

PROVISION OF RAIL PASSENGER SERVICES (SCOTLAND) BILL

EXPLANATORY NOTES

(AND OTHER ACCOMPANYING DOCUMENTS)

CONTENTS

1. As required under Rule 9.3 of the Parliament's Standing Orders, the following documents are published to accompany the Provision of Rail Passenger Services (Scotland) Bill introduced in the Scottish Parliament on 29 September 2006:

- Explanatory Notes;
- a Financial Memorandum; and
- the Presiding Officer's Statement on legislative competence.

A Policy Memorandum is printed separately as SP Bill 78-PM.

EXPLANATORY NOTES

INTRODUCTION

2. These Explanatory Notes have been prepared on behalf of Tommy Sheridan MSP, the member in charge of the Bill, in order to assist the reader of the Bill and to help inform debate on it. They do not form part of the Bill and have not been endorsed by the Parliament.

3. The Notes should be read in conjunction with the Bill. They are not, and are not meant to be, a comprehensive description of the Bill. So where a section or schedule, or a part of a section or schedule, does not seem to require any explanation or comment, none is given.

THE BILL

4. The Bill directs the Scottish Ministers as to how they shall exercise powers conferred upon them under Part 1 of the Railways Act 1993 (as amended by the Railways Act 2005) (hereinafter referred to as “the 1993 Act”). Under the 1993 Act as amended the Scottish Ministers are the “appropriate franchising authority” and the “relevant franchising authority” in relation to the provision of rail passenger services in Scotland. In particular, in exercise of those powers the Scottish Ministers must from time to time issue invitations to, and consider tenders for the provision of rail passenger services in Scotland. Under the 1993 Act the Scottish Ministers may grant the franchise to an organisation who submitted a tender. Section 26ZA was introduced as an amendment to the 1993 Act by the 2005 Act. The section deals with the situation where no adequate tender is received by the appropriate franchising authority. The section defines 2 situations where it is to be considered that no adequate tender has been received:

- “(a) *the appropriate franchising authority receives no tender in response to the invitation; or*
- (b) *it receives a tender but considers that the services would be provided more economically and efficiently if they were provided otherwise than under a franchise agreement entered into in response to the tender.*”¹

In those circumstances the appropriate franchising authority has three options. They may:

- “(a) *issue a new invitation to tender under section 26 for the provision of the services;*
- (b) *decide to secure the provision of the services under a franchise agreement with a person who did not submit a tender; or*
- (c) *decide not to seek to secure the provision of the services under a franchise agreement.*”²

5. Under the 1993 Act the Scottish Ministers may not operate rail passenger services as a franchisee³. However, the Scottish Ministers have an absolute duty to act as the operator of last

¹ Section 26ZA(1)(a)&(b) of the 1993 Act

² Section 26ZA(2)(a),(b)&(c) of the 1993 Act

³ Section 25 of the 1993 Act. Indeed, neither the Scottish Ministers nor any other emanation of the state may submit a tender under Part 1 of the 1993 Act

resort, and accordingly of rail passenger services, in certain circumstances⁴. Thus, where the Scottish Ministers receive no adequate tenders and where they decide not to seek to secure the provision of the services under a franchise agreement under section 26ZA(2)(c) of the 1993 Act they must act as operator of last resort under section 30 of the 1993 Act.

6. The Bill defines the criteria the Scottish Ministers must apply when issuing and considering tenders for the provision of rail passenger services in Scotland. It defines how the Scottish Ministers shall interpret and apply section 26ZA(1) of the 1993 Act and accordingly when they shall conclude that “services would be provided more economically and efficiently if they were provided otherwise than under a franchise agreement entered into in response to the tender”. The Bill further directs that where the Scottish Ministers receive no adequate tender, either because no tenders are received or by operation of the provisions of the Bill which defines the term “economically and efficiently”, they shall act as operator of last resort by reason of section 30 of the 1993 Act.

7. Section 1 of the Bill directs when the Scottish Ministers shall conclude that rail passenger services shall be provided more economically otherwise than under a franchise agreement. The section contains 2 tests against which any tender must be judged. If either test is met the Scottish Ministers shall conclude that services shall be provided more economically and efficiently otherwise than under a franchise agreement. The tests are explained in further detail below. In short, a tender will only pass the legislative test and be capable of winning the tender if the company (which in practice is likely to be a company specifically created to hold the franchise, whether it is a sub-division of a larger company or not) intends to operate the franchise on not for profit basis and without issuing dividends and similar emoluments to its directors. For the avoidance of doubt, any organisation is capable of lodging a tender which could not be rejected by the Scottish Ministers under the operation of the Bill. If a company, partnership, sole trader or any other organisation lodged a tender which met with the not for profit test contained with the Bill, that organisation could not have its tender rejected under the operation of section 1(2) of the Bill and indeed would be likely to be awarded the tender. The second test contained in section 1(3) is however such that a tender could not be rejected on the basis of section 1(2) but could still be rejected because the Scottish Executive concludes that it could operate the service at an equivalent or better standard with the same revenue or less.

8. Thus, the effect of the Bill will be that rail passenger services will be operated by an organisation on a not for profit basis or by the Scottish Ministers as the operator of last resort.

9. The Bill consists of 8 sections as follows:

- sections 1 and 2 define the factors the Scottish Ministers must apply when considering tenders for the provision of rail passenger services and directs the Scottish Ministers as to the circumstances when they shall run the services themselves as an operator of last resort;
- sections 3 and 4 deal with the duration for which the Scottish Ministers may run rail passenger services as an operator of last resort and how this affects other obligations upon the Scottish Ministers in relation to this issue; and

⁴ Sections 26ZA & 30 of the 1993 Act

- sections 5 to 8 deal with certain general and supplementary provisions.

COMMENTARY ON SECTIONS

Section 1: Circumstances where rail passenger services to be deemed to be provided more economically and efficiently if provided otherwise than under a franchise agreement

10. This section provides two separate tests. They are contained in subsection (2) and subsection (3). If either test is met subsection (1) directs that the Scottish Ministers must conclude that rail passenger services would be provided more economically and efficiently than if provided otherwise under a franchise agreement.

11. The first test is contained in subsection (2). This test will be met where tenders are framed in such a way that the franchised service, in the event of the Scottish Ministers issuing a franchise agreement, would be run for profit or where dividends or similar payments are made to shareholders, directors or other relevant stakeholders. If the tender document is framed in that way the Scottish Ministers shall conclude that rail passenger services would be provided more economically and efficiently if they were provided otherwise than under a franchise agreement. If a tender document is framed such that the potential franchise operator intends to run the franchise service on a not for profit basis and does not intend to pay dividends or similar payments to directors then there is no reason why the Scottish Ministers should not enter into a franchise agreement with the author of the tender by reason of subsection (2). Indeed, subject to subsection (3), it would be very likely that a company which lodges such a not for profit tender will be granted the franchise.

12. The second test is contained in subsection (3). This section provides that where the Scottish Ministers could operate rail passenger services at an equivalent or better standard for the same level of revenue, or less, than the level of service likely to be provided under a tender, then again, the Scottish Ministers shall conclude that the provision of services would be provided more economically and efficiently if they were provided otherwise than under a franchise agreement.

13. While the two tests are closely related they are independent from one another. There will certainly be cases where tenders shall be unacceptable to the Scottish Ministers because of both tests. There will however be occasions where a tender will only be unacceptable because of the operation of one test. For example, a tender may be framed in such a way that it is intended for rail passenger services to be provided under a service which shall not be run for profit and where no dividends will be paid (and accordingly where there is no reason why the Scottish Ministers should not enter into a franchise agreement by reason of subsection (2) but where the Scottish Ministers could operate the service at an equivalent or better standard and accordingly a franchise agreement should not be entered into by operation of subsection (3) only.

Section 2: Circumstances where the Scottish Ministers to operate rail passenger services

14. Under the 1993 Act in the event of the Scottish Ministers receiving no adequate tender because they consider the provision of rail passenger services would be provided more economically and efficiently if provided otherwise than under a franchise agreement, or no tenders are received at all, they have several options open to them. They may enter into a

franchise agreement with someone who did not submit a tender in the first place. They may also invite fresh tenders and start the process again. Finally, under the 1993 Act the Scottish Ministers may decide not to secure the provision of services under a franchise agreement at all and may instead run the service themselves as an operator of last resort. This section directs that the Scottish Ministers shall not pursue any other option if no adequate tender is received and shall instead operate the services themselves as an operator of last resort.

15. The section also contains provisions in relation to the length of time which Scottish Ministers shall operate rail passenger services as the operator of last resort. The Bill directs that where the Scottish Ministers take control of rail passenger services by operation of this section they shall run the service for 7 years which is the period of existing franchise agreements under the 1993 Act. Subsection (2) allows the Scottish Ministers to vary that period but contains a lower limit proviso by directing that the Scottish Ministers may not reduce the period to less than 4 years.

Section 3: Effect of Act upon other obligations on Scottish Ministers to issue tenders

16. Under Part 1 of the 1993 Act it is the duty of the Scottish Ministers “from time to time” to designate services to be provided under franchise agreement and to invite tenders for such franchise agreements. This section of the Bill acknowledges that duty and acknowledges that the Bill does not seek to alter or affect the Scottish Ministers obligation to do so from time to time. It also acknowledges that other legislation may seek to limit the length of time the Scottish Ministers may act as an operator of last resort and confirms that the Bill does not seek to fully extinguish such obligations. This section however directs that notwithstanding other obligations the Scottish Ministers shall operate rail passenger services as an operator of last resort for the period set out in section 3.

Section 4: Calculating the length of time the Scottish Ministers run rail passenger services

17. This section sets out how to calculate the period of time for which the Scottish Ministers run passenger services from time to time. The section confirms that where after running rail passenger services as an operator of last resort the Scottish Ministers invite tenders and, again by operation of the Bill, assume control of rail passenger services this will be deemed to be a new period during which the Scottish Ministers run rail passenger services as an operator of last resort and no account shall be taken of the previous period even where the two periods run consecutively. This section is required because other enactments contain restrictions upon the length of time that passenger rail services may be run by an operator of last resort. The purpose of the section is to ensure that when measuring the length of time the Scottish Ministers may operate passenger rail services against those provisions, the Scottish Ministers are not deemed to have acted as operator of last resort for period which contravenes those other enactments by reason of having operated passenger rail services for consecutive periods.

Section 5: Orders

18. This section directs that where the Scottish Ministers seek to alter the period referred to in section 2(2) they must do so by statutory instrument which must be passed by a resolution of the Scottish Parliament.

Section 6: Interpretation

19. This section defines certain expressions used in the Bill or refers to the provision in the Bill or other legislation where the expression is defined.

20. Section 7: Commencement and the Bill to come into force on the 1st of June 2007. Subsection (2) makes it clear that the Bill is not retrospective and does not apply to any franchise agreement in existence at the time the Bill comes into force. Such a pre-existing franchise shall continue until its natural contractual conclusion.

Section 8: Short title

21. This section gives the short title to the Bill.

FINANCIAL MEMORANDUM

INTRODUCTION

22. This memorandum relates to the Provision of Rail Passenger Services (Scotland) Bill introduced in the Scottish Parliament on 29 September 2006. The memorandum has been prepared by Tommy Sheridan MSP, the member in charge of the Bill, to satisfy Rule 9.3.2 of the Parliament's Standing Orders. It does not form part of the Bill and has not been endorsed by the Parliament.

23. Between 1994 and 1997, British Rail's passenger services were divided into 25 separate franchises. On 31 March 1997, just over a month before the General Election, ScotRail became the last of the franchises to be privatised. Public subsidy was then paid to those private train operators who had successfully bid to provide passenger services. The rolling stock was to be leased from three private train leasing companies, all of which are now owned by major international financial institutions.

24. To run their passenger services the train operators paid track access charges to the newly created infrastructure controller, Railtrack (now Network Rail). Hundreds of engineering and infrastructure companies were contracted and sub-contracted to maintain and renew the railway infrastructure. Freight services were also sold off to private interests.

25. There are no direct additional costs resulting from the provisions of the Bill. The Scottish Executive will be expected to continue to subsidise the rail passenger services currently operated by ScotRail by an amount no more than and probably less than the subsidy expected under the current arrangements.

26. A parliamentary reply from 6 Jun 2006 indicates that the level of public subsidy due to be paid for the existing ScotRail franchise will be as follows;

Tommy Sheridan (Glasgow) (SSP): *To ask the Scottish Executive what subsidy has been paid to First ScotRail to operate the ScotRail franchise in each year since 2004-05 and how much will be paid to operate the franchise in each year to 2011.*

(S2W-26143)

Tavish Scott:

The ScotRail franchise payments are as follows:

2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
£103.14m	£187.15m	£261.69m	£261.69m	£270.37m	£269.19m	£267.08m

All figures shown above (with the exception of 2005-06) are specified in the franchise agreement, are expressed in 2004 prices, subject to indexation and will vary according to performance payments/penalties. The 2005-06 figure is actual. The SRA/SPT was responsible for subsidy payment at the time of the 2004-05 payment.

27. The provisions of the Bill will take effect when the current ScotRail franchise expires in 2011. The level of public funding for post 2011 Scottish passenger rail services has yet to be decided by the Scottish Executive.

COSTS ON THE SCOTTISH ADMINISTRATION

28. There will be little cost to the Scottish Administration. Indeed, given that the profits currently taken out of the industry by private franchise holders will after 2011 remain in the industry to be re-invested, the Scottish Administration will save money. For information on First ScotRail profits see paragraph 48.

29. The current ScotRail franchise, operated by First Group, began on 17 October 2004 and will run for seven years with the possibility of a three-year extension. The 20 August 2004 Strategic Rail Authority press release announcing the franchise award indicated that the total subsidy for the seven-year period would be £1.9 billion at 2004 prices.

30. Between 1997-98 and 2004-05, when services were operated by the National Express Group, public subsidies of to £1.9 billion were made to the ScotRail franchise.⁵

31. This means that since 31 March 1997 £3.8 billion of public money has been paid or is committed to be paid to private sector companies to run ScotRail passenger services.

32. Transport Scotland recently provided Tommy Sheridan MSP an explanation of how the private franchising operation works in Scotland. The explanation includes:

The contract is a fixed price “deal” to operate rail services on behalf of the Ministers. The Ministers specify the service level, quality etc and in response the bidders for the franchise show, via a financial model, the price for which they are willing to operate the franchise.

⁵ Scottish Parliament written reply 6 September 2005

(b) Simply put the model is an equation:

Costs + profit – revenue (mainly fares) = subsidy.

(c) Costs are the bottom-up rolling stock, staff, access charge and other costs of operating the service level specified.

Profit is the level of profit the franchisee is looking for to deliver the contract.

Revenue is the level of fares and other incomes the franchisee is forecasting for the 7 years of the contract.

Each of these assumptions was tested and ultimately contractualised in the financial model in the contract. Because the figure generated is a minus, a subsidy is required (of circa £2bn over 7 years). Accordingly there is in truth no absolute “contribution” from First ScotRail, this being a contract for services requiring a subsidy rather than say an infrastructure contract or other joint venture.

33. Simply put this financial model amounts to the following equation: Costs + Profit – Revenue (Mainly fares) = SUBSIDY. Thus taxpayers and farepayers pay the private company, First ScotRail, to manage the rail services under certain specifications and with a guaranteed level of profit.

34. Indeed, recent reports reveal that First ScotRail is generating sizeable operating margins. The May 2006 issue of Modern Railways magazine reports that in 2004/05 First ScotRail showed an operating margin of 5.8% on a turnover of £183.1 million. On 17 May 2006 First Group published their preliminary results for the year to 31 March 2006. Across the whole group UK rail operating profits rose by 23% to £79.6 million.⁶ Press reports indicate that ScotRail’s contribution was a full-year profit of £13 million.⁷

35. The member in charge of this Bill concludes that if these profit levels were to be removed from the franchising equation then rail services in Scotland could be run directly by Scottish Ministers, or by another not-for-profit organisation, for less public subsidy than that currently being paid to the franchise holder.

36. In terms of tendering costs a Westminster Parliamentary reply of 7 June 2004 indicates that at that time the Strategic Rail Authority had spent £2.8 million on tendering the ScotRail franchise. It was expected that final costs would be £3.9 million which would include prudent provisions for evaluation and completion expenditure. The member in charge of this Bill would expect a large part of the £3.9 million to be saved by the Scottish Administration should the provisions of this Bill be enacted.

Margins of uncertainty

37. The member in charge of the Bill considers that the following margins of uncertainty should be taken into account.

⁶ First Group preliminary results for the year to 31 March 2006 available at www.firstgroup.com

⁷ The Scotsman, Thursday 18 May 2006

38. Should there be significant rises in fuel prices these costs will be borne by the publicly operated or not-for-profit provider. Given that public subsidy currently accounts for around half of the cost of operating passenger services – this will continue to be the case in the future - significant unforeseen rises in fuel prices would be borne by the Scottish Executive. Rises in fuel costs are currently borne by the franchisee.

39. Shortfalls in fare-box revenue would also be borne by the Scottish Executive. The following parliamentary reply of 31 May 2006 sets out the current arrangements in relation to fare box revenue:

Tommy Sheridan (Glasgow) (SSP): *To ask the Scottish Executive what proportion of the excess revenue collected from rail ticket fares is (a) retained by the operator and (b) passed on to the Executive.*

Tavish Scott: *The annual level of target revenue in the franchise agreement was determined as part of the franchise bidding process. This target revenue level is commercially confidential.*

Revenue collected in excess of the target revenue is split between the operator and the Scottish ministers on the following basis:

<i>Target Revenue Exceeded By:</i>	<i>% Retained by Operator</i>	<i>% Retained by Scottish Ministers</i>
<i>More than 2%</i>	<i>50%</i>	<i>50%</i>
<i>More than 6%</i>	<i>20%</i>	<i>80%</i>

This information has been published by the Executive in the Public Register for the ScotRail franchise agreement and is available in the Scottish Parliament Information Centre.

40. The August 2006 Network Rail Scotland Route Utilisation Strategy indicates that demand forecasting projections are for an up to 3% per annum growth in passenger demand throughout the next ten years across a number of services within the Scotland RUS area.

41. The member in charge of the Bill broadly concurs with these demand forecast projections and therefore does not foresee significant short-falls in fare box revenue for post 2011 rail passenger services. Any revenue collected in excess of the target revenue would remain with the post 2011 not-for-profit operator.

42. A publicly owned or not-for-profit operator would also bear the cost of providing new livery for passenger rolling stock as well as the provision of new staff uniforms. Previously these costs were borne by the franchise holder, who did however, continue to make a profit. The member in charge of the Bill anticipates a not-for-profit operator would be able to absorb these costs within its operating margins and there would be no cost to the Scottish Executive.

43. A board for a new not-for-profit company may need to be created. The costs of a board are in part included in the operating costs of the existing franchisee, however, if a new body were to be established some additional costs may be required for board members.

44. The establishment of a publicly owned or not-for-profit operator could present the opportunity for favourable negotiations with rolling stock leasing companies (ROSCOs) over longer leases of rolling stock than that available to the current franchise holder. This could provide an opportunity for cost savings, although the amounts involved are impossible to quantify as they would be subject to commercial confidentiality. It would however be hoped that a publicly owned or not-for-profit operator would introduce greater financial transparency to the process than is currently the case.

45. A publicly owned or not-for-profit operator could possibly choose to purchase and maintain their own trains, with the opportunity for savings as they would be not paying for the profits of the privately owned ROSCOs.

COSTS ON LOCAL AUTHORITIES

46. Local authorities do not fund Scottish rail passenger services. There will therefore be no expected costs to Scottish local authorities. In addition there will be no expected costs to Regional Transport Partnerships.

COSTS ON OTHER BODIES, INDIVIDUALS AND BUSINESSES

47. Loss of possible future profits will accrue to the private passenger rail provider who may have expected to operate passenger services post 2011 and thereby make profits and pay shareholder dividends based on their control of the franchise. However, the award of a tender to a private operator would not be guaranteed under existing tendering rules. These future profits would for any given operator be classed as hypothetical, qualified by a high degree of risk.

48. The May 2006 issue of Modern Railways magazine reported that in 2004/05 First ScotRail showed an operating margin of 5.8% on a turnover of £183.1 million. In their response to the consultation process First ScotRail said that post-tax profits in the year to 31 March 2006 were some £8.3 million and that the company make a margin of 2.1% on the operating cost of the franchise.

49. There will be no expected costs to the rail infrastructure controller Network Rail, the Office of Rail Regulation, Virgin West Coast, Virgin Cross Country, Great North Eastern Railways or to the freight operating companies.

PRESIDING OFFICER'S STATEMENT ON LEGISLATIVE COMPETENCE

50. On 28 September 2006, the Presiding Officer (Right Honourable George Reid MSP) made the following statement:

*These documents relate to the Provision of Rail Passenger Services (Scotland) Bill (SP Bill 78)
as introduced in the Scottish Parliament on 29 September 2006*

“In my view the provisions of the Provision of Rail Passenger Services (Scotland) Bill are not within the competence of the Scottish Parliament.

The reason for this view is that in my opinion the provisions of the Bill relate to the provision and regulation of railway services, a matter reserved under Section E2 of Schedule 5 to the Scotland Act 1998. Section 29(2)(b) of that Act states that a provision is outside the legislative competence of the Parliament if it relates to reserved matters.”

*These documents relate to the Provision of Rail Passenger Services (Scotland) Bill (SP Bill 78)
as introduced in the Scottish Parliament on 29 September 2006*

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Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by Astron.

ISBN 1-4061-2626-8

