Board

TRANSPORT FOR LONDON
EVERY JOURNEY MATTERS

Date: **17 March 2016**

Item: **London Overground Train Operating Concession**

This paper will be considered in public

1 Summary

1.1 The purpose of this paper is to update the Board on the procurement process being undertaken by Rail for London (RfL) for the next concession agreement to operate London Overground passenger train services from November 2016 (the Concession Agreement) and seek approval to enter into the Concession Agreement.

1.2 On 2 March 2016, the Finance and Policy Committee endorsed the recommendations in this paper.

1.3 A paper is included on Part 2 of the agenda, which contains exempt supplementary information. The information is exempt by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 in that it contains information relating to the business affairs of TfL. Any discussion of that exempt information must take place after the press and public have been excluded from this meeting.

2 Recommendations

2.1 The Board is asked to note this paper and the supplementary information on Part 2 of the agenda and:

(a) approve entry into the Concession Agreement and ancillary agreements (the Concession Agreements) with the bidder identified in the paper on Part 2 of the agenda;

(b) authorise the TfL Officers and Subsidiaries described in paragraph 2.2 below to finalise the terms of the Concession Agreements;

(c) authorise the agreement and execution (whether by deed or otherwise on behalf of TfL or any Subsidiary as appropriate) of any documentation to be entered into in connection with the completion and implementation of the Concession Agreements and any of the matters referred to therein (including, without limitation, all agreements, deeds, guarantees, indemnities, property or other licences, announcements, notices, contracts, certificates, letters or other documents); and

(d) **authorise TfL Officers and Subsidiaries to do all such other things as they consider necessary or desirable to facilitate the execution and implementation of the Concession Agreements and the matters referred to in them.**

2.2 The following Officers and Subsidiaries shall have authority:

(a) **TfL Officers: the Commissioner, Chief Finance Officer, Managing Director Rail and Underground and General Counsel; and**

(b) **Subsidiaries: Subsidiaries of TfL including Transport Trading Limited and any other subsidiary (whether existing presently or to be formed) of Transport Trading Limited and any of the directors of the relevant company shall be authorised to act for and on behalf of that company.**

3 Background

3.1 London Overground is the network of urban and suburban rail services that is managed by TfL. The network was formed on 11 November 2007 when the franchise for the North London Railway routes run on Network Rail infrastructure was devolved to TfL, having previously been operated by Silverlink Metro. In November 2007 London Overground Rail Operations Ltd (LOROL), a 50/50 joint venture between Arriva UK Trains and MTR Corporation[1], was awarded the concession to operate London Overground services for a period of seven years with a two year extension. In 2013 TfL exercised the option to extend the concession until November 2016.

3.2 London Overground has successfully supported the Mayor’s case for rail devolution, building on significant TfL investment that will continue into the next concession with the introduction of a new fleet of Class 710 trains (the LOTRAIN), a programme of station upgrades, the electrification of the Gospel Oak to Barking line, potential route extensions to developments at Barking Riverside and Old Oak Common and further anticipated train service enhancements.

3.3 In May 2015, metro services between Liverpool Street and Enfield Town, Cheshunt (via Seven Sisters) and Chingford, as well as the Romford to Upminster branch line service, were devolved to TfL, having previously formed part of the Greater Anglia Franchise (GAF). These services are currently operated by LOROL under a variation agreement to their existing concession.

3.4 In March 2015 RfL issued a notice in the Official Journal of the European Union to commence a procurement process to appoint the next operator (Operator) to operate London Overground services via a new Concession Agreement. The concession term will cover an initial period of seven and half years with a pre-priced option exercisable by RfL to extend by up to two years at RfL’s discretion, placing the end date of the concession between March 2024 and March 2026.

[1] Formerly a joint venture between MTR and Laing Rail with the latter bought by Deutsche Bahn AG in 2008, the parent of Arriva UK Trains.

4 The Scope of the Concession Agreement

4.1 The Concession Agreement will cover the operation of the London Overground Services over existing networks including those devolved in May 2015. RfL has reviewed lessons learned and best practice for similar arrangements in TfL (such as the Crossrail concession and the Docklands Light Railway franchise) and from the wider franchising market. This has informed the scope and structure of the Concession Agreement, a summary of which is set out below, and procurement and approvals processes which are described further in this paper.

4.2 The procurement to appoint an Operator began 18 months ago and included a process of consultation that has involved the interests of TfL's customers through London Travelwatch's involvement in both the initial consultation and the technical evaluation of bidders'' customer experience delivery plans.

Operations

4.3 The Concession Agreement will cover all aspects of train and station operations over the London Overground network. Whilst RfL will retain responsibility for specifying service levels, the Operator will be required to develop timetables that offer convenience to customers, including coordination of connecting services with other operators.

Train Services

4.4 The new Concession Agreement includes a number of pre-priced options for introducing additional services (Service Increments) on many routes including: extended evening and weekend services, Boxing Day and New Year's Eve services, increased service frequencies between Clapham Junction and Stratford and East London Line routes, and the introduction of all-night running on Friday and Saturday nights between Highbury & Islington and New Cross Gate.

4.5 The Operator will be required to support Bombardier in the testing and commissioning activities related to the introduction of the LOTRAIN fleet.

Interfaces

Infrastructure

4.6 London Overground services operate over infrastructure owned by RfL and Network Rail. RfL is responsible for sections of track between Dalston Junction station and New Cross station, New Cross Gate station and the junction immediately south of Surrey Quays station collectively known as the East London Line Core Route (ELL Core).

4.7 Network Rail is responsible for all other sections of the London Overground network and the Operator will be required to enter into a Track Access Agreement (TAA) and pay charges set by the Office of Rail and Road (ORR) for these sections of the railway. RfL retains a right in the Concession Agreement to direct the Operator in these negotiations if required.

4.8 The TAA will not only govern the level of access and associated charges payable but also set benchmarks and financial incentives in relation to Network Rail's performance. The process for agreeing the TAA will be controlled and ultimately approved by the ORR[2].

4.9 In relation to Network Rail's performance, this includes being satisfied that Network Rail is adequately and continuously incentivised to improve performance, whilst not discriminating between train operating companies. In addition, the ORR will also ensure reasonable provision is made for compensation for the expected revenue loss to passenger operators as a result of Network Rail's poor performance.

4.10 Access charges paid by the Operator to Network Rail will be treated as a straight pass through to RfL to avoid unnecessary risk pricing. Any payments received by the Operator under the TAA relating to poor performance of Network Rail or other operators will also pass straight to RfL. All other payments under the TAA in relation to the Operator's own performance will remain the responsibility of the Operator.

4.11 The Concession Agreement will strongly encourage and financially incentivise the Operator to form a close relationship with Network Rail with aligned incentives to ensure optimum contribution from both parties to overall train service performance.

Stations

4.12 The Operator will be responsible for the management and staffing of 82 stations, including 49 stations where the Operator will be required to enter into a lease with Network Rail and pay a rent and 33 stations where the Operator will enter into either lease with RfL where no rent will be payable. The Operator will be expected to pay a proportion of common charges and exclusive charges (where applicable) for regulated access at stations managed by other train operators.

4.13 The Operator will support RfL station enhancement projects but will not be responsible for delivering the works unless otherwise specified by RfL.

Fleet

4.14 From the start of the next concession the Operator will lease a fleet of 96 rolling stock units comprising:

(a) 8 x 2-car Class 172 diesel units leased from Angel Trains and maintained by Bombardier as part of the new LOTRAIN contract;

(b) 31 x 4-car Class 315/317 electric units leased from Eversholt with maintenance procured by the Operator and undertaken by GAF; and

(c) 57 x 5-car Class 378 electric units sub-leased from RfL and maintained by Bombardier under the existing train services contract.

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[2] In accordance with "Criteria and Procedures for the Approval of Track Access Contracts" published by the ORR, December 2011.

4.15 The 31 x 4-car Class 315/317 units are currently receiving refreshment and reliability modifications, which will be completed by the start of the next concession. From May 2018 this fleet, along with the 8 x 2-car Class 172 units, will be progressively replaced by the LOTRAIN fleet consisting of 45 x 4-car units built and maintained by Bombardier.

4.16 The Operator may make arrangements with the rolling stock companies (ROSCOs) to return the Class 315/317 units before the lease expiry date, subject to a cost sharing arrangement set out in the Concession Agreement.

4.17 The Operator will manage the performance of Bombardier’s maintenance obligations under both the Class 378 and LOTRAIN Train Service Agreements (TSA) on a day-to-day basis under tripartite agency agreements that see RfL delegate certain rights under each TSA to the Operator for the duration of the concession.

Safety

4.18 The Operator will be required to comply with a number of safety management requirements, including the Health and Safety at Work etc Act (1974) and the Railways and Other Guided Transport Systems (Safety) Regulations 2006 (ROGS). The Operator will be required to hold appropriate a safety certification and safety authorisation from the ORR for the operation of vehicles and management of infrastructure (stations). The ORR requires that these, as well as a Safety Management System (SMS) are in place before commencement of the next concession.

Revenue Risk

4.19 Revenue generated from the sale of fares and rail products together with patronage risk will be retained by TfL. Experience on other TfL concessions demonstrate this approach to be good value when the responsibility for the matters that influence revenue outcomes, such as fare policy decisions, investment decisions, advertising, marketing and letting of retail concessions are retained by TfL. Secondary income (for example, from retail activities) will also be managed and retained by TfL.

4.20 The Operator will be responsible for the operation of ticket offices and ticket vending machines, and for undertaking revenue protection activities.

Payment Mechanism

4.21 The Operator will be remunerated through a fixed concession payment, indexed by the Retail Price Index and adjusted according to performance against a suite of measures. The Operator will be paid bonuses and/or charged deductions to concession payments should actual performance be better and/or worse than target.

4.22 Monetary values ascribed to bonuses and deductions across various performance measures have been set to provide the Operator sufficient financial incentives to achieve TfL’s objectives for the concession to deliver increased levels of performance and/or mitigate under-performance.

Operating Performance

4.23 The operating performance regime will incentivise the Operator to actively manage its rolling stock suppliers, Network Rail and other rail operators to deliver train services against the timetable and achieve the following contractual targets, specific to each route:

(a) Service Reliability – a measure that service capacity is delivered as planned, namely cancellations (all services operated from origin to destination), part-cancellations (service call at a all booked stations with emphasis on interchange stations), short formations and train services are arriving significantly later timetabled (greater than 10 minutes);and

(b) Service Punctuality – a measure where services arriving three or more minutes late at their final destination will be considered a punctuality failure. This compares to the national standard measure of commuter train punctuality of 5 minutes (the Public Performance Measure or PPM) reflecting the high frequency, urban nature of services on London Overground and the typical short duration and enroute nature of journeys made by customers.

4.24 PPM will continue to be measured as a default trigger for performance and to allow comparisons with other operators.

4.25 A consequence of moving to a three minute measure of punctuality is that target levels defined in the Concession Agreement cannot be compared to historical performance based on a five minute measure. For example, the network target trajectory for the new three minute measure under the new Concession Agreement will start from current levels and reach 94.1 per cent which is equivalent to 97 per cent for the five minute measure. We believe this is achievable considering performance achieved historically or expected to be achieved with new infrastructure and rolling stock.

4.26 Under the operating performance regime the Operator will be incentivised to bear down on the impact of delays caused by Network Rail and other train and freight operating companies. For incidents where Network Rail or another train or freight operator is deemed responsible the Operator will suffer financial deductions calculated at 10 per cent of the equivalent Operator caused incidents. The Operator will therefore be financially incentivised to exert maximum pressure on Network Rail with respect to its performance.

4.27 Under the Service Reliability regime the Operator will be subject to a financial deduction only mechanism with performance compared to a defined benchmark level for each route, affording the Operator some margin for failure before suffering penalties. In contrast, the Service Punctuality regime provides the Operator an opportunity to receive financial bonuses as well as suffer deductions based on punctuality performance achieved. However, bonuses under the Service Punctuality regime are only available where all measures under the Service Reliability regime have been met thus avoiding a situation where the Operator is perversely incentivised to miss station stops in order to arrive at final destination within the three minute punctuality measure.

Service Quality

4.28 The Concession Agreement includes a suite of service quality measures designed to incentivise the Operator to contribute to achieving TfL's vision for customer service. Both overall satisfaction (measured by customer satisfaction surveys) and specific measures for information, security and staff behaviours have targets.

4.29 As with the current concession the new Concession Agreement includes a deduction-only Standards (KPI) regime that measures the availability of customer-facing resources (staff and equipment) and the condition and cleanliness of assets. The Operator's achievement of a range of group standards in comparison to other TfL modes will continue to be measured through a Standards (MSS) regime.

Revenue Protection

4.30 The Operator will be incentivised effectively to protect TfL's revenue by preventing fraudulent travel. The Operator will achieve a bonus and/or be charged a deduction based on additional and/or foregone revenue compared against a ticketless travel target of 2 per cent of customers travelling without a valid ticket for their journey.

4.31 The target level will apply on existing routes throughout but will be set initially higher on devolved routes to reflect currently observed higher levels of ticketless travel. The target will then tighten to reflect TfL's programme for gating stations during the first two years of the next concession.

Other regimes

4.32 The Operator will also be measured against some targets which do not have financial incentives attached to them where there are overlaps with those regimes for which bonuses and/or penalties are payable. These targets relate to measures against matters such as ticket queuing time, mystery shopper surveys, accessibility mystery traveller surveys and PPM.

Enforcement Regime

4.33 The enforcement regime escalates through remedial plan notices, corrective action notices, step-in rights and ultimately contractual default; designed to provide RfL with appropriate recourse to remedy poor performance quickly without resulting in hair triggers to contractual default.

4.34 The Concession Agreement contains a wide range of matters that constitute an event of default without being subject to earlier stages of the enforcement process. These include, inter alia, the Operator reaching certain operating performance financial deduction caps in any thirteen periods, the Operator reaching default benchmarks in the operating performance and customer service regimes, insolvency related events, change of control without RfL's consent, safety related matters, breach of law and failure by the Operator to provide the guarantee and bank bond referred to in paragraph 4.53. The Concession Agreement also includes a right for RfL to voluntarily terminate at any time.

Other Commercial Matters

4.35 The Concession Agreement specifies that the Operator will secure its obligations with an on-demand bank bond of £25m and a parent company guarantee (which reflects the Operator's limits on liability of £80m, excluding certain general indemnities where liability remains uncapped and performance regime deduction caps set at £10m plus/minus bid forecast net performance income/deductions). This reflects a review of any credit risk in the Concession Agreement and takes into consideration the structure of the bidding entities.

4.36 The Concession Agreement includes a mechanism whereby profits made by the Operator will be shared with RfL. This mechanism pays RfL a 50 per cent share of the Operator's profit over a predetermined threshold of 30 per cent above the level of profit bid by the Operator, calculated on a cumulative basis throughout the concession. This is designed to allow sufficient flexibility for the Operator to earn additional return should they perform well given the risk they are bearing but also provides a means by which RfL can limit excess returns.

4.37 Some activities currently undertaken by LOROL will not transfer to the Operator but will instead transfer to TfL to leverage best practice and efficiencies. In some cases transferred activities will be managed centrally and in other cases out-sourced to other TfL suppliers where responsibility better sits (maintenance of Class 172 fleet to be undertaken by Bombardier).

5 Concession Pre-Qualification and Invitation to Tender

5.1 In June 2015, the following four bidders pre-qualified to receive an Invitation to Tender (ITT):

(a) Arriva Rail London Limited;

(b) LoKeGo Limited (a Keolis/Go-Ahead joint venture);

(c) Metroline Rail Limited; and

(d) MTR Corporation (London Overground) Limited

5.2 All four bidders submitted a response to the ITT on 21 October 2015.

5.3 The key principle of the evaluation methodology was to ensure that the Concession Agreement would be awarded to the most economically advantageous bid based on a balance between technical, commercial and price bid components. The ITT responses were evaluated and the following weightings were applied:

Component	Weighting
Price	50 per cent
Technical	40 per cent
Commercial	10 per cent

5.4 TfL Internal Audit conducted a review of the procurement and found that RfL has followed a robust procurement process in accordance with procurement documentation. The main components of the evaluation are set out in further detail below.

5.5 Where appropriate, RfL has sought internal and external expert advice, including input from Steer Davies Gleave (technical advisors) and Grant Thornton (financial advisors).

Technical

5.6 Bidders provided written responses to the following 12 Delivery Plans split into three key components relating to:

Business Management	Operating Performance and Delivery	Excellence in Customer Service and Revenue Protection
1A Organisation and People	2A Operating Performance Projections	3A Service Quality and Revenue Protection Projections
1B Mobilisation and Management Systems	2B Operating Staff	3B Customer Experience
1C(i) Environment 1C(ii) Health and Safety	2C Infrastructure and Other Operators	3C Revenue Protection
1D TfL Relationship	2D Rolling Stock and Other Suppliers	

5.7 Each bidder's Delivery Plan submission was evaluated for their understanding of RfL's requirements and confidence that their proposals and initiatives would deliver TfL's requirements.

5.8 Bidders were scored using an 11-point scale ranging from 0 (Major Concerns) to 100 (Excellent) on a linear basis. Bidders were required to score a minimum of 30 (Minor Concerns) in each Delivery Plan, otherwise the bidder would be automatically excluded from further participation in the competition.

Price

5.9 Bidders were required to provide a financial model, record of assumptions, financial management and funding plan and other supporting documentation to support their price submission. Price represented the net present value (NPV) of the expected concession payments (in real terms), including base concession payments and pricing for the pre-priced options.

5.10 The bidder with the lowest weighted NPV of expected concession payments was awarded full marks for this component with other bidders assigned a score in the inverse proportion.

5.11 Financial submissions were also reviewed to consider if any bid appeared to be abnormally low.

Commercial

5.12 Bidders were invited to provide a mark up of the draft Concession Agreement and certain associated documents. This was evaluated for the extent to which the proposed mark-up transferred risk, obligations or had any other adverse impact on RfL.

5.13 Bidders were restricted from amending certain key elements of the Concession Agreement, including: the Service Increments, minimum staffing requirements, the performance regimes, the requirement to lease the LOTRAIN units, the structure of liabilities, indemnities and credit support arrangements, RfL's right to set off and the structure of the payment mechanism.

5.14 Bidders were scored using a six point scale ranging from 0 (Major Concerns) to 100 (Excellent) on a linear basis. Bidders were required to score a minimum of 40 (Minor Concerns) in each component otherwise RfL retained a discretionary right to exclude the bidder from further participation in the competition.

5.15 In addition, bidders' financial documentation and validity of the underlying pricing assumptions were evaluated on a pass / fail basis for their completeness, clarity, ease of use and the robustness (and ultimately the risk of financial default).

6 Views of the Finance and Policy Committee

6.1 On 2 March 2016, the Finance and Policy Committee considered a similar paper. The Committee raised no specific issues for the attention of the Board and endorsed the recommendations in this paper.

List of appendices to this report:

Exempt supplementary information is included in a paper on Part 2 of the agenda.

List of background papers:

None

Contact Officer: Gareth Powell, Chief Operating Officer, London Rail
Number: 020 3054 8196
Email: GarethPowell@tfl.gov.uk