



30 September 2021

Fit and proper people? Govia's profits and the South Eastern franchise

LSER stripped of South Eastern franchise

On 28 September, Secretary of State Grant Shapps announced that he was stripping Govia Limited's subsidiary company, London and South Eastern Railways Ltd (LSER), of the South Eastern franchise following 'a serious breach of the franchise agreement's "good faith" obligation in relation to financial matters'. The Department for Transport said that it had 'identified evidence that since October 2014 LSER has not declared over £25 million of historic taxpayer funding which should have been returned.'

£25 million, it should be noted, is the minimum that is owed based on current knowledge. Reports indicate the final sum could be far more.

This was also a franchise that had received a significant government subsidy over the last five years. ORR data show that it received a net subsidy of £360 million from the taxpayer between 2015 and 2020.¹

Govia knew that the DfT were onto them from March 2020

LSER have held the franchise since 2007. In 2014 they received a Direct Award, which was supposed to be followed by a competition in 2019. After repeated delays, this competition was cancelled in August 2018 and LSER were given an extended Direct Award that would run to 1 April 2020.

As LSER's Company Accounts from 2020 show, Go Ahead's CEO David Brown and the other Directors of LSER were aware in March 2020, before the pandemic really took hold, that the DfT were challenging whether LSER were accurately declaring their profits and the profit share due to the DfT. Below are extracts from LSER's Annual Report in 2020.

¹ <https://dataportal.orr.gov.uk/statistics/finance/rail-industry-finance/table-7226-franchised-passenger-train-operator-finances-over-five-years-by-franchise/>

On 31 March 2020 (the final day of the DAC), DfT wrote to the Company to formalise for the first time that it disputes elements of the DAC profit share calculations performed by the Company since the DAC commenced in October 2014. The DfT provided further details supplemental to its letter on 20 April 2020. The Company engaged Womble Bond Dickinson to provide legal advice, and provided informational and substantive responses to the DfT's claim on 3 June 2020 and 1 July 2020 respectively. The Company does not have reason to believe that the DAC profit share calculations are materially incorrect. A response from DfT is awaited. Further discussion can be found in note 19 to these Financial Statements.

London & South Eastern Railway Limited
Notes to the financial statements
for the year ended 27 June 2020

19. Contingent liability (continued)

Profit share dispute

On 31 March 2020, the DfT notified the Company that it was required to recalculate the profit share payable over the period from 12 October 2014 to 29 June 2019 pursuant to the Franchise Agreement dated 10 September 2014.

The Company has subsequently provided the DfT with an explanation for the historical calculation of profit share and has recognised a best estimate of the assessed outcome within these financial statements. Any additional amounts payable are disputed due to the Company's statement of position being supported by express terms or agreement, correspondence between the Company and the DfT, treatment in practice and the development and terms of the Franchise Agreement.

Should the DfT notification prove successful then the outflow of resources could be in the region of £8,000,000.

The accounts make clear that LSER were disputing the DfT's figures. and they reported that their overall exposure was likely to be around £8 million. David Brown, Claire Hollingsworth and Elodie Brian's Annual Report to Go-Ahead's shareholders in September 2020, reproduced these words exactly:

*"On 31 March 2020, the Secretary of State for Transport notified one of the Group's subsidiary companies, London and Southeastern Railway Limited (LSER) that it was required to recalculate the Profit Share payable over the period from 12 October 2014 to 29 June 2019 pursuant to the Franchise Agreement dated 10 September 2014. LSER has subsequently provided the Secretary of State for Transport with an explanation for the historical calculation of profit share and has recognised a best estimate of the assessed outcome within these financial statements. Any additional amounts payable are disputed due to LSER's statement of position being supported by express terms or agreement, correspondence between LSER and the Secretary of State for Transport, treatment in practice and the development and terms of the Franchise Agreement. Should the Secretary of State for Transport's notification prove successful then the outflow of resources could be in the region of £8.0m."*²

Govia's managers were reassuring shareholders in 2020 that their maximum exposure in the worst case scenario would be £8 million. In reality, it appears, the situation was far worse than shareholders understood.

Govia's profits from the South Eastern franchise

Go-Ahead Group hold the Thameslink, Southern and Great Northern franchise and the South Eastern franchise through their subsidiary joint venture Govia, in which they control 65% of the shares.

The South Eastern franchise has been of the utmost importance for Govia's profitability.

² https://www.go-ahead.com/download_file/force/1181/242

While Govia has struggled to make profits from the Thameslink, Southern and Great Northern franchise, LSER has effectively been its cash cow. In his 2016 Report to shareholders, Brown showed how important Southeastern was: *‘ Trading in the Southeastern and London Midland franchises continues to be robust and help offset weakness in GTR.’*³

RMT analysed LSER and Govia’s dividend payments over the period in which the DfT says LSER breached their financial obligations over profit sharing. These show that LSER extracted £182 million in dividends over this period. On average this dividend payment accounted for more than 60% of Govia’s dividend payments to the Go-ahead Group (Table 1).

Table 1: LSER and Govia Dividend Payments 2014-2020⁴

Year	LSER Dividend payments 2014-2020	Govia Limited Dividend Payments	LSER dividend as % of Govia dividend
2014	£5,000,000	£24,652,000	20%
2015	£25,000,000	£36,352,000	69%
2016	£37,000,000	£50,804,000	73%
2017	£30,000,000	£60,942,000	49%
2018	£25,000,000	£39,680,000	63%
2019	£30,000,000	£36,313,000	83%
2020	£30,000,000	£42,000,000	71%
Total	£182,000,000	£290,743,000	61%

Executive remuneration packages and the South Eastern franchise

Because of its financial importance to the Group, retaining the Southeastern franchise became vitally important to Govia and it became one of the strategic KPIs on which Executive remuneration would be based. When it was retained in 2020, it was clearly a cause for celebration. In 2020, Brown reported to Go-Ahead’s shareholders, *“Southeastern has been an important part of Go-Ahead since 2006 and we are pleased it will remain within the Group until at least October 2021.”*

Senior executive remuneration packages came to depend heavily on the South Eastern franchise. Performance related bonuses for Go-Ahead group senior executives were tied to the profitability of rail and rail profitability depended almost entirely on Southeastern. 65% of the performance bonus element of executive pay was tied to the delivery of operating profit targets, split proportionately between rail and buses. Around a third of operating profit in the Group in 2018 was accounted for by rail and this was entirely accounted for by LSER’s performance.⁵

³ https://www.go-ahead.com/download_file/force/457/242

⁴ London and Southeastern Railway Annual Reports, Companies House 2014-2020; Govia Limited Annual Reports, Companies House 2014-2020

⁵ https://www.go-ahead.com/download_file/force/61/242, p. 93. LSER’s operating profit in

In 2016, Go-Ahead’s Annual Report revealed that part of performance element of David Brown’s remuneration package for that year (which was in excess of £1.2 million) was explicitly linked to the performance of Southeastern: *'15% of the profit target (25% weighting) was achieved on the basis of the performance on London Midland and Southeastern having been excellent, with both franchises being extended and generating the maximum possible profit under their direct awards.* ⁶

Since 2014, David Brown himself has taken home £9 million in executive remuneration, around £1 million a year on average.

Table 2: David Brown remuneration 2014-20⁷

2014	£1,960,000
2015	£2,134,000
2016	£1,214,000
2017	£782,000
2018	£1,175,000
2019	£1,219,000
2020	£558,000
Total	£9,042,000

Summary

In summary, senior executives at Govia were under serious corporate pressure and had significant material incentives to hold onto the South Eastern franchise and to maintain its profitability. South Eastern was the only part of Govia that created significant Group profitability, it underpinned dividend payments from the Rail division and because of this, executive remuneration packages were tied in some measure at least, to these objectives.

It is not yet clear precisely what LSER did that led it to breach trust in its financial probity with the DfT but reports indicate that it turns on whether LSER were transparent about the amount of profit they were making. Under the franchise agreement, once profits passed a certain threshold, the profit-share mechanism kicked in and a tapering percentage would be due to the DfT.⁸

This research points to the fact that Govia executives were under significant pressure and had material incentives to maximise the amount of profit heading up to the Go-Ahead Group and, consequently, not flowing back to the public purse through the profit sharing

2018 was £52 million, amounting to more than 100% of Group Rail division profits, offsetting losses elsewhere and emphasising just how important LSER was to Govia and Go-Ahead.

⁶ https://www.go-ahead.com/download_file/force/457/242, p. 96

⁷ Source: Go-Ahead Group Annual Reports 2014-2020

⁸ Southeastern Franchise Agreement

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/893501/south-eastern-franchise-agreement.pdf, p. 374

mechanism. Something happened which meant that for seven years, the taxpaying public, who were already contributing a net subsidy of in excess of £360 million between 2015 and 2020, were losing out. For years, money that was due to be returned to the public was sitting in Govia's accounts. Shareholders and directors of Govia have materially benefited from money that did not belong to them. However this happened, it demonstrates, yet again, that the privatised rail system, with its profit-fixation, is utterly broken.

However, it's also clear that there is an immediate problem with Govia, who still run one of Britain's biggest franchises.

Govia: Not fit and proper

Responsibility for this scandal goes right to the top not only of LSER but of Govia. Four out of five of Govia's Directors are also Directors of LSER, including Go-Ahead's CEO David Brown. There is, in essence, no difference between the management of the two companies. They are, overwhelmingly, the same people.

Table 3: Directors of Govia and LSER

Directors of LSER	Directors of Govia Ltd
D A Brown	D A Brown
E Brian	E Brian
D I Statham	M Dean
A F J Gordon	A F J Gordon
B D M Tabary	B D M Tabary
C A Hodgson	

RMT believes this episode highlights fundamental problems built into the system of privatised rail operation and the urgent need to return it, permanently to public control. But it also throws into serious question Govia's fitness to run any rail operations.

Govia's Directors, the same people who oversaw what was happening at LSER, are in control of the biggest rail franchise in Britain: Thameslink, Southern and Great Northern. This cannot be allowed to continue.

RMT believes that David Brown should repay any performance element of his remuneration since 2014 that has related to Southeastern's performance, while the Go-Ahead group should repay all the dividends extracted from the Southeastern franchise since 2014.

However, it is vitally important that Govia are removed from the rail network entirely. The Operator of Last Resort should take over Govia's Thameslink, Southern and Great Northern franchise. There can be no question of leaving any rail operation in the hands of people who have had a franchise removed from them for breaching trust in their financial probity.