



Department for Transport

From the Permanent Secretary

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Dear Secretary of State,

Northern and TransPennine Express Franchises – Invitations to Tender (ITT)

This note explains why I have reservations about the proposal to issue Invitations to Tender (ITT) for the Northern and TransPennine Express franchises containing obligations to withdraw all Pacer vehicles by 2020 and to bring into operation a minimum of 120 new build vehicles.

My reservations relate to my obligations as Accounting Officer. These are set out in *Managing Public Money*. This says that it is the personal responsibility of the Accounting Officer to ensure that an organisation's use of resources achieves good value for money. We can expect to achieve good value for money if the benefits of a course of action are likely to exceed its costs, taking account of risks. *Managing Public Money* advises that I should seek a written direction from you if, for example, an alternative proposal or doing nothing would deliver better value for money, such as a cheaper, higher quality or more effective outcome for the Exchequer as a whole.

I will make some comments first on the context and then set out my reasons for seeking a written direction.

As you know, the Department for Transport has a well-developed system for appraising the costs, benefits and risks of new transport investments. The economic case is assessed using an approach known as WebTAG that is generally regarded as among the world's leading systems of project appraisal and considers non-quantifiable as well as quantifiable benefits. This allows a systematic assessment of proposals using the best available information on the impact of, for example, reduced journey times or improved services.

There are two reasons why I am seeking a written direction in relation to this proposal. The first is that the assessment of the business case we have undertaken suggests it is poor value for money. In particular the analysis gives an estimated benefit to cost ratio (BCR) for the proposal of 0.35 if we take a 30 year view of the likely impact. (If the impact is assessed only over the life of the franchise the BCR is much poorer, at 0.12.¹)

¹ The overall specification for both franchises demonstrates a BCR of 0.6 over 10 years. If the Pacer replacement analysis is excluded from analysis of the overall specification, the vfm category is likely to improve from poor to low (BCR around 1.3). Note that these figures were produced using a quick proportionate calculation and this number should be treated with caution.

The analysis recognises that the Pacers will need to be replaced when they reach the end of their useful life, if the current level of service is to be maintained. The fundamental reason for the poor BCR is that there will be large costs from bringing forward that replacement to 2020 (new build vehicles will be much more expensive than Pacers), but relatively few benefits (eg no significant improvements due to this investment in journey time, frequency or new services). It would be possible as an alternative to maintain the Pacers in use for longer but to modify them to bring them into compliance with disability legislation.

There are good reasons why this analysis may underestimate the true BCR. In particular bidders for the franchise may find ways to reduce the cost of the investment and/or to realise more benefits compared to our assumptions (though these are based on industry experience over many years). For example, there is a reputational impact from the use of Pacers on the rail services in the Northern franchise. Withdrawal may help to attract new users to rail and thus improve the benefits. I have taken account of these factors in making my decision to seek a Direction. But my view, supported by sensitivity analysis, is that one would need to make implausible assumptions about the size of these effects to conclude that the proposal is likely to represent value for money.

My second concern is that there may be better ways of achieving value for money than the precise stipulations included in the ITT. In particular, the requirement to withdraw Pacers by 2020, and to introduce a minimum of 120 new build vehicles, significantly reduces flexibility for bidders. This is compared to alternative formulations which might have left more flexibility with bidders over rolling stock but put more weight on other aspects of the specification (such as quality) in evaluating tenders.

Finally, I should note that the extra cost of the proposal is likely to be just under £250m over the life of the franchise. Whether or not this is affordable will depend on the outcome of the next Spending Review, but I should draw attention to the pressures expected on the Department's budget.

In light of my reservations, I am seeking a formal Direction from you in order to approve issuance of the ITTs for the Northern and TPE franchises. I consider that now is the right time at which to seek a Direction as once the Department has issued ITTs containing these requirements they will be binding components of the competition, and it will not be possible for the Government to vary these requirements readily if at all.

Should you issue a Direction, I am required to copy promptly all relevant papers to the Comptroller and Auditor General and the Treasury Officer of Accounts. I understand the former would normally draw the matter to the attention of the Public Accounts Committee.

Yours sincerely,
Philip Rutnam

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