

The First ScotRail passenger rail franchise



Prepared for the Auditor General for Scotland
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Introduction



First ScotRail provides most passenger rail services in Scotland through a franchise contract with Scottish ministers, and will receive £2.5 billion in government subsidy during the contract term.



Setting the scene

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 train operating company First ScotRail Limited. The First ScotRail franchise covers more than 95 per cent of Scotland's passenger train services and the long distance sleeper service between Scotland and London. First ScotRail operating statistics for 2007/08 are set out in [Exhibit 1](#).

2. The franchise is in its second term following privatisation of passenger rail services in Britain in 1993.¹ The franchise was operated by National Express from 1997 to 2004. Following a tendering process, the Strategic Rail Authority (SRA) and the then Strathclyde Passenger Transport Executive (SPT), in consultation with the then Scottish Executive, awarded the franchise to First ScotRail Limited, a subsidiary of FirstGroup, in August 2004.^{2,3} First ScotRail began operating the franchise in October 2004.

3. In November 2005, the Scottish Executive took over responsibility from the SRA and SPT for letting, subsidising and managing the franchise and monitoring First ScotRail's performance. These responsibilities were transferred to the Scottish Executive agency Transport Scotland when it was established in January 2006.

Responsibilities for rail services in Scotland are complex

4. Although most of the funding, strategic planning and management of Scotland's rail industry is devolved

Exhibit 1

First ScotRail 2007/08 operating statistics

Statistic	British context
Provided 81 million passenger journeys	6.6% of Britain's passenger journeys
Passengers travelled 2.5 billion kilometres	5.1% of Britain's passenger kilometres
An average of 31 kilometres travelled per journey	An average of 40 kilometres travelled per journey
Covers 3,032 route kilometres	Highest of all British franchises
Manages 341 stations	Second only to Northern Rail's 471 stations ²

Notes:

1. Twenty franchised and six non-franchised train operating companies provide passenger services in Britain. The data in this exhibit do not include the non-franchised train operating companies.

2. Northern Rail provides train services in the north of England. Northern Rail covers 2,696 route kilometres, the second highest after First ScotRail.

Source: *National Rail Trends 2007-2008 yearbook*, Office of Rail Regulation

to the Scottish Government, a number of rail functions for Britain are reserved to Westminster, for example, health and safety and Disability Discrimination Act compliance. The relevant British bodies consult with Transport Scotland on reserved matters where they affect Scottish railways. [Exhibit 2 \(overleaf\)](#) illustrates the structure of passenger rail service provision in Scotland.

5. Network Rail owns and operates most of Britain's rail infrastructure (tracks, signals, bridges, tunnels and stations), and receives funding from the Scottish Government to maintain and improve Scotland's rail infrastructure.⁴ First ScotRail leases the stations it manages from Network Rail, its trains from rolling stock companies, and secures the use of tracks through a track access agreement with Network Rail.⁵

6. The Office of Rail Regulation (ORR) is responsible for setting and monitoring targets for Network Rail, including setting station access charges and track access agreements. ORR is also responsible for ensuring that Network Rail, train operating companies (including First ScotRail), and rolling stock companies comply with rail specific health and safety regulations and that First ScotRail and Network Rail comply with their operating licences. The Department for Transport oversees Britain's compliance with European Union rail strategies and safety standards and the Disability Discrimination Act 1995. The British Transport Police (BTP) is the national police force for the railways, with its services in Scotland largely funded by First ScotRail and Network Rail.

1 The rail network and passenger services in Northern Ireland remain state owned.

2 The Transport (Scotland) Act 2005 dissolved the Strathclyde Passenger Transport Executive (SPT), transferring its rail functions to Scottish ministers and remaining transport functions to the Strathclyde Partnership for Transport (SPT), established by the Act.

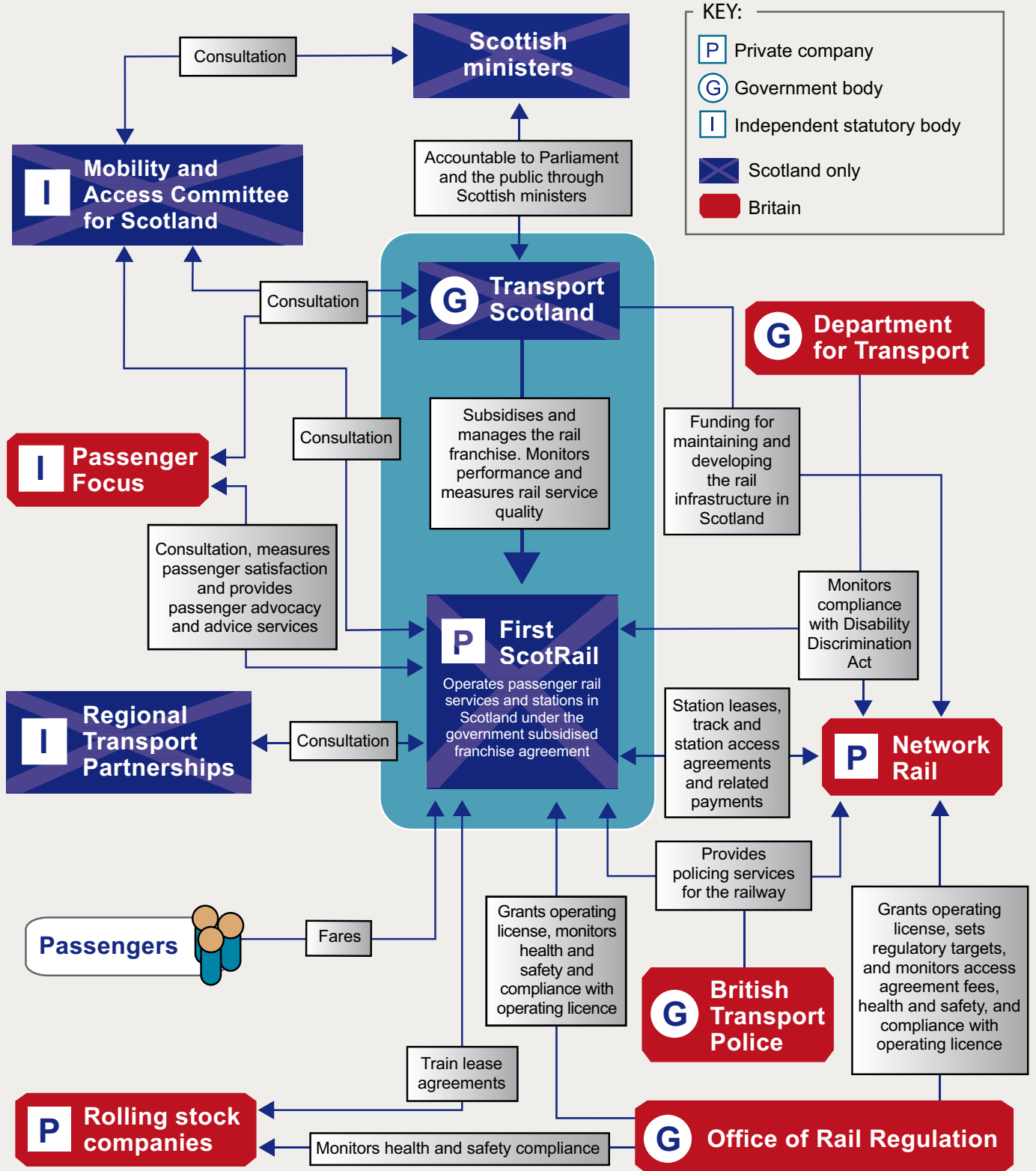
3 Prior to September 2007, the Scottish Administration was referred to as the Scottish Executive. It is now called the Scottish Government. When dealing with the earlier period this report refers to the Scottish Executive but in all other instances it refers to the Scottish Government.

4 In 2007/08, Transport Scotland provided £365 million in capital and resource grants to Network Rail for the operation, maintenance and renewal of the rail infrastructure network.

5 First ScotRail manages most stations in Scotland except for: Edinburgh Waverley and Glasgow Central stations, which are managed by Network Rail; Dunbar station, managed by the National Express East Coast franchise; and Glasgow Prestwick station, which is privately managed by Glasgow Prestwick Airport Limited.

Exhibit 2

Passenger rail service structure in Scotland



Note: Transport Scotland and First ScotRail also consult or work with wider public transport passenger representative groups such as Passengers' Views Scotland, and other train operating and rail freight companies. Although First ScotRail provides more than 95 per cent of Scotland's internal passenger services, Cross Country Trains, First TransPennine Express, National Express East Coast and Virgin Trains also provide passenger services in Scotland. Source: Audit Scotland

7. Transport Scotland and First ScotRail consult with Passenger Focus and the Mobility and Access Committee for Scotland (MACS) on rail passenger-related matters in Scotland.⁶ First ScotRail passengers' satisfaction is assessed as part of Passenger Focus's national rail passenger surveys. First ScotRail also consults with the statutory Regional Transport Partnerships (RTPs) regarding regional timetables, performance and regional transport priorities.⁷

Transport Scotland is responsible for managing the First ScotRail contract and developing the long-term priorities for Scotland's railways

8. The Railways Act 2005 established the current regulatory structure for rail in Britain, devolving most of the funding, strategic planning and management of Scotland's rail industry to the Scottish Executive in April 2005. Along with the Transport (Scotland) Act 2005, the Railways Act 2005 replaced the Strategic Rail Authority and Strathclyde Passenger Transport Executive with Scottish ministers as parties to the franchise contract.

9. The Railways Act 2005 also enabled Scottish ministers to develop their long-term strategy for rail in Scotland, with Transport Scotland leading this work. *Scotland's Railways* was published in December 2006, detailing Scottish ministers' 20-year vision for rail in Scotland.⁸ *Scotland's Railways* shares the strategic aims of *Scotland's National Transport Strategy* to improve journey times and connections, reduce emissions, and improve the quality, accessibility and affordability of public transport in Scotland.⁹

10. Network Rail published its first *Route Utilisation Strategy* for Scotland in March 2007, developed in consultation with Transport Scotland and First ScotRail.¹⁰ The strategy considers future changes in demand, assesses existing services, and identifies a range of initiatives aimed to make more effective use of Scotland's railways. The initiatives include increasing capacity between Fife and Edinburgh, reducing journey times between the central belt and northern cities, and improving connectivity between Edinburgh and Glasgow.

11. In July 2007, Transport Scotland published the *High Level Output Specification* (HLOS), setting out Scottish ministers' priorities for the rail industry from 2009 to 2014.¹¹ The HLOS aims for First ScotRail to achieve an average of 92 per cent of services arriving on time by the end of 2014, and details a number of major and small-scale rail infrastructure projects to improve reliability, reduce journey times and increase capacity.¹² The projects include the Glasgow Airport Rail Link (GARL); re-opening the Airdrie to Bathgate and Edinburgh to Tweedbank (Borders) passenger rail lines; lengthening station platforms on specified routes to allow longer trains and increased capacity; and infrastructure improvements to improve journey times.

First ScotRail will receive £2.5 billion in government subsidy over the ten-year franchise term

12. The First ScotRail franchise was established in 2004 as a seven-year term with the option to extend the term by a further three years. In April 2008, Scottish ministers

extended the franchise to November 2014. First ScotRail will receive £2.5 billion in government subsidy over the ten-year franchise term, which includes subsidies to ensure First ScotRail provides vital but non-commercially viable rail services.¹³ In 2007/08, First ScotRail received an average of 11 pence per passenger kilometre in government subsidy. Remaining operating costs are met through passenger fares and other revenue generated by First ScotRail.

13. The franchise contract sets out both Scottish ministers' and First ScotRail's obligations.¹⁴ Transport Scotland, on behalf of Scottish ministers, is required to manage the franchise contract, monitor First ScotRail's performance, and ensure all other Scottish ministers' obligations under the contract are fulfilled. First ScotRail is to pursue agreed revenue targets and is required to deliver a number of service obligations under the franchise, namely:

- Operate train services specified in the franchise contract.
- Meet reliability, punctuality and capacity targets that become more challenging over time.
- Meet the Service Quality Incentive Regime (SQUIRE) 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.

6 Passenger Focus is Britain's independent rail consumer watchdog, established under the Railways Act 2005, replacing the regional Rail Passengers' Committees. MACS is a statutory advisory body established in 2002 to advise the Scottish Executive on disability issues regarding transport.

7 The seven Regional Transport Partnerships were established by the Transport (Scotland) Act 2005 to allow local authorities and other regional representatives to plan and develop the transport strategy for their regions.

8 *Scotland's Railways*, Scottish Executive, December 2006.

9 *Scotland's National Transport Strategy*, Scottish Executive, December 2006.

10 *Scotland Route Utilisation Strategy*, Network Rail, March 2007.

11 *High Level Output Specification*, Transport Scotland, July 2007.

12 The 'Public Performance Measure' (PPM) will be used to determine whether 92 per cent of First ScotRail services arrive on time. The PPM is the main method used in Britain to assess passenger train punctuality. For regional operators, including First ScotRail, 'on time' is defined as arriving within five minutes of the timetabled arrival time. A train service's punctuality depends on the performance of both the infrastructure (Network Rail) and the service provider (First ScotRail).

13 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.

14 The contract is available on Transport Scotland's website www.transportscotland.gov.uk

- Deliver specified service improvements, such as introducing new services, when requested by Scottish ministers. Scottish ministers can choose to purchase any service improvements, including improvements for which Transport Scotland has already agreed prices with First ScotRail (priced options).

Scottish ministers introduced a number of changes to the contract in the franchise extension agreement

14. During the first year of the contract (2004/05), First ScotRail reached a point at which 80 per cent of any additional revenue for the year was returned to the Scottish Executive (a condition of the original contract, [Exhibit 3](#)). First ScotRail's revenue has not reached this level again, however, in 2006/07 it would have required only 0.4 per cent additional revenue to do so. Additionally, by the end of 2005/06, First ScotRail's performance was outstripping its punctuality and capacity targets.

15. Transport Scotland's forecasts indicated that First ScotRail would continue to return 80 per cent of additional revenue for the remainder of the franchise. Transport Scotland was concerned that this would reduce the incentive for growing services, since First ScotRail's costs to improve services might exceed its 20 per cent share of the revenue achieved. This would be contrary to the Scottish Government's strategic aims as set out in *Scotland's Railways*, the *Route Utilisation Strategy* and *High Level Output Specification*.

16. Transport Scotland reviewed options to address these concerns, and the three-year extension to the franchise contract was announced

in April 2008 ([Part 3](#) of this report describes the review process).¹⁵ The extension introduced the following main changes:

- Punctuality and capacity compliance targets have been made more challenging from 2008/09 onwards. Permitted delays caused by First ScotRail and the percentage of services permitted to provide less than the planned capacity have both been reduced by more than a third, bringing the targets more in line with recent performance.
- Revenue targets have been revised from the start of 2007/08, in line with more recent forecasts, increasing the target by 7.5 per cent between April 2007 and November 2014.
- The revenue share and support arrangements have been changed ([Exhibit 3](#)). The combination of the revised, higher revenue targets and the change in the revenue share arrangement means that, providing it achieves, each year, revenue of more than ten per cent above the revised revenue targets, First ScotRail could retain up to £236.7 million in additional revenue over the remaining franchise term without paying a share to Scottish ministers. However, this would require First ScotRail to achieve significant further improvement, a situation Transport Scotland considers unlikely.

- Additionally, a profit cap has been introduced to guard against First ScotRail achieving unexpected profit levels.¹⁶ Half of any profit (revenue minus costs) exceeding £27.3 million in any year, and half of any profit achieved from the additional service improvement options, is to be paid to Scottish ministers, or invested into further service improvements.¹⁷

- In exchange for the extension and the change in the revenue share arrangements, Transport Scotland has secured a guaranteed £73.1 million investment from First ScotRail.¹⁸ Scottish ministers will determine how to use this investment. For example, ministers could decide to reduce the government subsidy or invest in service improvements that will address the priorities set out in *Scotland's Railways*.
- First ScotRail is required to provide additional information to better inform planning for the next franchise or to inform alternative options.
- First ScotRail is required to participate in the development of new major rail projects that will begin services after the franchise term.

The franchise contract reflects but does not determine the structure for passenger fares

17. Fares for First ScotRail services are a mix of controlled fares (where Scottish ministers determine the fare prices for the greater Strathclyde area), regulated fares (where price increases are restricted by Scottish ministers) and unregulated fares (with price increases determined by First ScotRail).¹⁹ [Appendix 1](#) provides

¹⁵ The franchise extension agreement is available on Transport Scotland's website www.transportscotland.gov.uk

¹⁶ First ScotRail is required to provide Transport Scotland with its profit and loss account statement every four weeks, and have its annual accounts audited by an independent auditor approved by Transport Scotland.

¹⁷ All figures in this paragraph are at 2004/05 prices, except the £27.3 million profit cap, which is at 2007/08 prices, and will be inflated by the retail prices index (RPI) each year.

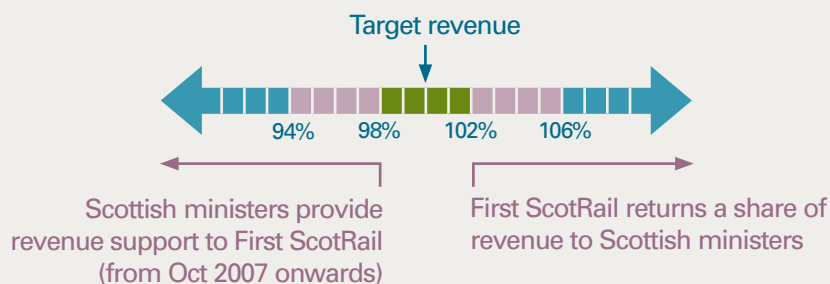
¹⁸ This is in addition to the £40 million First ScotRail is required to spend on a range of capital improvements during the first seven years of the contract.

¹⁹ Fares classed as controlled and regulated were determined by the fares policies of the SRA and SPTE (for which Scottish ministers are now responsible) or the British-wide Ticketing and Settlement Agreement (TSA).

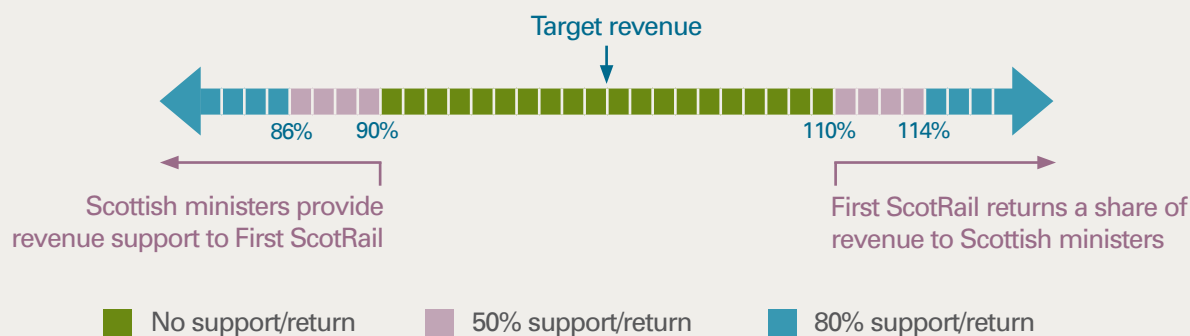
Exhibit 3

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.

further details on the structure of First ScotRail fares.

18. The Britain-wide Ticketing and Settlement Agreement (TSA) covers fares on routes served by more than one train operating company and is administered by the Association of Train Operating Companies (ATOC) and approved by the Office of Rail Regulation (ORR). Following the devolution of rail responsibilities, Scottish ministers became responsible for the fares policy for routes covered only by First ScotRail. The Scottish ministers' fares policy is administered by Transport Scotland but outside of the management of the First ScotRail franchise contract. Transport Scotland is currently developing a new fares policy to encourage a shift to rail transport, with the intention that the fares structure be easily understood by passengers and, where possible, be competitive with other transport modes.

About the study

19. This report provides an assessment of Transport Scotland's management of the franchise contract, including the awarding of the three-year extension in April 2008, and First ScotRail's performance against the franchise terms. 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 Government. The report is organised into three sections:

- Management of the franchise ([Part 1](#)).
- The franchise extension ([Part 2](#)).
- First ScotRail's performance ([Part 3](#)).

20. This report draws on various sources of information, including:

- a review of relevant documents, including the franchise contract, the extension agreement, meeting minutes and franchise management reports

- analysis of the costs of the franchise, including subsidy levels, performance payments and management costs
- analysis of First ScotRail performance data, including comparisons with other British passenger rail franchises
- interviews with Transport Scotland officials, First ScotRail staff, other rail and transport bodies, rail transport academics, and passenger representative groups.

21. A project advisory group provided the study team with independent advice and feedback at key stages of the project. The membership of the group is shown in [Appendix 2](#).

Summary of key messages

- First ScotRail will receive £2.5 billion in government subsidy for the franchise over its ten-year term.
- Transport Scotland is generally managing the franchise contract effectively, but there is some scope to improve its consultation with stakeholders, budgeting for performance payments, and the alignment between performance measures and passenger and wider government priorities.
- Transport Scotland makes only limited information about the contract and associated performance readily accessible to stakeholders and the wider public.
- By extending the franchise Transport Scotland has secured a guaranteed £73.1 million that will be used to reduce the government subsidy or be invested in rail services. However, governance arrangements for the review that led to the extension could have been better managed.

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

Recommendations

To improve the management of the franchise Transport Scotland should:

- review performance measures to improve alignment with passenger and wider government priorities
- consider allocating and monitoring a budget for franchise performance payments
- clarify whether all other funding commitments relating to the franchise are secured until the end of the extended franchise term in November 2014. Where funding has not been secured, Transport Scotland should clarify the arrangements
- clarify its consultation arrangements, both for passenger rail and its overall transport responsibilities, to improve stakeholder engagement.

To improve stakeholder understanding and transparency regarding the franchise, Transport Scotland should:

- establish a single source from which stakeholders can easily access the information they consider relevant regarding the franchise
- ensure a guide to the franchise contract is developed that identifies key elements for passengers and taxpayers, is reviewed for its readability and made publicly available

- publish a summary of the performance meeting minutes identifying key elements for passengers and taxpayers.

When developing the specifications for the next franchise contract, 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
- specify under what conditions an extension will be considered or the criteria that will be used to decide whether an extension is appropriate, should the next franchise agreement include an extension option
- consider any relevant recommendations from the recent National Audit Office report on letting rail franchises.²⁰

The Scottish Government may also wish to consider:

- introducing an obligation for all public transport providers to consult with other affected transport providers when proposing service or timetable changes, to assist further integrated transport improvements
- introducing versions of the Service QUality Incentive REGime (SQUIRE) for other transport and service providers.

Part 1. Management of the franchise



Transport Scotland manages the core aspects of the franchise contract well, but there is some scope to improve.



Key messages

- First ScotRail has received £864 million in public funding from the start of the franchise contract to March 2008, £296 million of which was in 2007/08.
- Overall, Transport Scotland's management arrangements are effective, but there is some scope to improve.
- Performance measures are effective, but could be reviewed to improve alignment with passenger and wider government priorities.
- There is no single source of information about the contract and franchise performance.

First ScotRail has received £864 million in public funding from the start of the franchise contract to March 2008

22. To date, First ScotRail has received a total of £864 million in public funding in cash terms (including £296 million in 2007/08).²¹ Most of this (96 per cent) has been the subsidy for providing rail passenger services (Exhibit 4). The amount of subsidy per year was determined prior to the start of the franchise. The subsidy increased by more than a third from 2005/06 to 2006/07, with little expected variation in the annual subsidy levels between 2006/07 and the end of the franchise term.²²

23. The contract includes a system of financial rewards and penalties to encourage First ScotRail to maintain and improve performance. Transport Scotland monitors train running and quality of service performance

Exhibit 4

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

and pays or penalises First ScotRail accordingly.²³ To date, First ScotRail has received £22.7 million in performance payments, made up of £27.4 million in payments for train running performance minus £4.7 million of penalties for service quality performance.

24. Train running performance consists of punctuality, providing the planned seated passenger capacity and minimising changes to timetables. The £27.4 million paid to First ScotRail to date for its train running performance comprises £29.8 million for punctuality performance, minus penalties of £2.3 million for not providing the planned capacity and £96,800 for changes made to its timetables.

25. Transport Scotland assesses the quality of First ScotRail's services at stations and on trains through the Service QUality Incentive REgime (SQUIRE), which covers 38 performance areas, such as

cleanliness, security, accessibility, comfort, and provision of travel information (see Appendix 3 for a list of the performance areas).²⁴ Transport Scotland can pay financial incentives or impose penalties for each of the 38 performance areas. The balance of penalties and rewards for service quality has resulted in £4.7 million being collected from First ScotRail to date, consisting of £2.6 million for the quality of service at stations and £2.1 million for the quality of service on trains. However, SQUIRE penalty payments overall have reduced over time.

26. To date, First ScotRail has received £23.9 million for its delivery of specified service improvements requested by Scottish ministers. Under the revenue share arrangements, First ScotRail has so far paid £4.5 million of revenue to government bodies in Scotland (the government).²⁵ To date, First ScotRail has also paid the government £10.5 million in miscellaneous payments. Miscellaneous payments between the government and First ScotRail include

²¹ Funding was initially provided by the Scottish Executive via the Strategic Rail Authority and by the Strathclyde Passenger Transport Executive. Since November 2005, following the devolution of rail responsibilities to Scotland, the funding has been provided directly by the Scottish Executive/Scottish Government.

²² The increase between 2005/06 and 2006/07 was as a result of a Britain-wide review by the ORR rebalancing the government grants to Network Rail with the track access charges the franchise operators pay Network Rail. This resulted in First ScotRail's track access charges increasing substantially from 2006/07 onwards, which had to be accommodated in the Scottish Government's subsidy payments to First ScotRail.

²³ Given First ScotRail can both receive payments and incur penalties, the figures provided in this section are net, that is, payments minus penalties.

²⁴ SQUIRE was originally developed by the Strathclyde Passenger Transport Executive.

²⁵ 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.

payments to First ScotRail for additional passenger services and First ScotRail refunds to the government if the final price it pays for a sub-contract is less than what the government had initially provided for the sub-contract.

Transport Scotland's management arrangements are generally effective

27. The franchise contract specifies First ScotRail's performance and compliance requirements, the consequences for not meeting these requirements and the steps to be taken to rectify any non-compliance. Transport Scotland has a dedicated rail franchise management team within its rail delivery directorate ([Exhibit 5](#)). This team reviews and acts on performance information and forecasts, and plans for future performance to ensure that First ScotRail meets its contractual requirements. More than half of the rail franchise management team were previously with the Strathclyde Passenger Transport Executive, bringing operational knowledge and experience to Transport Scotland. This experience included involvement

in establishing the original contract, monitoring First ScotRail's operations and managing its contractual compliance.

28. Transport Scotland monitors First ScotRail's train running and service quality performance on a daily basis. Automated monitoring systems operated by Network Rail record First ScotRail's train running performance at various points on the rail network. Both Transport Scotland and First ScotRail receive this information. This allows Transport Scotland to assess whether First ScotRail addresses performance issues and to calculate the performance-based financial payments or penalties. Transport Scotland's SQUIRE inspectors visit stations and board trains daily (unannounced to First ScotRail) to assess service quality. Each station that First ScotRail manages and a representative sample of trains are inspected at least once every four weeks. Transport Scotland reviews the inspection results each day, enabling it to quickly identify and address poor performance.

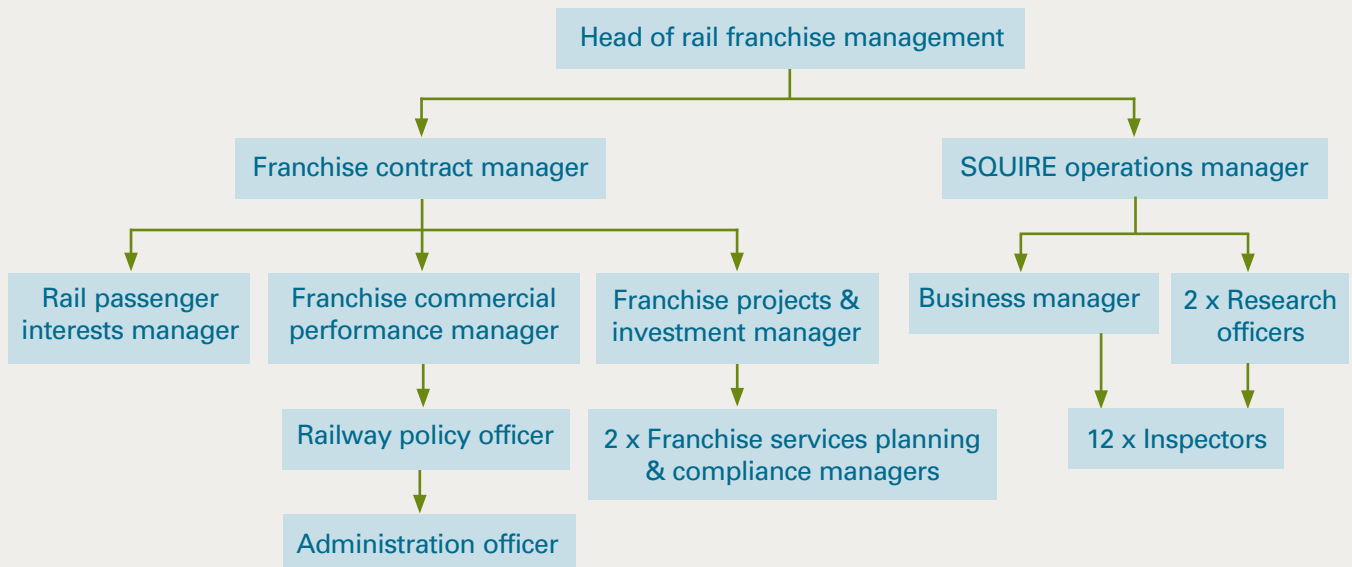
29. Transport Scotland also monitors First ScotRail's progress with: the capital investments programme and

specified service improvements; its service delivery obligations; levels of service use; safety performance; financial performance; efforts to reduce fare evasion; commercial and marketing activities; human resources issues; and compliance with the franchise contract obligations. Transport Scotland also reviews National Passenger Survey data and draws upon data from other rail bodies, such as Network Rail and the Office of Rail Regulation, to assess First ScotRail's performance. This includes comparisons with other British franchises.

30. The franchise contract requires Transport Scotland and First ScotRail franchise managers to meet every four weeks to discuss performance and compliance issues. However, the contract allows for additional performance meetings, and Transport Scotland and First ScotRail have established a number of additional meetings. Transport Scotland and First ScotRail's senior management meet quarterly to address any high-level performance issues. Transport Scotland and First ScotRail have also introduced meetings to address

Exhibit 5

Transport Scotland rail franchise management team structure



Note: The rail performance, rail finance and technical support teams within Transport Scotland's rail delivery directorate and a Security and Policy manager seconded from the British Transport Police support the rail franchise management team with its day-to-day business.
Source: Transport Scotland

particular aspects of the contract in further detail (eg, four-weekly service quality, financial compliance, and fares and marketing meetings; bi-monthly transport integration and train planning meetings; and quarterly human resources compliance and revenue protection meetings). Transport Scotland also meets bi-monthly with Network Rail and First ScotRail to discuss rail services and infrastructure performance issues.

31. The performance meetings are intended to drive improvement, with a focus on resolving performance issues and forward planning (for example, the planning for major events and updates on ministerial priorities and associated implications). Actions are allocated and reported back to the next meeting. Examples of Transport Scotland's management actions from meeting minutes include: instructing First ScotRail to deliver its outstanding remedial action plans; instructing First ScotRail to improve the quality of the train toilets, following an increase in failed inspections, with a subsequent improvement acknowledged in a later meeting; and requiring First ScotRail to implement an improvement strategy to address an increase in the number of cancelled services.

32. The full range of performance meetings equate to 82 meetings per year (Exhibit 6) and daily performance monitoring accounts for the majority of Transport Scotland's overall franchise management costs. Transport Scotland believes that the detailed specification in the franchise contract and the high level of scrutiny minimises risks to the taxpayers' subsidy of the franchise. Transport Scotland reports its overall franchise management costs were £1.4 million in 2007/08, equivalent to 0.5 per cent of the £274 million subsidy paid to First ScotRail in that year.

Exhibit 6

Rail franchise performance meetings per year

Meeting	Frequency	Meetings per year
Franchise performance (senior management)	Quarterly	4
Franchise performance	Four-weekly	13
Service quality	Four-weekly	13
Financial compliance	Four-weekly	13
Fares and marketing	Four-weekly	13
Transport integration	Bi-monthly	6
Train planning	Bi-monthly	6
Human resources compliance	Quarterly	4
Revenue protection	Quarterly	4
Rail services and infrastructure performance	Bi-monthly	6
	Total	82

Source: Transport Scotland

Transport Scotland could improve some aspects of its management of the franchise

33. Transport Scotland manages the core aspects of the franchise contract effectively. However, it could improve in some areas.

34. Regional Transport Partnerships, passenger representative groups and other transport stakeholders reported that, while Transport Scotland consults well on specific projects, it has not clarified its consultation arrangements, both for passenger rail and its overall transport responsibilities. However, Transport Scotland considers that it consults with stakeholders as appropriate. Transport Scotland confirmed that it consults on specific priorities and projects rather than on an ongoing basis, choosing instead to place reliance on the Scottish Government's Transport Directorate's consultations.

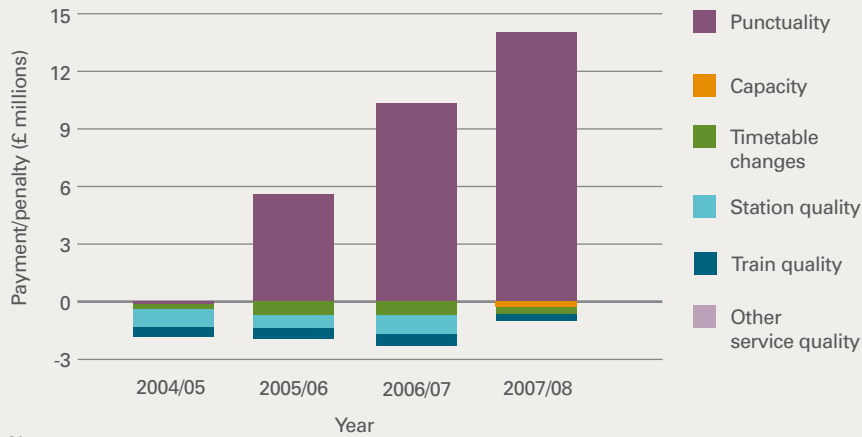
35. Although performance payments have accounted for only 2.6 per cent of the payments to First ScotRail to date, the values involved are considerable and have increased over time (Exhibit 7, overleaf). Transport Scotland does not currently allocate a budget for performance payments, and in 2007/08 Transport Scotland's actual spending was significantly different from its forecasts:

- £14 million punctuality payment was 26 per cent more than forecast.
- £0.5 million penalty for not providing the planned capacity was 38 per cent less than forecast.
- £78,000 penalty for changes made to timetables was nearly seven times more than forecast.²⁶
- £344,000 quality of service penalty was 74 per cent less than forecast.

26 Transport Scotland reports that the larger than anticipated penalty for changes made to timetables was due to a train drivers' dispute which resulted in many timetable changes.

Exhibit 7

Performance based payments and penalties 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

Current performance measures are generally effective but could benefit from review

36. Transport Scotland uses industry-wide approved performance measures to assess the running of train services (ie, punctuality, capacity and timetable changes), and has used the contract extension to make the punctuality and capacity targets more challenging. Both Transport Scotland and First ScotRail report that the financial incentive placed on train running performance has been an important contributor to the improvements achieved to date.

37. However, there may be some situations where financial incentives take precedence over passengers' requirements. First ScotRail is not penalised for delays to its services due to weather disruptions, infrastructure issues or the performance of other train operating companies (with Network Rail and the responsible train operating company instead penalised). However, it is penalised if it delays a service to accommodate a delayed connecting bus or ferry service. Transport Scotland may wish to review this for

circumstances where missing the connecting train has consequences for passengers, given one of the Scottish Government's priorities is to improve integrated transport.

38. First ScotRail receives payments for each of the SQUIRE performance areas if its percentage of passed inspections for that performance area exceeds the benchmark. It also incurs penalties when this falls below the benchmark, with many of the benchmarks requiring 90 per cent or more of the inspections to pass (see [Appendix 3](#) for the performance areas and benchmark levels). First ScotRail incurs additional penalties if it does not rectify failed inspections within required timeframes. All of the rail bodies we spoke to credited the regime with driving improvements in service quality and considered it good practice within the industry. The Department for Transport has introduced similar forms of the regime in recently let rail franchises, however, it does not pay financial incentives or impose penalties for service quality performance. It is too early to say whether these schemes are as effective as the SQUIRE regime in promoting service quality improvement.

39. The overall suite of performance measures may benefit from review to improve its coverage, including consideration of other service performance areas, and alignment with passenger and wider government priorities. For example, in some areas, the SQUIRE regime is not aligned with passengers' priorities. Toilet facilities and providing information during delays, for instance, are currently areas of low passenger satisfaction. However, under the current regime, toilet facilities incur lower performance payments or penalties than the majority of the performance areas. Although SQUIRE assesses whether passenger announcement systems work, it does not assess the appropriateness of the information provided.

40. The costs involved in rectifying some SQUIRE performance areas could limit the opportunities to rectify other performance areas which are likely to be of greater importance to passengers. For example, as part of the SQUIRE regime First ScotRail is required to remove graffiti, and this is the station performance area with most financial incentives. The SQUIRE definition for graffiti includes marking or scratching. First ScotRail reports it spends £230,000 a year on replacing station glazing that has minor blemishes, which is likely to be beyond passengers' expectations, and suggests that this money could instead be spent on areas of greater importance to passengers, such as improving toilets.

41. The Scottish Government has a policy priority to reduce emissions, and the extension to the franchise includes a number of environmental improvement actions in its list of service improvement options. Transport Scotland does not currently assess any environmental outcomes of the franchise, such as energy consumption, emissions or waste recycling efforts. However, in June 2008, Scottish ministers requested First ScotRail to produce, by April 2009, a report assessing the

possible energy efficiency and waste minimisation techniques that could be introduced and how performance in these areas could be assessed.

42. Additionally, Transport Scotland does not assess some aspects of performance. For example, the franchise contract aims for all passengers to have a seat within ten minutes of boarding. Transport Scotland and First ScotRail acknowledge that this aim cannot be achieved on some services due to current infrastructure limitations (for example, longer trains that provide greater capacity cannot stop at stations with short platforms). However, routine and reliable assessment of overcrowding is not conducted to establish the extent of the problem.

43. Transport Scotland monitors First ScotRail's progress with service improvements but could do more to assess the intended outcomes of these improvements. For example, whether improvements to station accessibility have resulted in increased numbers, or greater satisfaction, of disabled passengers, and if initiatives to encourage tourist or business passengers have resulted in increases in these passenger sub-groups.

Stakeholders cannot access information about the contract and franchise performance from a single source

44. Transport Scotland's website contains the franchise contract and extension to the franchise. However, the contract is highly technical and is not accompanied by a guide highlighting the important elements for passengers and for taxpayers. Transport Scotland reports that it will place a 'plain English' version of the contract on its website by April 2009, that will update the original contract to reflect the amendments introduced by the extension, along with a summary guide.

45. Transport Scotland is required by the contract to publish the minutes of the franchise performance meetings. Transport Scotland has interpreted this as a requirement to distribute the minutes to attendees rather than public disclosure, and has suggested this is partly because discussion can include issues that are commercially sensitive. This interpretation is also common across the Department for Transport's franchise contracts. However, we believe this is unlikely to be the interpretation held by other stakeholders. Publishing a summary of the various performance meetings identifying those elements relevant to passengers and taxpayers would improve transparency about Transport Scotland's management of the franchise.

46. Transport Scotland publishes information on some of the areas of franchise performance that it assesses. The website provides train and station results for the SQUIRE regime, but does not include train running performance information. Additionally, passenger representative groups were generally unaware of the availability of SQUIRE information, and some Regional Transport Partnerships reported difficulties in securing regional SQUIRE information from Transport Scotland. Transport Scotland acknowledges that currently SQUIRE information cannot be easily aggregated to regional areas. Transport Scotland does not provide links to, and explanations of, First ScotRail performance information published by First ScotRail and other rail bodies, such as the Office of Rail Regulation's National Rail Trends and Passenger Focus's National Passenger Survey data.

There may be some risks to the success of the franchise

47. Listing potential risks to the success of the franchise does not imply that any of these risks are likely to occur, but it is important that stakeholders recognise and plan for any risks that might apply to them. While the extension may affect the relative importance of some of these risks, most have existed since the original contract was put in place. Transport Scotland currently monitors these risks and it is important that it continues to do so.

48. There may be a risk to the viability of the franchise if there is a sustained downturn in the economy. As economic growth is the strongest predictor of passenger demand, and therefore revenue levels, an economic downturn is likely to result in less revenue for First ScotRail, potentially putting the franchise and its services at risk. The franchise contract has a number of conditions to address this risk: Transport Scotland regularly reviews First ScotRail's budgets; the revenue support arrangements in the contract mean Scottish ministers can provide financial support to continue services; and ultimately, Transport Scotland can become the 'operator of last resort' and take over running the franchise until it is re-let. Transport Scotland can recover the costs involved in becoming the 'operator of last resort' from the bond First ScotRail was required to deposit to cover such a situation.

49. Scottish ministers' obligation to provide revenue support (if required) is in place to reduce the risks of the operator being unable to provide essential services.²⁷ However, it does pose a financial risk to taxpayers. The higher revenue targets set in the franchise extension may be harder for First ScotRail to achieve. This could have increased the risk of Scottish ministers needing to provide revenue support. However, the revenue

support parameters were also re-set in the franchise extension so that the value of the Scottish ministers' revenue support remains the same as in the original contract.

50. To encourage further service growth the franchise extension extended the point at which First ScotRail is required to provide a share of its revenue to Scottish ministers. This has increased the possibility that First ScotRail may achieve greater profit levels than anticipated, while still receiving the set levels of government subsidy. However, the franchise extension also introduced a profit cap (where 50 per cent of any profit over £27.3 million in any year is to be returned to Scottish ministers), ensuring that the Scottish Government will receive a share of any high profits that First ScotRail achieves.²⁸

51. The franchise extension ends in November 2014, shortly after the Glasgow Commonwealth Games. There is a risk that First ScotRail resources may be focused on preparing FirstGroup's bid for the new franchise contract at a time when there will be greater demand for its services. However, the franchise extension requires First ScotRail to co-operate in the preparations and service provisions for the Commonwealth Games, a requirement that was not in the original contract. Additionally, it could be seen not to be in FirstGroup's interests to allow First ScotRail's performance to decline during the Commonwealth Games, should it wish to secure future franchises.

52. Given First ScotRail is now able to secure a significant increase in revenue before returning a share to Scottish ministers, there is a risk that the penalty and reward arrangements for service quality performance may become less of an incentive, resulting in reduced service quality. However, the franchise extension agreement provides protection to October 2009, with Scottish ministers able to cancel

the extension if service quality performance does not meet 98 per cent of the performance achieved in 2007/08. After October 2009 Transport Scotland can consider, as in the original contract, cancelling the contract if First ScotRail breaches the service quality performance requirements.

53. First ScotRail may attempt to increase revenue by increasing the prices for its unregulated fares, over which Transport Scotland has little control (see [Appendix 1](#) for further details on the structure of First ScotRail fares). This situation also existed in the original contract. However, passengers can opt to buy an alternative, regulated ticket for the same route. Additionally, First ScotRail faces the risk that remaining passengers may instead choose other transport options if fares were increased, as regulated tickets do not offer the same flexibility in travelling times as non-regulated fares. The fares policy is separate to the rail franchise, and is currently being reviewed.

Recommendations

To improve the management of the franchise Transport Scotland should:

- consider allocating and monitoring a budget for franchise performance payments
- improve stakeholder engagement by clarifying its consultation arrangements, both for passenger rail and transport needs overall. This should identify the parties to be consulted, the aspects they are to be consulted on, and the type and timing of consultation
- review performance measures to improve alignment with passenger and wider government priorities.

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; provide contact details for further information requests; and include a guide to the franchise contract and a summary of performance meetings which identify key elements for passengers and taxpayers.

The Scottish Government may also wish to consider:

- introducing versions of the service quality incentive regime (SQUIRE) for other transport and service providers.

28 The £27.3 million profit cap is at 2007/08 prices and will be inflated by the retail prices index (RPI) each year.

Part 2. The franchise extension



Transport Scotland reviewed the contract using a rigorous appraisal process, and has secured £73.1 million of investment from First ScotRail. However, governance arrangements could have been better managed.

Key messages

- By April 2006, First ScotRail was outstripping contractual performance requirements and 80 per cent of additional revenue achieved was being returned to the Scottish Government. Transport Scotland was concerned this could discourage further service growth and improvements.
- To address these concerns, the franchise extension increased target revenue levels and extended the point at which a proportion of revenue must be returned to the Scottish Government. The extension also set more challenging contractual performance requirements.
- Transport Scotland has secured a £73.1 million investment and other commitments from First ScotRail in exchange for the franchise extension. The investment will be used either to reduce the government subsidy or to fund service improvements to address the Scottish Government's strategic aims for passenger rail transport.
- Transport Scotland used a rigorous option appraisal process when considering the extension and its alternatives. However, governance arrangements could have been better managed.

Key aspects of the original franchise contract were no longer fit for purpose

54. First ScotRail was performing above its punctuality and capacity improvement targets within its first year of operating ([Exhibit 8](#)) and it had reached the point where it was returning 80 per cent of additional revenue to the Scottish Government.

First ScotRail's revenue has not reached this level again, however, in 2006/07 it would have required only 0.4 per cent additional revenue to do so. Transport Scotland forecasts also indicated that First ScotRail would return 80 per cent of additional revenue for the remainder of the franchise.

55. Transport Scotland was concerned that the revenue return arrangement would create a perverse incentive for First ScotRail not to deliver service improvements, because it would cost First ScotRail more to introduce the improvements than its share of the associated revenue. There is some evidence to support Transport Scotland's concern ([Exhibit 9](#)). Transport Scotland acknowledges that it was not possible to predict with certainty how First ScotRail would have behaved had the original revenue share arrangements remained, but was of the view that undertaking an early review would be in the public interest.

56. Transport Scotland was also concerned that the situation could lead First ScotRail to cut costs, resulting in reduced service quality and passenger numbers. For example, when First ScotRail submitted its 2006/07 business plan to Transport Scotland, it proposed a reduction in its advertising spend. The revenue share arrangements appeared to be leading First ScotRail to reduce costs, rather than seek additional revenue, because it would retain only 20 per cent of that revenue. Essentially, when spending an additional £1, First ScotRail would need to secure a minimum of £5 in revenue to break even (the remaining £4 would be returned to Transport Scotland). Transport Scotland was concerned that First ScotRail would consider it easier simply to reduce costs by £1.²⁹

Transport Scotland's appraisal process was rigorous and has resulted in a guaranteed £73.1 million investment by First ScotRail

57. The precise date at which Transport Scotland decided to review the franchise contract is not clear. However, both Transport Scotland and First ScotRail have indicated that by Autumn 2006 they had begun discussing whether a change to the existing contract was necessary. [Exhibit 10 \(page 20\)](#) provides a timeline of the options appraisal and extension approval process.

58. Transport Scotland established a team to review the contract, which worked with other staff in the organisation to consider the options available. The team also secured advice from expert consultants at an early stage. The options considered by Transport Scotland fell into three broad categories:

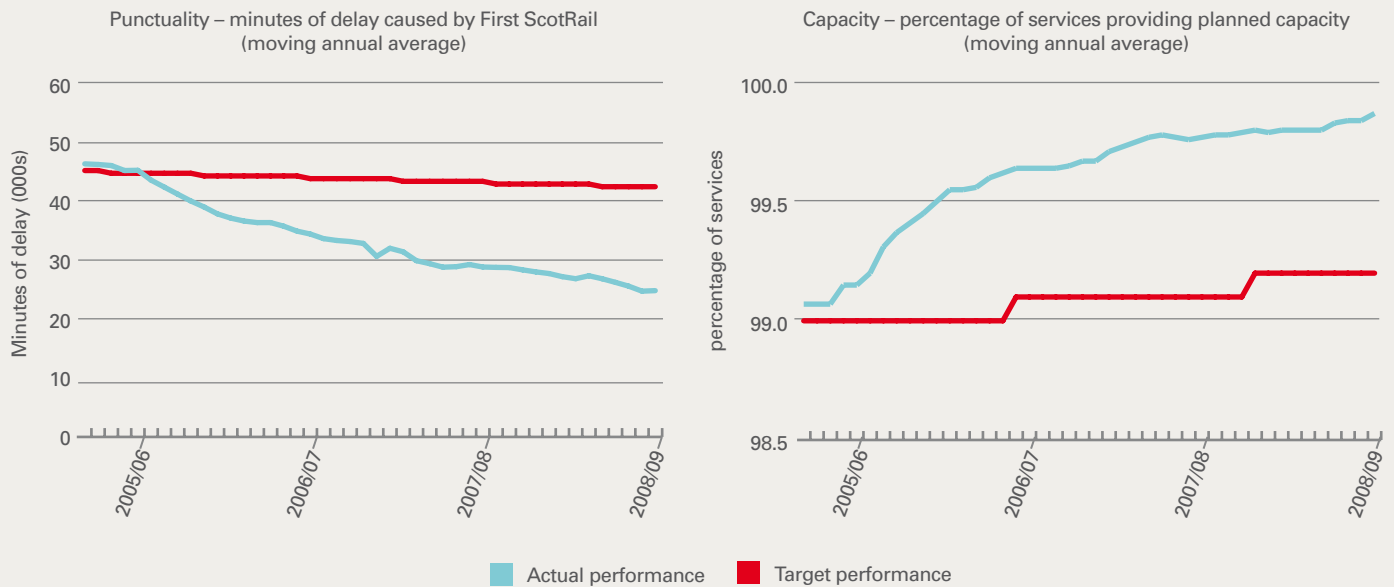
- To take no action, ie to run with the existing arrangements until the expiry date and accept any associated risk.
- To negotiate changes to the contract (retaining the seven-year term).
- To negotiate further changes in exchange for the three-year extension to the franchise (the original contract contained an option to extend the franchise, but did not specify any criteria for considering an extension).

59. Transport Scotland met with the then Transport Minister in December 2006 to discuss its concerns about the franchise contract and to seek approval to undertake further review work. The Minister agreed that Transport Scotland should undertake further work on possible alterations to the franchise contract.

²⁹ It is important to note that the options for reducing costs would be limited to those that did not involve a reduction in any of the services or obligations required by the franchise contract. However, because First ScotRail was performing above target levels in many areas, it would have been possible for it to reduce some aspects of service quality without breaching contract obligations.

Exhibit 8

First ScotRail punctuality and capacity performance compared with targets



Note: The moving annual average is the average of the current and preceding 12 reporting periods (there are 13 reporting periods per year).
Source: First ScotRail

60. The review team involved specialist internal staff to help model options and scenarios. Transport Scotland has indicated that the modelling work was based on industry best practice. For example, Transport Scotland used the Network Modelling Framework and drew on the Department for Transport's templates and guidance on franchise continuation.³⁰ It also engaged expert external consultants to review the modelling work. Separate external consultants provided advice on the procurement implications for a franchise extension.

61. As part of the review, Transport Scotland wished to encourage further performance improvement by resetting performance targets in line with current performance. Of the three options, only the two that involved changes to the contract would provide Transport Scotland with the opportunity to introduce the desired improvements.

Exhibit 9

Additional North Berwick services and Musselburgh stops

Transport Scotland identified a need for an additional evening service on the Edinburgh to North Berwick route, together with two additional stops at Musselburgh, to meet the needs of the relocated Queen Margaret University College.

However, First ScotRail could not justify the expenditure as the £100,000 in costs to provide the services was greater than its likely share of revenue. The estimated revenue from the services was £172,000. Given revenue performance at the time, it was likely that First ScotRail would have to return 50 or 80 per cent of the revenue to Scottish ministers, allowing it to retain, at most, £86,000 of the revenue, resulting in a loss to First ScotRail of at least £14,000 and up to £64,600.

Acknowledging that the services were required, Transport Scotland had to allow a reduction in the franchise subsidy payment to First ScotRail and an increase in the level of revenue First ScotRail could retain (specific to the service). This was necessary in order for First ScotRail to earn enough in profit from the services to make them a viable addition.

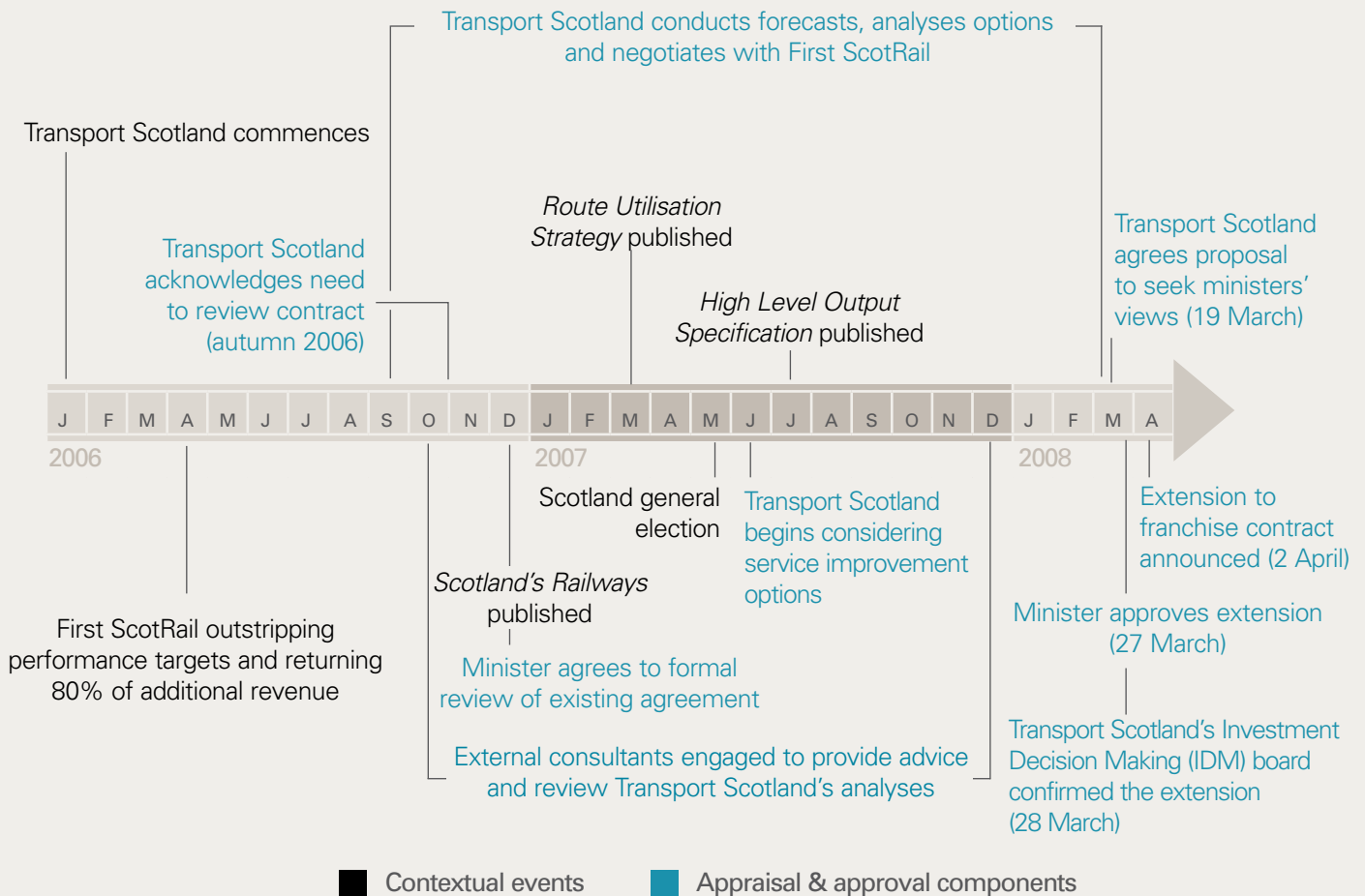
Source: Transport Scotland

³⁰ The Network Modelling Framework is a Britain-wide rail network modelling tool, developed by the Department for Transport, Transport Scotland, the Office of Rail Regulation and Network Rail.

Exhibit 10

Timeline for the franchise contract options appraisal and approval of the extension

Transport Scotland's review took approximately 18 months. According to advice from the consultants appointed by Transport Scotland, the time needed to undertake a review of performance in preparation for a re-tendering exercise would be in the region of 18 months. This was based on the consultants' knowledge of experience elsewhere in Britain.



Source: Audit Scotland

62. However, First ScotRail was reluctant to commit to improvements without some incentive. Transport Scotland recognised that the three-year extension could be a significant incentive to securing First ScotRail's agreement to more challenging performance benchmarks and other service improvements. Additionally, a number of major rail projects are planned between 2011 and 2014. Transport Scotland was aware that re-letting the franchise in 2011 would therefore require a more complex bid specification process to accommodate the projects and that the consequences of these projects

for services could be unclear at the time operators would submit their bids. Transport Scotland believes this could have resulted in bids requiring higher subsidy levels to cover the potential risks.

63. Transport Scotland continued to develop and review options throughout 2007 and into 2008, and undertook negotiations with First ScotRail throughout this period. The review team, working with colleagues, modelled a range of scenarios. The scenarios were generated by varying a range of factors, including: economic growth;

inflation; passenger numbers; revenue growth; and First ScotRail's performance. The modelling also took account of anticipated service and infrastructure changes and improvements.

64. Transport Scotland's modelling and negotiations indicated that, over the existing seven-year term, and based on what it considered the most likely revenue levels if the contract was not amended, it would be possible to secure investment of £25 million from First ScotRail in exchange for an estimated £20 million in potential revenue return to the Scottish

Government. However, by offering the extension it could secure investment of £65 million in exchange for potential revenue of £57 million. In addition, with the extension option, the review team was able to negotiate an additional £8.1 million by making a case that FirstGroup would save a significant sum by not having to submit a new tender in 2011 and First ScotRail could secure additional revenue from service improvements to 2014.

65. On concluding the core review work in early 2008, Transport Scotland aimed to secure ministerial approval and introduce the extension in time for the next financial year, ie April 2008, to ensure maximum benefits and investment. The guaranteed investment of £73.1 million will allow Transport Scotland to either reduce the government subsidy or to secure service improvements in line with the Scottish Government's strategic aims, such as introducing services with reduced journey times and services that connect with other transport providers. In order to avoid the need for new negotiations on all possible improvement options, Transport Scotland's contract review team consulted with colleagues and negotiated with First ScotRail to secure a list of 28 price-agreed service improvement options to be included in the extension.³¹

66. Transport Scotland ensured that there was no increase in the franchise subsidy levels. It also ensured there was an option to cancel the extension. Scottish ministers can choose, up until October 2009, to end the franchise agreement at the original seven-year expiry date of 2011 if First ScotRail:

- does not at least maintain the new train running performance improvement targets
- does not at least maintain SQUIRE

performance across any 12 consecutive months at 98 per cent of its 2007/08 performance

- fails to deliver its committed passenger service obligations or specified service improvement options called by Scottish ministers
- has on more than one occasion not submitted a remedial plan or agreed to a remedial agreement within the required time periods (should First ScotRail receive any remedial notices)
- has any business default event (the various types of which are detailed in the franchise contract, for example breaching the law, failing to make payments to Transport Scotland, having any operating licences revoked, or going into administration).

67. The review team reported to Transport Scotland's senior management throughout the process. Transport Scotland also negotiated with First ScotRail regularly throughout the process to assess the viability of the options being considered at the time. On 19 March, Transport Scotland agreed to seek the minister's views. Ministers announced the franchise extension on 2 April 2008.

Governance arrangements for the review process could have been better managed

68. The original contract contained an option to extend the franchise but did not specify the conditions under which an extension should be considered, or the criteria to be used to decide whether an extension might be appropriate. Transport Scotland reports that criteria were established to determine whether the extension should be awarded, however, no formal record was made of the criteria being approved.

69. Transport Scotland indicates that the review team considered risks during meetings, although the team did not record this activity and a formal risk register was not prepared until a relatively late stage in the process (August 2007).

70. Transport Scotland's board is an advisory body, without a legal identity. Its role is to support and advise the chief executive. The board consists of the chief executive and the five executive directors, along with two non-executive members. Transport Scotland's chief executive is formally accountable for the performance of the organisation and for the advice given to Scottish ministers on major investment decisions. Transport Scotland's Investment Decision Making (IDM) board assists the chief executive with major investment decisions. The IDM board consists of Transport Scotland's chief executive and its five executive directors. At its meeting on 28 March 2008, the IDM board confirmed the extension of the franchise contract and agreed the associated adjustments, described elsewhere in this report, be implemented. Transport Scotland has agreed that its non-executive members should not be part of the IDM board. In line with these procedures the non-executive members of the board were not involved in the franchise review and extension options.

71. Transport Scotland's register of interests indicates that the director of Finance and Corporate Services holds shares and share options in FirstGroup. Transport Scotland's annual accounts also declare this interest. The director of Finance and Corporate Services was present at key meetings in March at which the rail franchise extension was discussed. Good practice generally requires that members with an interest should declare it in advance and take no part in any relevant agenda item. The

³¹ Details of each of the 28 service improvement options (referred to as 'priced options') are in the franchise extension agreement, available on Transport Scotland's website www.transportscotland.gov.uk. Scottish ministers retain the option to agree additional options with First ScotRail or to change the terms of the 28 options already secured.

minutes of the March meetings do not record if the director of Finance and Corporate Services declared an interest or removed himself from discussions about the franchise extension. The register of interests and the management commentary in the accounts indicate that Transport Scotland has put in place practices to address the potential conflict. Transport Scotland's chief executive has stated that the director of Finance and Corporate Services has no vote on any decision-making relating to FirstGroup, and was not involved in the review process, including development of the options, although the director of Finance and Corporate Services was aware that a review was ongoing and attended the meetings in March.

72. Transport Scotland did not provide the Minister for Transport, Infrastructure and Climate Change with a fully documented business case, taking the view that presentations to the minister were more appropriate. The presentations were based on the option appraisal work.

73. Transport Scotland did not consult on the franchise review and extension options with external bodies. First ScotRail informed Transport Scotland that the agreement was price sensitive. Consequently, Transport Scotland was concerned that public disclosure about the review and negotiations could influence market activity and breach financial regulations. Transport Scotland did not secure separate advice on this point, but is of the view that it balanced appropriately commercial sensitivities and the public interest.

74. The option to extend the franchise was included in the original contract, which Transport Scotland reports was widely consulted on. Transport Scotland also contends that it was able to rely on the consultation for long-term strategic rail priorities undertaken between October and December 2005, which led to the publication of *Scotland's Railways*. However, some organisations

(Regional Transport Partnerships, Passenger Focus, and the Scottish Trades Union Congress) reported that they were concerned at the lack of consultation and would have appreciated a confidential, high-level discussion to consider any additional benefits that could be secured, or potential risks that might arise, from the extension.

75. The lack of consultation created practical difficulties. Transport Scotland anticipated that, as a consequence of the franchise extension, it may need to provide support from 2011 to 2014 for commitments currently funded by other bodies. Transport Scotland intends to provide this support from the £73.1 million it received for the extension. However, given these costs were not established prior to the extension being awarded, they may reduce the amount of the £73.1 million that will be available for further investments. To date, one example of such costs has become evident. The Strathclyde Partnership for Transport (SPT) agreed to fund the running costs for CCTV in its region's stations until the end of the franchise. The SPT reports that it anticipated this would be until 2011. Transport Scotland has now agreed to cover these ongoing costs, of approximately £425,000 per annum, for the three-year extension period.

Recommendations

To improve the management of the franchise Transport Scotland should:

- clarify whether all other funding commitments relating to the franchise are secured until the end of the extended franchise term in November 2014. Where funding has not been secured, Transport Scotland should clarify the arrangements.

When developing the specifications for the next franchise contract, Transport Scotland should:

- continue to develop its management and planning arrangements, including development of 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
- specify under what conditions an extension will be considered or the criteria that will be used to decide whether an extension is appropriate, should the next franchise agreement include an extension option
- consider any relevant recommendations from the recent National Audit Office report on letting rail franchises.

Part 3. First ScotRail's performance



Overall, First ScotRail's performance to date has been good, and continues to improve.



Key messages

- Overall, First ScotRail's performance has been good, and continues to improve:
 - more trains are running on time and the number of seats provided has improved, but unscheduled changes to timetabled services have increased
 - overall, the quality of service both at stations and on trains has improved
 - passenger satisfaction has increased
 - the increase in passenger numbers has exceeded Scottish Government targets.
- First ScotRail's positive working relationships with key rail sector bodies have also contributed to improved performance.
- First ScotRail and its staff have received a number of awards since it began operating.

First ScotRail's train running and service quality performance has improved

76. The 'Public Performance Measure' (PPM) is the main method used in Britain to assess the percentage of passenger train services that arrive on time, that is, the combined reliability (ie, the train arrives) and punctuality (ie, the train arrives on time) of passenger train services. For regional operators, including First ScotRail, 'on time' is defined as arriving within five minutes of the timetabled arrival time. In 2007/08, 90.6 per cent of First ScotRail's services arrived at their final destination on time (meaning

9.4 per cent of services were either cancelled, or delayed by five minutes or more), compared with 89.9 per cent across all British services. First ScotRail's PPM has increased by 4.8 per cent since its first full year of operating (2005/06), compared with a 3.5 per cent increase across Britain.

77. First ScotRail's *Passengers' Charter* sets out reliability and punctuality standards for each of its service groups. The *Passengers' Charter* defines First ScotRail's punctuality as the percentage of trains arriving at their final destination within five minutes of the scheduled time for the urban (East, Central and Strathclyde) service groups, within ten minutes for the regional (Express, Highland and South West) groups, and within 30 minutes of scheduled time for the long-distance Caledonian Sleeper services to London.³² Each month, First ScotRail is required to provide discounts to season ticket holders if either or both of its reliability and punctuality levels fall below the levels specified in its *Passengers' Charter*. Reliability performance has not fallen below the specified levels for any of the service groups since First ScotRail began operating. Discounts have been provided for punctuality, but performance has improved since First ScotRail began operating, with no service groups' punctuality performance falling below its specified level between May 2007 and March 2008.

78. First ScotRail is not able to control completely a train service's reliability and punctuality. Whether a train arrives on time depends on the performance of the service provider (First ScotRail), the infrastructure (Network Rail) and, to a lesser extent, the activities of other train operating companies (TOCs). First ScotRail reports to Transport Scotland every four weeks on the number of First ScotRail services cancelled and the number of minutes that services were

delayed due to First ScotRail (eg, mechanical breakdowns), Network Rail (eg, faults on the line and weather related incidents), and other TOCs (ie, a First ScotRail service being delayed due to another TOC's delay).³³ Network Rail and First ScotRail have a co-located train running performance team who determine the allocation of delay minutes.

79. The percentage of scheduled services being cancelled has increased since the previous operator's last full year of operating (2003/04), from 1.48 per cent to 1.79 per cent of scheduled services in 2007/08 (12,631 services). However, the percentage of these cancellations which were due to the operator have reduced from 61.9 per cent in the previous operator's last full year of operating to 40.5 per cent in 2007/08. This is as a result of both a decrease in the number of cancellations due to the operator (from 0.91 per cent of services to 0.73 per cent of services), and an increase in the number due to Network Rail (from 0.53 per cent of services to 1.02 per cent of services) ([Exhibit 11](#)).

80. In its first full year of operating (2005/06), First ScotRail cancelled 5,036 services (0.73 per cent of services), a 12.4 per cent decrease from the previous year. The number of cancelled services increased slightly in 2007/08 (to 5,118). However, this was mainly due to an increase in cancelled services for the Strathclyde service groups, mostly as a result of train driver industrial action that affected services in the Glasgow area. All other service groups experienced a further decrease in cancellations made by First ScotRail.³⁴

81. When examining whether delays were due to First ScotRail, Network Rail or other train operating companies, the *number of delay minutes* is used, rather than the

³² Details of the services within each of the service groups are in First ScotRail's *Passengers' Charter* on its website www.firstscotrail.com

³³ Network Rail operates automated monitoring systems at various points on the rail network which record delay minutes. The system is audited by the Office of Rail Regulation.

³⁴ The train running performance service groups are: East Coast; Express; Strathclyde PTE Diesel; Strathclyde Electric; South West Rural; Highland Rural; and Sleeper. Details of the services within each of these groups are in the franchise contract, available on Transport Scotland's website www.transportscotland.gov.uk

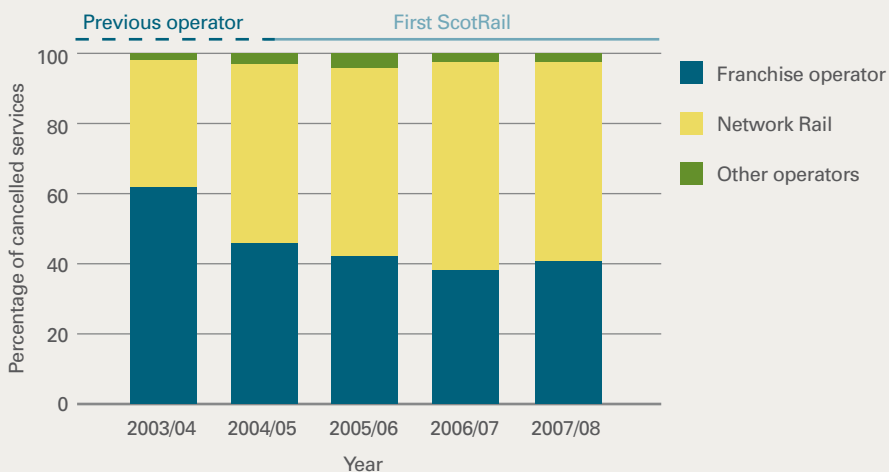
number of services, as a single service can experience delays due to different causes. The number of delay minutes has decreased from 1.3 million during the previous operator's last full year of operating (2003/04), to 961,000 in 2007/08 under First ScotRail. This is equivalent to a decrease from an average of 2.0 minutes to 1.4 minutes per service run. Transport Scotland, First ScotRail and Network Rail attribute this improvement to First ScotRail and Network Rail actively addressing the causes for delays for which they are each responsible.

82. The average number of delay minutes per service run varies across the service groups, typically reflecting longer delays on longer journeys.³⁵ In 2007/08, passengers on the sleeper services experienced an average of 18.8 minutes delay (with First ScotRail responsible for 6.9 minutes) compared to an average 0.9 minutes delay on the Strathclyde electric services (0.3 minutes due to First ScotRail).

83. The number of delay minutes due to First ScotRail has reduced by 43.6 per cent, from 577,000 in the previous operator's last full year of operating to 326,000 in 2007/08 (Exhibit 12).³⁶ During 2007/08 alone, First ScotRail and Network Rail reduced the number of delay minutes for which they were each responsible, by 12.4 and 16.2 per cent, respectively.

84. Transport Scotland inspectors conduct SQUIRE assessments at stations and on trains every four weeks. First ScotRail passed 93 per cent of its station inspections and 96 per cent of its train inspections in 2007/08. Both have increased since the previous operator's last full year of operating (2003/04), from 89 and 92 per cent, respectively.

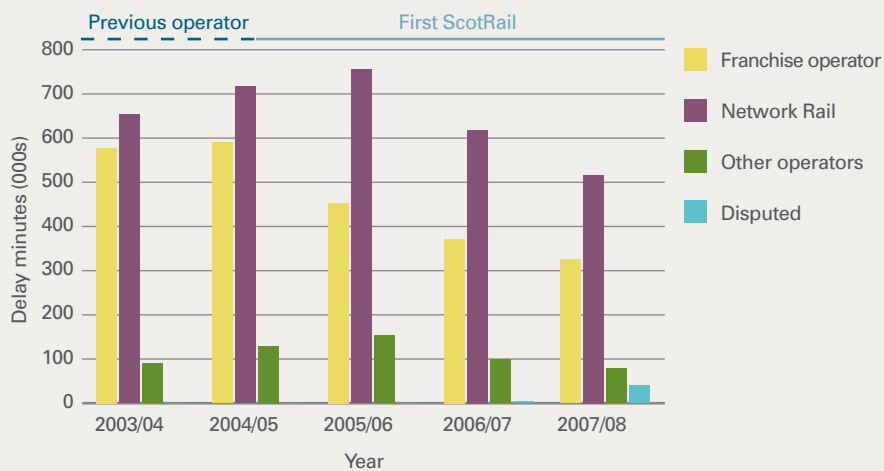
Exhibit 11
Responsibility for cancelled services



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.
Source: Transport Scotland and First ScotRail

Exhibit 12
Responsibility for delay minutes

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

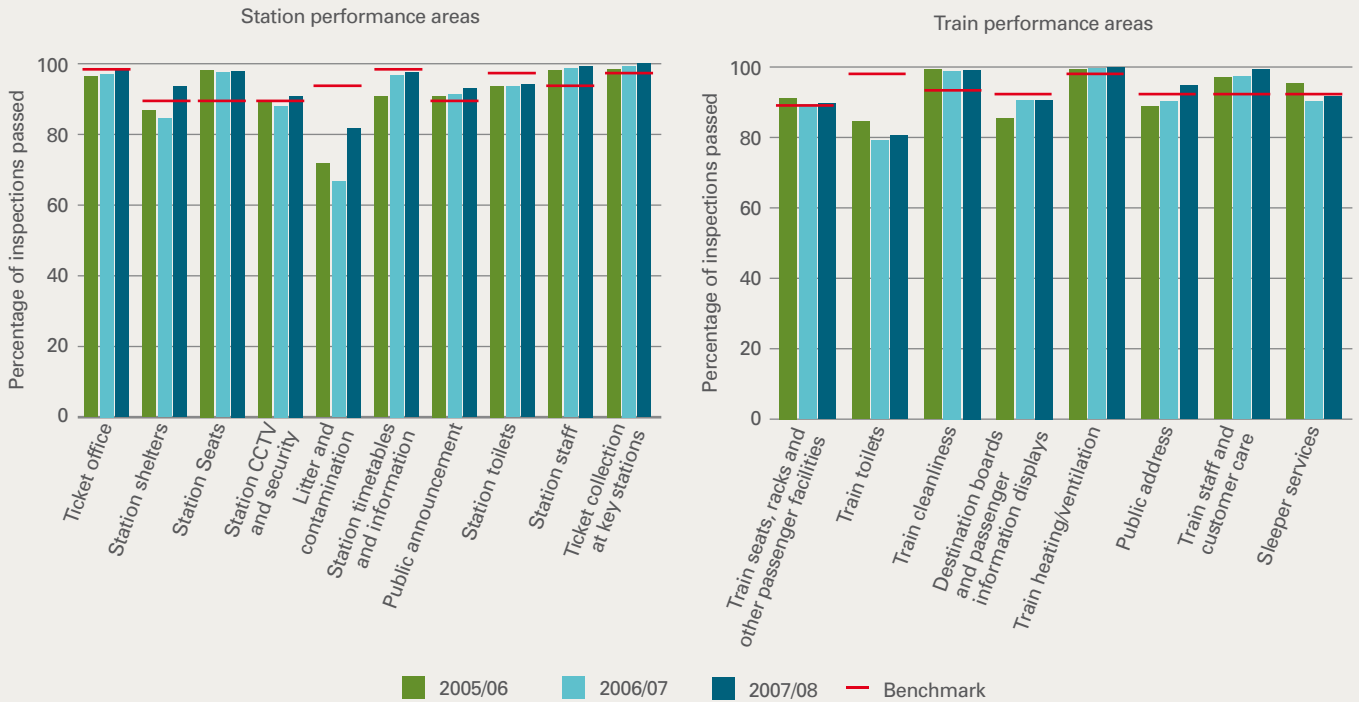


Note: 2003/04 was the previous operator's last full year of providing services, and 2004/05 is a mix of the previous operator and First ScotRail, which began operating in October 2004. Each year the responsibility for a small percentage of the delay minutes is disputed but resolved over time, therefore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

35 The likelihood for delays increases the longer the journey. However, additionally, many of the longer routes in Scotland cover areas of single tracks, with any delay occurring on these areas then affecting rail traffic in both directions. The long-distance sleeper runs at night, when most track work is conducted, which can delay services.
36 The 326,000 delay minutes in 2007/08 due to First ScotRail could increase to a maximum of 365,500 if all the disputed minutes are attributed to First ScotRail.

Exhibit 13

First ScotRail's service quality inspection performance for the areas on which passengers wish to see performance information, 2005/06 to 2007/08



Source: Transport Scotland

85. Twenty of the 36 service quality performance areas achieved performance above benchmark levels in 2007/08, compared with 15 in First ScotRail's first full year of operating (2005/06). Additionally, First ScotRail has demonstrated performance improvements in 22 of the 36 service quality performance areas since 2005/06. However, performance has declined in five of the service quality performance areas, with no change in the remaining nine areas (see [Appendix 3](#) for further details).

86. In 2007/08, all of the performance areas on which passengers wish to see performance information passed 90 per cent or more of their inspections, except for 'litter and contamination' at stations (82 per cent) and 'train toilets' (81 per cent) ([Exhibit 13](#)).³⁷

Passenger satisfaction has increased

87. Passenger Focus conducts a national survey of rail passenger satisfaction across Britain every six months. Of the 32 satisfaction areas included in the spring 2008 survey, First ScotRail achieved more than 75 per cent satisfaction in half of the satisfaction areas. The two highest areas of satisfaction were 'the length of time the journey was scheduled to take' (91 per cent) and 'how your request to station staff was handled' (89 per cent). However, less than half of First ScotRail's passengers were satisfied with the 'station facilities and services' (49 per cent), 'facilities for car parking' (44 per cent), 'train toilet facilities' (40 per cent) and 'how well the train company dealt with delays' (37 per cent).

88. First ScotRail achieved a significant increase in five satisfaction areas between spring 2007 and 2008, including overall satisfaction ([Exhibit 14](#)). Overall satisfaction increased from 83 per cent to 88 per cent, First ScotRail's highest rate of overall satisfaction to date. Satisfaction with car parking facilities, however, has decreased by 11 per cent to 44 per cent of First ScotRail passengers surveyed. Passenger Focus reports that passengers' dissatisfaction with car parking facilities is predominantly with the number of parking spaces available, rather than the way First ScotRail manages or maintains the spaces. Transport Scotland and First ScotRail are currently conducting feasibility studies into additional car parking.

37 These performance areas were identified in a summer 2006 customer research study commissioned by Transport Scotland.

Exhibit 14

Significant changes in First ScotRail's passenger satisfaction between spring 2007 and 2008

Satisfaction area	% of surveyed passengers satisfied			
	First ScotRail		Average across regional operators spring 2008	Average across Britain spring 2008
	Spring 2007	Spring 2008		
Overall satisfaction	83	88	84	80
Ticket buying facilities	75	82	79	71
Upkeep/repair of station buildings/platforms	66	76	69	62
Staff availability at stations	59	65	60	56
Punctuality/reliability	83	87	83	79
Car parking facilities	55	44	49	43

■ Significant increase ■ Significant decrease

Source: *National Passenger Survey*, Passenger Focus

89. First ScotRail achieved higher satisfaction levels than the British average for 31 of the 32 satisfaction areas in the most recent survey (spring 2008). Of passengers' eight main satisfaction areas, First ScotRail achieved higher satisfaction levels than the British average in seven areas and in six areas compared with the regional operators' average (*Exhibit 15*).^{38, 39} The satisfaction area below both the British average and the regional operators' average was 'connections with other forms of public transport', with 'value for money' below the regional operators' average.

90. Of the eight main satisfaction areas in the *National Passenger Survey*, First ScotRail's satisfaction levels have increased since the previous operator (last surveyed in spring 2004) for four of the areas:

- Overall satisfaction (from 84 per cent to 88 per cent).
- Providing information about train times and platforms (from 74 per cent to 80 per cent in spring 2005, with no significant change since).
- Punctuality and reliability (from 81 per cent to 87 per cent).
- Dealing with delays (from 31 per cent to 41 per cent in spring 2005, and no significant change since).
- Current satisfaction levels with the four remaining main satisfaction areas have not changed significantly since the previous operator.

91. First ScotRail has a *Passengers' Charter*, a complaints procedure and associated compensation arrangements. If a passenger is dissatisfied with First ScotRail's response to a complaint, Passenger

Focus can make an appeal complaint to First ScotRail on the passenger's behalf. The number of complaints received by First ScotRail between 2005/06 (its first full year of operating) and 2007/08 decreased by two per cent, from 3,905 to 3,826 complaints per 100,000 passenger journeys. In 2007/08, the four most frequent categories of complaints were train service performance (39.8 per cent), followed by quality on train (15.5 per cent), fares, retailing and refunds (14.8 per cent) and staff conduct and availability (11.4 per cent). These were also the top four complaint categories across Britain. Between 2005/06 and 2007/08, First ScotRail reported a 64 per cent increase in the number of compliments received, from 881 to 1,447.

Safety performance has improved

92. First ScotRail's safety incidents (injuries, assaults and unsafe practice) decreased by 18 per cent between 2005 and 2007, from 8.42 to 6.91 incidents per million passenger journeys.⁴⁰ Unsafe practice, passenger and staff safety incidents all decreased (by 17 per cent, 15 per cent and 32 per cent, respectively).

Passenger growth has exceeded targets

93. Since the start of First ScotRail's first full year of operating (2005/06) to the end of 2007/08, First ScotRail has experienced an average 5.8 per cent increase each year in the number of passenger journeys made on its services. This has exceeded the Scottish Government's target of a two per cent growth each year, and is similar to the growth experienced for Britain during this time (an average 5.7 per cent increase each year).⁴¹ The increase in First ScotRail's passenger numbers may be inflated by its efforts to address fare

38 The eight main satisfaction areas were identified through research by the Strategic Rail Authority in 2005; and Passenger Focus in 2007 assessing passengers' priorities.

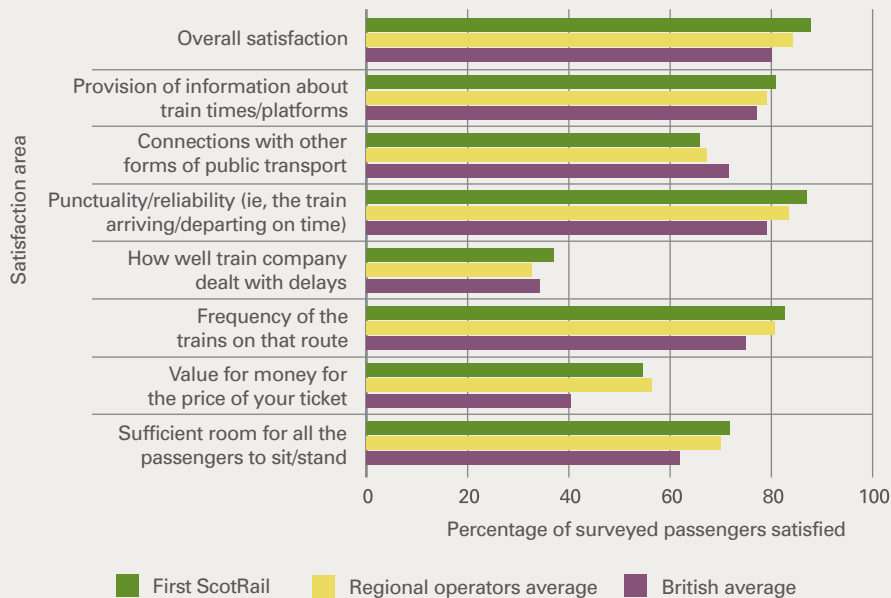
39 Passenger Focus categorises the operators into one of three groups: long distance; London and the South East; and regional operators. First ScotRail is classed as a regional operator (along with Arriva Trains Wales, Gatwick Express, Merseyrail and Northern Rail). Passenger Focus is currently reviewing the appropriateness of its categorisation of operators.

40 Safety performance is reported by calendar year while passenger journeys are by financial year. Therefore safety incidents per million passenger journeys uses the passenger journeys figure for the financial year commencing during that calendar year (eg, for 2005 safety incidents per million passenger journeys is calculated with the number of safety incidents in 2005 and the 2005/06 number of passenger journeys).

41 The Scottish Government's target for a two per cent growth in passenger journeys is not part of the franchise contract.

Exhibit 15

Passengers' eight main satisfaction areas, spring 2008



Source: *National Passenger Survey*, Passenger Focus

evasion, which is likely to have resulted in more accurate recording of passenger journeys.

Most capital improvements have been completed ahead of schedule

94. As part of its bid for the franchise, First ScotRail offered to fund a programme of capital improvements including station buildings and facilities improvements, new car parking spaces, CCTV and ticket machines. First ScotRail is required to spend £40 million on the capital programme during the first seven years of the contract.⁴²

95. By the end of March 2008, First ScotRail had spent £23.2 million on the capital investment programme. Transport Scotland reviews annual expenditure forecasts from First ScotRail to ensure the £40 million is spent by October 2011. The most recent forecast (from October 2007) indicates that the total capital investment programme spend, taking account of inflation, will be £43.9 million.

96. Most of the £23.2 million has been spent on fixtures, fittings and equipment (69 per cent), and improvements to stations (29 per cent). Of the 17 capital investment programme spend areas, six were completed by the end of March 2008, five of them ahead of the agreed completion date. However, improvements to the sleeper services were completed 14 months behind schedule. First ScotRail reports this was due to the initial timescales being underestimated.

First ScotRail's good working relationships with key rail sector bodies have also contributed to improved performance

97. The franchise contract sets out First ScotRail's co-operation and consultation requirements with other rail sector bodies. Network Rail, other rail operating companies, the British Transport Police (BTP), Passenger Focus and disability groups all reported that First ScotRail fulfils and

is pro-active in meeting and, in some cases, exceeding these obligations. For example:

- First ScotRail and Network Rail's co-located train running performance team work together to address delays.
- First ScotRail and the BTP conduct joint patrols. First ScotRail fully funds joint BTP and First ScotRail press releases and offers rewards for information to assist BTP investigations.
- Passenger Focus reported that First ScotRail promptly addresses issues arising out of the *National Passenger Survey*.
- First ScotRail has held an open day for other train operating companies to share good practice.

98. The Regional Transport Partnerships (RTPs) were established at different times. While the longer established RTPs have clearer communication and consultation arrangements with First ScotRail, all partnerships felt First ScotRail's consultation with them could be more formal, regular and timely. For example, they felt timetabling consultations were held too late in order for comments to be fed into the proposed timetable.

99. First ScotRail also reported that integrated transport can be hampered when connecting transport providers change their timetables without consulting First ScotRail in sufficient time to allow First ScotRail to accommodate the changes in its timetables. Currently, there is not an obligation across all public transport providers to consult with other affected transport providers when proposing service or timetable changes.

⁴² The £40 million investment in the capital programme is in 2004/05 prices. Annual payments towards the programme are RPI inflated accordingly.

First ScotRail has received a number of awards

100. First ScotRail has received a number of awards, including the National Transport Awards 'Public Transport Operator of the Year' (2006); the Scottish Transport Award (2007); the HSBC Rail Business Awards 'UK Train Operator of the Year' award (2008); and the Human Resources Excellence Awards 'Best Learning & Development Strategy' (2008).

101. First ScotRail's managing director has also received the Passenger Transport Management Awards 'Passenger Transport Professional of the Year' award (2008); the Quality Scotland 'Leadership Award' (2008); the Spirit of Scotland Awards 'Business person of the Year' award (2006); the Institute of Directors Scotland 'Director of the Year' award (2006); the Insider Elite Awards 'Businesswoman of the Year' award (2005); and the Scottish Transport Awards 'Young Professional of the Year' award (2005).

Recommendation

The Scottish Government should consider:

- introducing an obligation for all public transport providers to consult with other affected transport providers when proposing service or timetable changes to assist further integrated transport improvements.

Appendix 1.

Fares structure for First ScotRail passenger services

Fare type ¹	How fare price changes are determined ²
<p>Strathclyde Passenger Transport Area (SPTA) controlled fares</p> <p>Single and return fares, and weekly, monthly, quarterly, seasonal and annual season tickets for services between SPTA stations and designated services between SPTA stations and stations within 25 miles beyond the SPTA.³</p> <p>30.1% of fare revenue in 2007/08</p>	<p>Any increase or decrease in these fares is determined by Scottish ministers, and comes into effect in May each year.</p>
<p>Regulated commuter fares</p> <p>Covers the Edinburgh commuter zone.⁴</p> <p>8.2% of fare revenue in 2007/08</p>	<p>First ScotRail decides whether to increase or decrease these fares. However, the Scottish ministers' fares policy restricts the extent to which the fares can be increased (schedule 5 of the franchise contract provides further detail). Any increases in fares come into effect in January each year.⁵</p>
<p>Other regulated fares</p> <p>Off-peak returns and weekly, monthly, quarterly, seasonal and annual season tickets for services not covered by the regulated commuter fares and the SPTA controlled fares.</p> <p>14.5% of fare revenue in 2007/08</p>	<p>First ScotRail decides whether to increase or decrease these fares. However, the Scottish ministers' fares policy restricts the extent to which the fares can be increased (schedule 5 of the franchise contract provides further detail). Any increases in fares come into effect in January each year.</p>
<p>Unregulated fares</p> <p>All remaining fares – predominantly standard single, open return, and first class fares for services not covered by the commuter fares and the SPTA controlled fares.</p> <p>47.2% of fare revenue in 2007/08</p>	<p>First ScotRail decides whether to increase or decrease these fares. As the fares are unregulated, the Scottish ministers' fares policy does not place any restrictions on the extent to which these fares can be increased.</p>

Notes:

1. Scottish ministers can, via a variation to the franchise contract, change the number, content and/or geographical boundaries of the fares in each fare type, and regulate or specify fares for any passenger services. Performance benchmarks can be re-set if they are likely to become either harder or easier to achieve due to changes in passenger demand levels on affected services as a result of Scottish ministers' changes to fares.
2. First ScotRail requires Scottish ministers' consent for any other increases to regulated or controlled fares it wishes to apply in addition to that allowed, for example, if in connection with service improvements relevant to the particular fare/s.
3. SPTA stations include Glasgow Central High level, Prestwick International and any other west central Scotland stations as designated by the Strathclyde Passenger Transport Area (Designation) Order 1995.
4. This covers services within and including the boundary of Kirkcaldy, Glenrothes with Thornton, North Berwick (but not Dunbar), Addiewell, Bathgate, Falkirk High and Falkirk Grahamstone.
5. Transport Scotland and First ScotRail are currently considering options for all fares to come into effect in either January or May.

Appendix 2.

Membership of the project advisory group

Member	Organisation
Gary Bogan	Head of Network Relations and Futures, Transport Scotland
Ivor Jones ¹	Head of Rail Franchise Management, Transport Scotland
Mike Price	Head of Contracts, First ScotRail
Alan Scott ¹	Franchise Partnership Manager, First ScotRail
Jo Noble	Customer Relationship Executive for First ScotRail, Network Rail
Valerie Davidson	Assistant Chief Executive, Business Support, Strathclyde Partnership for Transport
Robert Samson	Passenger Link Manager for Scotland, Passenger Focus
Fiona McCall	Committee Member, Mobility and Access Committee for Scotland

Note: 1. Attended a project advisory group meeting when the designated member was not available.

Appendix 3.

Service QUality Incentive REgime (SQUIRE) performance areas

The full SQUIRE schedule service agreement is available on the Transport Scotland website www.transportscotland.gov.uk

The shaded performance areas indicate the areas that passengers wish to see performance information reported on.¹

The performance areas are ranked from highest to lowest in terms of the amount of penalty and payment points that can be awarded.

The benchmark is the target per cent of inspections to pass. First ScotRail incurs a penalty if less than the benchmark is achieved and receives a payment when it achieves more passes than the benchmark level.

Station performance areas	Benchmark %	2007/08 performance %	Improvement or decline since 2005/06 %
Graffiti	75	83	11
Station shelters and waiting areas	90	93	7
Ticket collection at key stations	97	100	2
Litter and contamination	95	82	10
Car parks and taxi ranks	90	95	9
Station lights	75	84	2
Station CCTV and security	90	91	1
Station posters	85	90	-1
Station seats	90	98	0
Station lifts and escalators	90	97	4
Public announcement and customer information systems	95	93	2
Ticket offices	99	98	2
Help points, telephones and ticket machines	90	87	3
Station fault/complaint record	95	89	8
Station toilets	97	94	0
Station staff	95	99	1
Landscaping and vegetation	90	99	0
Lost luggage	95	100	0
Station clocks	94	97	1
Station timetables and information	99	97	7

Note: 1. The performance areas were identified in a summer 2006 customer research study commissioned by Transport Scotland.

Train performance areas	Benchmark %	2007/08 performance %	Improvement or decline since 2005/06 %
Train cleanliness	96	99	0
Train seats, racks and other passenger facilities	90	90	-2
Train graffiti	99	97	15
Train lighting	95	93	-1
Ticket inspection on trains	97	99	2
Train posters/on-train information	90	99	0
Public address	95	95	6
Sleeper services	95	92	-4
Destination boards and passenger information displays	95	91	5
Train staff and customer care	95	99	2
Train toilets	99	81	-4
On-train CCTV	90	83	34
Train heating/ventilation	99	100	0
Train doors	99	95	0
Seat reservation system	95	98	0
On-train refreshment and food facilities	95	93	7

Other performance areas	Benchmark %	2007/08 performance %	Improvement or decline since 2005/06 %
Management and processes	100	100	Not assessed in 2005/06
Information provision away from stations	99	100	Not assessed in 2005/06

The First ScotRail passenger rail franchise

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