

Key messages

# The First ScotRail passenger rail franchise



Prepared for the Auditor General for Scotland  
November 2008

# Auditor General for Scotland

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## **Note:**

Prior to September 2007, the Scottish Administration was generally referred to as the Scottish Executive. It is now called the Scottish Government. When dealing with the earlier period, this report refers to the Scottish Executive. Recommendations for the future refer to the Scottish Government.

## **Acknowledgements:**

Audit Scotland prepared this report for the Auditor General for Scotland.

We have had the generous support of the Scottish Government and Transport Scotland. In addition we would like to thank those who participated in the interviews for the study and the following organisations for providing data: First ScotRail, Passenger Focus, Strathclyde Partnership for Transport and the Office of Rail Regulation.

We would also like to thank the project advisory group (Appendix 2), which comprised a range of experienced individuals from the rail sector, for providing valuable advice and a sounding board for the project team throughout the study.

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

# Key messages

## Background

**1.** Rail transport is a vital service for Scotland, providing access to employment, education, services and leisure activities. Most passenger rail services in Scotland are provided through a franchise contract between Scottish ministers and the private company First ScotRail Limited. First ScotRail provided 81 million passenger journeys in 2007/08.

**2.** First ScotRail began providing services under the franchise in October 2004. The franchise was established as a seven-year term with the option to extend the term by a further three years. In April 2008, Scottish ministers extended the First ScotRail franchise to November 2014.

**3.** The franchise contract reflects, but does not determine, the structure for passenger fares. The policy for rail fares is determined by the Scottish Government outside of the franchise contract. Transport Scotland is currently reviewing the fares policy.

**4.** The Strategic Rail Authority (SRA) and Strathclyde Passenger Transport Executive (SPTEx), in consultation with the then Scottish Executive, were responsible initially for the letting, subsidising and managing of the franchise and for monitoring First ScotRail's performance.<sup>1</sup> In April 2005, these responsibilities were devolved to the Scottish Executive. The Scottish Executive agency, Transport Scotland, was established in January 2006 and took over these responsibilities.

**5.** First ScotRail pursues the franchise revenue targets and is required to deliver a number of service obligations under the franchise contract, namely:

- operate train services specified in the franchise contract

<sup>1</sup> Prior to September 2007, the Scottish administration was referred to as the Scottish Executive. It is now called the Scottish Government. When dealing with the earlier period this report refers to the Scottish Executive but in all other instances it refers to the Scottish Government.

<sup>2</sup> We did not examine the initial development and awarding of the franchise contract as this occurred prior to the devolution of rail responsibilities to the Scottish Executive.

<sup>3</sup> The £2.5 billion subsidy is in 2004/05 prices. Subsidy payments to First ScotRail are made annually, with its 2004/05 price inflated by the retail prices index (RPI) each year. The total inflation adjustment from the start of the franchise, October 2004, to the end of March 2008 was £36.5 million.

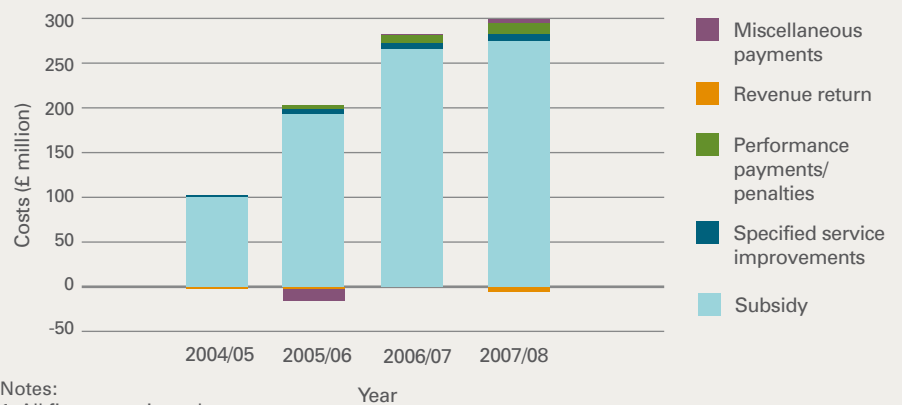
<sup>4</sup> 'To date' refers to the period from October 2004 (when First ScotRail began operating) to the end of March 2008.

<sup>5</sup> The £864 million in public funding is in cash terms.

<sup>6</sup> The annual subsidy is necessary to provide vital but non-commercially viable rail services.

## Exhibit 1

Payments to First ScotRail 2004/05 to 2007/08



### Notes:

1. All figures are in cash terms.

2. The 2004/05 figures are for half a year given First ScotRail began operating in October 2004.

Source: Transport Scotland

- meet reliability, punctuality and capacity targets that become more challenging over time
  - meet train and station quality benchmarks, including cleanliness, security, accessibility, comfort, and provision of travel information
  - deliver a capital programme of station, passenger information, safety, security and train stock improvements
  - deliver specified service improvements, such as introducing new services, when requested by Scottish ministers.
- meeting minutes and franchise management reports
  - analysed the costs of the franchise, including subsidy levels, and performance payments
  - analysed First ScotRail performance data, including comparisons with other British passenger rail franchises
  - held interviews with Transport Scotland, First ScotRail, other rail and transport bodies, rail transport academics and passenger representative groups.

## Key messages

**1** First ScotRail will receive £2.5 billion in government subsidy for the franchise over its ten-year term.<sup>3</sup>

**7.** To date, First ScotRail has received £864 million in public funding.<sup>4,5</sup> Most of this (96 per cent) has been the annual subsidy for providing rail passenger services.<sup>6</sup> First ScotRail has also received various other payments (Exhibit 1).

**8.** First ScotRail can be financially rewarded or penalised for its train running and quality of service performance. So far, First ScotRail has received £23 million in performance payments.

**9.** First ScotRail has also received £24 million for making specified service improvements.

**10.** Under the original franchise contract provisions, where First ScotRail exceeded the agreed revenue target by more than two per cent, it was required to return a share of its additional revenue to the Scottish Government ([Exhibit 2](#)). First ScotRail has so far returned £4.5 million of revenue to the Scottish Government.<sup>7</sup> First ScotRail has also returned £10.5 million in miscellaneous payments.<sup>8</sup>

**2** Transport Scotland is generally managing the franchise contract effectively, but there is some scope to improve.

**11.** Many of Transport Scotland's rail franchise management staff were previously with the SPTE, bringing operational knowledge and expertise to Transport Scotland.

**12.** Transport Scotland reviews and acts quickly to address poor performance. Transport Scotland also forecasts and plans for future performance. The rail franchise management team meets with First ScotRail every four weeks and escalates any unresolved issues to senior management.

**13.** The core aspects of the franchise contract are managed effectively and the performance measures used to assess First ScotRail are generally appropriate. However, Transport Scotland should consider improving alignment between performance measures and passengers' concerns and wider government priorities; clarifying its consultation arrangements

with stakeholders; and improving its budgeting for performance payments.

**3** Information about the franchise contract and associated performance is not readily accessible to passengers, user groups and others.

**14.** Transport Scotland's website contains the franchise contract and the extension. However, the contract is highly technical and is not accompanied by guidance highlighting the important elements for passengers and taxpayers. Transport Scotland does not publish information from franchise performance meetings.

**15.** There is no single point from which passengers, user groups and others can access information regarding the franchise. Transport Scotland's website provides limited information about performance and does not provide links to First ScotRail performance information published by other rail bodies.

**4** Transport Scotland's review of the franchise contract included a rigorous appraisal process, and it has secured a guaranteed £73.1 million investment by First ScotRail. However, governance arrangements could have been better managed.

**16.** Transport Scotland became concerned that key aspects of the franchise contract were no longer fit for purpose. Within its first year of operating, First ScotRail was outstripping its performance targets and it had reached the point at which 80 per cent of any additional revenue was returned to the Scottish Government. Concerned that this would discourage First ScotRail from pursuing further growth, Transport Scotland decided to review the contract.

**17.** Transport Scotland employed its own knowledge and expertise, and

standard industry practice, to generate options. The options fell into three broad categories, to:

- take no action
- negotiate changes to the existing contract
- negotiate further changes in exchange for an extension to the franchise contract.

**18.** Transport Scotland used a rigorous option appraisal process, modelling a range of scenarios. It used expert consultants throughout the process to review the modelling work and to advise on potential procurement implications of any extension agreement.

**19.** Transport Scotland secured an investment of £73.1 million from First ScotRail for the franchise extension in exchange for an estimated £57 million of potential revenue. The £73.1 million will either be used to reduce the government subsidy or be invested in service improvements in line with the Scottish Government's strategic aims.

**20.** The franchise extension has introduced the following main changes to the franchise contract:

- Reliability and capacity performance compliance targets have been made more challenging.
- Revenue targets have been revised in line with more recent forecasts.
- The point at which First ScotRail must return a share of its revenue to the Scottish Government has been extended ([Exhibit 2](#)).<sup>9</sup>
- A profit cap has been introduced, with half of all profits above the cap to be paid to the Scottish Government.

<sup>7</sup> Each year's annual revenue return is paid the following year. Therefore the £4.5 million revenue return up to the end of 2007/08 covers the period up to the end of 2006/07.

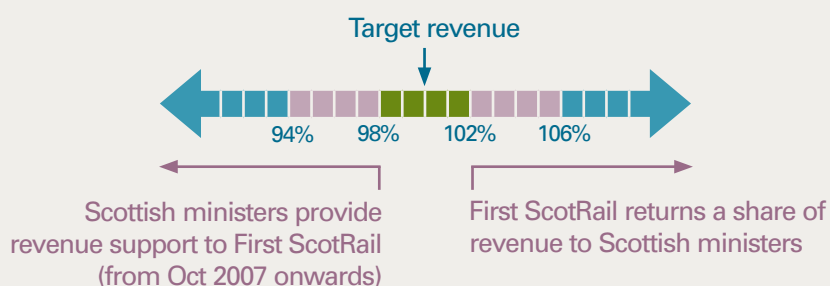
<sup>8</sup> For example, returning rebates received on subcontracts.

<sup>9</sup> The point at which Scottish ministers would provide revenue support has also been extended.

## Exhibit 2

The extension has changed the levels at which revenue share and support arrangements apply

### Original franchise contract revenue support and return arrangements



### Franchise extension revised revenue support and return arrangements



The contract includes a revenue share and support arrangement. When First ScotRail's revenue exceeds an agreed target level, it is required to return a share of the additional revenue to the Scottish Government. Conversely, if after three years of operating, First ScotRail was unable to meet the agreed target revenue then Scottish ministers would provide financial support.

As part of the extension, the point at which First ScotRail must return a share of its revenue to the Scottish Government has been extended from two per cent to ten per cent above annual revenue target levels. In exchange for the extension, Transport Scotland has secured a guaranteed investment of £73.1 million from First ScotRail.

Applied retrospectively from 2007/08, First ScotRail is to return 50 per cent of all revenue between ten and 14 per cent above target and 80 per cent of all revenue achieved above 114 per cent of the target.

In the original franchise contract, Scottish ministers were to pay revenue support to First ScotRail from October 2007 onwards, should revenue have fallen to 98 per cent or less of the target revenue. This has also been revised to 90 per cent or less of the target revenue in order to hold constant the value of any potential revenue support liability.

- Additional service improvement options have been added to address Scottish ministers' priorities, such as introducing services with reduced journey times and services that connect with other transport providers.
- First ScotRail is required to provide additional information to better inform planning for the next franchise.
- First ScotRail is required to participate in the development of new major rail projects that will begin services after the franchise term.

**21.** Scottish ministers retain, until October 2009, the option to end the franchise contract at the original expiry date of 2011 if First ScotRail breaches any of its obligations, such as failing to meet train running or quality of service performance standards.

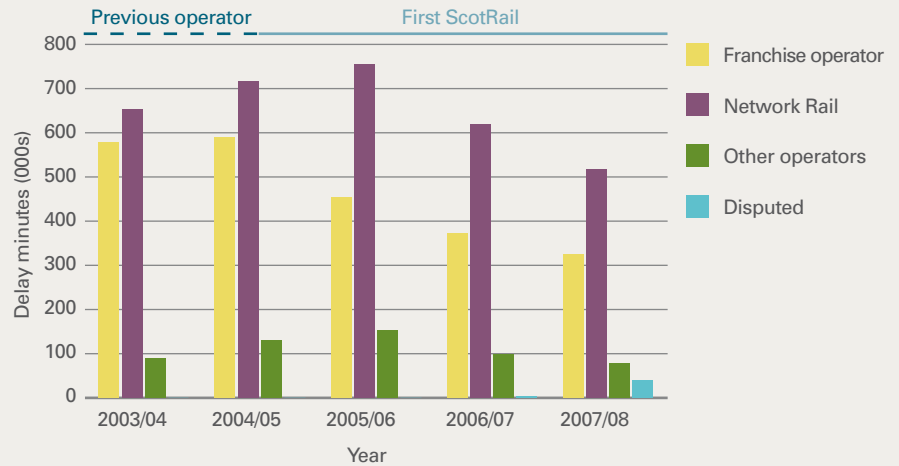
**22.** However, Transport Scotland's governance arrangements for the review process could have been better:

- Records of meetings were not always sufficiently detailed to provide adequate transparency about decision-making and a formal risk register was not developed until late in the process
- Presentations were made to the Minister for Transport, Infrastructure and Climate Change, but a documented business case was not provided.
- Transport Scotland also did not consult on the extension with external stakeholders, being of the view that there were commercial sensitivities and that previous consultations for Scotland's rail priorities were sufficient.

### Exhibit 3

#### Responsibility for delay minutes

Since its first full year of operating, the number of delay minutes due to First ScotRail has decreased.



Note: 2003/04 was the previous operator's last full year of providing services, and 2004/05 is a mix of the previous operator and First ScotRail, which began operating in October 2004. Each year the responsibility for a small percentage of the delay minutes is disputed but resolved over time, therefore more recent years include more disputed minutes.

Source: Transport Scotland and First ScotRail

### 5 First ScotRail's train running and quality of service is good and performance is improving in most areas.

**23.** More trains are running on time, and the number of delay minutes due to First ScotRail has reduced by 43.6 per cent since the previous operator's last full year of operating (Exhibit 3). Performance has deteriorated in terms of unscheduled timetable changes. This was mainly due to industrial action during 2007/08 affecting services in the Glasgow area, with other areas experiencing an improvement.

**24.** The quality of service both at stations and on trains has improved.

**25.** Passengers' overall satisfaction with First ScotRail services has increased. In 2008, First ScotRail achieved higher satisfaction levels than the British average for seven of the eight main passenger satisfaction areas, and for six areas against the regional operators' average, including overall satisfaction (Exhibit 4).

**26.** First ScotRail's positive working relationships with key rail sector bodies have contributed to improved performance.

## Exhibit 4

### Passengers' eight main satisfaction areas, spring 2008



Source: *National Passenger Survey, Passenger Focus*

## Key recommendations

To improve the management of the franchise Transport Scotland should:

- develop a systematic project plan for awarding the next franchise. This should identify the key stages and their timeframes, consultation strategy, decision-making criteria and reporting and approval arrangements
- review performance measures to improve alignment with passenger and wider government priorities
- improve stakeholder engagement by clarifying its consultation arrangements.

To improve stakeholder understanding, transparency, and accountability, Transport Scotland should:

- establish a single source from which stakeholders can easily access the information they consider relevant regarding the franchise, including a guide to the franchise contract that identifies key elements for passengers and taxpayers.

# The First ScotRail passenger rail franchise

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ISBN 978 1 906752 20 0      AGS/2008/11

Printed on Revive 100 Uncoated, a recycled grade, containing 100% post consumer waste and  
manufactured at a mill accredited with ISO 14001 environmental management standard. The pulp  
used in this product is bleached using an Elemental Chlorine Free process (ECF).