East Coast Early Franchise Termination

The UK Department for Transport has decided there will be an *early franchise termination* of the East Coast InterCity contract which covers the operation of one of Britain's principal main line routes. The franchise is held by a consortium led by Stagecoach with the Virgin group holding a minority interest. It commenced in March 2015 and covered an 8-year period to 2023 but will now end in 2020. The company is operated as Virgin Trains East Coast (VTEC) with trains branded accordingly.

There was an ambitious premium profile with a commitment to make payments to the Government totalling £3.3 billion over the contract period which represented a requirement to increase passenger numbers by 50% producing revenue growth of close to 10% per annum. From the start, results lagged behind the required trend although a replacement train fleet is due in service from 2019 which offers the opportunity to serve new destinations and increase service frequency.

The result was the £325 million premium payment due last year could not be funded from the operating profit and looking ahead the requirement to pay £424 million in 2021, £516 million in 2022, and £594 million in 2023 was unsustainable.

The Government had been reluctant to allow *early franchise termination* although it had the option of either transferring responsibility to its 'operator of last resort' SNC Lavalin or reviving the concept of Directly Operated Railways where the DfT assumed management control of the business. This had been the response when the previous franchise holder, National Express, defaulted in November 2009.

Current Government policy is to move towards greater integration of the provision of infrastructure and train services which started with creation of alliances between Network Rail and the main Train Operating Company on the route concerned.

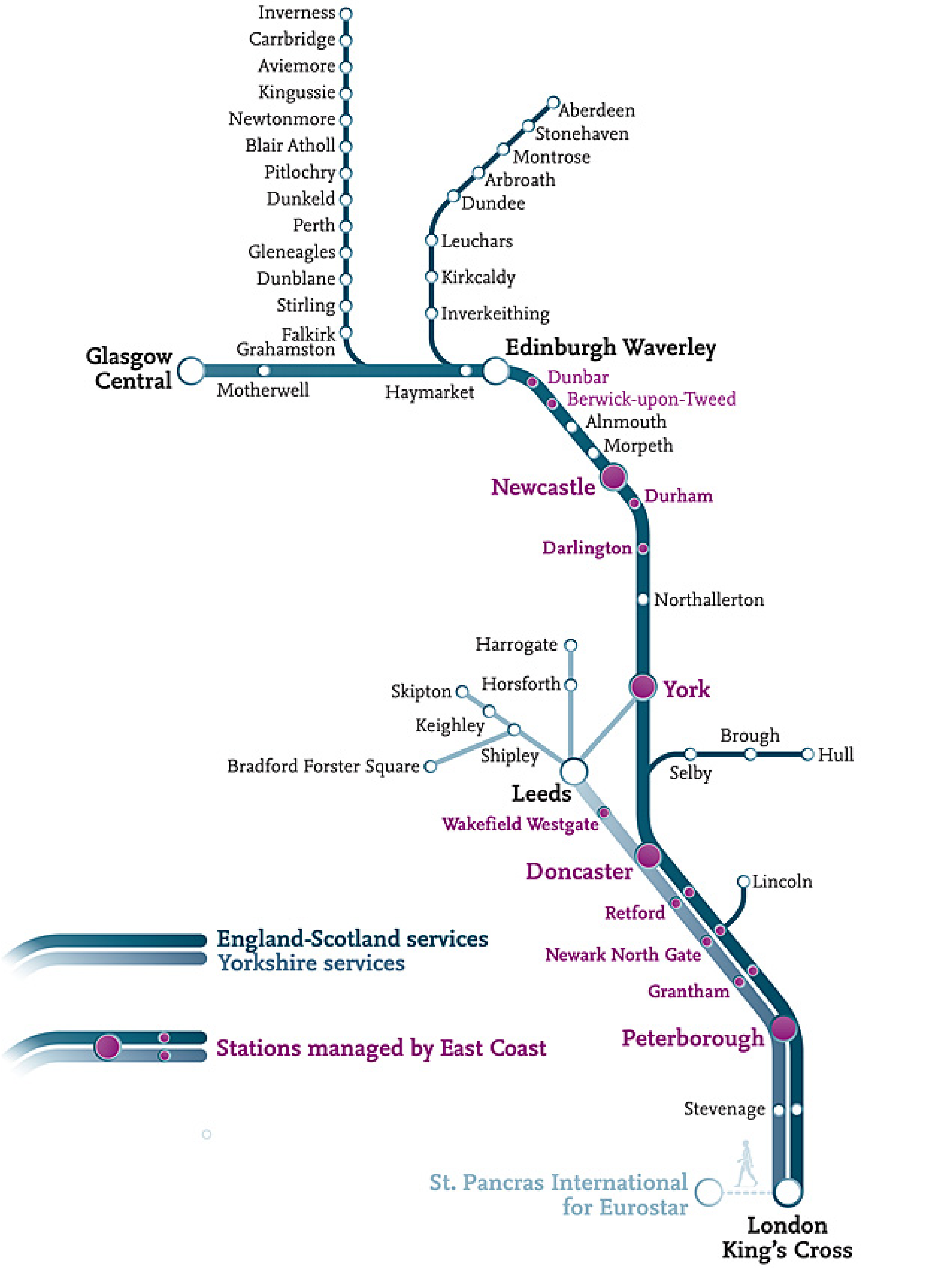
This has not always been workable as there was a corporate governance conflict between NR and the TOC and as a result the concept of a supervisory board has been adopted where freight operators and stakeholder representatives are included. A change of management control from NR Headquarters to Route Managers has also improved the process.

For East Coast the Government decided to opt for e*arly franchise termination* so that a more deeply integrated arrangement could be implemented with formal control vested in a Joint Board with a Chief Executive responsible for running the integrated business rather than a structure confined to an advisory role.

A new train operator will be chosen by competitive tender which will require a lot of work to be done to decide how the revenue risk is allocated if the unsuccessful structure of the Thameslink Southern and Great Northern contract is to be avoided. Here the franchise holder has a cost budget which has no regard to any revenue implications with the resulting temptation to save money by downgrading the product the customer receives.

Looking to the future it is of note that the most recent franchise Invitation to Tender for South Eastern has revived the ‘cap and collar’ regime. This provides that if revenue falls below 97% of what is forecast the Government will underwrite 80% of the shortfall and if it exceeds 103% the Government will be the beneficiary of 80% of the additional revenue.

In this increasingly complex and to an extent unpredictable environment strong expertise is needed which FCP can offer to both contract specifiers and operational businesses.


Inverness
Carrbridge
Aviemore
Kingussie
Newtonmore
Blair Atholl
Pitlochry
Dunkeld
Perth
Gleneagles
Dunblane
Stirling
Falkirk Grahamston
Aberdeen
Stonehaven
Montrose
Arbroath
Dundee
Leuchars
Kirkcaldy
Inverkeithing
Glasgow Central
Motherwell
Haymarket
Edinburgh Waverley
Dunbar
Berwick-upon-Tweed
Alnmouth
Morpeth
Newcastle
Durham
Darlington
Northallerton
Harrogate
Horsforth
Skipton
Keighley
Shipley
Bradford Forster Square
York
Brough
Hull
Selby
Leeds
Wakefield Westgate
Doncaster
Lincoln
Retford
Newark North Gate
Grantham
Peterborough
Stevenage
St. Pancras International for Eurostar
London King's Cross
England-Scotland services
Yorkshire services
Stations managed by East Coast