferred to maintain and enhance the strategic road network). The body would be able to plan in a more stable environment, speed up day-to-day operations, and align its internal processes more closely to that of the supply market it operates in.

46. On the other hand, the Secretary of State will no longer be directly liable for the management of affected roads. This means he will be able to concentrate on developing successive performance indicators and shaping a strategic direction for the company, without needing to be concerned about the tactical management of the network. At the same time, it is recognised that ultimate political responsibility will remain with the Secretary of State for Transport, as is the case with all transport modes.

47. There will, however, be a need to place some control over how the company performs and accounts for the stewardship of public money by which it will be funded.[7] This would be delivered by:

- the Department for Transport setting a RIS with a statement of funds available (consideration of the value for money of most major schemes would be made at this stage);
- a new structure for accountability including:
  - a licence under which the Secretary of State appoints the company as the highways authority, and imposes obligations on the company which provide the context for how it must act in this role,
  - a new Framework Agreement to set how the Government and the company interact with each other, how appropriate use of public money is assured, and requirements for transparency and the reporting of information.

48. The board of a separate company would be fully accountable for meeting the performance specification and outcomes in the RIS, effectively meaning it could be held to a long-term agreement with the Department that mirrors best practice of contracting in the regulated sectors. The Agency would then be incentivised and challenged to act even more like an innovative, delivery-focused infrastructure provider, closer to its market and focused on the needs of the network. Moreover, with the board given more freedom on how to deliver efficiencies, coupled with an effective long-term incentive plan, there is also potential for the company to outperform its efficiency targets. These potential improvements will be hard to attain unless the operator has a legally separate identity from government and has transparent, open processes that make it difficult to introduce disruptive and arbitrary changes to the agreed outputs in the RIS.

49. This would be an important improvement over the status quo. Once central government is not compelled to direct the HA closely, it will give the operator the freedom and responsibility to target efficient practices, and remove the risk that it has to act on more short-term pressures, which would alter its approach to network management on an unpredictable basis and would make the benefits of a long-term approach difficult to realise.

An environment where culture change can occur

50. The Cook Review envisaged the efficiency of the body that replaced the Highways Agency improving over time as a culture change occurred, in particular the move to a more commercial culture. In the present arrangement, as discussed above, a lack of independence means the HA has to defer to DfT at many different levels within its governance structure. This has led to a culture where the Agency is reliant on consultation with DfT officials, even where it is not mandatory. Furthermore, Agency staff have become conditioned to anticipating the

[7] We will be seeking to introduce a new arrangement with more flexibility at the micro-level, supported by a strategic controls framework, which will be important to delivering the full efficiencies in the table above. This new control framework will be dealt with separately and will be discussed further with the Cabinet Office and HM Treasury.

views of ministers and political priorities, which detracts focus from business and customer needs.

51. The independence and accountability described above are necessary first steps in building a wider culture of independence. The priorities of the board will be closer to those of a commercial business: focused only on delivery and costs, with clear expectations and performance indicators set by its client which have to be met to receive reward. Greater operational flexibility will also enable the company to align its practices with those of its suppliers, creating greater scope for innovation.

52. The company will be outside of the civil service, which will have two main consequences for its working culture. By removing many of the points where the HA’s staff currently have to consult with or defer to Whitehall civil servants, it will allow an independent culture to emerge within the organisation that is not dictated by civil service rules and priorities. Also, the company will be able to decide to depart from civil service terms and conditions for new staff, and recruit more quickly from the private sector labour market. This will aid the move to a more commercial and distinct corporate culture.

53. Culture change should also mean an increased focused on customers. The transparency of the RIS - with the Government as client and, separately, the company as operator – will make it clearer to the public and road users that the company owns responsibility for the state of the roads. The board will therefore have to operate with a clear focus on maintaining a good reputation with road users and with neighbours to the network. The Chairman, Chief Executive and the Board will have clear personal accountability and, in the case of the Chairman and CEO, a higher public profile than is the case now. They would therefore be subject to far greater public pressure to deliver a better operating network at genuinely lower costs.

Clear signal to suppliers and stakeholders that the Government is committed to improving roads and will not revise funding certainty

54. The Cook Review team undertook extensive discussions with the supply chain. It found that internal and external stakeholders perceive a disparity in treatment between roads and other transport modes. This is partly due to the way that roads funding has suffered from ‘stop-go’ in comparison other transport modes. If roads continue to be managed with less operational independence than rail and other modes, investment plans may not be seen as stable or credible by the companies in the HA’s supply chain.

55. This lack of credibility would mean that reform failed to address the risk perception among suppliers that restricted their investing in longer-term resources and bulk materials, planning their activity over longer periods, or signing lower cost contracts to secure government business. As a consequence, the potential efficiency savings of more efficient behaviour in the supply chain would not be realised to anything like the same extent.

56. The creation of a formally separate network manager would send a clear message regarding the Government's commitments to better roads. By putting roads on a similar footing to rail, we will increase confidence in the commitment to investment among suppliers so that they perceive greater incentives and less risk in taking more efficient approaches. The efficiency savings they create can be exploited by the company via its tendering process and passed on to taxpayers

Costs

Potential for decentralised decision-making

57. Corporatising the HA will provide it with a greater commercial focus, but there is a risk that it might take decisions that have negative consequences for the public. We would not expect a company at arm's length to make identical decisions to a minister, who is expected to take into account a wider range of impacts and views and is then held democratically accountable for them. We will be considering carefully how to ensure there are effective controls on the company's behaviour through the RIS, licence conditions, statutory duties, the efficiency monitor and road user watchdog, and other parts of the framework.

58. Related to this, a consequence of strengthening the strategic plan for roads will be restricting the flexibility of ministers within the circa five-year cycles. Once the Highways Agency is replaced by an arm's-length company, it will be harder to ministers to micromanage delivery and the relationships of the company with stakeholders, in order to serve changing priorities.

Reduced access to civil service labour pool

59. By moving the Highways Agency outside of the civil service, it will no longer be able to access the very significant internal civil service labour market. Whilst civil servants could still join the company, 'career civil servants' will be much less likely to. This is likely to have a detrimental impact on the company's ability to recruit in clerical and policy roles where the civil service has a wealth of talent.

60. However, the Traffic Officer Service makes up over half of the Highways Agency's staff at present, and suitable skills for these roles are better found in the private sector already. Likewise, recruitment for commercial and engineering roles is already focused externally, and will become quicker and easier when civil service recruitment principles no longer apply.

61. This cost could be mitigated if the company is given more autonomy on its pay and reward structure than the HA at present. However this is part of a wider discussion on corporate control arrangements that will be dealt with separately to this document.

New staff

62. As set out in the impact assessment, there will be new staff required to perform corporate functions in the company that were previously not necessary in an executive agency. Approximately 30 new posts will be created in these areas. All of these posts represent a cost on the company, but to some extent these roles may replace a cost currently incurred by DfT, therefore not representing new costs to the exchequer. Therefore we take between 10 and 30 new full-time staff costs to get a low and high end of the range, with a best estimate of 20. Assuming overheads of 30% of pay[8], this creates a new operating cost of £1.3m per year, within a range of £0.65m-£1.95m a year (£13m within a range of £6.5m to £19.5m over the first 10 years in 2013/14 prices, to be consistent with how benefits are projected).

[8] UK Standard Cost Model Manual, Better Regulation Executive September 2005. The overhead covers costs in connection with fixed administration costs, such as expenses for premises (rent or building depreciation), telephone, heating, electricity, IT equipment, etc. The overhead also includes absence owing to illness. The overhead also covers Employer's National Insurance Contributions.

6. Transitional arrangements

63. The majority of transitional work will be carried out using internal resources, freed up from other areas of work in the Department for Transport and the Highways Agency. Further internal support from the Shareholder Executive and DfT's Corporate Finance team will limit the need for external consultancy to handle procedural questions on transition.

64. However some further legal and specialist advice is being procured to help deliver corporatisation. And in order to assist with the PPM approach and joined-up working, a programme management function will also be acquired to drive forward implementation, working with teams in the HA and DfT.

65. Our latest estimate for the cost of internal staff time and external advice, updated since the roads reform impact assessment was published, is in a range of £8.2-£12.4m reflecting uncertainty about the extent of further advice that might be needed; we expect the final figure to be at the low end of the range. This is a very small figure in relation to the efficiency savings that are achievable. This will be firmed up further ahead of the publication of an impact assessment alongside the introduction of legislation to Parliament.

66. The transition process can be broken into various workstreams, which are allocated to DfT and the HA on the basis of who is closest to the issue.

Table 6.1 - Workstreams delivering reforms		
Number	**Workstream**	**Lead**
1	Legislation	DfT
2	Road Investment Strategy (RIS)	DfT/ HA
3	Business plan for 2015/16 to 2020/21	HA
4	Corporatisation	DfT
5	New company structures	HA
6	Cost and performance data	DfT
7	Watchdog and cost monitor	DfT
8	HA staff	HA
9	Supply chain	HA/ DfT
10	Communications	DfT/ HA

67. In addition to the individual project teams, every workstream is sponsored by a lead director at the HA, and will also have a primary point of contact at DfT. To oversee progress in these workstreams and undertake PPM functions, external consultants have been hired

Supply chain engagement

68. Engagement with the supply chain is key to securing the improvements in efficiency and delivery that this project is based upon. For this reason, the Agency will lead a specific workstream aiming to reassure the supply chain and encourage them to invest in preparation for future activity.

Human resources

69. There are approximately 3,400 full-time, permanent staff working in the HA throughout England in a range of roles, all of whom are civil servants. Keeping them informed of development and transition is critical. The HA have already started communicating with staff via briefings and Q&A. This will continue as an ongoing process – alongside dialogue with unions – ensuring that all staff are kept abreast of events and aware of the channels for raising concerns and queries regarding how they will be affected.

70. As part of moving to a government-owned company, staff would be transferred to the new company from the HA. Their terms and conditions of employment will be protected by the principles of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE).[9]

[9] For further details on TUPE see (http://www.legislation.gov.uk/uksi/2006/246/pdfs/uksi_20060246_en.pdf)

Under the Public Service Pensions Act 2013, public sector workers who are transferred out of the civil service will be able to remain members of the Civil Service Pension Scheme; most HA staff are in the Principal Civil Service Pension Scheme.

71. Regulation 13 of TUPE places an obligation on both the old and new employer to inform trade union representatives of staff affected by the transfer 'long enough before a relevant transfer'. In accordance with this, DfT and the Highways Agency will ensure the appropriate provision of information to such representatives. This consultation process will begin after DfT have begun public consultation on the policy proposals, and could continue up until the point just before staff are transferred from the Agency to the company.

Timescales

72. The DfT and HA implementation plan is to have an operational company in place by 2015/16. Our high-level forward timetable at this point includes the following milestones:

- aim to introduce legislation to parliament – June 2014
- draft licence and framework document – spring 2014
- publish initial Road Investment Strategy – late 2014
- receive royal assent on legislation – early 2015
- new company begins operations/Highways Agency is wound up – April 2015

73. The target times for implementation is ambitious but achievable, with passage of legislation being the key dependency. Further project documentation is available on request.

7. Conclusion

74. Delivering the investment programme announced at SR13 to support economic growth, whilst accelerating scheme implementation and driving down costs, is a huge challenge for the Highways Agency and its suppliers. It is crucial, in order to do this, that we reform the way roads are operated and funded to enable optimal fast, low-cost, high-standard infrastructure delivery. This means winning the confidence of suppliers in the Government's plans for future investment so that they tool up to deliver and change behaviour to more long-term, low-cost business approaches.

75. This case demonstrates that the establishment of a new arm's-length body is essential to take a step in this direction. Without replacing the HA with a new body that is a separate legal entity, the SRN will not be operated with the level of independence required to exploit the potential benefits of longer-term funding. Regardless of government's intentions, this risk will be too great and cause too much presentational risk for the full potential of behavioural change from suppliers to be realised, meaning cost savings may not be achieved.

76. Transforming the Highways Agency so that it is at greater distance from government than an executive agency, will enable it to operate more commercially, as it prioritises delivery against the RIS and driving down bottom line costs. It will be able to recruit faster to meet business and customer needs, and will begin to reflect the best practice of the private sector next to which it operates. Overall, this could unlock savings of £3.8bn over 10 years (2013/14 prices) with a range of £2.6bn and £7.4bn, depending on the level of investment as well as the savings that reform can deliver.

77. This case shows that the benefits far outweigh the relatively small costs of implementation. Moreover, the roads reform proposals announced by the Chief Secretary to the Treasury are clearly achievable, and a joint DfT-HA implementation programme is currently on course to deliver them.