Opposition policy costing: Public sector franchise bidder

Please remember that everything entered into this template, and email correspondence relating to its completion, may be published under the Freedom of Information Act

Description of policy

"Labour plans to reform the railways to get a better deal for taxpayers and passengers by:

- Reviewing the Government's failed franchising process as a priority, after the chaos of recent years, to safeguard taxpayer and passenger interests;
- Legislating to allow a public sector operator to be able to take on lines and challenge the train operators on a genuine level playing field to secure value for money for passengers and taxpayers".

Source: http://press.labour.org.uk/post/93493956279/miliband-calls-for-a-tough-cap-on-fares-and-radical

Additional policy assumptions

- A publically owned train operator is created which can bid for new franchises when they are tendered.
- It bids for all the franchises due to be awarded in the next Parliament – and will therefore need the necessary resources to bid for all the franchises. This should include a re-tendering of the Northern and TransPennine Express franchises, and the tenders for the East Anglia and West Coast franchises. The basis for this is that the Opposition have described the franchising process as "failed" and that reviewing it is "a priority", and so would not continue with the tender process for those contracts that have not been awarded, before they implement their proposed reforms.
- Assume that the bid costs are refunded the Northern and TransPennine Express franchises.
- Assume the exchequer has to fund the necessary working capital and risk capital for each of the successful bids – in order to assure a level playing field as specified in the quote below. Please therefore include an estimate of the costs of this and explanation of how they affect the public finances.
- Assume an authority is established to oversee the award of contracts to avoid a conflict of interest within DfT – again to ensure a level playing field.
- Assume the exchequer has to provide a contingency fund for any fines etc. faced by the provider.

Additional technical modelling assumptions or judgements required

n/a

If needed, information required on distributional effects of the policy

n/a

Cost/Revenue to the Exchequer over five years

This costing does not consider the question of whether a public or private sector train operation will generate a better return to government, as to answer this question an assumption would need to be made about the relative efficiency of the two alternatives. This costing does not make assumptions regarding the success of the public sector rail provider in winning bids or rail performance.

This costing therefore provides an analysis of the specific costs of establishing the policy set out above, based on the assumptions set out above.

A number of such costs have been identified and are explained below. These figures are estimates only and relevant assumptions on which these estimates are based are set out in each case.

1. **Change to legislation to allow for a public sector bidder**

Under Section 25 of the Railways Act, a Minister of the Crown, a company in which he or she has a majority shareholding, and a number of other public bodies, cannot bid for the operation of passenger rail services under a Franchise Agreement.

Therefore there would need to be legislative changes to enable a publicly owned body to bid for a rail franchise. It is assumed that there is a resource implication for this, including legal and policy resource, for a period of approximately one year. It is estimated that the cost of this would be c. £150k (based on 3 FTE members of staff at Grade 7). We have assumed no external legal costs are incurred.

For the purposes of the analysis, we have assumed that these changes would take approximately 1 year. This is an estimate and assumes that the process is undertaken expediently. This results in a delay to the franchising process which affects the first competitions to be let post May 2015.

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	£150k	-	-	-	-

2. **Refund of bidder costs for the cancelled TPE and Northern franchises**

The current Franchise Programme[1] assumes that the Northern and TPE Franchises will be awarded over the summer of 2015. Based on the assumptions provided by Treasury SpAds, these two competitions would be cancelled after May 2015. DfT does not believe that this would give rise to a legal obligation to refund bid costs, this is on the basis that the Department did not provide refunds for the cancelled Great Western franchise competition bids. Therefore the estimated cost of this is nil.

However, if bidders were refunded their costs (per the assumption provided by treasury SpAds), the cost of this is expected to be c£60m.

This estimate is based on the cost of cancelling the West Coast Franchise competition where bidders were refunded costs incurred to prepare their bids. Each bidder was refunded between £8m and £12m. For the purpose of this costing, a refund of £10m per bidder is assumed. There are 6 bidders and so the total estimated cost would be £60m.

With regard to the rationale for the costs arising on ICWC, and not in respect of Great Western, the Department did not fund costs on Great Western as no bids had been received on Great Western. With ICWC, the Department has been found to have incorrectly awarded the Franchise, and so it was believed that there was a case to pay bid costs for the failed ICWC competition.

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	£0m	-	-	-	-

3. Cost of re-running the Northern and TPE competitions

As the Northern and TPE franchises would be cancelled, the procurements for these franchises would have to begin again, to enable a public sector body to bid.

The cost of this is based on the internal development costs for another recently let franchise (Thameslink, Southern and Great Northern, TSGN). DfT spent c.£5m letting the TSGN franchise and the equivalent costs for Northern and TransPennine franchises are assumed to be slightly lower (as TSGN was one of the largest franchises) and so a cost of £4m is assumed for each competition to conduct that development work again. This cost is assumed to be spread over the two years it takes to procure a rail franchise.

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	£4m	£4m	-	-	-

4. Setting up a new organisation to award franchises

In accordance with the assumptions provided, it is assumed that a new franchising authority would need to be established to oversee the award of contracts.

It is envisaged that this would be based on carving out the existing Passenger Services part of DfT (which is responsible for letting new franchises), to make it more removed from central government. The assumption given does not state that this body could not share central services (including a building) with the DfT and so the cost of this new body is deemed to be

[1] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/363173/oct-2014-rail-franchise-schedule.pdf

negligible (although some organisational chinese walls would need to be established and a legal separation may be required).

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	negligible	-	-	-	-

5. **Maintaining a holding company to bid for franchises**

In order to facilitate bidding for multiple franchises, a holding company would be established (or maintained, if DOR[2] is used), which has a number of subsidiary companies which can bid for the following forthcoming franchise competitions:

- Northern;
- TransPennine Express;
- East Anglia;
- West Coast;
- East Midlands; and
- West Midlands

The current annual cost of DOR is c. £1m, however, to take account of the additional work necessary to bid for six competitions, it is assumed that this annual cost would increase to £2m. For the purpose of this assessment, we have assumed that all costs associated with DOR are incremental and therefore included in this costing, as in the base case DOR will have no purpose beyond the point at which the new East Coast franchise begins in February 2015.

The annual cost is based on the company being staffed by a chairman/chief executive, and directors for the key areas of the business (business development/commercial, safety and finance).

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	£2m	£2m	£2m	£2m	£2m

6. **Cost of Bidding**

The subsidiary companies will need to prepare bids for both the pre-qualification and ITT stages of franchise competitions. Based on recent competitions, and the scale of bid costs incurred for the West Coast franchise, the pre-qualification stage is expected to cost c. £1m per bid and the ITT stage c. £10m per bid.

This costing assumes that the public body bids for all franchises let over the next 5 years and is successful in pre-qualifying for all (i.e. receives the ITT and therefore prepares a full bid).

[2] DOR is Directly Operated Railways which is the holding company for the company currently operating the East Coast franchise.

It is assumed that the first two contracts (Northern and TPE) are let in 17/18, based on a two year procurement cycle starting after the May 2015 election. Pre-qualification costs are assumed to be incurred in 16/17 and full bid costs in 17/18.

The next two competitions, East Anglia and West Coast, are assumed to be awarded in 18/19, with costs again assumed to be incurred in 17/18 (pre-qualification) and 18/19 (full bid).

The next two competitions, East and West Midlands, are assumed to be awarded in 19/20, with pre-qualification in 18/19.

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	-	£2m	£22m	£22m	£20m

7. Evaluation

In order to demonstrate to other bidders that evaluation is undertaken in a fair and transparent manner, further steps are likely to be required to provide the private sector with assurance that there is a level playing field between bidders.

It is therefore assumed that extensive extra published guidance on bid evaluation would be required. This is based on experience of public sector bidding elsewhere in the public sector. The estimated cost of producing this is £1m.

It is also anticipated that the evaluation process itself would have to change, in order to ensure that the process accounts for the difference in public and private sector bids. The cost of this is expected to be c. £100k per competition, to cover the additional time required for the evaluation.

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	£1m	-	£100k	£100k	£100k

8. Capital Requirements

It is anticipated that the public body would require a loan from government to cover working capital, investment and a risk buffer. This is expected to be in the region of £200-250m per franchise.

This is assumed to be fiscally neutral as it is likely to be a transfer between public bodies (and so the money never leaves the public sector).

Cost

Year	15/16	16/17	17/18	18/19	19/20
RDEL Cost	-	-	-	-	-

Summary of costs

	DEL	AME

£m	15/16	16/17	17/18	18/19	19/20	15/16	16/17	17/18	18/19	19/20
Current	7.15	8	24.1	24.1	22.1	-	-	-	-	-
Capital	-	-	-	-	-	-	-	-	-	-
Total	**7.15**	**8**	**24.1**	**24.1**	**22.1**	**-**	**-**	**-**	**-**	**-**

Distributional effects (if none requested, any significant):

n/a

Comparison with current system (if applicable):

n/a

Other comments (including other Departments consulted):	
As a public sector train operator would be fully consolidated into government accounts, the full costs and revenues of that organisation would be scored, rather than purely the balancing figure (as per the current privately franchised system). Any investment made would therefore score as capital, but no assumptions have been made about the level of investment in this paper.	
To be completed by Permanent Secretary's Office Date costing signed off:	18 December 2014
[If applicable] Date revised costing signed off:	