

**FAO: Secretary of State for Transport**

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Your Ref:

Our Ref:

REC/RWS/ADS/00173458/1

Date: 5 March 2018

Dear Secretary of State,

**Re: Request for urgent clarification re a potential application for judicial review - East Coast Franchise**

**Sent on behalf of: We Own It and Bring Back British Rail**

1. We write on behalf of We Own It and Bring Back British rail in relation to the Secretary of State for Transport's decision to allow the current operators of the East Coast franchise to exit the franchise agreement.
2. We Own It campaigns on behalf of the public for public ownership of essential public services, including the railways. Since 2009, Bring Back British Rail has been campaigning for a re-unified, publicly-owned national rail network run for public benefit.
3. Both of our clients, together with the public generally, are very concerned about the recent decision to allow the private contractors running the East Coast to exit the agreement. That concern is heightened by the lack of clarity over two specific issues of significant public interest:
  - (a) whether Stagecoach has met any and all contractual obligations or fulfilled other guarantees capable of covering the cost of the franchise's failure – so that the costs are not incurred by the taxpayer; and

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- (b) the basis for the assertion that the Secretary of State is prohibited from excluding Virgin or Stagecoach from the East Coast franchise/other franchises in the future and/or to otherwise take into account its overbidding/deleterious performance on the franchise resulting in that failure.

## Limited public statements

- 4. On 5 February 2018, the Secretary of State made a statement in Parliament saying that:

“Since 2015, the franchise has met all its financial commitments to the taxpayer, returning nearly £1 billion to the public purse, but that has come at a substantial cost of nearly £200 million to Stagecoach. I have already informed the House that the franchise will, in due course, run out of money and will not last until 2020, but it has now been confirmed that the situation is much more urgent. It is now clear that the franchise will be able to continue in its current form for only a very small number of months and no more.

Last week, following detailed analysis, my Department issued the franchisee with notification that the franchise has breached a key financial covenant. It is important to make it clear to the House, and indeed to the public, that that will not affect the railway’s day-to-day operations. The business will continue to operate as usual, with no impact on services or staff on the east coast, but it does mean that in the very near future, I need to put in place a successor arrangement for operating the railway and to end the current contract...”<sup>1</sup>

- 5. This suggests that:

- (a) The £200 million cost to Stagecoach / the franchise operators – is the ‘cost’ of its overbidding between 2015 and the point of franchise failure. It is not a future cost, i.e. a cost it incurs as a result of paying for the consequences of the franchise failure.

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<sup>1</sup> Emphasis added; <https://hansard.parliament.uk/Commons/2018-02-05/debates/228EB6B2-2FD1-40AB-87C0-D6AEDA785DE5/RailUpdate>.

- (b) The franchise has breached a key financial covenant, i.e. a contractual commitment it freely entered into, at some point between 2015 and the date of the statement.
  - (c) A new operating arrangement will need to be put in place, which will obviously involve the incurring of substantial costs.
6. However, the Secretary of State then went on to state that:

“...The problem is very straightforward: Stagecoach got its numbers wrong. It overbid and it is now paying the price. Contrary to widespread speculation and rumour, no deal has been done on this railway, and I have not yet made a decision on the successor operator to run the east coast railway until the longer-term plans for the integration of track and train can begin in 2020. There is no question of anyone receiving a bail-out. Stagecoach will be held to all its contractual obligations in full. But, as the Brown review said five years ago, this is what we expect in a competitive franchise system: private businesses risk substantial amounts of their own capital, and if they fail to live up to their stretching targets, they lose out, not the taxpayer. For anyone who thinks that the nearly £200 million that Stagecoach will lose is insignificant, let me put it into context: the combined profit of every train operator in the country was only £271 million last year, and the loss equates to more than 20% of Stagecoach’s total market value. So this is a significant amount of money by any measure, and it should also act as a stark warning to any company tempted to overbid in future. Moreover, the franchising system has now been adjusted to deter further optimism when bidding...”<sup>2</sup>

7. The Secretary of State appears to be referring to the £200 million figure here as what Stagecoach ‘will lose’ – rather than the cost it incurred previously in complying with its financial commitments before the franchise failure. Whilst there is a reference to Stagecoach being held to all of its contractual obligations: (a) this is contradictory because the DfT issued it with notification that it wasn’t going to meet a key financial covenant; and (b) it is not explained what obligations Stagecoach has (beyond past loss profits) to make good the failure of the franchise.

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<sup>2</sup> Emphasis added; <https://hansard.parliament.uk/Commons/2018-02-05/debates/228EB6B2-2FD1-40AB-87C0-D6AEDA785DE5/RailUpdate>.

8. The lack of clarity over whether Stagecoach has met its obligations and what the cost/nature of those obligations was then exacerbated by the following further statement by the Secretary of State that: "the company is meeting its financial obligations to support the franchise, including with the full parent company's support, and because it has operated services on the east coast line successfully". The franchise has failed because of a breach of a key financial covenant.
9. The Secretary of State also stated that:

"In a competitive market, franchises will sometimes fail. When that happens, my duty is to protect passengers and taxpayers, and to ensure continued investment in the railway. Stagecoach has paid the price for failure, as stipulated in its contract. Passengers on the east coast main line can be assured that services will continue as normal. The Government will undertake a transparent appraisal of the options available to ensure that passengers and taxpayers are protected."<sup>3</sup>
10. How can it be said that the franchise is meeting all of its obligations? What obligations is it required to meet in order to address the consequences of its franchise failure? In short:
  - (a) What obligations were included in the franchise agreement to protect the taxpayer in the event of franchise failure?
  - (b) What is the price which Stagecoach has paid for its failure?
  - (c) Does this 'price' provide any or adequate protection from the current and future costs of the franchise failure? What will the cost be to the taxpayer, not only as a result of this franchise failure, but also from future failures where private contractors similarly overbid and do not adequately compensate the taxpayer for such failure?
11. The reference to the cost to Stagecoach of the franchise failure being £200 million, which seems to be past profit loss, is very concerning. If the only cost to Stagecoach is that it had to meet its own past commitments up to the point of breach, that does not suggest it has been obliged to pay for the current and future consequences of its failure.

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<sup>3</sup> Emphasis added; <https://hansard.parliament.uk/Commons/2018-02-05/debates/228EB6B2-2FD1-40AB-87C0-D6AEDA785DE5/RailUpdate>.

12. The Secretary of State's position also seems to be that there are to be no other future consequences for Stagecoach (or its consortium partners) for the franchise failure in terms of its ability to bid for franchises:

"There will be those who claim that because Stagecoach overbid, it should be excluded from bidding for future franchises. I have to be clear that the legal advice on this is clear. As the company is meeting its financial obligations to support the franchise, including with the full parent company's support, and because it has operated services on the east coast line successfully, the Department has concluded that there are no adequate legal grounds to restrict it from bidding on current and future franchise competitions on this basis. Members will understand that it is my duty to follow legal advice, but let me be clear that we will keep its eligibility for current and future bids under close scrutiny and constant review."<sup>4</sup>

13. Extraordinarily, the Secretary of State suggests that Stagecoach may be awarded the right to continue the franchise on a short-term arrangement for potential financial reward at the end of the contract. The Secretary of State also denied that there was any record of National Express being banned from bidding for franchises in 2009. However, Lord Adonis stated in the House of Lords that:

"... will [the Government representative] confirm that Mr Grayling appears, astonishingly, to be prepared to allow Stagecoach to continue operating the east coast line despite walking away from it, and that he has not ruled this out, although he is putting in place legal procedures that look to me to be the prelude to re-awarding it the contract? Fourthly—this affects my tenure in the office of Secretary of State personally—will she confirm that it is quite wrong to say that National Express was not banned by me from bidding for future contracts in 2009? It was banned. The incoming Conservative Government in 2010 lifted that ban, which is a fundamentally different point. I believe that that was a mistake and that it has prepared the way for the problems that we face today."<sup>5</sup>

14. On 1 March 2018, the Secretary of State was asked the following question in Parliament:

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<sup>4</sup> Emphasis added; <https://hansard.parliament.uk/Commons/2018-02-05/debates/228EB6B2-2FD1-40AB-87C0-D6AEDA785DE5/RailUpdate>.

<sup>5</sup> Emphasis added; <https://hansard.parliament.uk/lords/2018-02-05/debates/C9220E9A-47A4-4ECB-960D-BF0A0D9C43BB/RailUpdate>.

“Given that the taxpayer has already lost out on more than £2 billion of premium payments, can the Secretary of State advise the House as to whether the financial ramifications of the termination of the franchise are now completely known and concluded? If not, what sums of money are earmarked to settle any further system-gaming demands from Messrs Branson and Souter through litigation or arbitration?”<sup>6</sup>

15. The Secretary of State did not respond to the substantive questions asked.<sup>7</sup>

### Urgent clarification required

16. With respect to the first issue outlined at paragraph 3(a) above, whether Stagecoach has met any and all contractual obligations or fulfilled other guarantees capable of covering the cost of the franchise’s failure, please provide a full answer to the questions posed at paragraph 10 above.
17. With respect to the second issue outlined at paragraph 3(b) above, the basis for the assertion that there is no basis to exclude Virgin or Stagecoach from the East Coast franchise/other franchises in the future and/or otherwise take into account its overbidding/deleterious performance on the franchise resulting in that failure, please provide a full response to the following questions:
- a. Was National Express excluded from bidding for future franchises in 2009?
  - b. What is the legal basis for the assertion that the Secretary of State is prohibited from excluding Stagecoach/other members of the consortium from bidding irrespective of the franchise failure?
  - c. Is it the Secretary of State’s position that no account can be taken of the franchise failure in considering whether Stagecoach/the other members of the consortium are eligible for and the validity of any future franchise bids? If that is the Secretary of State’s position, please explain the basis for it. If it is not the Secretary of State’s position, please clarify what keeping Stagecoach’s “*eligibility for current and future bids under close scrutiny and constant review*” involves and/or how the franchise failure will be treated as relevant evidence.

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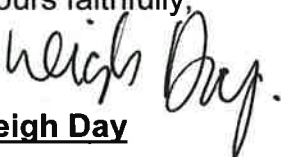
<sup>6</sup> Andy McDonald, see <https://hansard.parliament.uk/Commons/2018-03-01/debates/00B42C8A-C7D6-4FD1-A530-1739C102DB07/VirginTrainsEastCoast>.

<sup>7</sup> <https://hansard.parliament.uk/Commons/2018-03-01/debates/00B42C8A-C7D6-4FD1-A530-1739C102DB07/VirginTrainsEastCoast>.

## Proposed further action in the absence of a satisfactory response

18. Our clients are considering applying for judicial review of: (a) any failure to ensure the private contractors operating the East Coast Franchise meet all contractual obligations to meet the costs of the consequences of the franchise failure; and (b) the decision that Stagecoach could be awarded the temporary contract on the East Coast Franchise and/or other franchises despite the franchise failure and/or without that failure being taken into account.
19. We note that if the necessary information to address these concerns is provided by the deadline set below for a response to this letter, our clients will not need to initiate a legal challenge. We therefore encourage the DfT to provide a full and adequate response to this letter.
20. Given the urgency of this matter, please respond to this letter as soon as practicable and by no later than **4 p.m. on 12 March 2018**. We look forward to hearing from you. Please send your response to Rosa Curling, Rowan Smith and Anna Dews of this firm using the contact details on our letterhead.

Yours faithfully,

  
**Leigh Day**