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Transport Committee

Passenger Rail Franchising

Fourteenth Report of Session 2005–06

Report, together with formal minutes, oral and written evidence

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The Transport Committee

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1 Introduction

1. It is now thirteen years since the Railways Act 1993 started the process of breaking up and privatising British Rail, replacing it with one company owning and managing the infrastructure, an open-access system for freight services and a series of 25 passenger franchises let to private companies for a specified period of time. It has been thirteen years of almost continuous change. The Hatfield crash in 2000 resulted in a period of crisis and upheaval culminating in the demise of Railtrack. Subsequently, the Strategic Rail Authority was abolished, with the strategic planning, franchise letting and monitoring functions brought back under the Department for Transport. We are now seeing the new ‘triumvirate’ framework with the Department for Transport (DfT), the Office of Rail Regulation (ORR) and Network Rail, bed in. The third generation of franchises are now being let, with the number being reduced to nineteen.

2. The Railways have seen a high level of passenger growth in recent years and passenger numbers are expected to continue rising. It is widely acknowledged that parts of the network are running close to capacity, and yet with more than £5.5 billion in subsidies for the railways, of which more than £1 billion will be for passenger rail services alone, direct public subsidies are forecast to reach their highest level ever in the financial year 2006–07.

3. It is clear that the context and framework for the franchising system have changed very significantly in recent years, but the nature of franchises themselves has also changed since our predecessors last looked at passenger rail franchising in 2001–02. With a new thirty-year strategy for the railways, another White Paper for rail and a five-year purchasing strategy (known as the High Level Output Statement (HLOS)), due to be published in the summer of 2007, we decided to examine the functioning of passenger rail franchises. The inquiry addressed the following high-level questions:

a) What should be the purpose of passenger rail franchising? Is the current system achieving that purpose?

b) How well does the process for awarding franchises work?

c) Are franchise contracts the right size, type and length?

d) Do we need more competition and vertical integration?

4. The Committee is grateful to all the organisations and individuals who gave written and oral evidence to this inquiry. Written submissions are listed on page 56 and the names of witnesses who gave oral evidence are listed on page 55. We would also like to thank our

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1 Ownership of the infrastructure (i.e. track, signalling, bridges and most stations) was transferred to Railtrack on 1 April 1994. Railtrack was floated on the stock exchange on 1 May 1996. Railtrack Plc went into administration in 2001, and its assets were sold to the new ‘not for dividend’ organisation, Network Rail, in 2002.

2 Q 301 [Ms Bonar, Chartered Institute of Logistics and Transport]

3 Ev 142 [Department for Transport]

4 Department for Transport Annual Report 2006, para 5.6

5 Department for Transport Annual Report 2006, Figure 5d; see also Table 2 on page 21
specialist adviser, Professor John Preston, of the Transportation Research Group at the University of Southampton.
The objectives of passenger rail franchising

The railway system in Britain was created by entrepreneurs in a climate of often cut-throat competition. Incoherence, inefficiency and a failure to innovate created pressures which eventually led to the nationalisation of the railways through the Transport Act 1947. But over time, British Rail also came to be criticised for a failure to deliver an effective, innovative and value-for-money railway system. These criticisms culminated in the Railways Act 1993 which started the process of re-privatisation. The original objective of rail privatisation and the creation of franchises was to re-introduce competition and thereby, it was hoped, increase efficiency and innovation, enhance responsiveness to the needs of passengers and freight customers, lever private investment into the railways, and reduce the level of public subsidy. These objectives have not changed substantively since privatisation although the Government has acknowledged that, unlike some other privatised utilities, the railways are a public service which will always depend on substantial public subsidy. The Government reiterated to the Committee that the current objectives of the railways in general, and the franchising system in particular, are:

i. to improve passenger services,

ii. to harness private sector commercial judgment and innovation to reduce the net cost and increase the value for money (VfM) achieved from the Government’s overall support for passenger rail services.

Few would disagree with the aim of increasing the value for money achieved from Government subsidies, and even fewer with the aim of improving passenger services. Some, however, question whether the current structure of the rail industry, franchising in particular, is the most appropriate and efficient means with which to achieve those objectives in the longer term.

Privatisation and disaggregation are in natural tension with the requirement for an effective, sustainable and integrated transport system. Some witnesses argued that the Government’s objectives need to be re-balanced to emphasise the key role of rail as part of a “single integrated transport network, which is accessible to everyone, delivering punctual services at a reasonable price to passengers.” Others believed that, in reality, the Government simply has no consistent and well thought-through objectives for the

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8 Department for Transport, The Future of Rail, White Paper, Cm 6233, July 2004

9 Q 408 [The Parliamentary Under Secretary of State, Derek Twigg MP]

10 Ev 142 [Department for Transport]

11 Ev 208 [Simon Norton]; Ev 39 [Railfuture]; Q 326 [Mr Ford]

12 Ev 59 [Merseytravel]
franchising system. Transport consultants Tony Bolden and Reg Harman told us that there "seems to be no proper and consistent understanding of what franchises should be and how they should operate, which in turn does not allow for proper planning and development of the railway system."13 Nigel Harris of the Railway Consultancy echoed this perception, stating that he was unable to say whether the objectives were being met because "many of us are not entirely sure what this week’s objectives are."14 Roger Ford lamented the wider lack of long term strategic planning, development, and investment on the railways which, in his view had resulted in parts of the infrastructure now being effectively preserved in “aspic”.15

8. GNER highlighted the tension between the interests of the Government and those of many passengers and local communities when saying that the franchising system “provides the best value operator for the Government’s specification of a particular route, although this is not necessarily the same as providing the best value for the passenger or the railway which passengers and local communities would necessarily desire.”16

**Model or muddle?**

9. The Government cites the growth in rail patronage as a partial indicator of the success of the post-privatisation rail system in achieving the objectives set for it.17 Several of our witnesses were sceptical about passenger growth being used as an indication of system performance. The Railway Consultancy said that it would be invalid to claim that there is a “simple correlation between rail industry structure or franchise type with traffic growth.”18 John Segal of the MVA Consultancy told the Committee that “one of the key reasons demand increased was that fares were held down. Had fares been held down under British Rail then some of the demand growth would have happened without [franchising].”19 Mr Ford added that the decline in patronage in the early 1990s, before privatisation, had been the result largely of macro-economic factors, such as recession and high unemployment.20

10. Professor Knowles evaluated the delivery of the original objectives of rail franchising from the time of privatisation, and concluded that the franchise model had failed to fulfil them. He too saw passenger growth as only partly the result of privatisation and, identifying the central contradictions behind the franchising model, questioned the basic rationale for rail passenger franchising:

> “Is it realistic to expect competition for franchises in a basically loss-making industry to lever in substantial private sector investment and deliver extensive consumer benefits? Rail privatization will struggle to meet its investment, passenger-growth, and subsidy-reduction targets in a regime with extensive regulation of fares and little

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13 Ev 212 [Tony Bolden & Reg Harman]
14 Q 167 [Dr Nigel Harris, The Railway Consultancy]
15 Q 293 [Mr Ford]
16 Ev 7 [GNER]
17 Ev 142 [Department for Transport]
18 Ev 93 [Railway Consultancy]
19 Q 168 [Mr Segal, MVA]
20 Q 273 [Mr Ford]
‘on track’ competition permitted. Rail passenger services also face intensive intermodal competition with cars, air services, and intercity coaches.”

One independent passenger organisation, the Railfuture Passenger Committee summed it all up: “we are frankly not convinced that franchising is the only – or indeed the best – way of running the passenger railway.”

11. We agree wholeheartedly with the general objectives of improving passenger services and maximising the value for money achieved from Government subsidies. But we do not believe that the current system of passenger rail franchising can achieve those aims in the long term.

12. Our inquiry exposed fundamental tensions at the very heart of the Government’s model. The Government has embraced the notion that private enterprise is best at delivering high-quality, innovative services such as the passenger railways, and yet it does not trust companies to deliver these services without highly detailed and specific contractual requirements which reduce the scope for innovation. It supports competition, and yet appears to see open access operators as a threat to stability. It wants risk to be transferred from the public to the private sector, and yet risk cannot be transferred in anything other than name because, as everyone knows, no Government could afford to let the railways go bust. The Government hails the growth in passenger patronage, and yet it does not provide the long-term strategy and investment to increase capacity on the network. It wants coordination and yet continues to operate a system of fragmentation. Finally, the Government wants the private sector to invest, take risks and innovate, and yet it prioritises price above all of these. There is scant evidence that the current model balances and optimises the benefits from conflicting priorities. It looks more like a muddle that provides little more than a complex, costly and mediocre means of maintaining the status quo.

13. The Government has announced its intention to publish a long-term vision for the railways in the summer of 2007. This initiative is welcome, though long overdue. The strategy will look at long-term infrastructure requirements in the rail industry, but to have any real value, it should also contain a root and branch review of the way in which services are provided to passengers. The long-term strategy is an opportunity for the Government to provide real vision and direction for the development of the railways, backed by investment. This opportunity should not be missed through a failure to address the most fundamental questions of structure and long-term direction. The Government’s long-term vision for passenger rail services should be set out as an integrated part of its vision for the railways. This vision should in turn, be fully integrated into an overarching long-term transport strategy.

14. It is clear that after more than a decade of upheaval and flux, the railways need stability and continuity to consolidate and take stock. It might be argued that this is not the right

21 Richard D. Knowles: Impacts of privatising Britain’s rail passenger services – franchising, refranchising, and Ten Year Transport Plan targets published in Environment and Planning, volume 36, 2004

22 Ev 39 [Railfuture]

23 This strategy is due to coincide with the High Level Output Statement (HLOS) which sets out a five-year purchasing strategy for the network.
moment to commence a major reorganisation of the way in which passenger rail services are being procured and managed. However, the fact that the Government constantly has to tinker with the system in order to overcome the consequences of fundamental system failures, means that such stability is not likely to emerge without further fundamental change.

15. The objectives of the passenger rail franchising system are a self-contradictory muddle, providing no coherent framework or vision for the development of passenger services for future generations. The result is a system that is worth less, and costs more, than the sum of its parts. It is high time that the Government established a consistent and achievable set of objectives and a system capable of achieving them whilst providing good services and value for money to passengers and taxpayers.

16. The key objective of our railways for the next few decades must be to increase capacity, and facilitate growth in patronage through improvements in services to passengers. The only way to achieve this in the long term is to drop the dogmatic pursuit of competition where competition is not possible, and to make honest and tough choices about what the private and public sectors can and should do in future. We expect the Government’s forthcoming long-term strategy for the railways to tackle these fundamental issues head on. It must contain a structure and a strategy capable of securing quality passenger rail services to meet demand over the next half a century.

Risk

17. The transfer of risk from the public to the private sector is a key objective in the privatisation of public services. However, a number of witnesses argued that with regard to passenger rail services, the transfer of risk to the private sector has been quite limited.24 The reason for the lack of risk transfer is primarily because, at the end of the day, no Government can afford to let part of the railway system collapse. As a result, the Government and the taxpayer pay for a large part of the risk in the system. Mr Segal of the MVA consultancy told the Committee that:

“Some risk is borne by the operators but it is a relatively small amount. They have £10 million to £20 million invested in this. If it is making £400 million turnover, that is a hugely small investment and they can walk away from it if necessary. They lose some credibility but they can walk away. The government would have to make sure the train services run and it can refinance and relet it. The big risk is, if there is a downturn in the economy, almost all the train operating companies will find great difficulty on their revenue line and that means the government will end up bailing it out. As the saying goes, if you owe the bank five pounds you are in trouble; if you owe the bank five million, the bank is in trouble. In this case, the government is in trouble because if it has to relet all the franchises at once it is going to get lower bids for them. That is an unavoidable risk. The economy is the government’s risk.”25

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24 Ev 93 [The Railway Consultancy]
25 Q 203 [Mr Segal, MVA]
18. Examples of areas where risk is not transferred to the private sector, as one might have expected, are track access charges and the cost of industrial action. In the case of track access charges, the Government insulates franchises against increases in Network Rail’s fees for accessing the track by adjusting premiums or subsidies to take account of any changes in access charges. Another example is the cost of industrial action where the Government compensates franchise operators for losses incurred. The SRA paid out £15.65 million in 2003 and £7.63 million in 2004. One operator alone, National Express Group, was paid £12.65 million in respect of disputes on its ScotRail franchise.

19. The transfer of risk to the private sector is also highly inconsistent. Given the high level of risks borne by the Government in areas such as track access charges and industrial action, it appears strange that franchising companies are left to bear the risk of open access operators affecting their revenue without any assistance from the Government. This issue is discussed at length in Chapter 6 below.

20. Changes to franchise contracts in recent years have served to reduce the risk exposure of TOCs still further. These changes are an attempt to minimise the risk for the Government of operators getting into financial difficulties and seeking to re-negotiate the terms of their contracts part-way through the franchise. Franchise contracts now generally include “revenue risk-sharing mechanisms”, also known as “cap and collar protection”. This typically means that after the first four years of the franchise contract have passed:

i. “50 per cent of any fares revenues in excess of 102 per cent of the TOC’s original forecast are shared with DfT;

ii. DfT makes a contribution equivalent to 50 per cent of any revenue shortfall below 98 per cent of the TOC’s original forecast;

iii. but for any shortfall below 96 per cent, DfT’s contribution increases to 80 per cent.”

21. In the past, a significant number of franchise contracts have been re-negotiated part-way through their term because franchise operators have found themselves in financial difficulties. Since taking back the responsibility for franchises from the defunct SRA, and implementing the new arrangements outlined above, the Government has been adamant that it will no longer re-negotiate contracts under any circumstances, and that it is

27 HC Deb, 24 November 2005, col 2226W
28 HC Deb, 15 May 2003, col 340W
29 See HC Deb, 18 May 2006, col 1129W
31 Such renegotiations have occurred on a number of occasions in recent years, sometimes resulting in TOCs “operating for extended periods under ‘cost plus’ contracts” See Ibid.
32 Ibid, p 3
33 More than half of the original 25 franchises created at privatisation agreed changes to their contracts in the course of the contract.
prepared to see an operator go to the wall rather than renegotiating contractual terms.\textsuperscript{34} This resolve remains to be seriously tested. But with some operators entering into very high premium contracts on the basis of very optimistic growth forecasts, it is likely to be a question of time only before the Government has to show its mettle. GNER has already admitted that the growth projections upon which it agreed to pay £1.3 billion for the East Coast Main Line franchise just 18 months ago were unrealistic.\textsuperscript{35} On 22 October 2006, \textit{The Sunday Times} reported the Chief Executive of Seacontainers, GNER’s parent company, to have said that GNER would have to hand its franchise back to the Government by May next year if the terms of the franchise were not renegotiated.\textsuperscript{36}

22. The Government already appears to be shifting its position and opening the door to renegotiations, despite its firm commitment to the contrary when giving evidence in July. Mr Lambirth, the Director of Rail Strategy & Finance at the DfT assured us in oral evidence that, in the case of the newer types of franchise contracts with revenue-risk-sharing mechanisms built in, the Department would be ‘sticking to the letter of the contract,’ and not renegotiating.\textsuperscript{37} When asked to confirm this commitment in October, the Secretary of State wrote to us that ‘more generally […] we are not prepared to renegotiate the main terms on which a franchise was awarded in the first place other than in circumstances where doing so would clearly benefit the public purse.’\textsuperscript{38} The emphasis on optimising the benefit to the public purse is new, and appears to open up the possibility of renegotiating contracts where it would be cheaper to do so than to refranchise. This change of emphasis has undoubtedly come about because the Government may soon face the choice of either renegotiating a contract, or seeing a major franchise, awarded just eighteen months ago, being handed back. The implications of such a change would be significant and damaging. Operators would be able to produce over-optimistic revenue forecasts and bid wild sums to run franchises, safe in the knowledge that the Government would bear the full risk of any failure to meet the forecast revenue figures.

23. The practice of renegotiating contracts effectively meant that the Government was underwriting franchise operators in the past. This is the ultimate form of risk retention by the Government. Having re-designed franchise contracts to include ‘revenue risk-sharing mechanisms’, it is crucial that the Government resist any pressures to renegotiate franchise agreements if operators get into difficulties. If it were to bail out operators through renegotiation despite taking over most of the medium- and long-term revenue risks, the Government would have failed doubly.

24. The risk to the Government is potentially compounded by the fact that the concentration of the market means that a few large companies increasingly run multiple franchises.\textsuperscript{39} If the Department for Transport were to use the cross-default principle, as has

\textsuperscript{34} Q 489 [Mr Lambirth, Department for Transport]; See also Q 28 [Mr Furze-Waddock, First Group; Mr Smith, Govia]; Qq 35–38 [Mr Smith, Govia; Mr Lyons, Railway Forum; Mr Franks, National Express]

\textsuperscript{35} The Independent, 17 October 2006, p 36; see also The Guardian 17 October, p 26. When awarding the franchise to GNER in March 2005, the SRA hailed it as “the biggest deal in European rail history”. See SRA press release, 22 March 2005, available at http://www.sra.gov.uk

\textsuperscript{36} Sunday Times, 22 October 2006

\textsuperscript{37} Qq 406–407 [Mr Lambirth, DfT]

\textsuperscript{38} Ev 206 [Department for Transport]

\textsuperscript{39} See paras 71 and 72 above
been hinted, whereby a franchise operator that runs multiple franchises will lose all its franchises where it fails to fulfil its obligations in one of these, the Department could be left with a very large financial and management problem.\textsuperscript{40} The concentration in the market also means that, in such situations, it might be difficult for the Government to find bidders able and willing to take on a whole series of franchises removed from a failing incumbent at an acceptable price.

25. The transfer of risk to the private sector was a core objective of privatisation. But in the current system only a very limited proportion of risks are, in reality, borne by franchise operators. There are also significant inconsistencies about what risks are borne by operators, and which by the Government. The relative lack of risk transfer calls into question the fundamental assumptions and objectives of the franchising system. If risk is not transferred, there is little point in involving the private sector in the running of the railways.
3 The process of awarding passenger rail franchises

The franchising cycle

26. Table 1 below summarises the key stages in the franchising cycle.41 In this chapter we consider the evidence put to us with regard to the specification and procurement stages of the re-franchising process.

Table 1 Franchise lifecycle

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<th>Content</th>
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<tr>
<td>Specification</td>
<td>Specification of what Government wishes to buy; consideration given to VfM and affordability; consultation with key interested parties;</td>
</tr>
<tr>
<td>Procurement</td>
<td>Competition to elicit the most competitive bid from prospective Train Operating Companies (TOCs)</td>
</tr>
<tr>
<td>Mobilisation</td>
<td>Period between the announcement of an award to the commencement of new the franchise by the selected bidder</td>
</tr>
<tr>
<td>Operations / Service delivery</td>
<td>TOC operates the franchise for a defined period; DfT monitors relevant commitments to ensure benefits are realised and assesses operational and financial risks</td>
</tr>
<tr>
<td>Franchise close</td>
<td>During the final 12 months of the franchise contract the Government exerts stronger contractual control</td>
</tr>
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Source: adapted from Ev 142 Department for Transport

Specification of franchises

27. Our evidence indicated that rail policy in general needs to be better integrated with wider Government policies as well as wider transport and regional development strategies, such as the Sustainable Communities Plan from 2003.42 In the case of the Sustainable Communities strategy, no developments in rail infrastructure are planned to match a high level of housing growth in parts of the Southeast. The absence of infrastructure developments in turn limits what can be achieved through franchise specifications.43

28. The consultant Jim Steer highlighted that, before its abolition, the SRA had created an industry planning framework which has yet to be fully implemented. This framework was intended to ensure full coordination between high level strategy for the industry, assessments of local and regional needs, and the constraints of a stretched network. As illustrated in Figure 1, a sequential process would lead from a strategic plan through Regional Planning Assessments (RPAs) and the Route Utilisation Strategy (RUS) to

42 Office of the Deputy Prime Minister, Sustainable communities: building for the future, February 2003
43 Ev 212 [Tony Bolden & Reg Harman]; see also Ev 33 [Association of Transport Coordinating Officers (ATCO)]; Ev 191 [Transport 2000]
franchise specifications, with adjustments to previous stages along the way. One franchise operator, GNER, also emphasised the vital importance of always having the RUS in place so that there is full clarity regarding capacity and access on a route before the consultation on franchise specification. The Department’s Regional Planning Assessments for a route should also be consulted upon and published before the franchise specification process.

**Figure 1: SRA industry planning framework**

![SRA industry planning framework]

Source: adapted from Ev 195, Jim Steer

29. The Government has recently indicated that, in line with the 2004 White Paper, it is seeking to engender greater coordination of the long-term planning for the network. This coordination incorporates the elements of the SRA model as illustrated in Figure 1. Crucially, the Government does not commit itself to a linear sequential approach. Notably, the High Level Output Specification (HLOS) will not necessarily precede the RPA and RUS. We welcome the fact that the Department for Transport is taking steps to better integrate the franchising process with long term strategic plans, Regional Planning Assessments (RPA) and Route Utilisation Strategies (RUS). This is a move in the right direction. We are, however, concerned that the Government has failed to embrace the notion of RPAs, RUS and franchise specifications flowing from a wider strategic plan rather than the other way round. This approach is likely to result in perpetuation of the status quo rather than development based on a strategic vision for what is required and desirable for the future.

**Pre-specification consultation**

30. The full process of re-letting a franchise takes about two years. It involves three distinct phases, the specification, procurement, and mobilisation stages, as set out in Table 1 above. At the specification stage, the Department for Transport determines what services should be procured. Through an iterative process, the Department draws on available Route Utilisation Strategies (RUS), as well as forecasts of future demand. The industry is

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44 Ev 195 [Jim Steer]
45 Ev 7 [GNER]. See also Ev 5 [First Group], and Ev 195 [Jim Steer]
47 Department for Transport, *The new system for the role of English PTEs in the rail franchising process*, 21 July 2006, paras 2.1–2.9
48 Ibid. Para 2.2; Ev 205 [North West Group of Labour MPs] noted that in the case of the North West, where operators are now bidding for three new franchises, even though neither the regional RUS nor the RPA had been completed.
50 Following the Railways Act 2005, Network Rail took over responsibility for the development of Route Utilisation Strategies across the network. As explained by the Office of Rail Regulation (ORR), “a RUS takes a strategic look at the rail network and its usage and capability in relation to current and future demand. Where shortfalls in capacity are identified, the RUS will identify options for addressing them. These options may involve timetabling changes or investment. A RUS therefore seeks to balance capacity, passenger and freight demand, operational performance, infrastructure maintenance, and costs, to address the requirements of funders and stakeholders.” See: http://www.rail-reg.gov.uk
consulted throughout this process, particularly Network Rail, which provides timetabling assistance during the development of the service specification. The initial service specification is then put out for consultation, at which point Passenger Transport Executives (PTEs) and organisations representing passengers are invited to comment on the initial specification. When comments made during the consultation process have been considered, and integrated into the service specification, the Department issues an invitation to tender.

**Consultation with the industry**

31. The Association of Train Operating Companies (ATOC) stressed the importance of consultation with Train Operating Companies (TOCs) throughout the service specification process, because TOCs are in daily contact with customers and are inevitably closer to the market than those specifying the franchise. ATOC was content that in recent franchise rounds, the Department had taken account of responses from TOCs. Govia also valued the informal consultation with the DfT, but told us that operators often chose not to participate in the formal consultation process because they wanted to preserve competitive confidentiality around their ideas for franchise delivery.

**Consultation with passengers**

32. Organisations representing passengers were not, on the whole, impressed by the DfT’s efforts to consult passengers. Transport 2000 pointed out that there is no statutory obligation for the Department to consult widely among passengers and other interested parties about the design of franchised services. In their view, consultation was far too restrictive, and sometimes failed to take on board concerns expressed by passengers, environmental groups as well as local authorities. A number of witnesses acknowledged that the willingness to consult with passengers and take account of their views had increased significantly since the Department for Transport had taken over the franchising process from the SRA, though they believed that there is ample room for further improvements. Passenger Focus, the South Hampshire Rail Users Group and the Railfuture Northeast all believed that this improvement was beginning to feed through into actual service specifications, reporting that significant changes had been made either as a result of their involvement or of general public

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51 Ev 142 [Department for Transport]
52 Ibid.
53 Ev 109 [Chartered Institute of Logistics and Transport]
54 Ev 1 [ATOC]
55 Ibid.
56 Ev 9 [Govia]
57 See Ev 208 [Simon Norton]; Ev 42 [Railfuture Northeast]; Q107 [Mr Pout, Railfuture]; Ev 191 [Transport 2000]
58 Ev 191 [Transport 2000]
59 Ev 36 [Passenger Focus]; Ev 42 [Railfuture Northeast]
pressure.\textsuperscript{60} Passenger Focus was currently carrying out research on passenger priorities for the three franchises to be let in 2007.\textsuperscript{61}

34. We are pleased to learn that, since the demise of the SRA, there has been some improvement in the willingness to consult with passengers about franchise specifications. Given that improvements in passenger services is one of the Government’s key objectives for the franchising process, passenger views and aspirations surely have to be at the heart of the franchising process. A **broad-based consultation with passengers should be a statutory requirement, and we recommend that the Government include such provisions in its next railways bill.**

**Consultation with regional and local authorities**

35. The Department for Transport incorporates the views of local authorities, PTEs and Transport for London (TfL) into franchise specifications through the formal consultation stage. At this stage, TfL and PTEs can also exercise their right to buy additional services (increments) or propose savings (decrements).\textsuperscript{62}

36. Many of our witnesses emphasised the importance of consultation with local and regional authorities. ATCO noted that local government transport coordination officers are able to add significant value at the specification stage because they have local knowledge about travel patterns and are better placed than outsiders to evaluate local needs.\textsuperscript{63} National Express Group also highlighted that the involvement of local and regional authorities in the specification process enabled them to develop partnerships with TOCs at a stage where they could contribute, for example, to plans for the modernisation and expansion of stations.\textsuperscript{64}

37. As with passenger consultation, some of our evidence noted improvements in the willingness to consult with local and regional authorities since the DfT had taken over responsibility for franchising from the SRA.\textsuperscript{65} ATCO noted that the consultative process is more professional under the DfT, and that there has been “an openness and willingness to come out and meet local authorities.”\textsuperscript{66}

38. The Passenger Transport Executive Group (PTEG) pointed out that the franchising process has to address the inherent tension between national and local objectives. The letting of the Northern Franchise in 2005 illustrated this tension. In some parts of the franchise, rail services were overcrowded to the extent that passengers were regularly unable to board trains, and Local Transport Plans in the area included targets for further growth of rail patronage. Extra capacity was required to handle existing volumes of

\textsuperscript{60}Ev 169 [South Hampshire Rail Users Group]; Ev 42 [Railfuture Northeast]; Q 125 [Mr Foxall, Passenger Focus]

\textsuperscript{61}Ev 36 [Passenger Focus] The three franchises are: the West Midlands, the East Midlands and the Cross Country franchises. See the Annex to this report.

\textsuperscript{62}Ev 142 [Department for Transport]

\textsuperscript{63}Ev 33 [ATCO]

\textsuperscript{64}Ev 13 [National Express]

\textsuperscript{65}See for example: Ev 33 [ATCO]; Ev 13 [National Express]

\textsuperscript{66}Ev 33 [ATCO]
passengers, let alone further growth, but the re-franchising agreement did not include any requirement to increase capacity, let alone funding for investment to expand capacity.67

**The involvement of PTEs and TfL**

39. Prior to the Railways Act 2005, PTEs had the right not only to be consulted about the specification of rail franchises which affected them, but to be co-signatories to such franchise agreements. This meant that they were able, in effect, to specify service levels and quality for all their local services.68 The Act removed this provision, and reduced PTE powers to the same level as previously held by Transport for London (TfL). The White Paper which preceded the Act indicated the Government’s reasons for reforming the role of PTEs in relation to rail franchising. It argued that the old system was associated with a disproportionately high level of expenditure on rail in some conurbations outside London. This resulted in part from PTEs having a direct say over franchise specifications, but no financial responsibility for these decisions as the general UK taxpayer footed the bill.69

40. The Department for Transport published guidance on the new role of PTEs in the franchising process in July 2006. The guidance emphasises that PTEs remain central to the DfT’s bid to improve coordination of long-term planning for the rail network.70 It highlights the continued statutory right of PTEs to be consulted about the specification of rail franchises, as well as at key stages during the franchise cycle, their right to buy extra services or propose savings to be included in the franchise specification71 and to enter into direct agreement with franchise operators about enhancements to the rail service or ancillary infrastructure, such as CCTV.72 On this background, the Minister did not accept that PTEs were being marginalised in the franchising process.73

41. PTEG took a very different view, arguing that key specifications were now determined by the Department on its own, with PTEs only able to add, reduce or remove services round the fringes. Consultation did not make up for the loss of co-signatory status.74 David Franks from the National Express Group added that where, before the Act, PTEs had had a lever to force through service requirements that were vital to them, this was no longer the case. The balance of power in terms of the specification of franchises in PTE areas had shifted significantly.75 Transport for London felt hamstrung by the current system for specification as well as management of franchises.76 It argued that “it is essential that the

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67  Ev 65 [PTEG]; see also Ev 33 [ATCO]
68  Q 128 [Mr Sargant, PTEG]
70  Department for Transport, *The new system for the role of English PTEs in the rail franchising process*, 21 July 2006, section 2
72  *Ibid.* para 6.3
73  Q 517 [Derek Twigg MP, Parliamentary Under Secretary of State for transport]; See Also Q 521 [Mark Lambirth, Department for Transport]
74  Q 128 [Mr Sargant, PTEG]
75  Q 97 [Mr Franks, National Express Group]
76  Although from November 2006, Transport for London will take over the current Silverlink Metro franchise from the Department for Transport, and the services will be re-franchised by TfL as the North London Railway in November 2007. See Ev 69 [Transport for London]; See also Department for Transport press release, *Mayor to take*
relevant principal transport planning authority [such as TfL] is able to influence outputs and selection of franchises where these play a key role in the effective provision of multi-modal transport in densely populated urban areas.77

42. The franchise operator, National Express Group, said that from their point of view, cooperation with PTEs had been fruitful,78 and Mr Cousins for Railfuture pointed out that PTEs had been a force for good in terms of investment in local infrastructure and staffing at stations. This was noticeable when crossing the border out of PTE areas into areas that had not benefited from PTE investment.79

43. The Mayor of London was in the process of seeking extended powers so as to be able to influence fares and the integration of rail with other transport modes through, for example the Oyster smartcard system.80 The transport consultants Tony Bolden and Reg Harman went further, arguing that in order to ensure an efficient matching of local and regional rail services to local needs, responsibility for the franchising of services other than the main inter-city trunk routes should be transferred to public bodies at regional and city level, for example PTEs.81 Merseytravel82 told us that localised decision-making had enabled them to deliver new stations and boost regeneration by aligning rail strategy with wider regional economic, spatial, and transport strategies.83

44. Local and regional needs and priorities should be a central factor in the determination of rail services. These considerations must not take precedence over a national strategy, but should be integrated with it. The Government’s role is to ensure that a balance is achieved between different parts of the network, between urban and rural areas and between conurbations with and without PTEs. The removal, in the Railways Act 2005, of the statutory right of PTEs to co-sign franchise agreements was a mistake. We therefore recommend that the Government consult PTEs in order to determine what adverse consequences have resulted from it, and take steps to address them. We also recommend that franchise specifications should take account of regional and inter-regional economic strategies.

Procurement — the bidding process

45. Once a franchise specification has been completed and published, the Department for Transport invites expressions of interest from potential bidders for the franchise. The aim of this pre-qualification process is to ensure that the number of actual bids in the subsequent round is kept small and the quality of bids high. The intention is for three to

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77 Ev 69 [Transport for London]
78 Q 88 [Mr Franks, National Express Group]
79 Q 121 [Mr Cousins, Railfuture]
80 Ev 69 [Transport for London]
81 Ev 212 [Tony Bolden & Reg Harman]
82 Merseytravel is “a public body comprising the Merseyside Passenger Transport Authority (MPTA) and the Merseyside Passenger Transport Executive (MPTE)“ with the objective of creating and managing an integrated transport network for Merseyside. See Ev 59
83 Ev 59 [Merseytravel]
five bidders to be pre-qualified and submit full bids. \(^8^4\) Once expressions of interest have been submitted, pre-qualification is now based on a scoring system where 70% of points are awarded for proven track record of service and financial management in relevant areas of activity, and 25% of the points are awarded for the proposed plans for mobilising and operating the franchise with the remaining 5% awarded for the approach to bidding. \(^8^5\) The Department stresses that the recent shift of emphasis towards past performance ensures that only companies who are likely to be able to run a franchise well go forward to the full bidding stage. \(^8^6\) The emphasis upon past performance might potentially pose a problem to new market entrants, an issue we consider below.

**The criteria for bid selection**

46. The criteria and weighting of different factors in the evaluation of franchise bids have changed significantly and frequently since the first round of franchises. The Railway Consultancy commented that criteria had often been problematic because of a lack of empirical measurement and inadequate clarity and public accountability about the criteria used. \(^8^7\) Since the Department for Transport took over the role of franchise selection from the SRA, efforts have been made to make the process clear and transparent through the publication of relevant documentation on the Department’s website. \(^8^8\)

47. In the current system, bidders who have passed through the pre-qualification process are subsequently invited to submit a full bid on the basis of the detailed specification for the franchise. The Department emphasised that the franchise specification is critical because it ensures a “level playing field” where bids are directly comparable because they are based on, and measured against, one set of output and performance requirements. The Department highlighted that the evaluation is based on an analysis of “the reliability of operational deliverability and the achievability of the bid revenue”. These factors being equal, the most competitive bid, providing the best overall deal for the taxpayer, is selected. \(^8^9\)

**Innovation**

48. Mr Segal of the MVA Consultancy argued that the criteria for selecting bids were weak because they did not promote innovation. He explained that if a bidder had “some great brilliant idea which is not quite formally compliant”, it would not be considered in the evaluation process. \(^9^0\) Once a bidder had met the moderately high quality threshold, quality

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84 Department for Transport, *A guide to the railway franchise procurement process*, 31 March 2006, para 5  
85 Ev 142 [Department for Transport]  
86 The assessment of track record will only go back to 2001, and thus not cover the first generation of contracts let by OPRAF. See: Department for Transport, *A guide to the railway franchise procurement process*, 31 March 2006, 2  
87 Ev 93 [Railway Consultancy]  
88 See [http://www.dft.gov.uk](http://www.dft.gov.uk)  
89 Ev 142 [Department for Transport]  
90 Q 225 [Mr Segal, MVA]
effectively ceased to be a key factor in the choice of bids: “somebody who is one inch above the threshold is just as likely to get it as somebody who is a foot above the threshold.”

49. GNER countered this argument by arguing that it is better for new requirements and innovative ideas to be included in the franchise specification because that would bring “the combined commercial ingenuity of all bidders to bear on a specified issue” and enable the Department to select the bidder who can provide the new service at the best value for money. As an example, the recent South West franchise competition was mentioned, where bidders were challenged through the specification to make their systems compatible with Oyster smart-ticketing.

50. We are concerned by evidence that the franchise bidding process is failing to encourage bidders to innovate when putting together their bids. Given that franchise contracts are highly specified, leaving very little room for innovation and development once a franchise has been awarded, it is particularly worrying that the system also fails to reward innovation at the bidding stage. Surely, one of the basic objectives of having regular re-franchising competitions is to ensure that fresh thinking and innovation is brought to bear on the provision and management of rail passenger services.

51. In more general terms, we were concerned to find that examples of innovation by franchise operators mostly fell a long way short of real innovation. When we asked train operators to provide examples of their innovative advances, he heard of only one example of real innovation. This was a case of timetabling problems being resolved innovatively to facilitate extra services. Other examples mentioned were revenue protection and wi-fi internet access on trains. Revenue protection, however, is no innovation, and should be considered as a basic performance requirement, whilst wi-fi hardly revolutionises services for the majority of passengers. Increasing innovation is one of the stated key objectives in involving the private sector in running the passenger railways. The Government must ensure that real innovation contained in franchise bids is rewarded, even where it goes beyond the strict requirements of the franchise specification.

Cost – subsidies and premiums

52. There was broad agreement among witnesses that cost had risen right to the top of the Government’s list of priorities when letting franchises. On subsidised parts of the network, the emphasis is on reducing subsidies whilst on profitable parts of the network, the focus is on maximising the premium paid by the franchise operator to the Government. The Railway Forum emphasised that the shift towards some parts of the network effectively raising money for the Treasury marked a fundamental shift in the balance of railway economics away from the traditional model where the Government consistently pays franchises modest, if declining, subsidies. Several franchise operators

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91 Qq 211–213 [Mr Segal, MVA]
92 Ev 7 [GNER]
93 Q 5 and Q 30 [Mr Franks, National Express Group]; Q 34 [Mr Metcalf, GNER]
94 See: Ev 5 [First Group]; Ev 13 [National Express Group]; Ev 42 [Railfuture Northeast]; Ev 17 [Railway Forum]; Ev 36 [Passenger Focus]
95 Ev 17 [Railway Forum]
had noticed the shift in priorities. National Express told us that they were concerned about “the lowest subsidy or the highest premium line […] emerging as the dominant reason for awarding a franchise” emphasising that wider questions of best value, deliverability and meeting many other policy initiatives that Government is promoting” should be properly taken into account also. Even the rail regulator, the ORR expressed concern, emphasising the importance of encouraging innovation and responsiveness, emphasising that “franchise tendering exercises which focus on the level of premium or subsidy to the exclusion of other desirable qualities may not always achieve this.” Passenger Focus was concerned that the trend towards franchises paying premiums would be to the detriment of passengers because operators would cut services in order to meet their premium obligations. Railfuture Northeast summed up the concerns:

“The evidence available from the recently awarded GNER and [Greater Western] franchises suggests that whatever window dressing may be applied, the evaluation of franchises is now dominated by direct financial return to the Government. This is unhelpful not only because the return is so far into the future that some may consider it illusory but also because it fails to give adequate recognition to the wider economic needs of communities or to the qualitative benefits of supporting services needed and offered.”

53. In 2004–05, the Government made net franchise payments to Train Operating Companies (TOCs) of £878 million and Passenger Transport Executives (PTEs) of £277 million, a total of £1,155 million in direct subsidies for passenger rail operations (see Table 1). Franchise net payments made up some 30% of total government support to the railways in 2004–05.

54. Franchise net payments vary significantly among the TOCs. In 2004–05 Virgin CrossCountry received £118.5 million whereas ONE paid the Government £45 million. They also vary significantly depending on the stage of the franchise contract. In the new Greater Western franchises, First Group will receive £97.4 million in subsidy during the first year of the contract, but in year 10 it has to pay £427.7 million. Variation in franchise net payments leads to variation in subsidy per passenger kilometre. In 2004–05, ARRIVA Trains Northern received a subsidy of 16.1 pence per passenger km, whereas Gatwick Express paid the Government 8.1 pence per passenger km for the opportunity to operate a profitable route.

96 Ev 13 [National Express Group]; see also Ev 5 [First Group]
97 Ev 132 [Office of Rail Regulation]
98 Ev 42 [Railfuture Northeast]
99 Department for Transport: http://www.dft.gov.uk
100 Strategic Rail Authority Annual Report 2004–05, Appendix 3; HC Deb, 9 May 2006, col 139W lists the premiums and subsidies payable over the lifetimes of the seven rail franchises awarded over the two years up to May 2006. These range from a £2.43 billion Government subsidy to the Northern Rail franchise over less than nine years to a £1.36 billion premium payable to the Government for the ICEC franchise over ten years.
101 Department for Transport, Franchise payments year by year, available at: http://www.dft.gov.uk Figures are in 2006–07 prices. In the Greater Western franchise, the operator receives a declining subsidy in each of the first three years of the contract, but is expected to pay a steadily increasing premium over the remaining seven years. The Greater Western franchise will produce a net payment to the Government of nearly £1.47 billion over ten years in 2006–07 prices. Expressed in present value of the nominal payment, the figure is £1.13 billion.
102 Strategic Rail Authority (SRA) Annual Report 2004–05, Appendix 5
Table 2: Government funding for the railways in £million (actual prices unless otherwise indicated)

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<tbody>
<tr>
<td>Direct Government Support to Franchises</td>
<td>878</td>
<td>812</td>
<td>1,075</td>
<td>929</td>
</tr>
<tr>
<td>Grants to PTEs</td>
<td>277</td>
<td>267</td>
<td>285</td>
<td>283</td>
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<tr>
<td>Direct Grants to Network Rail</td>
<td>2,058</td>
<td>1,984</td>
<td>2,671</td>
<td>2,620</td>
</tr>
<tr>
<td>Channel Tunnel Rail Link</td>
<td>312</td>
<td>1,380</td>
<td>1,181</td>
<td>180</td>
</tr>
<tr>
<td>Freight Grants</td>
<td>26</td>
<td>5</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>296</td>
<td>134</td>
<td>201</td>
<td>175</td>
</tr>
<tr>
<td>Total</td>
<td>3,747</td>
<td>4,582</td>
<td>5,554</td>
<td>4,328</td>
</tr>
<tr>
<td>Total adjusted for inflation</td>
<td>3,747</td>
<td>4,440</td>
<td>5,311</td>
<td>4,031</td>
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Source: Department for Transport Annual Report 2006, table 5d, page 97

55. Financial support to franchise operators also take forms other than direct subsidy, such as compensation from Network Rail for infrastructure failure\(^{103}\) or from the Department for Transport for losses incurred through industrial action.\(^{104}\) Professor Jean Shaoul highlighted that there is very little transparency about subsidies and compensation for franchise operators.\(^{105}\)

56. The Department for Transport has signalled that the franchise award criteria have been broadened to take greater account of non-financial aspects.\(^{106}\) Whilst cost in purely financial terms is central to the evaluation of franchise bids under the current regime, there is little evidence that less tangible costs and externalities are considered at all. Environmental criteria are not used, and operators have therefore been free to opt for increasingly heavy rolling stock. This is problematic not only because it increases emissions, but also because it increases wear and tear to rail tracks. Mr Ford told us that in environmental terms, the railways were losing the edge over cars and planes.\(^{107}\)

57. We acknowledge the Government’s commitment to fiscal prudence and value for money. We are, however, concerned that too much weight is attached to price when it comes to evaluating franchising bids. Our evidence suggests that the effort to reduce subsidies and increase premiums is taking precedence over the objectives of improving passenger services, securing environmental benefits and ensuring adequate development and investment in services for the future. A re-balancing of the importance of cost among the criteria for the evaluation of franchise bids is urgently required. We recommend that the Government develop ways of evaluating cost relative to proposals for innovation and franchise development over and above the basic franchise specification. The re-balanced evaluation criteria should also take into account less

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104 HC Deb, 24 November 2005, col 2226W; HC Deb, 15 May 2003, col 340W
105 Jean Shaoul, op. cit. p 6
106 Ev 142 [Department for Transport]; see also Ev 17 [Railway Forum]
107 Qq 308 and 313 [Mr Ford]
tangible costs and benefits such as wider environmental and socio-economic factors. This would serve to reward innovation and development whilst retaining cost as a criterion.

58. We are concerned that the drive to extract premiums from some parts of the network will result in further above-inflation fare increases and a deterioration in customer service, investment and innovation. Where rail franchises are profitable, the structure of premium payments to the Government should provide incentives for franchises to invest and be more innovative. We recommend that future contracts include the possibility to make a proportion of the premium payments from a franchise available for re-investment directly into that franchise or into infrastructure used by the train operating company involved. Such reinvestment should be dependent on clear, specific and innovative investment proposals from the operator with a demonstrable benefit to passengers and the environment.

The cost of bidding for franchises

59. The cost of running the re-franchising process is significant, both to bidders and the Government. ATOC estimated that it costs each bidder between £3m and £5m to bid for a franchise, and the Department for Transport also spends substantial sums on the re-franchising process. In response to Parliamentary Questions, the Department for Transport revealed that between April 2001 and April 2004, the SRA had incurred total costs of £40.7 million on franchise replacements and extensions. This figure included the full costs of tendering and implementation. Between April 2004 and November 2005, £14.4 million had been spent. The Department estimated that the annual expenditure for the DfT would be approximately £11 million in each of the financial years 2005–06 and 2006–07. The cost to the DfT of each franchise award was estimated to be in the region of £2.5 million. The Department is seeking to reduce its own cost by reducing the use of external consultants, but this process is expected to take some time. The combined cost of a franchise award with just three bidders is thus estimated to lie between £11.5 million and £17.5 million.

60. Tom Smith from the Govia Group explained that the cost to operators of submitting a franchise bid was driven by the level of detail required by the Department from each bidder. Mr Smith noted that when Govia bid for the Integrated Kent Franchise in 2005, its bid had consisted of 22 lever arch files, all of which had to be submitted to the Department in six copies. Govia said the requirements were becoming ever more theoretical, and indicated that there was a risk bidders could win simply on “good exam technique”. Govia pointed the finger at the involvement of consultants as the driver of the escalating complexity and cost of the bidding process. It was now common for bidders to pay £2

108 Ev 1 [ATOC]
109 HC Deb, 7 June 2004, col 4W; HC Deb, 22 November 2005, col 1857W
110 Qq 507–510 [Mr Lambirth, Department for Transport]
111 Using the cost estimates from the DfT and ATOC referred to above, the minimum cost in a round with three bidders and the lowest estimated cost to each TOC would be £2.5m+(3x£3m)=£11.5m. If the higher estimate of costs to each TOC was used, the calculation would be £2.5m+(3x£5m)=£17.5m
112 Q 50 [Mr Smith, Govia]
23

million in consultancy fees in connection with the preparation of a franchise bid. Mr Smith said:

“I do not believe the Department needs a complete encyclopaedia of how to run a railway in order to evaluate a bid. It certainly needs detailed and robust financial information and it needs to be able to satisfy itself that a prospective franchisee, a bidder, has thought about the operational and commercial challenges of the franchise in question to a sufficiently robust degree to be able to pick up the threads of running the business and make a success of it and deliver their financial outcomes. I do not believe they need the volume they are requiring at the moment and personally I feel it has gone that way because the Department have allowed themselves to be consultant led, consultant driven, in terms of specification of requirements”

61. National Express Group offered a slightly different explanation for the spiralling complexity and cost of the bidding process, arguing that the Department was driven, at least in part, by fear of legal action by unsuccessful bidders. Mott MacDonald, a consultancy firm also pointed to the risk of litigation as a factor. Mott MacDonald argued that the high level of complexity was an inevitable consequence of a competitive market where bids were of a high quality. With little to separate the bids, the process had to enable the Department to differentiate between relatively small differences in the offers, without being open to legal challenge.

62. Railfuture Northeast believed that the cost of the re-franchising process is a fundamental flaw in the system because it diverts resources from the core objective of running and developing a railway. Although the Department for Transport is looking to reduce its own costs through a reduction in the use of consultants, it argued that current re-franchising costs should be seen in the light of the average annual revenue of a franchise which was around £200 million.

63. The process of letting passenger rail franchises to private companies needs to be thorough and fair, and it must establish a healthy balance between good services to passengers and best value for money for taxpayers and passengers alike. That said, we are concerned by the current complexity and costs of the re-franchising process. We fear the re-franchising process is driven more by consultants and lawyers than by people with an in-depth understanding of the railways and what is required to run good passenger services, now and in the future. We urge the Government to revise its re-franchising procedure to focus clearly on the core requirements, weeding out unnecessary detail. Costs incurred by bidders will eventually be paid by taxpayers and passengers through increased fares, and subsidies or decreased premiums. It is therefore in the public interest to keep the costs of the re-franchising process at the lowest possible level.

113 Ev 9 [Govia]
114 Q 50 [Mr Smith, Govia]
115 Ev 13 [National Express Group]
116 Ev 89 [Mott MacDonald]
117 Ev 42 [Railfuture Northeast]
118 Q 511 [Mark Lambirth, Department for Transport]
64. The Rail Division within the Department for Transport should be staffed so that, on the whole, it can manage the entire process of re-franchising without outsourcing significant parts of the work to external consultants. Consultants should be used only to deal with the occasional special or unusual aspect of a franchise specification and procurement. We recommend that the Department review its staffing requirements and establish clear guidelines for the use of consultants. We would expect such guidelines to be made publicly available with performance against them open to scrutiny.

The role of the competition authorities

65. Franchise awards are treated as mergers under the Enterprise Act 2002. As with other mergers, bids are referred to the OFT for an evaluation of potential competition issues, and where concerns are identified, the case is referred to the Competition Commission for an in-depth investigation. The Commission may impose restrictions or conditions on the bid if concerns are confirmed by its investigation. A total of five franchise bids, involving three different companies, have been referred to the Competition Commission since 2002. The Commission imposed conditions in only one of these cases. Such conditions could be (partial) divestments, price controls or other forms of regulation.

66. The way the Act is applied to rail franchising has changed several times in recent years. Initially, notification was voluntary, and investigations carried out retrospectively, sometimes initiated on the basis of complaints. During the 2004–05 period, every single bid was required to be referred to the OFT at the bidding stage. Referrals to the Competition Commission were also initiated before the franchise was actually awarded. This meant that all bidders had to go through the OFT process, and sometimes the Competition Commission process as well, even though most did not win the franchise. For each franchise round, three to five bids were reviewed, all but one of them in vain. National Express and First Group both estimated that it costs a bidder in the region of £1 million to take a bid through the full competition process, including a referral to the Competition Commission. Mr Franks of the National Express Group indicated that this figure was on the increase. To arrive at the total cost for each bid, the costs borne by the taxpayer would have to be added to this figure.

67. In recognition of the significant, and often redundant cost, of the competition process, the Competition Commission, the OFT and the Department for Transport have agreed to change the system so that in future, only the winning bid will be subject to the Competition

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119 Ev 135 [Competition Commission]; Ev 204 [Office of Fair Trading]
120 Ibid.
121 Q 369 Mr Banfield, [Competition Commission]; Ev 135 [Competition Commission] lists the franchises and bidders in question. The three companies are: First Group Plc (two referrals), National Express Group Plc (two referrals), and Stagecoach Holdings Plc (one referral).
122 Ev 135 [Competition Commission]; In the case of the Scotrail franchise, awarded to First Group plc, the Competition Commission anticipated a substantial lessening of competition, particularly in the Glasgow area. Controls were therefore imposed, including for example with reference to fares.
123 Ev 204 [Office of Fair Trading]
124 Ibid.
125 Q 49 [Mr Franks, National Express Group; Mr Furze-Waddock, First Group]
process.126 The new process was implemented for the first time with the South Western franchise, awarded to Stagecoach on 22 September 2006.127 These changes will reduce the cost to the taxpayer as well as the costs of companies who fail in their bids.

68. Despite these recent changes, the OFT expressed concern that the competition process for rail franchises is less than effective. It argued that competition considerations should be brought into the process at a significantly earlier stage, and be incorporated into the design of franchises rather than awaiting analysis until the awards stage. The OFT explained that this is because “competition factors may conflict with other public policy considerations in the rail transport sector.” There is no formal integrated mechanism for resolving such tensions and therefore, “efforts to adopt a ‘joined up’ approach across government are complicated.”128 The late consideration of competition issues also means that the range of potential remedies available to competition authorities is reduced. Structural remedies such as divestment may not be feasible at a late stage, making it more likely that price or service regulations have to be used. Such regulation is costly.129

69. Mr Franks of National Express Group also told us that where a company was referred repeatedly to the Competition Commission in different franchising processes, an enormous amount of time and effort could be saved, were it possible for that company’s case to be resurrected from previous rounds. At present, the process starts from scratch with every franchise competition.130 Mr Furze-Waddock from First Group argued that the competition process needed to recognise that:

> “the franchising process already identifies a service level that operators have to sign up to and there is no varying that without going back to the Department for Transport, […] there is a high degree of fares regulation both directly and indirectly, […] there is very little substitutability between bus and rail, apart from a very few exceptions where there are overlaps that could be substitutable, and [it should also be recognised] once and for all that the car is the big competition, which they singularly fail to do every time and they just look at the small picture”.131

70. Although remedial action has been imposed in only one case since 2002, the fact that three large transport groups each with significant bus or coach divisions currently own, or have significant stakes in, thirteen passenger rail franchises in England and Wales is an indication of the importance of having a robust and effective competition process.132 The apparent difficulty in designing a simple and cost-effective mechanism of competition scrutiny to safeguard passengers against the abuse of dominant position by such large players is symptomatic of fundamental problems in the system of rail franchising. The proposal that companies referred repeatedly to the Competition Commission should not

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126 Q 514 [Mr Jones, Department for Transport]; see also Ev 135 [Competition Commission] and Ev 204 [Office of Fair Trading]
127 Ev 135 [Competition Commission]; Ev 204 [Office of Fair Trading]
128 Ev 204 [Office of Fair Trading]
129 Ibid.
130 Q 50 [Mr Franks, National Express]
131 Q 50 [Mr Furze-Waddock, First Group]
132 The three companies are First Group, National Express Group and Stagecoach Group. The latter has a 49% stake in Virgin Rail Group.
need to start afresh every time is unlikely to save much time and effort. This is because the market circumstances will be different in every franchise, and the company’s position is also liable to change over time. The Government must consider, in cooperation with the OFT and the Competition Commission, the suggestion of incorporating competition considerations into the specification of franchises. It must also monitor the effects of the new process for referral to competition authorities only once a franchise has been awarded to ensure that the late referral does not limit the range of remedies available to the Competition Commission. It is vital that the Commission has the full range of structural remedies at its disposal to prevent abuses of dominant position by monopolist operators.

**Barriers to new market entrants**

71. The UK rail franchising market is relatively concentrated with just three large transport groups either owning outright or holding more than 48% of shares in the operators of fourteen passenger rail franchises in the UK. The franchising market has also attracted very few new entrants in recent years. Govia noted that most companies bidding for franchises are now either transport groups that entered the market around the time of privatisation or overseas rail operators. In the competition for three franchises taking place in the autumn of 2006, eight different companies were pre-qualified to bid, and all but one currently operate rail franchises in the UK. Several factors may act as barriers of entry to the franchise market. Firstly the cost and complexity of bidding for a franchise may act as another disincentive for potential newcomers. Secondly, the relatively new emphasis upon past performance in the evaluation of bids is clearly a handicap to companies that have not previously managed rail franchises.

72. The ORR emphasised the importance of attracting bids from the “widest possible range of private sector operators” in order to introduce fresh ideas and working practices to the sector. Mr Segal of the MVA consultancy argued that one partial solution could be to consider the performance record of new market entrants in other business sectors when evaluating their franchise bids. The absence of new entrants into the passenger rail franchising market is a clear indication of unreasonably high barriers to entry. Whilst we agree with the Government’s policy to include past performance as a criterion for

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133 The Annex to this report lists the companies currently managing passenger rail franchises in England and Wales. In Scotland, the Scotrail Franchise is run by First Group. The three large transport groups are First Group, National Express Group, and Stagecoach Group. See page 52.

134 Q 142 [Mr Hewitson, Passenger Focus]

135 Ev 9 [Govia]

136 Some were pre-qualified for more than one of the franchises.

137 According to the Department for Transport Stock Market Statement, released 19 September 2006, the companies pre-qualified to make full bids in the three current re-franchising processes are subsidiaries of the following groups: Cross Country franchise: Arriva Group, First Group, National Express Group, Virgin Rail Group; East Midlands franchise: Arriva Group, First Group, National Express Group, Stagecoach Group; West Midlands franchise: Govia, MTR Corporation of Hong Kong, Serco NedRailways (Joint Venture between Serco and NedRailways).

138 Q 53 [Mr Austin, ATOC]; Q 56 [Mr Metcalf, GNER]; Q 243 [Dr Brown, Halcrow Rail]; Q 355 [Mr Emery, ORR]; Q 363 [Mr Beswick, ORR]

139 Q 233 [Mr Segal, MVA Consultancy]

140 Ev 132 [ORR]

141 Q 233 [Mr Segal, MVA Consultancy]
new franchise awards, we are deeply concerned that a small number of companies have come to dominate the franchising market. There is little evidence of the Department positively encouraging new entrants, and we recommend that steps be taken to bring new companies into the franchising market. Our recommendation to cut the cost and complexity of the bidding process would also serve to make the market more attractive to new entrants.
4 The management of the passenger rail franchising system

73. The Department for Transport told the Committee that, since the 2004 White Paper, it has been “driving forward improvements to the franchising process, in collaboration with industry partners, through new working practices and changes to contractual relationships.” Many of these changes have taken their expression in the nature of franchise agreements, and in the process and cost of bidding for such contracts. Have they struck the right balance?

Level of detail in franchise agreements

74. The Department for Transport aims to balance the need for flexibility for private operators to innovate and apply commercial judgment with the need to achieve its own high-level objectives through service specifications and targets used in the franchise procurement process as well as subsequent contracts. Specifications in franchising contracts are intended to secure five key objectives:

i. to set out the level of train service provision required (through a review of historic provision and forecast of future demand) where, otherwise, market forces would not normally deliver;

ii. to protect the passenger from monopolistic actions in specific markets (e.g. through regulation of London commuter fares);

iii. to protect the benefits of a national rail network in the UK mainland;

iv. to provide a “level playing field” for a competition to successfully award the franchise within the terms of procurement legislation and general best practice; and

v. to allow the specification to be varied over time to reflect emerging market needs through innovation and commercial judgment.

75. We received much evidence suggesting that franchise contracts have become too detailed, restricting the scope for innovation and the flexibility of franchise operators to react to changes in market conditions.

76. The Department for Transport is clearly aware of this criticism, and the Guide to the Railway Franchise Procurement Process published earlier this year emphasises that:

“the Secretary of State is keen to maximise input and innovation that bidders make to the detailed design of the timetable. The Secretary of State therefore intends to

142 Ev 142 [Department for Transport]
143 Ibid.
144 See Ev 42 [Railfuture Northeast]; Q 30 [Mr Metcalfe, GNER; Mr Franks, National Express Group]; Q 204 [Mr Valk, NedRailways]; Q 244 [Mr Segal, MVA]; Q 288 [Ms Bonar, Chartered Institute of Logistics and Transport]; Q 290 [Professor Nash]
avoid over-specifying the base service specification, whilst providing sufficient clarity about the requirements to ensure that there is a level playing field when bids are appraised.”\textsuperscript{145}

77. In recent re-franchising processes, the Department has also divided the franchise specifications into two sections, one containing standard terms that apply to all new franchises, and the other containing terms that are specific to the franchise in question.\textsuperscript{146} Train operating companies appeared to appreciate this recent innovation. Mr Smith of Govia commented that this separation improves both efficiency, market understanding and the general procurement process. Mr Furze-Waddock from First Group added that it concentrated minds on the things that are really important in a particular franchise.\textsuperscript{147}

78. We welcome the move towards a general set of base specifications that are used across all franchises, with a separate set of specifications setting out requirements that are franchise-specific. The base specifications should remain strictly limited to essential conditions. Franchise-specific conditions should be allowed to vary widely so that the tightness of service specifications can be tailored to the circumstances of individual franchises. Taxpayers are entitled to expect that heavily subsidised franchises have tighter specifications than ones that pay a premium.

79. Several witnesses pointed to the connection between risk, innovation and the level of detail in franchise agreements. National Express Group told us that, “as the only true customer facing part of the railway industry, the TOCs [should be] able to take risks appropriate to growing a true customer focused business and can be rewarded appropriately for taking those risks. At the moment, we feel unnecessarily constrained.”\textsuperscript{148} This problem manifested itself even during the bidding process where the tender specification stipulated a frequency of five trains per hour, but National Express Group wanted to offer six trains per hour. The Group gained nothing in the bidding process as a result of proposing an extra train every hour. Mr Franks warned that, “if you do highly specify the franchises at bid stage, it does prevent innovation if you are not careful.”\textsuperscript{149} The ORR concurred:

“…the government should place those commercial risks with franchised operators which the operators are best placed to manage. […] However, it would be difficult to expect them to do so unless they also had greater freedom over service specification and had the ability to make changes to services where this could impact on revenue. The need for this is likely to vary according to the involvement and requirements of the funder of the services. In some cases, particularly intercity services, we consider that too prescriptive an approach to service specification can prevent operators from

\textsuperscript{145} Department for Transport, \textit{A guide to the railway franchise procurement process}, 31 March 2006, para 13
\textsuperscript{146} Ev 142 [Department for Transport]
\textsuperscript{147} Q 31 [Mr Furze-Waddock, First Group; Mr Smith, Govia]
\textsuperscript{148} Ev 13 [National Express Group]
\textsuperscript{149} Q 30 [Mr Franks, National Express Group]; See also Q 225 [Mr Segal, MVA]; Q 288 [Ms Bonar, Chartered Institute of Logistics and Transport]; Q 360 [Mr Emery, ORR]
responding by using their expertise to optimise services in a way which meets the needs of passengers better.150

80. Whilst acknowledging that tighter and more detailed franchise specifications reduce the scope for innovation, Jim Steer, a consultant, argued that tight specifications are vital because they make it possible to compare bids fairly on dimensions other than mere price.151 Passenger Focus referred to a finding from the Strategic Rail Authority (SRA) that the only way to ensure that franchise operators make the desired improvements in the quality of passenger and station services is to specify this in the contract. The drawback, however, was a loss of innovation.152

81. A related point was made by Mr Sargant of PTEG who told us that a distinction needs to be made between franchises that are subsidized by the public purse and those which return premium payments to the Treasury. The former, he argued, need tight specifications to protect passengers’ best interests where these might be at odds with commercial interests, whereas the latter should be allowed greater freedom to innovate and improve services for passengers.153 The Department for Transport did not agree on this point, arguing that it is just as important to specify the base requirements in profitable franchises as it is in non-profitable franchises because a service which is profitable over all might nonetheless contain unprofitable elements which are deemed by ministers to be socially necessary.154

82. NedRailways explained to us that the Dutch system is structured around broad framework contracts that provide long-term direction relating to capacity growth, overcrowding and other broad issues. The broad long-term contract is complemented by more specific short-term agreements and targets, negotiated and reviewed on an annual or bi-annual basis. This contractual framework is more flexible than the model currently used in England and Wales, and as a result, there is more scope for innovation and cooperation between industry partners.155

83. The aim to attract private companies who are prepared to take commercial risks, provide innovation and adapt to market circumstances is fundamentally at odds with the need for the Department to guarantee the consistent delivery of a quality public service and value for money for taxpayers and passengers. On the one hand there is a need for loose and flexible franchise specifications with room for innovation and risk, and on the other hand there is a need for very tight specifications and targets. Franchise operators have very limited flexibility to innovate, and they assume only a relatively small part of the overall risk. This tension cannot be fully resolved within the current framework, but the Department could mitigate the problem to some extent by reassessing the gains and losses of its current approach with a view to achieving greater flexibility.

150 Ev 132 [Office of Rail regulation]
151 Ev 195 [Jim Steer]
152 Q 143 [Mr Foxall, Passenger Focus]
153 Q 166 [Mr Sargant, PTEG]
154 Q 475 [Mr Lambirth, Department for Transport]
155 Q 169 and 170 [Mr Valk, NedRailways]
Franchise length

84. The length of passenger rail franchises has varied significantly since privatisation. The majority of the 25 franchise contracts initially awarded after privatisation were short contracts of around seven years,156 and following a change of policy, franchises were meant to become much longer. But only one long franchise, Laing Rail’s 20-year contract for the Chiltern franchises was awarded by the Strategic Rail Authority (SRA) before the fall-out from the Hatfield crash caused another change in policy.157 Since the Department for Transport took over responsibility for franchising from the defunct SRA in 2005–06, franchise awards have been 8–10 years with a break clause before the final 2–3 years.158 Many witnesses in our inquiry agreed that the length of franchise contracts is crucial to the delivery and costs of services,159 but there is no clear consensus in the industry as to the optimal length.

85. Some witnesses, including many franchise operators160 suggested that short or medium length franchises, ranging between eight and 15 years were optimal:

i. If franchises become longer than 10–12 years, demand forecasting and the management of risks becomes much more inaccurate.161 It is particularly difficult to forecast up and down-turns in the economy for that kind of scale.162 This in turn is likely to increase the risk premium, and therefore make subsidy payments by Government higher or the premiums paid to the Government lower.163

ii. Relatively short franchises maintain the competitive pressure on operators, and prevent them from “going stale.”164

86. Others believed that franchises needed to be longer, for example 20 years. Transport 2000 argued that the current franchises are too short, and that this:

“discourages the kind of investment essential to a thriving railway and constrains franchisees as businesses. […] To make a profitable system out of the railways, companies need to know that their investment will be useful not just in the short term but in the mid and long term, with the proviso that companies are monitored at checkpoints during the franchise to ensure they are performing well and to enable action if they are not.”165

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156 Ev 222 [Professor Knowles]
157 Ev 195 [Mr Steer]
158 The Greater Western contract is a ten-year contract running from 1 April 2006, with the final three years dependant on performance targets being achieved. The Integrated Kent Franchise is an eight year contract running from 1 April 2006 with the final two years dependent on meeting targets.
159 See for example Ev 191 [Transport 2000]
160 Q 20 [Mr Metcalf, GNER]; Ev 9 [Govia]
161 Q 22 [Mr Austen, ATOC]
162 Q 21 and 22 [Mr Furze-Waddock, First Group]
163 Ev 109 [Chartered Institute of Logistics and Transport]
164 Ev 115 [Professor Chris Nash]; Q 116 [Mr Foxall, Passenger Focus]
165 Ev 191 [Transport 2000]; See also See Ev 208 [Lord Bradshaw]; Ev 208 [Simon Norton]
Merseyrail Electrics, the only English rail franchise not controlled by the DfT, is managed by a Passenger Transport Executive (PTE), Merseytravel. Merseytravel, which opted for a 25-year contract when letting the franchise, told us that their long contract was vital in order to secure a high level of commitment and investment from the franchise operator. The MVA consultancy, however, said that the notion of a link between investment and franchise length is misguided:

“TOCs do not have balance sheets able to support capital investment. Capital investment is either undertaken by the franchisee, Network Rail or some form of bank or finance house. Where investment of this kind is made, the funder merely needs to take a commercial view as to whether the asset will be of use beyond the length of the current franchise, and therefore lease payments made, or whether it needs a government underwriting to protect its position. In either case, there is no additional cost or risk to the TOC.”

87. Other arguments in favour of longer franchise contracts were:

i. Stagnation during the last years of a franchise means that innovation and new initiatives cease, and improvements in performance may falter because of lack of incentive for the incumbent franchise holder. The shorter franchise the contracts, the greater the overall proportion of time in stagnation.

ii. In short franchises, there is a tendency for investment to be made very early on, in order for the franchisee to have some prospect of earning a return before the end of the contract. In a longer franchise, the TOC is able to take a more measured approach.

iii. The re-franchising process is a significant cost for TOCs as well as the DfT, so if contracts are longer, the relative cost per year of the franchise is lower.

iv. Longer franchises would also provide the incentive to buying rather than the more expensive option of leasing trains. Or at least, they might be in a better position to bargain with Network Rail and the Rolling Stock Leasing Companies (ROSCOs).

166 And formerly the SRA.
167 Ev 59 [Merseytravel]
168 Ev 91 [MVA Consultancy]
169 This is most likely to occur in cases where the franchise operator has decided to divest and not to apply for the re-franchise, or where poor performance has already made a re-award unlikely. In that situation, there is no incentive to invest, or even to maintain or improve performance standards.
170 Ev 42 [Railfuture Northeast]; Ev 109 [Chartered Institute of Logistics and Transport] made the same point, but also explained that “arrangements are beginning to be put in place for the DfT to ‘buy’ the remaining life of the investment from the franchisee – albeit this can create a contingent liability for the DfT which they have been traditionally reluctant to accept.”
171 Ev 13 [National Express Group]
172 Ev 39 [Railfuture]
173 Ev 191 [Transport 2000]
174 Ev 13 [National Express Group]
v. Longer franchises make it easier to develop a coherent strategy of infrastructure investment, such as electrification. Although such investments are undertaken by Network Rail, frequent changes of franchise operators can be an obstacle because the operator’s horizon will be too short for them to take any interest in such large scale projects.\textsuperscript{175}

vi. The relatively frequent changes of employer inherent in short franchises might affect the performance of employees. The Chartered Institute of Logistics and Transport also questioned whether frequent changes of franchise operator might have an effect on safety.\textsuperscript{176}

88. Several witnesses identified break clauses as the key to the issue of optimal length of franchises. The Railfuture Passenger Committee suggested that contracts could run for up to 15 years with one or more break points along the way. This would allow the Government to terminate the contracts of train operators who performed poorly, whilst well-managed franchises would enjoy the stability of a full 15 years between re-franchising rounds.\textsuperscript{177} The Government has used this mechanism in the recent re-franchising of the Greater Western and Integrated Kent Franchises with two- and three-year break clauses respectively. National Express Group took this argument a step further, proposing that rather than automatically launching a full tendering process towards the end of contracts, contracts should be made renewable for incumbents who perform well:

“We incumbents to be subjected to a review of performance and finances instead, and given the option to negotiate the extension of the franchise, the investment hiatus, the distraction of managers and employees, the wasted effort of handing over the franchise to another operator, and the costs to the DfT and bidders from the competitive process could be avoided.”\textsuperscript{178}

89. Govia pointed out that there is no transparency about the reasoning behind what appear to be arbitrary choices for the length of franchises. They pointed to the example of the two new Midlands franchises for which the formal bidding round for pre-qualified bidders are now starting. The West Midlands franchise will be 7 years and 10 months, whereas the East Midlands franchise will be 7 years and 4 months. The new Cross Country franchise will be 8 years and 4 months.\textsuperscript{179}

90. We recommend that the Government move towards medium-length franchises of up to fifteen years with one or two in-built break-points where contracts may be terminated if performance is unacceptable. We believe longer franchises will enable greater stability, increase the willingness by TOCs to invest, and reduce the cost of re-franchising. The Government already deploys break clauses, and we think they are the key to having longer franchises without losing the ability to set incentives and targets for TOC performance.

\textsuperscript{175} Q 238 [Mr Ford]
\textsuperscript{176} Ev 109 [Chartered Institute of Logistics and Transport]
\textsuperscript{177} Ev 39 [Railfuture]; See also Ev 13 [National Express Group]
\textsuperscript{178} Ev 13 [National Express Group]
\textsuperscript{179} Ev 9 [Govia]
**Franchise numbers, sizes and types**

91. At the time of privatisation, 25 franchises were created. In October 2004, the Government announced that the number of franchises would be reduced from 25 to 19, and a year later, it revealed the exact delineation of its 19 new franchises. Mr Steer explained that four factors had motivated the discussion about the number and size of franchises right from the process of privatisation:

i. Commercial and operational coherence, defined by the market served (intercity, regional or commuter) and the physical configuration of the network

ii. The benefit of continuity (including onwards from BR’s devolved management structures)

iii. The economics of the franchising process which do not help the case for small franchises

iv. The desire to reduce complexity on the railway, including the number of contractualised operational interfaces.

92. ATOC was content with the current re-mapping exercise because it matches Network Rail’s structure more closely, but the organisation also emphasised that there should be no further reduction in the number of franchises just for the sake of it. It was noted that there are very good structural reasons for having a variety of sizes and types of franchises. The Railfuture Passenger Committee was also broadly content with number and sizes although it thought it was questionable whether the Northern franchise, which spans three local government regions and five PTEs might have become too large. The Chartered Institute of Logistics and Transport argued that in operational terms, it was beneficial to have as few interfaces as possible, and that there was some justification for having fewer franchises. The Institute also pointed out that the cost of bidding and letting franchises was more or less the same irrespective of the size of the franchise, and fewer franchises would therefore be more cost-effective for the system as a whole.

93. With the creation of the two new Midlands and the Cross Country franchise, the number and sizes of franchises across the network is broadly sound. Any further re-mapping should be undertaken only if there are compelling operational reasons for doing so.

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180 Ev 142 [Department for Transport]
181 Ev 195 [Mr Steer]; The North West Group of Labour MPs (Ev 205), though broadly content with the recent franchise re-mapping, argued that in the North West, increases in capacity and coordination between different operators would be crucial in improving services for passengers. In particular, commuter services needed to be seen as separate from long-distance services.
182 Ev 1 [ATOC]
183 Ev 39 [Railfuture]
184 Ev 109 [Chartered Institute of Logistics and Transport]
Controlling operator costs

94. Professor Chris Nash raised concerns that franchise operators were failing to control their costs since the Hatfield crash. During the first few years after rail privatisation, operator costs had declined significantly, but this trend had been reversed in recent years. His research indicated that for the four years directly post-Hatfield train operating costs appear to have gone up 47 per cent in real terms when track access charges and rolling stock leasing payments are controlled for. Professor Nash indicated that part of this cost increase was likely to be caused by entirely valid reasons such as increased pension liabilities and higher energy prices; the introduction of more expensive, sophisticated rolling stock; and more tightly defined quality standards in franchise agreements. However, these factors did not come close to explaining the scale of the increase, and Professor Nash believed this was a significant problem in need of attention.

95. Train operators rejected the view that their costs had increased unreasonably, and as a result of anything other than factors beyond their control. ATOC argued that the mere fact that operators were now carrying more passengers and running more trains was a contributory factor to the increase in costs, and noted that the cost of external factors such as insurance, policing and fuel had increased above inflation. Mr Franks from National Express Group argued that in the case of one of its operating companies which has a cost base of £450 million, only £25–50 million were variable costs, whilst the largest slice of its cost base was track access charges, ROSCO costs, or services which are driven by the timetable. “The timetable requires a number of trains, a number of drivers and a number of staff on trains and at stations so the true variable element of a cost base for a train operating company is very small.”

96. The Government was not concerned by the developments in operator costs because:

“When we are letting a franchise, we are not actually interested in what the costs of the franchisee are, although we are very interested in whether their cost reduction plans are realistic or in what their revenue is, though we are very interested in whether their revenue increase plans are realistic, because the price that they are bidding to us is the difference between the two. So if a train operating company looks at an opportunity and says, “Look, if I spend an extra £1 million on improving catering or recruiting extra revenue protection staff, that will generate £2 million of revenue” then they will do it and that must be in both their interests and ours. So we have no separate aim of controlling their cost line. We are very concerned about the gap between revenue and costs, which is what they bid to us.”

97. This argument is, however, not valid on two counts. Firstly, if operators fail to control costs, they are likely to increase fares unnecessarily and to the detriment of passengers. Secondly, the argument only holds if the Government is indeed rock-solid in its

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185 Qq 225–228 [Professor Nash]
186 Ev 115 [Professor Nash]; see also Q 234 [Ms Bonar, Chartered Institute of Logistics and Transport]
187 Q 283 [Professor Nash]
188 Q 40 [Mr Austin, ATOC]
189 Q 40 [Mr Franks, National Express Group]
190 Q 412 [Mr Lambirth, Department for Transport]
commitment not to re-negotiate the contracts of operators who get into financial
difficulties. If operators entertain any notion that they can go cap-in-hand to the
Government, the Government could end up bearing the cost of slack cost control. The
Government must ensure, through franchising contracts, that franchise operators keep
their costs tightly under control.
5 Vertical integration

98. In 2002, our predecessor Committee, the Transport, Local Government and the Regions Committee, concluded that “there is no evidence that vertical integration [of the railways] would work.” That Committee found that whilst vertical integration might be suitable in self-contained regional franchises, it would not be a realistic option for other, less self-contained franchises. We asked our witnesses to revisit this debate, but found that little has changed since 2002.

99. Our witnesses put forward a wide range of arguments rejecting the idea of vertical integration. Simon Norton argued that vertical integration is problematic because, in many cases, track is shared by a number of franchise operators. The Railfuture Passenger Committee said that vertical integration was likely to be an obstacle to further competition on the network, not least in the freight sector. The Department for Transport also cited competition as a key reason for rejecting vertical integration, stating that a vertically integrated network would consist of monopolies and therefore, additional regulation would be required to secure an adequate level of competition, particularly in terms of inter-regional and freight traffic. The Association of Transport Coordinating Officers (ATCO) emphasised that:

“It is important that Network Rail is able to exert its role as an impartial ‘honest broker’ for train pathing and as overall infrastructure operator, it is able to maintain uniformity of standards across the network. It is important that the availability of freight paths is given appropriate importance and not excluded because of aspirations for increased passenger services.”

100. The Association of Train Operating Companies (ATOC) embraced the view of our predecessor Committee that some measure of vertical integration might be an option for small and self-contained sections of the network. As for the wider network, both ATOC, Network Rail, and the Department for Transport (DfT) concurred that current projects to integrate operational management and planning between Network Rail and Train Operating Companies (TOCs) as well as the development of joint ventures are already increasing the level of integration and coherence between track and wheel. The key objective of vertical integration, to control interfaces on the network, is being achieved through partnerships and integrated Control Centres. The current consultation by the Office of Rail Regulation (ORR) on a new incentives framework for Network Rail and its partners is an example of the efforts of the regulator to promote integration by proposing a formal structure in which incentives for Network Rail, franchise operators as well as other

192 Ev 208 [Simon Norton]
193 Ev 39 [Railfuture]
194 Ev 142 [Department for Transport]
195 Ev 33 [ATCO]
196 Ev 1 [ATOC]
197 Ev 142 [Department for Transport]; Ev 109 [Chartered Institute of Logistics and Transport]; Ev 17 [Railway Forum]; Ev 64 [Network Rail]
parts of the industry are interconnected and thoroughly aligned to the interests of passengers.198

101. Mr Ford dissented from the view that cooperation and partnerships have achieved as much as might be gained through vertical integration. He highlighted persistent failures of coordination, such as train operators leasing ever-heavier rolling stock which causes unnecessary and costly damage to tracks. Mr Ford said:

“I would have thought that the radical approach would be to consider vertical integration upwards from the rail rather than downwards from the train. […] They have produced a timetable. Perhaps there might be a case for Network Rail acquiring trains and running a franchise themselves. That would give you a lot of continuity and it could have break points in it at which the Government could say, ‘You are doing a good job or a bad job.’”199

102. Professor Nash highlighted that “day-to-day operations, planning of the timetable, the flexibility to adjust things, and indeed perhaps planning investment” are more straightforward in a vertically integrated system, but also emphasised that such advantages have to be weighed up against the advantages of competition.200

103. Merseytravel and NedRailways, a Dutch passenger rail operator, strongly argued the case in favour of vertical integration at a regional level. Merseytravel took over the management of the self-contained “electric urban third rail system” on Merseyside from the SRA in 2003 and subsequently agreed a 25-year franchising contract with the joint venture Serco-NedRailways.201 Merseytravel has actively sought to achieve full vertical integration on the Merseytravel network. Their proposal was for Merseytravel to set up:

“a joint venture ‘InfraCo’ with Serco-NedRailways to maintain and renew the infrastructure. The aim is to replicate the success of our operating franchise. Network Rail’s operational responsibilities for track and signals would pass to Merseyrail, enabling the InfraCo to work solely on maintenance and renewal, and the train operator to introduce more efficient integrated management.”202

104. Merseytravel estimated they would save £33 million net over the 25-year franchise by integrating track and wheel. They also anticipated other benefits from vertical integration, for example improvements in reliability and punctuality; improved responsiveness of maintenance works; increased control, reliability, transparency and accountability; and more investment and refurbishment of assets. The Chartered Institute of Logistics and Transport (CILT) agreed that there is a strong case for vertical integration on regional or local networks which do not form part of the national infrastructure, but that this argument cannot be transferred to the wider network.

198 Office of Rail Regulation press release: ORR consults on the incentives framework for Network Rail to apply from 2009 ORR/23/06, 31 July 2006

199 Q 246 [Mr Ford]

200 Q 244 [Professor Nash]

201 Ev 59 [Merseytravel]

202 Ibid.
105. Merseytravel suggested that an additional benefit of vertical integration on their network would be the ability for ORR to use the performance of a vertically integrated franchise as a benchmark against which the performance of Network Rail could be measured. Network Rail, however, withdrew from discussions with Merseyrail, and the project therefore never came off the ground.

106. We did not receive any compelling evidence to determine whether vertical integration would improve passenger services. We believe that vertical integration across the entire network, and in conjunction with the current franchising model, would be a retrograde step. But we also believe that vertical integration may have some merit in self-contained regions, such as Merseyside. We therefore recommend that Network Rail and the Government, with advice from the ORR, design and carry out pilots of vertical integration on self-contained parts of the network, where a sound case for such pilots can be made. It is essential that Network Rail supports such pilots. We look to the ORR and the Government to ensure that pilots are encouraged and given the best possible conditions of success.
6 Open access

107. The vast majority of passenger rail services in the United Kingdom are provided through franchises. A handful of services are, however, provided by open access operators, the most prominent current example being Hull Trains, which operates trains between Hull and London King’s Cross. Despite the very small number of services currently being provided by open access operators, the issue is seen by many as crucial to the future of franchising. The decision by the ORR to grant open access to a new operator, Grand Central, on the East Coast Main Line (ECML) earlier this year culminated in a High Court Judicial Review during the summer, but despite the High Court decision, serious issues remain.

108. An open access operator does not enter into a contract with the Department for Transport, does not have to comply with any service specifications, receives no subsidies, pays no premiums, and bears the full range of risks involved in the enterprise themselves. Like franchised operators, open access operators pay to access the rail infrastructure. But where franchised operators pay both fixed and marginal charges to Network Rail, open access and freight operators pay only marginal charges. The only requirement that must be met if authorisation is to be granted to set up an open access passenger rail service is that the Office of Rail Regulation is satisfied that there is a valid business case for the operation. This means that sufficient track capacity has to be available, and that the proposed service genuinely fills a gap in the market, generating new custom and revenue, without extracting unreasonable amounts of revenue from franchise operators serving parts of the same route. Abolishing open access completely would require agreement at European level because EU legislation requires Member States to ensure fair mechanisms whereby operators who wish to access the rail network on a marginal basis can do so. It is also required that freight services are run on the basis of open access across the network.

109. The case which has caused the issue of open access to rise to the very top of the passenger rail franchising agenda was the award of paths to a new open access operator, Grand Central (as well as extra paths to an established open access operator) on the ECML. Grand Central was allocated paths for three daily return services between Sunderland and London, and Hull Trains was allocated one extra daily return service between Hull and London.
London. Network capacity is severely constrained on ECML, and at the time, it appeared that GNER’s application to run five extra daily London to Leeds return services on the ECML would be rejected, despite the fact that the increase in daily services between London and Leeds had been a central part in GNER winning the re-franchise for the ECML the previous year. The open access award thus meant that GNER was unable to fulfil its contractual obligation to the DfT. Apart from being unable to fulfil its own contractual obligations, GNER believed that it would be competing with Grand Central on unfair terms because Grand Central would be paying significantly lower track access charges and would also be able to extract fares revenue through the centralised system of allocating revenue to operators. GNER believed that the ORR had failed to apply the regulations correctly, and therefore initiated the Judicial Review mentioned above. GNER’s principal claim was that Grand Central was given favourable conditions amounting to an illegal state aid.

110. The High Court rejected the case, ruling that the ORR had applied current regulations correctly. Following a capacity review by Network Rail, ORR has subsequently announced that there is sufficient capacity on the line to accommodate both open access operators as well as GNER. However, GNER, which is already falling short of its expected revenue just 18 months into its franchise contract, is now apparently considering whether to bring the case to the European Court of Justice.

**Benefit to passengers**

111. It is widely held that an element of competition through open access is beneficial to passengers, provided that a level playing field exists. The most important passenger benefit is the provision of rail services to regions and towns that are poorly served by the franchised industry. Railfuture Northeast highlighted the fact that rail connections serving Hull had improved dramatically in terms of quality as well as quantity with the advent of the open access operation. Other important benefits to passengers included greater freedom to innovate and experiment with new services. Railfuture Northeast concurred with open access operators that the highly specified nature of franchise agreements left little room for franchise holders to innovate and experiment with new services, therefore making the role of open access operators all the more important.

112. Where clear gaps in rail services can be identified, open access is good for passengers. Open access operators identify neglected opportunities where franchises leave communities poorly served. If the basic infrastructure already exists, it can only be a bonus to passengers and taxpayers that open access operators step in to fill such gaps with unsubsidised services. The possibility of bidding for open access to neglected routes is open

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210 Office of Rail Regulation: Press Release: “ORR announces decision on additional services between London and Yorkshire and the North East”, 23 March 2006, ORR/07/06

211 Ev 7 [GNER]


213 See for example Ev 1 [ATOC]; Ev 42 [Railfuture Northeast]; Ev 17 [Railway Forum]; Ev 132 [ORR]; Ev 5 [First Group]

214 Ev 42 [Railfuture Northeast]

215 Ibid. See also Ev 17 [Railway Forum]
to companies that operate franchises just as well as anyone else, and despite the issue of capacity, it is surprising that this opportunity has not been used more frequently by established franchising operators.

**The effect of open access on network strategy and coordination**

113. Where open access operators are able to take up space on the network, there is a danger that the coherence of the network and the strategy for its future development could be thwarted. As outlined in paragraph 28 above, the SRA developed an industry planning framework creating a direct link between the strategy for the network at regional and national levels on the one hand, and franchising specifications and open access decisions on the other.\(^{216}\) The ORR had been obliged to take this industry planning framework into account when reaching decisions on open access applications. Mr Steer suggested that this obligation had been abandoned with the demise of the SRA and there was now a lack of coherence and coordination between the decisions of the Department for Transport (DfT) in awarding franchises, and the ORR in granting open access paths. This needed to be remedied by the Department setting out a strategic plan not only at a general policy level, but down to the level of individual routes. The DfT should, it is argued, make clear what open access opportunities might be considered on individual routes through its input into Network Rail’s Route Utilisation Strategies. The ORR should, in turn, be obliged to “reflect these strategies in its decisions.”\(^{217}\) This would aid the coherent planning for the network, and it would enable bidders for franchises to evaluate more accurately the risk of open access being granted and to price this risk into their bids.

114. **Rail services need to be planned and coordinated.** It is crucial that all decisions on access to the network cohere into a long-term strategy optimising the passenger benefit of the network. This is all the more true for parts of the network where capacity is scarce. Whilst open access services can bring significant benefit to passengers on some routes, it is imperative that such access is not allowed to reduce the capacity and jeopardise the efficiency of the network as a whole.

115. Mr Yeowart, the managing director at the open access company Grand Central, also acknowledged the importance of coordination between franchised and open access services, though he only went as far as the coordination of timetables, giving passengers the best possible connections between routes operated by the different types of companies.\(^{218}\) Where open access is granted to the network, the ORR must ensure that timetables are coordinated between open access and franchised operators so that passengers reap the full benefits of the services available.

116. Any discussion about the future of open access operations on the rail network is academic if the track capacity is not available. It is widely acknowledged that many parts of the network are approaching saturation point,\(^{219}\) and therefore paths granted to open access operators in those areas could result in fewer paths being available to franchised

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\(^{216}\) Ev 195 [Jim Steer]. A similar point was made by PTEG in Ev 65

\(^{217}\) Ibid.

\(^{218}\) Q 338 [Mr Yeowart, Grand Central]

\(^{219}\) Q 226 [Mr Norgate, Mott MacDonald]; Ev 1 [ATOC]
operators. The case of Grand Central demonstrates not only the severity of capacity constraints on some parts of the network, but more importantly the apparent lack of coordination between institutions at the heart of the rail network. It is a very serious flaw that open access decisions appear to be made without due regard for overall network strategy and existing contractual obligations. We appreciate the importance of the ORR acting as an independent regulator, but decisions about network access must never be made in a vacuum. We recommend that the ORR and the Department for Transport establish clear lines of communication about network capacity and access, and the scope for extra paths to be allocated, be it to a franchise or an open access operator.

Effect on franchises

117. One of the most crucial issues about open access is the way in which it affects franchises operating on the same part of the network. Whilst franchised operators were not generally opposed to open access operators per se, many of them expressed deep concerns about the way in which open access rights were awarded and what they perceived to be anything but a level playing field.220 There are several aspects to the argument that open access operators have unfair advantages over franchised operators, but two of the more important are financial. First, it is alleged to be unfair that, like freight operators, passenger open access operators pay only marginal costs to Network Rail whereas franchise operators pay both fixed and marginal costs. Second, the distribution of fare revenue among train operators through the ORCATS221 system may lead an open access operator effectively to extract revenue from franchised operators stopping at some of the same stations.222

118. The costs of rail infrastructure are charged to train operators in several different ways, marginal and fixed costs. All train operators pay a share of marginal costs, but only franchise operators pay a share of the fixed costs. Marginal costs largely reflect direct running costs such as electricity and wear and tear of track and other infrastructure. They consist of: variable usage charges, traction electricity charges, electrification asset usage charges, and capacity charges. Fixed costs effectively cover the difference between Network Rail’s costs and its income from marginal charges and direct grants from Government bodies. In other words, fixed charges help to pay for investment.223 In the recent High Court Judicial Review, GNER said that “the fixed track charge amounts to approximately 60% of its overall track access charges. In 2005/2006 it amounted to £60.5 million, and this will increase to £127.5 million (equating to £10.81 per train mile) in 2006/2007.”224 Many witnesses believed that this involuntary difference in cost base created a playing field which is anything but level.225

220 See for example: Ev 1 [ATOC]; Ev 9 [Govia]; Ev 5 [First Group]; Ev 13 [National Express]
221 The Operational Research Computerised Allocation of Tickets to Services system which is used to divide up ticket revenue between passenger rail operators.
222 Ev 1 [ATOC]
223 An overview of the current structure of track access charges as charged to franchised, open access and freight operators can be found in: Office of Rail Regulation, Periodic Review 2008: Structure of track access and station long term charges, June 2006, paras 2.10–2.16 and 2.21–2.23
224 GNER v. ORR
225 Q 324 [Professor Nash]; Ev 173 [London Travelwatch]; Ev 1 [ATOC]; Ev 7 [GNER]
119. The majority of rail tickets are ‘inter-available’ which means that they are valid for use on the trains of more than one operator. For example, on the Leicester to Leeds route, passengers might choose to travel on any combination of services provided by three different operators.\textsuperscript{226} There is no record of the passenger’s actual choice of service operator, so unless a very restrictive fare was chosen, there is no way of knowing which operator actually carried the passenger. As a consequence, a central industry model, ORCATS,\textsuperscript{227} is used to compute the allocation of fare box receipts to the different operators on a route. To do this, assumptions are made about the most likely choices of passengers. It is assumed, for example, that passengers are more likely to choose a faster, more frequent service than a slower, less frequent one if their ticket allows.\textsuperscript{228} This system is vital in facilitating passenger choice, but it also potentially enables a new operator on a route to extract revenue from existing operators, thereby significantly altering the financial circumstances of the franchise. In the case of Grand Central operating on the East Coast Main Line, much of the argument hinged on the extent to which the Grand Central services would be predatory in extracting revenue from GNER.\textsuperscript{229} The Grand Central route is due to call at York, and as a result London to York revenue will be divided between GNER and Grand Central on the basis of timetable frequencies. The current ORCATS model means that irrespective of which operator carries the passengers, the revenue will be divided between them on the basis of the timetable.

120. The current system places the risk that a successful open access operator will extract premium and growth potential from an existing franchise squarely with the franchise operator.\textsuperscript{230} This is surprising given the limitations on risk transfer to franchise companies in other areas discussed in paragraphs 17 to 25. The Chartered Institute of Logistics and Transport argued that “since the risk [of a successful open access bid] is not easily quantifiable this risk allocation is likely to result in a risk premium (i.e. increased subsidy or reduced premium). This would be avoided if DfT agreed to take the specific risk of revenue abstraction separately.”\textsuperscript{231}

121. Unlike many other and more predictable risks, the risk that a successful open access bid will reduce the ‘fare box’ and limit track access of an incumbent franchise falls entirely with the franchise operator. This makes little sense given the probable size of the risk premium that will be priced into franchise bids as a result. The risk of new open access operations should be shared between the Government and the franchise operator. We recommend such an arrangement because it would create an incentive for the Department to coordinate policy in this area more closely with the Office of Rail Regulation which grants open access rights, and to be more explicit about the open access potential in the course of the re-franchising process.

\textsuperscript{226} The three operators are: Midland Mainline, GNER and Virgin Trains. Depending on the choice of service providers, the interchange can be made at Doncaster, Sheffield or Derby.

\textsuperscript{227} ORCATS is the Operational Research Computerised Allocation of Tickets to Services system

\textsuperscript{228} AEA Technology: Station Usage 2004/05: A Report for John Larkinson, Office of Rail Regulation, Project Number 2058, Appendix A: Overview Of The ORCATS Allocation Process

\textsuperscript{229} HC Deb, 18 May 2006, col 1129W indicates that, with the exception of the Trans Penine Express in 2003, no franchise operator is explicitly given a guarantee or indemnity against loss of revenue arising from new open access operations on its routes.

\textsuperscript{230} Ev 7 [GNER]

\textsuperscript{231} Ev 109 [Chartered Institute of Logistics and Transport]
## Conclusion

122. Our inquiry identified two distinct sets of tasks to which the Government must dedicate itself. First, the Government must conduct a strategic review of the long term needs of rail passengers, and an honest appraisal of the structure best suited to fulfil these needs over the next several decades. Second, a number of immediate issues need to be resolved in the short term in order for the current system to function in the best possible manner for the time being.

123. More than a decade after rail privatisation and the introduction of franchising of passenger services, we remain to be convinced that the system has achieved its objectives, or that it is indeed capable of doing so. Passenger numbers have increased significantly, but the evidence suggests this has not resulted primarily from any improvement brought about by the franchising system. There is little evidence that competition has produced significant increases in innovation or improved the value for money for taxpayers and passengers. The Government is committed to competition, and yet there is very little real competition within the system, partly because capacity is scarce. There is little innovation because franchise contracts are so tight that there is no room for flexibility. In reality, there is also little evidence that risk has been transferred from the public to the private sector. The more risk that the Government transfers to private operators, the more money will they charge to do the job. It is not feasible to combine a policy of increasing the level of risk transferred to the private sector with the policy of maximising premiums and minimising subsidies.

124. Passenger rail franchising, far from being a model capable of delivering quality rail services for the next half century, appears to be a policy muddle. For that reason, it is vital that the Government’s new long-term strategy for the railways, due to be published in the summer of 2007, should identify the needs of rail passengers in the future as well as the structure that will be best able to fulfil them.

125. In the short term, we welcome the Government taking steps to link franchise specifications to strategies for the network, but still more needs to be done to imbed the process into the broader context of transport and regional policy. We also welcome improvements in the willingness to consult with passengers and local and regional authorities, but we recommend further improvements. The Government must ensure that the re-franchising process becomes less costly and concentrates on core requirements only. The Government must ensure that innovation is rewarded, and it should take action to encourage new entrants to the rail franchising market.

126. With the completion of the recent re-mapping exercise, the length and size of franchises is broadly right. Further change should be avoided unless compelling reasons arise. The Government should, however, move towards medium length franchise contracts of around fifteen years in order to bring about greater stability, to increase the willingness to invest, and to reduce the relative cost of re-franchising.

127. We found little conclusive evidence in support of vertical integration of the rail network in general, but it may be a useful option for some self-contained regional networks. We recommend that pilots be carried out on such regional networks.
128. Open access is good for passengers in areas poorly served by the franchising structure. But it is essential that decisions on open access fit into the wider strategy for the network and the utilisation of the network. Planning and coordination are vital for the efficiency of the network, and open access operators have to fit into this structure. We believe the Government and the ORR must work more closely together to make coordinated decisions about access, be it for franchise or open access operators. Franchise operators are left to bear the entire risk of open access operators affecting their routes; this is not sensible, especially given that the Government has retained an overwhelming share of many other risks in the sector. Given the size of the premium that future franchise bidders are likely to demand from the Government, it would be sensible for the Government and operators to share this risk.
List of Recommendations

The objectives of passenger rail franchising

1. We agree wholeheartedly with the general objectives of improving passenger services and maximising the value for money achieved from Government subsidies. But we do not believe that the current system of passenger rail franchising can achieve those aims in the long term (Paragraph 11).

2. The objectives of the passenger rail franchising system are a self-contradictory muddle, providing no coherent framework or vision for the development of passenger services for future generations. The result is a system that is worth less, and costs more, than the sum of its parts. It is high time that the Government established a consistent and achievable set of objectives and a system capable of achieving them whilst providing good services and value for money to passengers and taxpayers. (Paragraph 15)

3. The key objective of our railways for the next few decades must be to increase capacity, and facilitate growth in patronage through improvements in services to passengers. The only way to achieve this in the long term is to drop the dogmatic pursuit of competition where competition is not possible, and to make honest and tough choices about what the private and public sectors can and should do in future. We expect the Government’s forthcoming long-term strategy for the railways to tackle these fundamental issues head on. It must contain a structure and a strategy capable of securing quality passenger rail services to meet demand over the next half a century. (Paragraph 16)

4. Having re-designed franchise contracts to include ‘revenue risk-sharing mechanisms’, it is crucial that the Government resist any pressures to renegotiate franchise agreements if operators get into difficulties. If it were to bail out operators through renegotiation despite taking over most of the medium- and long-term revenue risks, the Government would have failed doubly. (Paragraph 23)

5. The transfer of risk to the private sector was a core objective of privatisation. But in the current system only a very limited proportion of risks are, in reality, borne by franchise operators. There are also significant inconsistencies about what risks are borne by operators, and which by the Government. The relative lack of risk transfer calls into question the fundamental assumptions and objectives of the franchising system. If risk is not transfered, there is little point in involving the private sector in the running of the railways. (Paragraph 25)

The process of awarding passenger rail franchises

6. We welcome the fact that the Department for Transport is taking steps to better integrate the franchising process with long term strategic plans, Regional Planning Assessments (RPA) and Route Utilisation Strategies (RUS). This is a move in the right direction. We are, however, concerned that the Government has failed to embrace the notion of RPAs, RUS and franchise specifications flowing from a wider
strategic plan rather than the other way round. This approach is likely to result in perpetuation of the status quo rather than development based on a strategic vision for what is required and desirable for the future. (Paragraph 29)

7. A broad-based consultation with passengers should be a statutory requirement, and we recommend that the Government include such provisions in its next railways bill. (Paragraph 34)

8. The removal, in the Railways Act 2005, of the statutory right of PTEs to co-sign franchise agreements was a mistake. We therefore recommend that the Government consult PTEs in order to determine what adverse consequences have resulted from it, and take steps to address them. We also recommend that franchise specifications should take account of regional and inter-regional economic strategies. (Paragraph 44)

9. The Government must ensure that real innovation contained in franchise bids is rewarded, even where it goes beyond the strict requirements of the franchise specification. (Paragraph 51)

10. A re-balancing of the importance of cost among the criteria for the evaluation of franchise bids is urgently required. We recommend that the Government develop ways of evaluating cost relative to proposals for innovation and franchise development over and above the basic franchise specification. The re-balanced evaluation criteria should also take into account less tangible costs and benefits such as wider environmental and socio-economic factors. This would serve to reward innovation and development whilst retaining cost as a criterion (Paragraph 57)

11. We are concerned that the drive to extract premiums from some parts of the network will result in further above-inflation fare increases and a deterioration in customer service, investment and innovation. Where rail franchises are profitable, the structure of premium payments to the Government should provide incentives for franchises to invest and be more innovative. We recommend that future contracts include the possibility to make a proportion of the premium payments from a franchise available for re-investment directly into that franchise or into infrastructure used by the train operating company involved. Such reinvestment should be dependent on clear, specific and innovative investment proposals from the operator with a demonstrable benefit to passengers and the environment. (Paragraph 58)

12. We fear the re-franchising process is driven more by consultants and lawyers than by people with an in-depth understanding of the railways and what is required to run good passenger services, now and in the future. We urge the Government to revise its re-franchising procedure to focus clearly on the core requirements, weeding out unnecessary detail. Costs incurred by bidders will eventually be paid by taxpayers and passengers through increased fares, and subsidies or decreased premiums. It is therefore in the public interest to keep the costs of the re-franchising process at the lowest possible level. (Paragraph 63)

13. The Rail Division within the Department for Transport should be staffed so that, on the whole, it can manage the entire process of re-franchising without outsourcing
significant parts of the work to external consultants. Consultants should be used only to deal with the occasional special or unusual aspect of a franchise specification and procurement. We recommend that the Department review its staffing requirements and establish clear guidelines for the use of consultants. We would expect such guidelines to be made publicly available with performance against them open to scrutiny. (Paragraph 64)

14. The Government must consider, in cooperation with the OFT and the Competition Commission, the suggestion of incorporating competition considerations into the specification of franchises. It must also monitor the effects of the new process for referral to competition authorities only once a franchise has been awarded to ensure that the late referral does not limit the range of remedies available to the Competition Commission. It is vital that the Commission has the full range of structural remedies at its disposal to prevent abuses of dominant position by monopolist operators. (Paragraph 70)

15. The absence of new entrants into the passenger rail franchising market is a clear indication of unreasonably high barriers to entry. Whilst we agree with the Government’s policy to include past performance as a criterion for new franchise awards, we are deeply concerned that a small number of companies have come to dominate the franchising market. There is little evidence of the Department positively encouraging new entrants, and we recommend that steps be taken to bring new companies into the franchising market. (Paragraph 72)

The management of the passenger rail franchising system

16. We welcome the move towards a general set of base specifications that are used across all franchises, with a separate set of specifications setting out requirements that are franchise-specific. The base specifications should remain strictly limited to essential conditions. Franchise-specific conditions should be allowed to vary widely so that the tightness of service specifications can be tailored to the circumstances of individual franchises. Taxpayers are entitled to expect that heavily subsidised franchises have tighter specifications than ones that pay a premium. (Paragraph 78)

17. The aim to attract private companies who are prepared to take commercial risks, provide innovation and adapt to market circumstances is fundamentally at odds with the need for the Department to guarantee the consistent delivery of a quality public service and value for money for taxpayers and passengers. On the one hand there is a need for loose and flexible franchise specifications with room for innovation and risk, and on the other hand there is a need for very tight specifications and targets. Franchise operators have very limited flexibility to innovate, and they assume only a relatively small part of the overall risk. This tension cannot be fully resolved within the current framework, but the Department could mitigate the problem to some extent by reassessing the gains and losses of its current approach with a view to achieving greater flexibility. (Paragraph 83)

18. We recommend that the Government move towards medium-length franchises of up to fifteen years with one or two in-built break-points where contracts may be terminated if performance is unacceptable. We believe longer franchises will enable
greater stability, increase the willingness by TOCs to invest, and reduce the cost of re-franchising. The Government already deploys break clauses, and we think they are the key to having longer franchises without losing the ability to set incentives and targets for TOC performance. (Paragraph 90)

19. With the creation of the two new Midlands and the Cross Country franchise, the number and sizes of franchises across the network is broadly sound. Any further remapping should be undertaken only if there are compelling operational reasons for doing so. (Paragraph 93)

20. The Government must ensure, through franchising contracts, that franchise operators keep their costs tightly under control. (Paragraph 97)

Vertical integration

21. We did not receive any compelling evidence to determine whether vertical integration would improve passenger services. We believe that vertical integration across the entire network, and in conjunction with the current franchising model, would be a retrograde step. But we also believe that vertical integration may have some merit in self-contained regions, such as Merseyside. We therefore recommend that Network Rail and the Government, with advice from the ORR, design and carry out pilots of vertical integration on self-contained parts of the network, where a sound case for such pilots can be made. It is essential that Network Rail supports such pilots. We look to the ORR and the Government to ensure that pilots are encouraged and given the best possible conditions of success. (Paragraph 106)

Open Access

22. Rail services need to be planned and coordinated. It is crucial that all decisions on access to the network cohere into a long-term strategy optimising the passenger benefit of the network. This is all the more true for parts of the network where capacity is scarce. Whilst open access services can bring significant benefit to passengers on some routes, it is imperative that such access is not allowed to reduce the capacity and jeopardise the efficiency of the network as a whole. (Paragraph 114)

23. Where open access is granted to the network, the ORR must ensure that timetables are coordinated between open access and franchised operators so that passengers reap the full benefits of the services available. (Paragraph 115)

24. It is a very serious flaw that open access decisions appear to be made without due regard for overall network strategy and existing contractual obligations. We appreciate the importance of the ORR acting as an independent regulator, but decisions about network access must never be made in a vacuum. We recommend that the ORR and the Department for Transport establish clear lines of communication about network capacity and access, and the scope for extra paths to be allocated, be it to a franchise or an open access operator. (Paragraph 116)

25. Unlike many other and more predictable risks, the risk that a successful open access bid will reduce the ‘fare box’ and limit track access of an incumbent franchise falls
entirely with the franchise operator. This makes little sense given the probable size of the risk premium that will be priced into franchise bids as a result. The risk of new open access operations should be shared between the Government and the franchise operator. We recommend such an arrangement because it would create an incentive for the Department to coordinate policy in this area more closely with the Office of Rail Regulation which grants open access rights, and to be more explicit about the open access potential in the course of the re-franchising process. (Paragraph 121)
Annex: Current franchise operators

The table below provides a list of the current franchise operators in England and Wales, their franchisees as well as the start and end dates of current franchise agreements.

<table>
<thead>
<tr>
<th>Franchise operator</th>
<th>Franchisee</th>
<th>Franchise start</th>
<th>Franchise end</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arriva Trains Wales</td>
<td>Arriva Trains Ltd.</td>
<td>December 2003</td>
<td>October 2018</td>
</tr>
<tr>
<td>C2c Rail Limited</td>
<td>National Express Group plc.</td>
<td>May 1996</td>
<td>May 2011</td>
</tr>
<tr>
<td>Central Trains Limited</td>
<td>National Express Group plc.</td>
<td>March 1997</td>
<td>November 2007&lt;br&gt;Central Services are to be split up and merged into three new franchises in November 2007</td>
</tr>
<tr>
<td>Chiltern</td>
<td>M40 Trains Ltd.</td>
<td>March 2002 (&lt;br&gt;with a shrink-back provision if future enhancements are not met. At present the minimum franchise term is confirmed at 12 years)</td>
<td>December 2021</td>
</tr>
<tr>
<td>Crosscountry</td>
<td>Virgin Rail Group Ltd. (49% share owned by Stagecoach Group plc)</td>
<td>January 1997</td>
<td>November 2007&lt;br&gt;To absorb parts of the current Central Trains franchise when re-franchised</td>
</tr>
<tr>
<td>First Greater Western</td>
<td>Great Western Holdings Ltd. (First Group plc.)</td>
<td>April 2006</td>
<td>April 2016</td>
</tr>
<tr>
<td>Gatwick Express</td>
<td>National Express Group plc.</td>
<td>April 1996</td>
<td>April 2011</td>
</tr>
<tr>
<td>GNER</td>
<td>Great North Eastern Rail Ltd.</td>
<td>May 2005</td>
<td>May 2012 (with an automatic further 3 years if targets are met)</td>
</tr>
<tr>
<td>Island Line</td>
<td>Stagecoach Group plc.</td>
<td>February 2004</td>
<td>February 2007&lt;br&gt;Franchise merged with South Western from February 2007</td>
</tr>
<tr>
<td>Midland Mainline</td>
<td>National Express Group plc.</td>
<td>April 1996</td>
<td>April 2008 (November 2007)&lt;br&gt;To be re-named the East Midlands franchise and absorb parts of the current Central Trains franchise</td>
</tr>
</tbody>
</table>

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232 The three new franchises are: East Midlands Franchise, the West Midlands franchise, and the Cross Country franchise. See: [http://www.dft.gov.uk](http://www.dft.gov.uk)
<table>
<thead>
<tr>
<th>Franchise Name</th>
<th>Operator</th>
<th>From Date</th>
<th>To Date</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern</td>
<td>Northern Rail Ltd.</td>
<td>December 2004</td>
<td>September 2011</td>
<td></td>
</tr>
<tr>
<td>Greater Anglia</td>
<td>ONE (National Express Group plc.)</td>
<td>April 2004</td>
<td>April 2014</td>
<td></td>
</tr>
<tr>
<td>Silverlink County</td>
<td>National Express Group plc.</td>
<td>February 1997</td>
<td>October 2006 (November 2007)</td>
<td>To be re-named the West Midlands franchise and absorb parts of the current Central Trains franchise when re-franchised in November 2007</td>
</tr>
<tr>
<td>South Eastern Trains</td>
<td>Govia (Go-ahead and Keolis SA)</td>
<td>April 2006</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Southern</td>
<td>Govia Ltd.</td>
<td>May 2003</td>
<td>December 2009</td>
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<td>Thameslink-Great Northern</td>
<td>Great Western Holdings Ltd. (First Group plc.)</td>
<td>April 2006</td>
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<td>Trans Pennine Express</td>
<td>First/Keolis TransPennine Holdings Ltd.</td>
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<td>1 February 2012 (with a possible five years extension of not more than 65 reporting periods)</td>
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<td>Virgin West Coast</td>
<td>Virgin Trains (49% share owned by Stagecoach Group plc)</td>
<td>1997</td>
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</table>

*Shaded out cells indicate franchises that are due to be merged into other franchises when current franchise contracts expire in 2007.*
Formal minutes

Wednesday 25 October 2006

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Clive Efford
Mrs Louise Ellman
Mr Robert Goodwill
Mr John Leech

Mr Eric Martlew
Mr Lee Scott
Mr David Wilshire

The Committee deliberated.

Draft Report (Passenger Rail Franchising) proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 128 read and agreed to.

Annex agreed to.

Resolved, That the Report be the Fourteenth Report from the Committee to the House.

Ordered, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

Ordered, That the Chairman do make the Report to the House.

Ordered, That the provisions of Standing Order No. 134 (Select committees (reports)) be applied to the Report.

Adjourned till Wednesday 1 November at 2.30 pm.
Witnesses

Wednesday 5 July 2006

Mr Chris Austin, Director of Public Policy, Association of Train Operating Companies; Mr Paul Furze-Waddock, Commercial Director, First Group; Mr Jonathan Metcalfe, Chief Operating Officer, GNER; Mr Tom Smith, Planning Director, Go-Ahead Group, Govia; Mr David Franks, Chief Executive, Train Division, National Express Group; Mr Adrian Lyons, Director General, Railway Forum

Mr David Blainey, Chair, Rail Sub-Committee, Mr Kevin Williams, former Chair, Association of Transport Co-ordinating Officers; Mr Colin Foxall, Chairman, Mr Michael Hewitson, Senior Policy Adviser, Passenger Focus; Mr Peter Cousins, Member, Passenger Committee, Mr Richard Pout, Secretary, Railfuture

Wednesday 12 July 2006

Mr Neil Scales, Director General and Chief Executive, Merseytravel; Mr Anton Valk, Chief Executive, NedRailways; Mr Ian Coucher, Deputy Chief Executive, Network Rail; Mr Peter Sargant, Assistant Director Rail Services, Centro; Mr Peter Field, Director, London Rail Development, Transport for London

Dr Mark Brown, Development Director, Consulting, Halcrow Rail; Mr Peter Norgate, Division Director, Mott MacDonald; Mr John Segal, Director Rail, MVA; Dr Nigel G Harris, Managing Director, Railway Consultancy

Ms Mary Bonar, Chair, Strategic Rail Forum, Chartered Institute of Logistics and Transport; Mr Roger Ford; Professor Chris Nash, Institute of Transport Studies, University of Leeds

Wednesday 19 July 2006

Mr Ian Yeowart, Managing Director, Grand Central; Mr Mike Jones, Director, Renaissance Trains

Mr Bill Emery, Chief Executive, Mr Michael Beswick, Director Rail Policy, Mr Brian Kogan, Deputy Director, Rail Markets, Passenger and Freight, Office of Rail Regulation; Mr Martin Stanley, Chief Executive, Mr John Banfield, Inquiry Director, Ms Catherine Abbott, Policy Coordinator, Competition Commission

Mr Derek Twigg MP, Parliamentary Under-Secretary of State, Mr Mark Lambirth, Director Rail Strategy and Finance Directorate, Mr Roger Jones, Divisional Manager, Rail Franchise Specification, Department for Transport
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List of unprinted written evidence

Additional submissions have been received from the following and have been reported to the House but to save printing costs they have not been printed and copies have been placed in the House of Commons Library where they may be inspected by Members. Other copies are in the Record Office, House of Lords and are available to the public for inspection. Requests for inspection should be addressed to the Record Office, House of Lords, London SW1. (Tel 020 7219 3074). Hours of inspection are from 9:30 am to 5:00 pm on Mondays to Fridays.

Mr Colin Maughan
Mr Peter Nelson
## Reports from the Transport Committee since 2005

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Oral evidence

Taken before the Transport Committee

on Wednesday 5 July 2006

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Mr Jeffrey M Donaldson          Mr John Leech
Clive Efford                     Mr Eric Martlew
Mrs Louise Ellman                Graham Stringer
Mr Robert Goodwill               Mr David Wilshire

Memorandum submitted by the Association of Train Operating Companies

The role of train operators

Train operators are the core of the passenger railway. Train operating companies (TOCs) provide the comprehensive service that passengers need, against an outline specification set by Government, in partnership with Network Rail, and by drawing together the services and facilities of many suppliers and contractors.

Franchised train operators have an absolute focus on passenger needs, because their success depends on their ability to attract and retain more passengers. No other part of the rail industry is so directly dependent on passengers or so focussed on their needs.

Flaws in the original structure of franchising were identified both in the Future of Rail White Paper, and by the Committee in 2001, but train operators have overcome these problems to deliver 20% more services to 40% more passengers than 10 years ago. TOCs have successfully overcome institutional barriers to make the system work for passengers.

ATOC has provided the infrastructure to protect passenger benefits, including through ticketing across the national network. It has also established the successful National Rail Enquiry System, which handles some 600,000 calls a week, and around 1.5 million weekly website or text enquiries. This has provided the basis for passenger growth through expanding information, ticketing, and technical support and through coherent and co-ordinated service planning for passengers.

The provision of services for rail passengers goes well beyond the bare bones of the franchise agreement and requires specialist skills, co-ordination and drive by train operators to make it work. In particular, train operators:

- Take the revenue risk for the operation of passenger services.
- Procure track access, lease stations, hire rolling stock and plan and operate the train services specified.
- Train and develop the staff running trains and looking after passengers. TOCs employ around 1,000 more staff than 10 years ago.
- Manage, maintain and service the rolling stock fleet, which accounts for about 15% of the industry’s total costs.
- Provide the infrastructure for passenger information, ticketing and revenue allocation systems through ATOC to protect network benefits.
- Market and promote the railway.
- Provide supporting facilities and services to meet passengers’ needs, such as catering.
- Run car parks, sponsor bus links, and improve station accessibility.
THE FUTURE FRAMEWORK OF FRANCHISING

As noted by the Committee, franchising policy has evolved significantly over 10 years, and a long term strategy for the future of the railway is now being developed by Government.

Our business as train operators is to deliver added value to passengers and society

We prosper by carrying more passengers, and our vision for the future is one of continued growth over the next decade. This means providing better services with more capacity to continue to build on the popularity of rail, and because greater rail use has significant benefits for the economy and the environment.

The challenge is how to accommodate this growth on a capacity constrained network. Some expansion is in hand (such as Channel Tunnel Rail Link), while other schemes are being developed (like Crossrail). In practice, major projects like these take a generation from concept to implementation, so other solutions must be found in the interim.

Train operators believe there is more to get from the existing system through using the railway more intensively, both in operational terms, and in terms of the way it meets the needs of the economy and the environment. There is more to do to deliver service quality consistently as well as to contribute to economic, environmental and social objectives. Whilst the number of trains run has increased to 19,636 a day (more than any other European country, except Germany), further major growth will be constrained by network capacity. Double deck trains may be considered on some routes, longer trains elsewhere, along with some extra trains. Some of this may require modest capacity enhancement to deal with the bottlenecks in the system, and ATOC is working with Network Rail through the Route Utilisation Strategy process to identify and prioritise those schemes that offer best value for money, and which can be achieved within a five year framework.

Increasing rail’s social value may include expanding its role in reducing congestion and road accidents, reducing environmental impacts, and particularly carbon emissions, and expansion of community rail development.

It will involve TOCs, Network Rail and DfT Rail working closely together to achieve this. No one party has the solution, and the key role of the TOC on behalf of passengers will need to be reflected in the future development of passenger rail franchising.

PASSENGER FRANCHISE COSTS AND VALUE

Comparisons are difficult, because some infrastructure costs are now paid by direct grant to Network Rail, rather than through the TOC via access charges. Nevertheless, National Rail Trends show that over the 10 years of franchised services, Government and PTE grants to TOCs have fallen by 39% to £1.3 billion. At the same time, the number of franchises receiving financial support from Government has declined, while the number paying premium has increased, and this trend is expected to continue.

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<td>Total number of TOCs</td>
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<td>21</td>
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<td>% of TOCs paying premia</td>
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The focus for TOCs is now on improving service quality, and this is reflected in the improving trends in the National Passenger Survey. Not only has overall satisfaction with the journey increased to 80%, but punctuality, cleanliness and upkeep and repair of trains also show big increases in satisfaction due, in part, to the introduction of new trains, as well as new depots, staff training and increased cleaning costs.

SPECIFIC QUESTIONS RAISED BY THE COMMITTEE

What should be the purpose of passenger rail franchising?

The principle purpose of franchising is to provide a complete service to the passenger as described in the first section of this paper on The Role of the Train Operator (above).

Passenger rail franchising was established by the Railways Act, 1993 to ensure value for money for taxpayers through a competitive process. This process of market testing provides assurance to Government that the franchises are being delivered efficiently.

For Government, franchising also provides a means of managing the financial risks of the passenger business compared with running services directly. The franchise payment provides some insulation to the DfT budget from the ups and down of franchise revenues and costs.
Franchising is now the approach used for providing some passenger rail services in many European countries, including Sweden, the Netherlands and Germany. Consequently, it is encouraging innovative thinking and drawing interest from bidders from other parts of Europe and beyond.

Is the current system achieving that purpose?

We believe that it is. In addition to the examples given elsewhere in this paper, TOCs and ATOC have delivered many benefits for passengers together, including:

- Commissioning 4,800 new passenger coaches, (45% of the fleet) with associated training for train crew and maintenance staff.
- Major investment in new ticketing and information systems to support train inquiries by phone, through the National Rail website and text messaging through Train Tracker.
- Network benefits such as through ticketing, information and impartial retailing have been protected and improved—benefits that have been lost in other countries like Sweden.
- A comprehensive programme for improving travel for passengers with disabilities, including accessibility to all trains, discounted travel for disabled passengers and companions, tactile platform surfaces, better lighting, ramped access or lifts and practical assistance with guide dog training. That National Rail Enquiries has the ability to transfer calls from the single national telephone number (08457 484950) direct to the relevant train operator who can provide mobility assistance.
- ATOC has provided technical support for the train operators on rolling stock development, including HST 2. It also now provides the passenger input to the Route Utilisation Strategies and the national timetable planning process.
- Improved performance, with PPM now running at over 90% (the highest level for six years), and a 24% improvement in fleet reliability since 1994. Over the last two years, train operators have reduced delay minutes by over a third, which has led to a significant improvement for passengers.

How well does the process for awarding franchises work?

The process for awarding franchises has been improved. It should be based on a clear specification, on clear evaluation criteria and on a clear timescale for bidding that is adhered to. The process is expensive to enter—typically it will cost between £3 million and £5 million to bid for each franchise, so clarity and timescale are important. Recent awards by DfT Rail have kept to planned timescales.

The present process provides for consultation prior to setting the franchise specification, and our recent experience is that DfT Rail has taken account of responses from TOCs. This is important, as TOCs are in daily contact with customers and are inevitably closer to the market than those specifying the franchise.

There is currently a mismatch between infrastructure planning and franchise specification. With the establishment of an effective Route Utilisation Strategy process, it is important that the priority RUS outputs that are designed to meet the passenger growth identified in the studies, should be taken forward and reflected in the Invitation to Tender as part of the refranchising process.

Less regulation is needed in the franchising process, particularly on franchises that are likely to return a premium rather than require a subsidy, such as Intercity services and many in London and the South East. A less prescriptive approach than the current Service Level Commitments would give more scope for operators to propose timetables that serve passengers’ needs better.

Whilst further structural change might be proposed, the Committee also recommended in 2002 that “Once the new arrangements are in place, the railways will need a period of stability with minimal Government interference to enable the day to day performance of train services to be improved and to invest in new infrastructure and rolling stock.” There is evidence that the new structure and processes set up recently under Railways Act 2005 are providing stability, and this is welcome as further major structural change would be a diversion from the task of service delivery and improvement.

Franchising is a key part of planning tomorrow’s railway, and increasingly planning is being undertaken on an industry-wide basis. This involves a co-ordinated approach between Network Rail, DfT and train operators. It is important that a single plan or approach is developed by all three, as success cannot be achieved by one or two parties independently.

Are franchise contracts the right size, type and length?

Size and Type. There is no “one size fits all” approach for franchises. There are good reasons for having large single franchises for Scotland and Wales, for example, while there are equally good reasons for having a small self contained franchise for Merseyrail. Consolidation fits more closely with the Network Rail structure, but for TOCs, clarity and stability is more important than the precise structure chosen. However, we believe it would be a mistake to eliminate smaller operations to achieve an arbitrary reduction in the total number of franchises.
Length. In its previous report, the Committee recommended “new, long term passenger franchises with bigger, properly enforced, penalties and incentives to ensure that the train operating companies improve their performance dramatically.”

Bidding and setting up costs for franchises are high, and it takes time to build relationships with passenger groups, local authorities and other stakeholders. Implementation times for major train service changes and small investment projects are typically of the order of two to three years. Payback periods for such changes are typically of the order of five years. Against this background, franchise lengths of five or six years are too short, seven or eight years are sub-optimal, but 10 years would allow more to be achieved, particularly if associated with further extension based on meeting agreed criteria, such as delivering investment projects or defined higher performance standards.

Changing the culture and developing an absolute customer focus takes time, as does team building and building the pride needed to make the service work well for passengers. This is inhibited by short franchises, and frequent changes of employer are not the best way to produce a customer-focused organisation.

Do we need more competition and vertical integration?

Competition

There is already strong competition with car, with bus and coach and with air for longer distance journeys, while the scope for on-rail competition is limited by the available capacity on the network.

The key issue is again clarity and certainty. It is important that the scope of open access operation is clear to bidders at the outset. Open access competition can generally be expected to increase the cost of the parallel franchise for Government, so it would be logical to determine this as far as possible at the bidding stage.

Currently, fixed costs are borne by the franchise operator, and open access operators run at marginal cost. There is an argument for saying that a proportion of fixed costs should be borne by all users of the route—not just the franchise operator.

On a constrained network, effective timetable planning is needed to make the most of the available capacity. It has so far proved possible to accommodate open access or independent operators such as Hull Trains, Heathrow Express and Eurostar on existing congested routes, but this needs to be managed through the RUS process.

The conclusion has to be that competition would be good for passengers if it were to fill a gap in the market not covered by the franchise, but would not be good for them if it were to result in cherry picking, prevent the establishment of an integrated timetable based on passenger demand, worsen overall train performance or to preclude interavailable fares.

Vertical Integration

There has been a move towards closer integration of operational management and planning of the railway. Integrated Control Centres such as Waterloo, where TOC and Network Rail combine to manage the railway have been successfully introduced. Route Utilisation Strategies are led by Network Rail, but with a big input from TOCs and ATOC. Discussions are under way on the development of Network Rail’s plan as an Industry Plan.

Associated with this is the move to a “joint venture” approach where each agency or company has an interest in the outcome for the industry as a whole, and this needs to be reflected in a closer alignment of incentives, for example on those relating to performance.

Vertical integration exists exceptionally on Island Line, but it would be possible to conceive of closer integration on other self contained route sections, such as in Scotland, or, for example, on some Community Rail routes.

General Conclusions and Recommendations

— The business of train operators is to deliver added value to passengers and to society.
— Train operators have been effective in overcoming institutional barriers to deliver an expanding and increasingly reliable service for passengers.
— Train operators are the catalyst for the provision of services to passengers, in partnership with Government and Network Rail and by drawing together support services provided by other suppliers. Future planning requires the active participation of all three working together.
— Priority RUS outputs should be taken forward within the specification of new franchises to deliver modest capacity increases for growth.
— There is some over-regulation of franchising, which could be reduced in the interests of passengers.
— There would be advantages for passengers and stakeholders, as well as for train operators from some extension in franchise length to 10 years and beyond.
A period of stability is needed, as recommended by the Committee, to enable day to day performance to continue to improve and new investments put in place.

17 June 2006

Memorandum submitted by First Group

EXECUTIVE SUMMARY

The response below should be read in conjunction with the response by “The Association of Train Operating Companies”.

First believes that there have been considerable achievements as a result of the franchising process over the past 10 years, and the company is proud to play a leading role as the largest passenger rail operator in the UK. We now carry 222 million passengers a year.

We have seen significant increases in passenger numbers and investment since the latter days of British Rail, while we offer better value for money through reduced franchise subsidies or increased premiums paid to government.

First Great Western has seen 58% passenger growth since 1994, while service frequencies have risen by 35%. Franchises the group has won more recently have also seen increases in ridership; First ScotRail by 11%, and First TransPennine Express by 7% since their launch. On key services to and from Manchester Airport, First TransPennine Express has seen passenger numbers rise by 29%.

Hull Trains, an open access operator, carries 400,000 passengers a year, compared to an initial 80,000 journeys.

Since privatisation, First has invested more than £110 million on the last Great Western franchise including new trains, upgrades to the rest of the fleet, and improvements to maintenance depots and stations. As part of the new Greater Western franchise which was launched in April this year, First is committed to further investment of £220 million including interior redesign of High Speed Trains, station and car park upgrades, and improved passenger security. First TransPennine Express has a £260 million programme. This is paying for 51 brand new trains—the entire fleet is being replaced—as well as station enhancements. First ScotRail has a £40 million programme covering enhancements to the fleet and stations, and improved safety and security for both passengers and staff. First Capital Connect will spend more than £50 million on, among other measures, rolling stock upgrades, station and car park improvements, and greater passenger security.

In franchises awarded recently, there has been a greater emphasis than in the earlier phases of privatisation on achieving best value for money for the taxpayer, either through reduced subsidies or increased premiums, or a mixture of both. Our First Great Western franchise will deliver premiums totalling £1.6 billion over 10 years. Premiums from First Capital Connect will total £969 millions over nine years. Both figures are given in 2006–07 prices.

In addition to the above, First brings the added value of being the country’s biggest bus operator, serving 100 towns and cities. We are ideally placed to develop integrated transport, a key government objective. As examples, we lead the way in promoting and selling PlusBus and other intermodal tickets, and have launched dedicated bus links from rail stations to regional airports.

First is generally very supportive of the franchising process and aims to be an enthusiastic bidder for further train operating companies.

What should be the purpose of passenger rail franchising?

The purpose should be to secure a blend of private sector delivery with public sector specification—aimed at maximising value for money for the taxpayer and fare-paying passengers.

The re-franchising cycle should deliver the right mix of regular competition to bring in new ideas and investment and sufficient length of tenure for these to be delivered in the most cost-effective manner.

In the first round of franchising, the emphasis was on growing patronage and statistics prove that this has been overwhelmingly successful.

However, for well documented reasons, the associated investment in the network infrastructure failed to keep pace with the levels of growth—resulting in several instances of demand outstripping capacity, with an adverse affect on performance and reliability.

The latest round of re-franchising has attempted to address this by the procuring authority being far more prescriptive in the service levels and specification.

Whilst this is understandable and undoubtedly necessary in certain circumstances, more freedom needs to be allowed so as not to stifle growth and innovation moving forward.
As Network Rail starts to regain its health, the franchisees must be encouraged to work with the infrastructure provider to take full advantage of the continued potential for growing rail’s share of the transport market.

**How well does the process for awarding franchises work?**

There has been a discernable improvement in the efficiency of letting franchises in the latter days of the SRA and early days of DfT Rail.

Generally, there is greater clarity in the specification and bidding timetables are reasonably well adhered to.

There are still issues for many bidders regarding the quality and availability of accurate data supplied, but experienced operators are able to overcome these deficiencies, but lack of accurate data can increase bidding costs as more expensive research is required.

Some of the residual problems may be addressed through improved harmonisation between infrastructure planning (RUS) and franchise specification. It is important that the priority RUS outputs (designed to meet the passenger growth identified in the studies), are specified in the Invitation to Tender as part of the re-franchising process.

If a service is profitable, it will be specified in the SLC specified in the ITT and will, therefore, get into the Timetable. It is misleading for the DfTR to now say that this is a “Minimum Service Level Commitment”—as bidders will not dare to include loss-making services, as this depresses the value of the bid—which you might lose. There needs to be greater clarity on this between, DfTR, Stakeholders and bidders.

**Are franchise contracts the right size, type and length?**

**Size and Type**

Generally, First believes the current variety is appropriate. Consolidation has generally been helpful in terms of reducing the number of interfaces and improving service planning.

A less prescriptive approach would give more scope for operators to propose timetables that deliver better revenue and performance.

There should be some easement of fares regulation, which is already limiting the ability of operators to offer more and cheaper fares. This will be increasingly required, not as a way for train operators to overcharge customers, as is often reported in the media—but as a way of managing demand within a heavily-constrained network. Apart from the level of fares, there is also the need to deliver social objectives including impartial retailing.

A review of risk sharing might lead to reduced costs, particularly on issues that are outside the control of operators, or affected by Government taxation policies, like fuel price increases.

**Length**

The current seven to 10 year duration of franchises should be regarded as a minimum to allow a sensible period for investments to be implemented. There are some instances where larger investments would be desirable, where a longer term would be preferable.

**Do we need more competition and vertical integration?**

**Competition**

There is already strong competition with car, with bus and coach and with air for longer-distance journeys, while the scope for on-rail competition is constrained given the limited capacity on the network.

Every opportunity is given to serious new operators to bid for franchises.

One area that still needs to be clearly settled, is what rights a franchisee actually has to run services within its franchise area (reference Grand Central v GNER) where there is a clear belief amongst the franchisee fraternity that it is unfair for an Open Access Operator to steal revenue that has been committed to in a franchise bid.

FirstGroup, through its ownership of the only successful open access operator, Hull Trains, is uniquely qualified to comment on this aspect. Hull Trains was established to fill a gap in the market for high-quality through trains between Humberside and London. Research showed that there was significant demand for something better that the one GNER service in each direction every day with the remainder of the day requiring passengers to either drive to Doncaster or change trains there.
Throughout its history, Hull Trains has tried to generate more revenue for rail rather than abstract the revenue of other operators. This was an issue raised before services started and has been reviewed by ORR every time services have been increased. The ORR five-stage process in looking at new routes is based on the way that Hull Trains has built up its business with only limited early abstraction which is then overtaken by generated growth.

The conclusion has to be that competition is good for passengers where it fills a gap in the market not covered by the franchise, but not good for passengers where it results in cherry picking, prevents the establishment of an integrated timetable, worsens overall train performance or precludes interavailable fares.

Vertical Integration

On the multiple operator, mixed traffic sections of railway, there would be a need to alter the current structures to cope with the different interfaces. There are some areas, however, where there is one main operator where a trial might be the best way forward. The most significant of these is with First ScotRail in Scotland, where vertical integration could produce cost-savings and greater harmony between track and operator. Until the benefits of such a radical step are identified through a long term trial, it is unlikely that more widespread schemes would be sensible. Meanwhile, First has pioneered measures to improve the effectiveness of its working relationship with Network Rail including the creation of joint control rooms, where problems can be solved quickly, and of joint boards.

Conclusions

— Franchising has led to significant passenger growth, more frequent services, major investment, and increasing financial contributions to government.
— Planning for further growth and dealing with increasing customer expectations need to be priorities for future franchises.
— The major fixed costs such as franchise payments and track access charges should be set at a level that encourages investment and expansion of the railway.
— The railway generally, and franchising in particular, is helping to achieve political, and social goals.
— Some longer franchise terms will be appropriate.
— There is a case for exploring some vertical integration.
— The industry, its customers, staff and investors need a stable environment and a vision to buy into.

19 June 2006

Memorandum submitted by Great North Eastern Railway

1. Introduction

1.1 GNER welcomes the opportunity to contribute to this inquiry into passenger rail franchising. We have successfully bid twice for the Inter City East Coast (ICEC) franchise, in 1996 and 2004, and have bidding experience for franchises on other parts of the UK rail network.

1.2 This evidence is based on our franchise bidding experience and of running an important public service on a flagship rail route since 1996. However we have kept our comments at the general, rather than specific, level and would also defer to ATOC’s evidence for a wider perspective on franchising.

2. What should be the purpose of passenger rail franchising?

2.1 The franchising process gives the Government the ability to specify whatever sort of railway it sees as desirable from a public policy perspective, in terms of promoting public transport, economic productivity and social inclusiveness. Competition amongst private sector operators will guarantee this is provided in the most efficient and cost-effective manner.

2.2 However, there is a fear that this drive to secure value-for-money from franchises leads to the cheapest possible solution being the preferred option. The Government is doing relatively little to use the franchising process to increase capacity on the network, relying instead on Network Rail enhancements.
2.3 If the Government want a desired outcome, the Department for Transport (DfT) should include it in the franchise specification. Best value can be best obtained by bringing the combined commercial ingenuity of all bidders to bear on a specified issue. A good example is the specification in the current South Western franchise competition for Oyster compatibility where bidders have been explicitly challenged to include this function, which has a clear utility for many passengers, in their bids.

2.4 There has recently been an increase in passengers’ concern about their personal safety at stations, particularly at night, which is reflected by the fact the Committee is currently investigating the issue in a separate inquiry. If increased staffing levels at stations is perceived as a priority, it should be more clearly specified in an invitation to tender. The same could be said for a number of other bid elements, such as enhancing DDA access in stations.

3. How well does the process for awarding franchises work?

3.1 As indicated above, the process itself works effectively within its own terms. It provides the best value operator for the Government’s specification of a particular route, although this is not necessarily the same as providing the best value for the passenger or the railway which passengers and local communities would necessarily desire.

3.2 The key to improving franchising lies at the beginning of the process, when the franchise is specified. First, it would make obvious sense for the Department’s Regional Planning Assessment(s) for a route to have already been consulted upon and published. Similarly the availability of Network Rail’s Route Utilisation Strategy will give bidders a clearer understanding of the network capacity on the route.

3.3 However, the availability of the RPA and RUS notwithstanding, GNER would argue that the specification for a franchise is carried out with insufficient prior public debate about what is required from the franchise, within the boundaries of affordability. In our view, there could be wider stakeholder engagement in the pre-specification stage and wider understanding of the bidding criteria. One approach could be for the DfT to involve some constituency MPs and representative groups in examining a draft specification and making recommendations to provide additional or alternative services, or safeguard other routes.

3.4 A more inclusive approach would mean there was a wider understanding of what bidders were being asked to bid for, and hopefully greater buy-in for the new operator once the franchise had been awarded.

4. Do we need more competition and vertical integration?

4.1 As the Committee will know, earlier this year the Office for Rail Regulation (ORR) rejected GNER’s application for additional paths to run a half-hourly Leeds service which was a franchise commitment in the new ICEC franchise, but subject to regulatory approval. The ORR granted paths on the East Coast Main Line (ECML) instead to a new open access operator, and an additional path to an existing open access operator. Our comments in this section are obviously informed by this experience, but this submission focuses on the more generic issues raised at an industry level.

4.2 GNER believes firmly that competition has improved performance on the railway. Private sector operators have innovated and invested in their services, which is why we now see record levels of passengers on the railway.

4.3 However, competition must be fair. At present, franchise holders are forced to compete at a disadvantage with open access operators, because franchisees have to pay fixed and variable access charges to Network Rail for using its infrastructure, whereas open access operators only pay variable charges. This puts franchisees at an inherent competitive disadvantage.

4.4 This disadvantage is compounded by the fact that, in line with Government’s aspirations, a growing number of franchised operators are paying a premium to the Exchequer over the lifetime of their franchises. This is another cost which an open access operator does not face. Also, unlike franchised holders, who have clear commitments to invest in improvements to stations and other passenger facilities in their franchise, open access operators are free not to invest because they sit outside the franchising system.

4.5 Secondly, there is a danger that, rather than being a truly new service, putative open access operators can arrange their proposed service specifically to take existing fare revenue from franchised operators, rather than generate a new fare revenue. This is due to the Operational Research Computer Allocation of Tickets to Services (ORCATS)—a pooling system for allocating fare revenue when more than one operators stops at a station.

4.6 Thus, by calling at regional hub stations, open access operators are entitled to a share of the revenue at the station. Under ORCATS, an open access operator will get a share of the ticket income from Government-specified train franchises based on the number of trains they run, regardless of how many carriages they provide, the quality of service on offer or even how many (or few) passengers they carry. This can be the only way in which an open access operator is able to justify the economic viability for a proposed service.
4.7 If open access operators can run on a standalone basis, without primarily abstracting revenue from franchised operators, and can create a new market, then a genuine public benefit is served. If not, then it is questionable if a real public benefit is realised if franchise contracts become devalued or threatened.

4.8 Potential increases in open access services have significant implications for the Government (and the taxpayer). The Department for Transport is seeking—correctly in our view—to ensure that franchisees pay premiums for running services or at the very least minimise the subsidy operators receive. All franchise bidders are risk averse to some degree; the uncertainty in terms of both revenue and the ability to run new services which open access creates will hinder the DfT in ensuring that franchise bids represent as good value as possible.

4.9 The Department for Transport’s submission to the ORR on its proposed decision for East Coast Main Line access rights summarised this problem:

“Hitherto, [franchise bidders] have believed that new access rights will not be granted to competitors:
— whose main source of income will come from abstraction from the revenues of franchised operators; and
— whose trains will require the flexing of parallel franchise services.

Henceforth there will be a view, not only among new entrants but also among existing holders of franchises and access agreements, that the future of their businesses is less certain than before. As a result, we can expect to see more caution exercised by bidders, which may be reflected in lower bids, and a potential reduction in premium or an increase in subsidy required.”

4.10 At the very least, bidders should have the certainty that they will be able to fulfil their plans for enhancing and/or increasing services should their bid be successful. We welcome recent statements in the press that the ORR would advocate getting agreement on track access rights for extra services before any franchise contract with DfT Rail is agreed.

5. CONCLUSION

5.1 The Government must be bold when setting the specification for a franchise: train operators can innovate and provide the best value for money solutions for that specification, but cannot be expected to provide uncosted added value which the Government or other stakeholders desire. This is especially true since the DfT has taken over direct responsibility for franchising, as it has been made clear that cost will be the over-riding determinant in awarding a franchise.

5.2 It is essential that questions of capacity and access on a route are clarified before the franchise process begins. Ideally, the route RUS should be in place prior to consultation on franchise specification.

5.3 We welcome the ORR’s decision that it will be reviewing the access charge regime. The current charging regime is discriminatory and distorts competition between franchised and open access operators.

5.4 Whilst it is in the interest of passengers for open access operators to run services which are truly additional to that which is specified in a franchise, it cannot be right that the Government’s contracted operator is prohibited from fulfilling its franchise commitments because of an open access operator, and that the value of the franchise to the Government is diminished. Future bidders will be extremely risk-averse in costing their proposals if this remains a threat, which in turn will make it more difficult for Government to generate premiums from franchises.

5.5 Thus competition through open access can, in fact, undermine the benefits of innovation and cost-effectiveness gained from the franchising process. Intra-rail competition is injected into the UK passenger railway in two ways, through franchising, in the main, and through open access. The two can conflict; the Government may need to decide at what point competition in the railway should be focussed. To the passenger standing at the station platform, it is self-evident that a franchised service and an open access service, travelling to and from the same stations on the same route at roughly the same time, are in the same market and are vying for the same passengers.

19 June 2006

Memorandum submitted by Govia Ltd

INTRODUCTION

Govia Limited is a joint venture between the Go-Ahead Group plc and Keolis SA, first established in 1997. Since then Govia has run a number of passenger rail franchises:

- 1997–2006 Thameslink
- 2001–2009 Southern (formerly South Central)
- 2006–2014 Integrated Kent

Govia is also currently a shortlisted bidder for Transport for London’s London Rail Concession and intends to bid later this year for the East Midlands and West Midlands franchises.
SUMMARY

Passenger rail franchising should have as its objective the steady improvement of the service offered to rail passengers. The current system is broadly achieving that, while also allowing the government the opportunity to exercise policy choices about how it spends taxpayers’ money. The franchising process has become reasonably well established and understood by current industry players. However, it is expensive and onerous and may be deterring new entrants to the market. Franchise contracts are based on sensible commercial principles and risk allocation, but there would be benefit to all parties in making them on average 10 years in length, not seven. Open access operators have a role within the system. Franchised operators must be adequately appraised of the potential for such operations at the bidding stage. Thereafter they should live with the risk. Vertical integration has no particular virtue. Instead the current industry structure should be given time to settle and mature.

RESPONSE TO QUESTIONS THE COMMITTEE WISHES TO ADDRESS

1. What should be the purpose of passenger rail franchising?

Its purpose should be to bring private sector entrepreneurialism and customer service skills into the railway. The purpose of making franchises competitively bid is to ensure that passenger train operations remain fresh, dynamic and as passenger-focused as possible. The spur of competition drives up standards, best practice is disseminated and innovation introduced.

An allied purpose should be to permit the government to exercise policy choice and decisions about the provision of railway services, which it is able to do through the specification it sets in franchise competitions and through the terms of franchise agreements.

2. Is the current system achieving that purpose?

Up to a point. It has undoubtedly resulted in a greater focus on the passenger and a different attitude among providers of rail services. The challenge now for owning groups is to work to ensure that the customer focussed attitude they espouse permeates their organisations all the way to the front line of operations. This is currently happening with varying degrees of success. Franchising generally encourages the process, because when a franchise is re-let the successful bidder invariably commits to working to improve customer service (and through the National Passenger Survey and other means is measured objectively as to success). However, one downside of franchising is that staff have found themselves, every few years, subject to new ownership with attendant shifts in policy, corporate values and expected behaviours. This can breed a degree of cynicism. This is picked up below under comments on franchise length.

The government’s success in using the franchise system as the means to exercise and implement policy choice about rail services is more mixed. It has not helped that there has been a succession of government bodies (OPRAF, the SRA and now the DfT) responsible for franchising. The current industry framework needs time to settle and mature. We have seen signs, through our involvement in the franchise competition for IKF, that the government is making progress in its ability to use franchising to deliver policy, for example in the way it has specified the domestic services to be delivered using the new Channel Tunnel Rail Link.

Strong growth in the industry is an indication that the system is achieving at least some of its purposes. The fact that more than 1 billion passenger journeys were made last year can only be seen as a measure of success.

3. How well does the process for awarding franchises work?

It works reasonably well, but it has become extremely demanding on both bidders and the government. The highly onerous nature of bidding competitions may well be acting as a deterrent to new entrants to the passenger rail industry. It is noticeable that the current participants in the industry are almost entirely either those transport groups that entered the market around the time of privatisation or overseas rail operators (and at least one of those has withdrawn from the market in frustration).

4. What input do operators, passengers and other interested parties have into the design of franchised services?

There is opportunity for input, but it is limited. The RUS process and the specific consultation exercises the DfT undertakes prior to launching a franchise competition provide the main opportunities. We are aware, however, that many external parties, particularly passenger groups and local authorities, find the DfT disappointingly unresponsive in these exercises. That is partly because it is genuinely difficult for the DfT to meet everyone’s aspirations—often meeting one party’s wish for an additional service means eliminating or amending a service important to another party.
Operators have the opportunity to participate in the formal consultation exercises, but not surprisingly often prefer not to, in order to preserve competitive confidentiality around their ideas for franchise delivery. There are, however, opportunities for informal discussion with the DfT about the specification of franchises, which we value.

Network Rail has a large influence as the infrastructure operator, and is prone to adopting a rigid position about what can and can’t be achieved on the network, which can act as a constraint on the DfT’s ability to specify what it wants in franchises. It is very important that Network Rail is incentivised to work constructively with government in planning and specifying franchises. The current industry structure, which places much more responsibility on Network Rail for punctuality and reliability than for passenger service and convenience, does not help in this regard.

5. Has there been a smooth transition of franchising arrangements from SRA to DfT?

On the whole yes. We experienced it directly as the successful bidder for IKF, which began as an SRA competition and finished as the first franchise to be let by the DfT. Subsequent to that, the DfT appears to be meeting its timescales for awarding other franchises.

Franchise management (as opposed to franchise procurement) has also made a reasonably smooth transition, although the DfT appears to be struggling to find the necessary level of resources to undertake its side of franchise agreement implementation.

6. Are franchise contracts the right size, type and length?

There is no single prescription that works for all franchises and the DfT are right to keep this under regular review and to design franchises on a customised basis.

7. What criteria and processes are used to determine the nature and length of franchise?

We don’t know what criteria are used to determine the lengths of franchises. For example, the two Midlands franchises are seven years four months and seven years 10 months, which seems an arbitrary decision for which we have seen no explanation. In general franchises are too short in length. They need to be of sufficient duration to permit a franchisee to make real changes, whether through staff training and reorganisation (referred to above in relation to achieving customer focussed attitudes right through the organisation) or through investment in systems, station assets or rolling stock.

The present typical duration of seven years is too short to make a real difference. By contrast, anything over 12 years is probably too long in that the commercial risk envelope becomes too uncertain the further into the future one projects. The optimum period is probably therefore 10 years, with the possibility of two additional years at most.

As regards the nature of the franchise, the DfT is moving increasingly towards a templated contract for franchise agreements, so that the obligations on each party, the risks, incentives, levers and rewards are almost identical irrespective of what the franchise is. This is a sensible approach which helps the market to mature and bidders to work at continuously improving their offering. It works well in related areas of government procurement such as PFI.

8. What criteria and processes are used to evaluate franchise bids?

The DfT is active in providing visibility into its evaluation methods, which is to be applauded. They are also open to informal discussions with bidders to improve understanding further, and are conscientious about providing feedback after competitions. These are all positive points. However, the downside is that the criteria and processes seem to be becoming ever more theoretical. The process is consultant-led and there is some risk that a bidder can win through good exam technique. Another effect of this consultant-led approach is that the requirements of each bid are hugely onerous, so that it is common for bidders to have to spend at least £2 million on external advisers and consultants in order to prepare a compliant bid. This ties in with our earlier comment that the process is overly burdensome.

9. Do franchise holders deliver value for money to passengers and the government throughout the duration of their contract?

We feel that we have delivered and do deliver value for money and adhere to the deals we have done. The patronage and revenue growth that we and others have achieved seems clear and unambiguous evidence that we are getting something right. However, some bidders over-bid in their desire to secure a franchise and the government has to step in. It is probable in these circumstances that value for money is a casualty. The onus must be on the government to eliminate overly ambitious bids and not always go for the apparently cheapest solution.
10. Are risks suitably apportioned between the government and franchise holders?

Broadly speaking yes. This has been worked on in the light of experience and we feel comfortable with the current allocation. It is pointless to have the private sector running franchises if they will not take risks. We do not, however, wish to take unmanageable or foolhardy risks. During the life of the SRA there was definitely a tendency for the government to seek to overburden franchisees with risk, but the DfT now has a much better approach.

11. What is the scope for improving services through the franchise agreements?

Franchise agreements almost always build in continuous improvement targets and we are obliged to meet them. That provides a strong and clear incentive for continuous service improvement. In terms of additional train services, the real scope varies between franchises. For example it is certainly easier to provide additional services in a rural franchise where there is spare capacity than in a heavily congested SE commuter service. Franchise agreements are in any case only part of the story, as Network Rail, other operators including freight operators and the ORR all have a locus in determining whether additional services can or should be run.

The DfT is giving PTEs the authority to buy more services—that’s a sensible thing to do. If they want additional services, they can and should pay for them.

12. Do we need more competition and vertical integration?

We would welcome more competition than there is at present, whether through open access operators or more active players in the passenger rail business. But in return we would expect longer franchise periods, lower bidding costs and lower exit costs from the industry. This last point is a difficult one, but we believe that a franchisee should have the right to serve notice of ending a franchise if it is proving commercially unsuccessful. At present the rights are all on the side of the government in terms of bringing a franchise to an early end.

On vertical integration, we are doubtful that there is much to be gained from it at present, given that we are still in the early days of the current industry structure, which clearly places responsibility for infrastructure and its operation with Network Rail.

13. Is franchising compatible with open access operations?

It should be. We are a commercial business and accept that we operate in a competitive environment. We shouldn’t be protectionist. But where open access is possible it is essential that bidders should have as much information as possible in order to accept and appropriately price that risk as part of the franchise competition.

14. Should train, rolling stock and track operation be more closely integrated?

We see no pressing case for this, believing instead that the industry should continue its efforts to make the current structure work well, which we believe is perfectly possible. There is no sense in train operators owning a fleet of trains with an asset life of 30–40 years while operating franchises of less than 10. Similarly, as passenger transport operators we have little interest in owning infrastructure that places heavy capital requirements on a business and fundamentally changes the risk profile that our investors buy into.

The current industry structure needs time to settle further, but it is fundamentally logical and sensible. The infrastructure is owned and operated by a state backed company that is not required to make a commercial return and is able to access low cost capital to support the maintenance and development of the network. The expensive rolling stock is owned by commercial parties that are able to take a long term view of assets and their useful lives. And the passenger facing operations are managed by transport groups that focus on efficiency and customer service.

We see an analogy with a successful enterprise like Bluewater Shopping Centre, where the supporting infrastructure (road, energy, communications, water) is provided by utility companies; the property asset is owned by a long term player in real estate; and the outlets are leased on a shorter term basis by retailers who must provide an effective customer service or risk going out of business.

That is not to say that the present system could not work better, perhaps by means of limited further integration. For example, it may be possible to achieve further integration in the operation of the infrastructure between Network Rail and train operators (but not the funding or ownership). But the current industry structure is sound and should be allowed a further period of time to mature.
CONCLUSION

Passenger rail franchising has gone through a number of twists and turns since 1996, but is demonstrably delivering success in terms of growing rail patronage and revenue. It has also brought private sector expertise and innovation into the railway. The franchising process now has the opportunity to stabilise and mature under the industry structure established by the Railways Act 2005. The DfT should be allowed time to achieve this, without coming under pressure to introduce significant changes in the short term. The industry structure as a whole should also be allowed time to stabilise and mature—it is little more than a year since the 2005 Act came into force and too early to contemplate another period of restructuring in the industry.

19 June 2006

Memorandum submitted by National Express Group PLC

INTRODUCTION: ABOUT NATIONAL EXPRESS GROUP PLC

National Express Group (“NX”), one of the UK’s leading transport operators, is pleased to submit evidence to the House of Commons Transport Committee’s inquiry into passenger rail franchising.

The Committee’s previous report on this subject, published in 2002, made important recommendations. Many of these had a beneficial impact on subsequent events in the rail industry and on Government policy and legislation. We hope to be able to contribute to a similarly positive outcome this time.

NX serves more than one billion passengers a year worldwide on its train, bus, light rail and express coach operations. Our 40,000 employees, of whom 20,000 are in the UK, are dedicated to improving continuously the quality, value for money and safety of all our services for our passengers. We operate the following franchised Train Operating Companies (TOCs) on behalf of the Department for Transport (DfT): c2c, Central Trains, Gatwick Express, Midland Mainline, “one” and Silverlink. And our desire to win new contracts remains strong.

Our approach to franchises is entrepreneurial. In the rail business, we believe that the Government’s objectives and our own commercial goals are best achieved if we are free to innovate, always putting the customer first. Thus, we manage each of our businesses for growth in terms of both ridership and revenue. We achieve growth by investing in all aspects of our services, by working in partnership with key stakeholders, and by integrating our services with the wider public transport network.

We now turn to the specific questions asked by the Committee.

1. What should be the purpose of passenger rail franchising?

The purpose of franchising should be to deliver growing, successful railways, moving increasing numbers of passengers at higher levels of satisfaction whilst securing value for money to customers and taxpayers.

This purpose is best realised by the public sector being clear about the policy objectives it wishes to achieve through franchises but then ensuring private sector operators are incentivised and motivated to grow their businesses to a greater extent than would be the case if the railways were run either as a public utility or under facilities management contracts. Evidence also suggests that effective competition between operators for franchises can drive up standards.

Our success and very survival is dependent upon growing passenger numbers and revenue day after day. The TOCs are the only organisations in the railway industry to interface directly with the customer. As such, NX puts its focus on meeting the ends of those customers and ensuring that the needs of the production side of the railway, led by Network Rail, is always subsidiary to the needs of our customers. This helps to prevent the railway industry collectively from slipping into a production-led mentality where the customer must simply accept what he or she is given.

The fact that it is possible for us to talk in upbeat terms about the prospects for rail franchises represents a remarkable transformation. The first generation of franchises was let against the background of declining patronage and rising fares, in an industry which had been denied consistent investment by successive governments. When the Committee published its last report in 2002, the railways were still recovering from the consequences of the Hatfield accident, and facing uncertainty following the placing of Railtrack in administration. Today, with a stable legislative framework in place thanks to the present Government’s Railways Act 2005, the prospects for rail are much brighter.
1.a Is the current system achieving that purpose?

The rate of passenger growth in the portfolio of NX rail franchises suggests that the franchising system is working. Many rail users have choices as to their mode of travel. They are choosing rail in greater numbers because the product is becoming more competitive and attractive.

For example, our Midland Mainline franchise secured a 3% growth in patronage during 2005, despite the impact of the downturn in public transport usage following the tragic events of 7 July.

Some growth in rail patronage can, of course, be attributed to the generally benign economic conditions, reinforced by the capping of many fares at RPI-1 for several years after the privatisation of the railways. Nevertheless, the innovation, marketing and investments made by TOCs have undoubtedly played a significant part in increasing usage and customer satisfaction.

This is demonstrated by a non-economic measure: passenger satisfaction, as measured by the National Passenger Survey (NPS). Levels of passenger satisfaction are rising, just like demand. Our Gatwick Express TOC has secured the highest level of satisfaction of all franchises (93%), whilst our c2c TOC (the former LTS Misery Line) improved from 83% to 90% between 2004 and 2005. The biggest improvement of late has been by Midland Mainline, which rose by 10 points in 2005 to 89%. All of our TOCs continue to make progress, and the average NPS score across the six NX businesses is 82%.

Nevertheless, TOCs still have a great deal to do before they are truly appreciated by passengers as champions for their interests. The role of front-line employees is absolutely critical in securing this change of perception as improved employee morale directly impacts on customer satisfaction levels. This is why NX is making a long-term investment in empowering such employees by establishing three Customer Service Academies for its TOCs, at Derby, Birmingham and Stratford.

2. How well does the process for awarding franchises work?

The franchising process is of vital commercial importance to companies such as NX, yet it remains confusing and increasingly, and unnecessarily, expensive. Whilst there has been some progress of late from the DfT in explaining to bidders why they were or were not successful, it is still very difficult to understand exactly why a franchise was won or lost.

The cost escalation in bidding has been exponential. Only two years ago, the cost of bidding for a franchise was £2–3 million. In the last two years that has increased dramatically and the typical cost today for us and our competitors is up to £5 million per bid.

At up to 18 months’ duration from Expressions of Interest to the commencement of a franchise, the prolonged nature of the competitive process is highly disruptive for those who are continuing to operate the railway in the meantime. Although incumbent bidders do their best to prevent managers being distracted from their day jobs, inevitable human factors and a desire to win a further term results in a state of quarantine. Moreover, front-line employees can be distracted by the uncertainty of not knowing for whom they may be working in the future and this can be problematic in relation to gaining employee loyalty.

We believe that the complex process is driven in part by fear of legal action by unsuccessful bidders. Our proposal below for extendable franchises may be helpful to the Committee in recommending a more effective way forward.

As the SRA and DfT have become more prescriptive through their desire to be able to compare bids more precisely, innovation and vision have suffered. We believe that the DfT should now have sufficient confidence in the process to be more open to radical thinking from bidders. Robust based comparator bids with positive encouragement of variants to that base comparator may represent the best of both worlds. DfT will ultimately always have the final say on any radical proposal being implemented, but our industry needs fresh ideas if it is to be able to cope with ever-rising demand and meet the Government’s requirements for environmentally sustainable travel. We also need an unequivocal policy statement from the DfT that it is best value and the wider benefits of bids that will be successful, not the one that automatically generates the lowest subsidy or highest premium line.

2.a What input do operators, passengers and other interested parties have into the design of franchised services?

The DfT is taking an increasingly consultative approach to the design of franchises. We warmly welcome this approach, as reflected in the recent consultation papers on the West Midlands, East Midlands and New Cross Country franchises.

It is especially important that regional and local government bodies with access to funds through the Transport Innovation Fund (TIF) and Local Transport Plans (LTPs) are able to engage with the specification process for franchises so that, for example, station modernisation and expansion schemes can be taken forward in partnership with TOCs. Another interesting suggestion would be for the DfT to consider enhancing customer input into the franchising process.
2.b Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

Yes. We have not detected any problems.

3. Are franchise contracts the right size, type and length?

3.a What criteria and processes are used to determine the nature and length of franchises?

The original franchises were largely drawn up as subdivisions of the former British Rail Sectors: InterCity, Network SouthEast and Regional Railways. The most successful of the first generation franchises were those with a relatively distinct and self-contained geography and/or market, for example Chiltern Railways, GNER, c2c, ScotRail and Gatwick Express. Those which found the challenges greatest tended to be the far-flung former Regional TOCs, such as Central Trains and Northern Spirit, or those affected by major engineering works, such as our own Silverlink (County) as well as Virgin West Coast and Virgin Cross Country.

As the opportunity to award new franchises has arisen, there has been a considerable amount of remapping to reflect commercial, operational and political changes. We have been deeply involved in these processes. Remapping is continuing—and perhaps concluding—with the awarding of the West Midlands, East Midlands and New Cross Country franchises, and the London Rail Concession.

In its 2002 report (recommendation “c”), the Committee expressed reservations about the SRA’s policy of combining franchises serving major London terminals. NX was awarded the first of these combined franchises—Greater Anglia, now known as “one”—in 2004, and so is very well placed to comment on the arrangement.

We believe that the SRA was right at the time to propose the combined franchises, as the dominant issue facing the railways was improving performance. Railtrack had proved to be incapable of managing the conflicting needs of multiple operators, but the new approach of Network Rail with the underpinning of the Route Utilisation Strategies (RUSs) has largely overcome the problem for the future. Indeed, NX’s Wagn franchise (now part of First Capital Connect) reached a co-operative agreement with Network Rail and GNER on the use of scarce capacity at London Kings Cross station.

We do understand why franchise lengths were reduced in the SRA’s model of 2002. Primarily this was because as an industry, everyone was finding it impossible to forecast and therefore take risk on long term revenue positions in the light of the tremendous volatility following Hatfield and the subsequent collapse of Railtrack. However, the environment we now find ourselves in is much more stable and we feel more confident about the future. NX is keen to invest in this confidence and stability by taking more risk and making more commitments about the future performance of TOCs. In return for this, we would want to see considerably longer franchise terms made available. One of the consequences of short duration franchises is that investment tends to be made very early on, in order for the franchisee to have some prospect of earning a return before the end of the contract. Longer franchises would enable a more measured approach to investment and at greater levels to be taken as is the case with the 20 year Chiltern franchise.

3.b What criteria and processes are used to evaluate franchise bids?

Under the DfT, it is becoming a little clearer what criteria and processes are used to evaluate franchise bids. We are now seeing flow charts describing the processes.

However, we are concerned that the lowest subsidy or the highest premium line is emerging as the dominant reason for awarding a franchise, whereas the wider questions of best value, deliverability and meeting many other policy initiatives that Government is promoting must be properly taken into account.

The ability to generate revenue should, nevertheless, remain a very important determinant in awarding franchises. This is why we believe it generally to be correct for the TOC to take revenue risk, so that the incentives towards growth and entrepreneurship are in place.

3.c Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

In the year 2004–05, the nine TOCs then operated by NX received a net subsidy from the DfT of £281.4 million. In the same year, NX TOCs delivered 11,647.9 million passenger kilometres. The effective subsidy to our portfolio of TOCs was, therefore, 2.4p per passenger kilometre. We believe that this represents good value for money to the taxpayer.

1 National Rail Trends, October–November–December 2005, Office of Rail Regulation.
Franchises are almost invariably awarded with a declining subsidy or increasing premium profile, so value for money demonstrably improves during their lifetime. The specifics depend on the accuracy of the data which underpinned the original contract. Modern franchise contracts include arrangements to allow the Government to share in higher than anticipated profits.

3.d Are risks suitably apportioned between the Government and franchise holders?

The rail industry went through a period of considerable turbulence brought to a head by the collapse of Railtrack. We understand why following that period, in order to establish stability, a greater degree of specification was necessary. However, that period has passed. Stability has returned and it is vital, as the only true customer facing part of the railway industry, the TOCs are able to take risks appropriate to growing a true customer focused business and can be rewarded appropriately for taking those risks. At the moment, we feel unnecessarily constrained. NX is ready and willing to step up to taking greater risk and delivering for its customers if the franchise can empower it to do so.

Franchising created the incentive for NX to introduce its Performance-Management Improvement Plan (“P-MIP”) to confront the legacy of Hatfield. P-MIP brings together all industry partners, creating ownership and responsibility for delays, devising and implementing plans for tackling them, and monitoring progress.

By this means, we have:

- Lifted Midland Mainline to become the best performing InterCity TOC;
- Lifted c2c to become the best performing TOC in Public Performance Measure (PPM) terms;
- Secured for Gatwick Express top ranking NPS scores for two years running, with c2c second overall and Midland Mainline third overall; and
- Despite an extremely difficult operating environment, improved the PPM of Metro services in our Silverlink franchise from 77% in 2003 to 90% in 2006.

These performance improvements have won back our passengers, improved our revenue and made our franchises better value for money for the taxpayer.

We have also been incentivised to expand and modernise our train fleets and the frequency of our services to a greater extent than would have been the case in the traditional structure of the railways. For example:

- Central Trains delivered a massive increase in the frequency of West Midlands services;
- c2c procured an entirely new fleet, facilitating a substantial increase in frequency; and
- Midland Mainline introduced a new fleet to run alongside existing trains, doubling frequency on the core route.

However, one problem with TOCs taking revenue risk is that they are constrained by the regulatory framework for fares from managing cost shocks. NX fully understands the rationale for the fare capping regime imposed at the time of privatisation, and subsequently modified by the SRA. Yet, we face an immediate problem of a substantial increase in the price of electricity and diesel fuel to operate our train fleets. If we are unable to behave truly commercially, in a manner consistent with delivering value for money for customers, then that cost to the taxpayer will have to rise.

3.e What is the scope for improving services through franchise agreements?

We believe that greater value for the taxpayer, investment and innovation could be achieved if franchise agreements were made renewable with the incumbent operators. At present, franchises are opened to a full tendering process as they approach their end. Were incumbents to be subjected to a review of performance and finances instead, and given the option to negotiate the extension of the franchise, the investment hiatus, the distraction of managers and employees, the wasted effort of handing over the franchise to another operator, and the costs to the DfT and bidders from the competitive process could be avoided.

Longer-term franchisees would also be in a stronger position to strike bargains with Network Rail and the Rolling Stock Leasing Companies (ROSCOs), all of whom are permanent features of the industry landscape.

TOCs with longer franchises would be in a stronger position to invest in the long-term development of their workforces and the modernisation of working practices, all of which is difficult if employees see the incumbent management as short term.

The DfT and, previously, the SRA have made progress in this direction by making recently awarded franchises extendable for two or three years provided that public policy objectives and performance goals are being met. We see many advantages in allowing franchises to be renewable for longer periods. A quid pro quo for such a change might be a tougher performance regime for incumbents, increasing the risk of losing the franchise altogether in the event of consistent failure to meet DfT objectives.
4. Do we need more competition and vertical integration?

4.a Is franchising compatible with open access operations?

As a concept, we are entirely supportive of anything that improves services for customers without causing disbenefit elsewhere that outweighs those benefits. The problem with open access arises when it is not clear precisely what the public policy position is and what the rules of engagement will be. We are obviously watching the Grand Central case with interest but it must be the case that where railway lines are constrained in terms of capacity, then the limited capacity left ought to go to the services that deliver the widest possible benefits to the most numbers of customers. As long as that is clear to everyone at the outset, and as long as any commensurate loss in a franchise is compensated in an open and transparent way, then there can be no problem with open access.

We believe that this really highlights the major issue constraining growth—a lack of capacity on certain congested routes—and we will be increasing our pressure on Network Rail to address this. We noticed with some alarm recent statements made by Network Rail suggesting that there would be a moratorium on schemes of a certain value designed to address this very point. We trust this was not a policy position as it would be of very considerable concern.

4.b Should train, rolling stock and track operation be more closely integrated?

At the beginning of this evidence, we described the role of TOCs as champions for customers. Rail passengers generally hold TOCs responsible for performance, whether problems occur with trains or infrastructure. We work in partnership with Network Rail whenever and wherever we can. However, it is in the interests of passengers for TOCs to have the ultimate power of contractual or regulatory leverage over Network Rail to secure the best interests of rail users.

Network Rail is operationally focused, and is a monopoly supplier to the TOCs. Were the railways to be vertically integrated, either by TOCs taking over asset management or Network Rail running trains, the railways would once again inevitably be run as a production-led organisation. We regard the independent role of TOCs as the organisations in touch with passenger needs as absolutely essential in preventing this from happening. Passenger usage of the railways will dictate the long term success of the railway.

CONCLUSION

NX sees the prospects for the railways and for franchised passenger services as very much brighter than when the Committee last considered this issue. We believe that properly incentivised TOCs operating in the public interest can deliver high quality services at affordable prices for customers, whilst securing value for money for the taxpayer.

NX would be delighted to support this evidence with an appearance as a witness in the forthcoming oral hearings. We are also happy to arrange for the Committee to visit any of our TOC facilities.

21 June 2006

Memorandum submitted by The Railway Forum

THE RAILWAY FORUM

The Railway Forum is the industry-wide strategic think-tank and lobby group promoting the growth of a safe, efficient and affordable railway in the UK. It represents the majority of the industry including train operating companies, rolling stock leasing companies (ROSCOs), equipment suppliers, Network Rail and Transport for London. Both the Association of Train Operating Companies (ATOC) and The Railway Industry Association (RIA) are members and play a full part in Railway Forum activities.

SUMMARY

1. Rail franchises are the key mechanism through which rail services are specified and ultimately delivered. As such efficient franchise procurement and management procedures are crucial in ensuring value for money for both passengers and the taxpayer as much as meeting evolving passenger needs and expectations. Since privatisation the franchised train operators have delivered significant improvements in the quality and quantity of services and this has been, in part, reflected in the exceptionally strong growth experienced over the past 10 years. This growth—over 40% increase in passenger kilometres—has itself been achieved on 20% more services since privatisation, demonstrating significant improvements in efficiency and capacity utilisation. Similarly, despite the clear setback after Hatfield, performance, as measured by the Public Performance Measure (PPM), has risen steadily and is now consistently above 90% on many parts of the network.
1.1 Furthermore the most recent franchises (and most likely those that are pending) will deliver significant premium payments to the Government by the end of the decade. This marks a fundamental shift in the balance of railway economics: from a “traditional” model of modest, but possibly declining, operating subsidy to one in which franchisees are actively growing their business whilst contributing funds back to Government.

1.2 Franchising arrangements have evolved significantly since the early days of privatisation whereby the lowest subsidy was often the key criteria in successful bids. The DfT is now taking forward a revised franchising model based on a broader range of criteria alongside the development of a longer-term strategy for the railways. However although this franchising model is an improvement on its predecessors there remains cause for concern in some areas, in particular:

— the high degree of complexity and detailed specification inherent in many franchise agreements;
— tensions between open access operators and incumbent franchisees;
— the correct balance of risk between the public and private sectors; and
— appropriate incentivisation to meet changing passenger needs and rising expectations on a growing railway.

1.3 We have tried to structure our response around the key questions identified by the Committee (where relevant) and our comments on these—and other issues we feel are appropriate for consideration—are set out below.

What should be the purpose of passenger rail franchising?

2. Passenger rail franchises provide the most effective means of delivering cost-effective rail services to meet both passengers’ needs and, over time, increasing expectations. To best achieve these goals franchises should:

— be awarded according to a clear and realistic set of criteria as part of an open competition;
— be simple to both manage and monitor and be flexible enough to allow operators the scope to introduce new techniques and grow the business according to demand;
— be well structured with a clear indication of the likely balance of risks between the Government and the private sector; in particular the Government should take the public policy risk (eg planning, legislative risk) and leave operators with a range of commercial risks they are best placed to manage;
— contain appropriate incentives for improvement and clear, consistent penalties for underperformance;
— be framed within the context of a growing railway; it is clear that passenger demand is likely to increase significantly and franchise specifications must not be unduly constraining in this regard.

Is the current system achieving that purpose?

2.1 The current franchising system, whilst an improvement on previous models, is somewhat deficient in a number of these respects. In particular:

— there is still a high degree of complexity and prescription inherent in many franchise agreements eg managing and reporting on the large number of Key Performance Indicators, Service Level Commitments etc;
— the over-specification of franchises—with an emphasis on setting services to either maximise premium payments or limit subsidy—appears to stimulate open access operators to “fill the gaps” that might sensibly be filled by the incumbent franchisee if allowed greater flexibility;
— similarly allowing open access operators to enter the market on a marginal cost basis yet potentially abstract significant fare revenues from other, franchised operators is unfair;
— the appropriate balance of risk between the public and private sectors needs to be clearly delineated—Government must bear responsibility for that public policy risk which it is best placed to manage; and
— looking ahead we need to consider how incentives can be better aligned to meet changing needs and rising expectations on a growing railway.

2 The recent decision by the Office of Rail Regulation (ORR) to grant paths on the East Coast Main Line to Grand Central is a useful illustration of this issue.
How well does the process for awarding franchises work?

What input do operators, passengers and other interested parties have into the design of franchised services?

3. Stakeholder input into franchise specifications is an already well-established procedure. DfT consults not only with individual TOCs but also with local authorities, regional development agencies, business and passenger groups on the proposed base case specification that potential operators will be asked to bid against, as well as a range of additional increments/decrements that might be included in the final specification.

Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

3.1 Although the transfer of franchising functions from the SRA to DfT has been achieved relatively smoothly in the past 18 months or so we do have a residual concern over whether DfT Rail Group currently has the appropriate level and mix of skills to manage both the franchise procurement and monitoring processes going forward.

Are franchises the right size, type and length?

What criteria and processes are used to determine the nature and length of franchises?

4. There has been a tendency in the past to adopt a “one size fits all” approach to franchising. However it has been shown that this does not fit with the diverse nature of the railway business. In particular where a franchise seems to offer the best prospect of paying a premium (or alternatively receiving a small element of operating grant in relation to the service offered) every consideration should be given to enabling the operator to optimise the business and manage commercial risk. In many cases this may well lead to longer-term franchises.

4.1 Similarly the structure of the network and the type of businesses are not really reducible to a single model. Although the number of franchises should not be unmanageable (and the decisions made at privatisation in this regard were clearly not particularly effective in practice) reducing the number of franchises for no other reason than it seems like a “good thing” should not be a primary objective.

What criteria and processes are used to evaluate franchise bids?

4.2 We are somewhat concerned at the level of detail involved in the specification of services particularly in franchise bids where a premium is anticipated. The railways are currently experiencing very strong growth in demand across nearly all of the network and this must be allowed for in the franchise specification and bidding stages. In particular this growth must be realistically built into the longer-term element of any franchise.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

4.3 Franchised train operators have delivered significant benefits both to passengers and Government since privatisation. Passenger numbers are now back to levels last seen in the 1960s and overall journey satisfaction is now up to 80%. Underpinning this railway renaissance operators have achieved significant improvements in the travelling experience for passengers. For example:

— over 4,800 new vehicles have been commissioned (in partnership with ROSCOs) with significant improvements in accessibility for passengers with disabilities;

— a wide range of station upgrades—including improvements to waiting facilities, information provision and security—have been secured;

— the widespread development of online and telephone booking facilities has delivered much greater flexibility for customers; and

— significant investment in ticketing and IT systems has enabled passengers access to a much broader range of travel information eg via National Rail Enquiries, TrainTracker® SMS services, the National Rail website etc.

4.4 In addition recent franchises agreements have seen franchisees committed to paying significant premia over the life of the contract. As already noted, this trend marks a real shift the economic model of rail provision; looking ahead we can envisage a situation in which continuing railway growth underpins sharp reductions in operating subsidy and, in the case of the more profitable franchises, increasing revenues for Government.

3 See for example the premium payments agreed as part of the successful Inter City East Coast, Greater Western, Greater Anglia and Thameslink/GN franchise bids.
Are risks suitably apportioned between the Government and franchise holders?

4.5 We have some concerns over the precise balance of risk between Government and the franchised train operators. In particular:

- the public policy risk to operators of long-term Government decisions eg on planning, legislation, major projects can be significant. Operators should be left with that risk they are best equipped to manage—service delivery, operating costs etc—whilst Government should manage public policy risks; and

- overly tight specification of franchises can leave operators with little commercial room to manoeuvre to expand or develop new services. This can in turn stimulate open access operators that might not otherwise have entered the market with consequential revenue risk (see 5.1 and 5.2 below);

What is the scope for improving services through franchise agreements?

4.6 Franchises offer the best means of developing rail services to meet changing passenger needs and expectations over the long term. Service improvements can be “built in” to the specification from the beginning through the appropriate use of incentives (to achieve higher standards and develop new products) and penalties where relevant (to deter underperformance). Recent franchise awards illustrate the strength of this approach—significant investment and service improvements have been committed over the life of the agreements.

4.7 Nonetheless, over the longer term there remains scope for more sophistication in the way in which service improvement is framed and incentivised. This is particularly important in the context of a growing railway where franchisees must meet both a wider range and increased level of passenger expectation. In light of this, the current system of rewards and penalties based on somewhat “traditional” performance indicators (eg PPM) may need to be further developed to reflect these changing conditions. Looking forward a more dynamic set of performance indicators, linked to passenger expectations may be appropriate.

Do we need more competition and vertical integration?

5. The separation of track and train has stimulated significant competition on Britain’s railways. The level playing field for operators has helped to drive competition not only for franchises but also competition on the basis of reputation, innovation etc. It is therefore no surprise that the UK has, over the last decade, become the fastest growing railway in Europe; much of this growth is a result of the competition fostered by privatisation. By contrast those railways across Europe that have yet to fully implement the infrastructure/operations split have not managed to capture these benefits and, in many cases, have suffered from a lack of dynamism and generally slow growth.

Is franchising compatible with open access operations?

5.1 Whilst open access is, in principle, compatible with the existing franchising model there are clearly tensions with respect to the ability of open access operators to enter the market on different terms to incumbent franchise operators. The recent granting of scarce paths on the East Coast Main Line to Grand Central Trains is an illustration of this. As an open access operator, Grand Central pays track access charges on a marginal cost basis; GNER by contrast pays fixed costs and must deliver a premium as part of its franchise agreement (itself based on significant passenger growth and service expansion). Nonetheless both are allocated revenue on the same basis under ORCATS.

5.2 Open access operators do have an important role on the railway, particularly where niche services can offer real benefits to passengers and stimulate competition among providers. However in an environment in which DfT is increasingly looking to secure significant premium payments from publicly specified franchises their role needs to be carefully considered and incorporated into the franchise letting process. In particular:

- tightly drawn franchise specifications appear to stimulate open access operators to develop services that franchisees might otherwise have provided had they been given sufficient flexibility; and

- the ability of open access operators to enter markets on a marginal cost basis and yet potentially rely on a large proportion of fare revenue from abstraction is unfair.

The competition and cost implications of these issues need to be carefully considered by both the ORR and DfT going forward; it is quite possible that future franchise bidders will “price in” the possibility of open access operation on their routes in response.
Should train, rolling stock and track operation be more closely integrated?

5.3 The argument for vertical integration tends to focus on the perceived need to obviate the key interface between infrastructure management and operation. However there is now clear agreement between Network Rail and operators that operating decisions must be shared along clear lines of accountability and responsibility (Integrated Control Centres are good evidence of this). In addition the Network Code—a common set of rules that apply to all parties who have a contract for rights of access to the track—underpins all bilateral relations between Network Rail and franchised operators. Overall the current system is working well.

5.4 In light of this there is no industry consensus in support of further vertical integration. Furthermore the organisational changes made by Network Rail as well as the emergence of larger, integrated franchises are major developments and, at the very least, will provide a better understanding of the key areas that need to be further developed as part of the operator/infrastructure relationship.

CONCLUSION

6. Overall we believe that passenger rail franchises provide the best means of specifying and delivering services to meet passenger needs and future expectations. Since privatisation the franchised train operators have delivered real improvements in rail services as part of their franchise agreements and the latest round of franchise awards has secured further significant benefits for both passengers and the taxpayer. Nonetheless there remains room for improvement in several areas most notably:

— the level of complexity and detailed specification inherent in many franchise agreements could be usefully reduced;
— the tensions between open access operation and incumbent franchisees need to be addressed to ensure a level playing field;
— the correct balance needs to be struck between that risk best managed by Government and that managed by the private sector; and
— a more sophisticated system of incentives to meet changing passenger needs and rising expectations in the context of a growing railway should be considered going forward.

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regularly a competitive process to ensure that the services it is specifying and paying for offer best value for money. Those are two initial thoughts.

Q4 Chairman: Anybody else?
Mr Franks: It has certainly enabled much more innovation to be brought into franchising.

Q5 Chairman: What specifically?
Mr Franks: There are a number of issues. Perhaps I will touch on a very simple one. Revenue protection for me is a good example. I recall as a managing director of one of the franchises the ability, as a manager in the private sector, just to literally put £1 million on the table to put additional resources in place to manage revenue protection and drive the revenue at risk element.

Q6 Chairman: How often did you do that?
Mr Franks: That is an example. There are a number of examples in terms of how we have invested in the railway to drive up customer benefits.

Mr Metcalfe: I would agree with the point about innovation and the other thing I would add is about culture. We have worked very hard in GNER to train staff and we very much focus on customer service. I think that has been partially a contribution towards the numbers.

Mr Smith: Everyone of the four TOC representatives here has had the experience of losing a franchise.

Q7 Chairman: Is this part of your training? One of the advantages of the franchise system is that you lose your franchise and you are better next time.
Mr Smith: Exactly. That is the point. It really does spur you on to make improvements and to offer something that is going to beat the others next time.

Q8 Chairman: You think these objectives are different from a unified state system. You do not think the state run system is interested in its customers or you do not think that they train people?
Mr Smith: I was not seeking to make that point. The absence of competition within a unified state system is a marked, factual difference.

Q9 Chairman: The Association of Transport Coordinating Officers said that franchises are not putting passengers’ interests first; they are driven by financial objectives and are constrained severely so that the specifications from the Department for Transport restrict innovative thinking. Do you recognise that?
Mr Franks: I certainly do not recognise a number of the points made there. The purpose of the franchise is to grow the railway in a way so that we get more customers and happier customers travelling with us. If you then look back and see what has been achieved in the last 10 years, I will quote an example of one of our franchises on National Express. Midland Mainline have seen 92% revenue growth on that business. It has seen twice as many trains operating than at privatisation. If I am right that the purpose is to grow the railway in a way that makes people happy, Midland Mainline is a very good example of it.

Q10 Clive Efford: On the length of rail franchises, the average length has been eight to 10 years on the most recent franchises that have been issued. How do we strike the balance between the need to deliver an efficient service, get value for money for taxpayers and the need to encourage innovation and investment in our railways? Perhaps Mr Austin would like to start.

Mr Austin: On franchise length, we would certainly support a move from the norm which has been five to seven years with the possibility of extension to something closer to 10 because it gives a much better chance for you then to invest and for investments to come through in the period of the franchise. Also, picking up Mr Metcalfe’s point, it gives you a chance really to focus on serving customers’ needs, particularly in terms of staff training and motivation. For all of those things you need slightly longer than the current franchise length allows.

Q11 Clive Efford: I have heard that said a lot. Exactly what investment are we talking about? What would we miss out on if the contract length were too short?
Mr Metcalfe: I do not think there is one single answer to this. The franchise length may vary from one franchise to another, dependent on the nature of the investment required. In a big franchise that requires a lot of investment, that is where I think a longer franchise of 10 to 12 years is more sensible because it gives the ability for the franchisee to make that sort of investment. In our case we have brought in all the refurbishment of the rolling stock and major redevelopment of stations at around £140 million in the first franchise and about £125 million committed in this franchise. With a shorter franchise we certainly could not have done that. I think there is also more that could be done.

Q12 Clive Efford: You have invested in the infrastructure in railway stations and also in the rolling stock. The rolling stock is not owned by your company. Can you tell us a little bit more about how the length of contract affects your investment in that?
Mr Metcalfe: The way it works is that we agree the level of investment—for example, a complete refurbishment of a particular set of rolling stock. We then enter into an arrangement with the ROSCOs who own the trains to repay that investment over the duration of the franchise. The longer the duration of the franchise the more able to accommodate a greater slice of investment we are.

Q13 Clive Efford: The lifetime of the rolling stock may go well beyond the length of the contract. How reasonable is it of a ROSCO to expect you to repay that investment during the course of the lifetime of your contract?
Mr Metcalfe: It depends on the size of the investment. The system has changed. In the earlier franchises there was not a great deal of investment and it rolled over the end of the contracts. In the current round there is now the arrangement whereby the investment can continue into a future franchise so it is spread over a longer term.

Q14 Clive Efford: This issue about investment in rolling stock is a bit of a red herring?  
Mr Furze-Waddock: In the First Great Western franchise we have just committed to an investment profile of 220 million. Over half of that is in rolling stock. That is predominately rolling stock assets in the form of the high speed trains which are coming to the end of their life and we are into life extension. That investment is something that First Group has primed the pot with. There is a joint contribution, some going in from the ROSCO of about 40 million but over 60 million is being injected by First Group.

Q15 Clive Efford: You are only going to invest in that for the length of time that you are likely to be using that rolling stock. You are not going to make a donation to someone who is going to use it later on.  
Mr Furze-Waddock: It needs to be amortised over a reasonable period of time so that you can keep the cost to a reasonable level, so that you are not faced with trying to recover it over a very short period of time which would result in having to put fares up to passengers if you are trying to recover a huge investment like that over too short a period.

Q16 Clive Efford: I am still not clear. It is not your worry, is it? You need to pay the ROSCOs for the length of time that you use the rolling stock. It is the problem of the ROSCOs as to whether they get the return on their investment, is it not?  
Mr Furze-Waddock: In this case this was our worry because we had difficulties getting a competitive quote from one of the ROSCOs in question and so First Group made the decision to put its own money in.

Q17 Chairman: It was your decision for your own personal financing reasons, not something directly connected with the government’s grant of a particular franchise.  
Mr Furze-Waddock: No, quite the reverse. It was designed so that we could put in the most competitive, lowest price bid and pass on all of those benefits to the department.

Q18 Chairman: Which would be normal commercial practice because you wanted the franchise.  
Mr Furze-Waddock: Yes.  
Mr Lyons: It is not just about cash investment; it is about investment in the people who run the franchise and the inevitably lengthy process involved with all infrastructure to get change achieved. You have a large number of stakeholders, not just Network Rail. You have local authorities and other groups. Five years is just too short. The process of bidding for franchises is both exhaustive and exhausting and takes a great deal of time. If you are in a relatively short cycle franchise you will probably your team is already thinking about the next bidding process a few months into the franchise. What we need is a sufficient length of time that allows the owner, when he takes over the franchise, to invest in the people who are really going to make an improvement. I am convinced that a longer period of franchise has a better chance of achieving that.

Q19 Mr Martlew: I can see why you gentlemen would want longer franchises because they are better and give you more security. It does not seem in the interests of the passenger. The reality is you have all had the shock of losing a franchise. The longer the franchise is the more comfortable the companies will be. To disagree with Mr Lyons, a short franchise means that you have to train your staff up to a peak very quickly. Is there not the view that if you get a longer franchise at the beginning of it, at the very least, you can be complacent? Is it not against the passengers’ interests to have long franchises?  
Mr Metcalfe: I really do not believe so. If we take the train refurbishments as an example, those things take about two to three years for all the design, the rolling stock and specification changes and approvals and then taking the trains out of work to have them rebuilt. The purpose of doing that is to give the passengers a better train. Hopefully by giving them a better train and upgrading something that is 15 or 20 years old and starting to look very tired and old, that is going to attract more passengers, more patronage and grow the railway. I think passengers do benefit enormously by having that earlier, up front investment. The longer it is left into the franchise with a few years remaining, they get fewer benefits.

Q20 Mr Martlew: Why do we not have 20 year franchises?  
Mr Metcalfe: There is an optimum balance. We moved to eight to 10 years. There is an argument in some cases that it could be 12 or maybe 15 years in some circumstances to leverage in big investments. There is an understandable worry that 20 years is just too long in terms of the balance and risk.

Q21 Mr Martlew: You are against 20 years?  
Mr Metcalfe: I think probably 12 to 15 would be the optimum for a big, heavy investment franchise.  
Mr Furze-Waddock: I would be against 20 years unless there were defined review periods as Network Rail would have. For us to take a 20 year view on such things as revenue growth is pushing it out an awful long way so the risk increases as time goes by.

Q22 Chairman: You do not have any faith in your company still being there in 20 years?  
Mr Furze-Waddock: It is more not having the faith necessarily in the economy for that length of time.  
Mr Austin: To reiterate that point, having worked previously in the SRA where we did propose 20 year franchises and indeed secured one in Chiltern which
works well, in general the problem of managing risk over such a long period means that the optimum period is probably, as my colleagues have been saying, somewhere between 10 and twelve rather than as long as 20 but it is certainly longer than the three years you suggested. Mr Martlew. As you know, coming from a railway town, it takes a long time to change things in the industry. A lot of these investments take a long time to come on stream.

Q23 Clive Efford: Is not the answer to the length of the contracts that you need to be very specific—or the government needs to be very specific—in what the contracts must deliver so that the length of the contracts is irrelevant?

Mr Lyons: We come to the nub of the question. When the government is thinking about letting a franchise it has to take a very large number of factors into account. What is the state of the market it is looking at? What is the state of the condition of the infrastructure and so on? It can then reach an outcome which suggests what the ideal of franchise is to let. At that point it can then determine the conditions that it wishes to see the franchise perform but I think it should be the outcome of an iterative process that analyses what the basic business being let is about.

Q24 Mr Leech: I thought Mr Austin made a very interesting point when he said the industry sometimes take a long time to get things moving. Do you not think that that is an argument for shorter franchises to encourage the industry to change its ways?

Mr Austin: No, I do not, because a lot of the length of time taken is for very good, structural reasons. It was no different under BR. Planning and implementing major projects involving many disciplines and many parties, even in BR days, took a long time to achieve. New lines can take a generation, as we have seen.

Q25 Chairman: You are there because you are not going to be like BR. You have been telling us how innovative, imaginative and stimulating you are, so you cannot possibly say you are going to behave like BR because you do not want to behave like BR.

Mr Austin: There are a number of structural issues which mean that it takes longer to implement projects.

Chairman: That will not wash because that was the whole reason we got a franchise system in, so there would be different structures.

Q26 Mr Goodwill: It seems that the present franchising system is certainly good for the government because they are selling a monopoly on many routes. We know how much GNER gave for their licence. Would it be possible to come up with ways of introducing more competition on routes in order that maybe the pricing of the tickets or the services available to passengers on trains or at stations could be improved, because at the moment it does seem that we have this wonderful reward of franchises and some people would say you then have a licence to print money during the period of that particular franchise.

Mr Metcalfe: I certainly do not agree that there is a licence to print money. There is already intense competition on the east coast main line. There is quite a significant number of operators up and down the east coast main line competing against each other, government franchised operators. We are also competing against the airlines and roads. Competition is good. It has lifted the game of GNER and other operators to the passengers' benefit. I think there is a wider question about the current open access situation but I am not clear whether you want me to talk more generally about that or not.

Q27 Chairman: If you want to make general comments on the problem of open access, we would be interested but they must be very general.

Mr Metcalfe: Competition and open access per se are good things. Anything that drives new markets and improves competition is good for passengers and the industry. What I do not think is good for the industry is a competitive environment where a new operator can come along and pay different charges to existing government franchised operators that are then putting it on a totally different, unlevel playing field and also gaining the majority of their revenue without carrying extra passengers. That does not seem to make sense.

Mr Furze-Waddock: The point is one of understanding the franchise process and how we are committed within that. We are given a specification and we are asked to bid against that, to generate revenue and control costs across that specification. On the back of that for 10 years we commit to pay the government, through the Department for Transport, very significant sums of money that we are forecasting, driving up revenue, getting growth into that network. We have committed to do that. If you get an open access operator coming along half way through that process or even earlier in that process, who is then starting a new service with perhaps not a level playing field, who is also has a business case based upon extracting a certain amount of revenue from some of those flows, there is no flexibility in the franchise agreement to go back to the DfT and say, “We would like to adjust our service level commitment because there is now competition so we do not need to run as many services”, and we will have signed up to long term leases on rolling stock. Our cost base will be very much fixed for the franchise duration. We have committed to give that revenue to the government already. If somebody else comes along and says, “We want to take part of that”, it is leaving the public sector and going into the private sector because we have committed to pass that revenue on to the DfT.

Q28 Mrs Ellman: What about the issue of under-bidding for contracts, a bid going in and then being renegotiated later on? How big an issue is that?
Mr Furze-Waddock: I think the Secretary of State made it abundantly clear to all train operating companies and owners that that will not happen in future. There may arguably have been one or two cases in the past where there has been renegotiation. The competition is set up in such a way and the performance bonds are set up so as not to allow that to happen.

Mr Smith: The department now runs a very rigorous evaluation process that it has refined and developed over the years. They will be able to tell you about it in more detail. We only see it from the other side of the table but the purpose of that is to ensure that they select realistic bids as opposed to pie in the sky ones. It goes both ways but it is something that they are seeking to improve and I believe they are being quite effective now in the rigour of their assessment.

Q29 Mrs Ellman: Is everybody satisfied with the information that comes from the department and the way it is assessed?
Mr Smith: When you win you certainly are.

Q30 Mrs Ellman: Do you think it is a fair process?
Mr Metcalfe: The information is very specific and the franchises that people are asked to bid against are extremely specific. Possibly there is an opportunity for them to be slightly less specific to further encourage innovation, particularly around capacity and around the opportunity to grow new markets or new services, to try to find ways of creating new capacity on the network.

Mr Franks: On the ‘one’ rail franchise that National Express operates, when we were assessed in our bid, it was against a timetable that had five trains per hour between Ipswich and London Liverpool Street. The timetable that was successful delivered six trains per hour throughout the day and enabled more revenue to be generated. That was an innovative solution to the timetabling problems that existed on the route but we were judged in our bid against five trains per hour and that is what every bidder has to do. If you do highly specify the franchises at bid stage, it does prevent innovation if you are not careful.

Q31 Mrs Ellman: Has the separation of franchise contracts into general requirements and franchise specific items been helpful?
Mr Furze-Waddock: It helps in the long term because it cuts down on the amount of administration and negotiation over what are effectively some fairly standard terms and conditions and boiler plate conditions. It concentrates the bidder to look at the things that really matter to that specific franchise.

Mr Smith: I would endorse that point. It is a way of ensuring that the basic commercial framework of the contract which the government proposes to enter into with the operator is well understood at boiler plate level. The specifics are customised to each franchise. It helps efficiency, market understanding and the general procurement process.

Q32 Mrs Ellman: To what degree do you take into account the possibility of open access competition when you are making your bids?
Mr Furze-Waddock: It is extremely difficult, especially more recently, where the route utilisation strategy that the government has launched through Network Rail is getting very good now at identifying where the capacity is. You would expect the department to fill that capacity as well as it possibly can for franchises so that they can generate premia from letting those franchises and not leave white space available that could be otherwise used. They will surely specify that in the franchise to maximise the use for that. Trying to identify outside of that process, where there could be some hidden opportunities, is very much driven by the availability of the capacity on the network, which is in a lot of areas, particularly in the south east, heavily constrained.

Mr Franks: It is a risk that we have to assess and take a view on. There is one other point on open access which has not been mentioned yet and that is the whole issue about does the capacity exist. If there is some capacity, if you put more services into that capacity, does it have a negative impact on our ability to operate a reliable railway? We have a very good example at the moment that is affecting our Central Trains franchise where there is an open access proposition, where we have been working with Arriva Trains to improve the performance on the route between Wolverhampton and Shrewsbury. We have freed up some space on the route to enable the railway to work more effectively and more efficiently. That has created potentially a slot for a train operator to come in. There is a bid to use that slot. Whilst we do try to assess the risks, that is an example where it is very difficult for us because we are trying to deal with one objective, to run a reliable railway, against another objective that suddenly creates an opportunity that can damage what we are trying to achieve.

Q33 Mrs Ellman: Do you feel that some steps should be taken to reduce the possibility of open access competitors?
Mr Franks: I think competition is very good. If open access operators are to come on to the network capacity must exist. The cherry picking point which has been mentioned also needs to be dealt with. If those two things are taken into account and resolved properly, competition is good.

Q34 Mrs Ellman: Are there any other views? Mr Smith, earlier on you spoke about competition through franchising being good in that it looked at the needs of passengers but do you feel the existing franchise system really does look at passenger interests and innovation rather than the financial needs of the Treasury?
Mr Franks: Could I give another example? We operate the Gatwick Express franchise which is operating in a highly competitive way with two other operators. First Capital Connect and Southern. That franchise is leading the national passenger
survey scores and has done for almost two years. It is innovative; it is creative; it looks after customer needs and it delivers what airport users want. As a consequence, that business in a highly competitive environment has grown 42% in terms of its revenue over the life of the franchise so far. There is an example where, if you travel on that railway, you will see a very high quality railway, recognised in this country and outside of this country as a success.

**Mr Smith:** Despite being the owner of one of the franchises he has referred to as being in competition, I am very happy to endorse what he says both in responding to Mrs Ellman’s question and what Mr Goodwill referred to earlier on about competition. I think there is competition where the underlying demand will bear it and support it. The main line between London and Brighton is a very good example where three of the four train companies here actively compete with each other. It is in the interests of passengers. Most of the franchises we have operated have been in the London and south east area and we have always been used to there being alternative train routes and opportunities for passengers. It is not something that we are shy of. I would agree with Mr Franks that it does help overall to push up standards and responsiveness. Specifically as to whether the franchising process looks to the interests of passengers or the Treasury, I am not sure to what extent it is for us to answer that but I do think it does require us to look at the needs of passengers very clearly in terms of what we have to submit for bids. We are evaluated on that from the point of view of the robustness of the service quality that we will offer. Once we are in a franchise, we are held to account by a variety of measures for how customers perceive and rate our service. Above all, we are driven by the fact that we carry the revenue risk and we need and want to get people on trains.

**Mr Metcalfe:** We are talking about competition within the railway but we compete very heavily against the airlines. An example of one of the things we did as a result of that was putting in Wi-Fi on the trains and internet access on the trains at the end of the previous franchise before we knew we had the new franchise, because we believed it was such an important thing to do, to try and do something different to the airlines and attract airline passengers. That is an example of innovation and a way we can improve passenger benefits. I also endorse Mr Smith’s point. I think the current franchising model and the very clear focus on value for money and premia do make those examples of innovation more and more difficult.

**Mr Lyons:** There is an element in the franchising process that could be looked at more closely. There is very full consultation during the process. Inevitably, when the specification comes out from the DfT, some very hard decisions have to be made. In many cases, they are as much about the amount of capacity on the network to squeeze every service that has been requested. What I think could be improved is sometimes where the groups have made bids for extra services. This does not seem to be working in a perfect manner and there is often disappointment. Services people thought they were going to get are changed, reduced or whatever. I think that is a process that the DfT could probably improve on in the next round of franchises.

Q35 Mrs Ellman: Is it a really serious proposition for the department to say they would not renegotiate contracts? Do you take that literally?

**Mr Smith:** Yes.

Q36 Chairman: Are you saying it is a real threat?

**Mr Smith:** It is clearly meant to be that.

Q37 Chairman: Mrs Ellman is not asking you whether that is what it is meant to be. Civil servants are often very good at telling us what things are meant to be. Is it a real threat to you?

**Mr Smith:** It is a real threat that we must take account of when we bid because, if we disregard it as a threat—in other words, we do not see it as a real threat—we run the risk of putting in a commercially untenable bid, which is not in our interests.

Mrs Ellman: You do not somewhere in your mind think that maybe it would not happen?

Q38 Chairman: Mr Lyons, if they have a problem with you, are they genuinely going to let the entire service collapse?

**Mr Lyons:** We have had examples of that already. In the history of franchising we have seen Prism disappear in the very early days. South East Trains is another example where a franchise was stripped from an operator because of the perceived unsatisfactory service or a belief that the subsidy being asked for was unreasonable. I think there is plenty of evidence that if those operating franchises are not working well they are going to lose them.

**Mr Franks:** I hate to admit this but we ran a number of franchises at our own cost. Scotrail, for example, at the end of that franchise time, was costing National Express Group a lot of money so we do understand the threat.

Chairman: It is lovely to hear there are all these philanthropists in business.

Q39 Graham Stringer: If I can go back to the very first point. Mr Austin made a comment that one of the justifications for franchising for infrastructure of the railways was value for money. Is that not at odds with the facts? The railways are costing us five billion when they were expected to cost us nothing in this year. When you compare the franchising system, say, with the bus industry where costs have gone down, in the rail industry the franchise costs are going up. Surely the answer is you are terribly inefficient?

**Mr Austin:** I do not think so. In general terms, railway costs in terms of franchise support for the last recorded year, 2004–05, are just over a billion and that is down. It is difficult to make comparisons because of the impact of network grant which has shifted some of the subsidy from train operators direct to Network Rail. In general I would have said it is moving in the right direction. The other thing
which we reflected in our paper is the difference of the balance between those franchises that receive subsidy and those that pay a premium. We have already moved from a minority position of around 15% five years ago to a point today where about a third of the franchises are paying premia. Within a year or two that will be up to about half. That is the inexorable move away from subsidy towards premium.

Q40 Graham Stringer: Professor Nash is talking nonsense, is he, when he says that costs have grown substantially because, with the greatest respect, subsidy is a completely different issue, is it not, to costs?

Mr Austin: Professor Nash rarely talks nonsense. I would not challenge that. There are some real costs which, for example, the train operators have had to meet, partly as a result of increasing outputs, carrying more people, running more trains, which is good; partly as a result of external factors—for example, the costs of insurance, policing and fuel in particular which have gone up way beyond the rate of inflation.

Mr Franks: Could I give a summary of the cost base of one of our TOCs? It has a cost base of about 450 million. 150 million of that is Network Rail charges. That is outwith the grant contribution that we do not see through the TOC. About 100 million of it is to pay for the rolling stock. The true variable costs that we have within the business are in the region of about 25 to 30 million of the total cost base. In terms of what we are delivering, it is all driven really by the infrastructure and do a lot of the work in investment that has gone on over the years. There was quite a backlog that has been feeding the Network Rail costs over recent years.

Q44 Graham Stringer: You are saying that is coming out in your costs?

Mr Metcalfe: It is coming out in the overall, total industry costs yes.

Q45 Graham Stringer: Some of it is coming out in your costs as well as charges from Network Rail?

Mr Metcalfe: Yes.

Q46 Graham Stringer: Let us approach the question in a slightly different way. We have just finished taking evidence on a bus inquiry. Many of the companies you represent run buses as well. Why do you not make the same return as the bus arms of the companies you represent run buses as well? Why do you not make the same return as the bus arms of your organisations? Why is your profitability less?

Mr Franks: Because if we were to put in margins that are higher than we currently do we would not win the franchises.

Mr Smith: It is the competitive pressure of franchising.

Mr Metcalfe: In the early franchises, if we go back to the beginning in the mid-1990s, the margins were much higher and the equilibrium or the pendulum has swung back to the other end. That is why it is such a competitive environment.

Q47 Mr Wilshire: Can I ask those who have put in a bid for a franchise what they reckon it now costs to do that?

Mr Franks: In the National Express written evidence we quoted what we believe it costs to run a bid now which is in the region of £5 million. It is clearly commercially sensitive but I would at any point be prepared to run through with anybody the detail of the breakdown of that cost so that you can see exactly where those costs go.

Mr Smith: Our view would be that it costs a little less than that, based on what we have spent in bidding for franchises. We are certainly talking about £3.5 to £4 million for a bid for a franchise.

Mr Metcalfe: That is our experience: between £3 million and £4 million.
Mr Furze-Waddock: Similarly, closer to David’s estimate of five million. It will depend to some extent on the franchise you are bidding for and how much information is necessarily provided in advance as to how much cost you incur in developing the bid.

The Committee suspended from 3.29 pm to 3.37 pm for a division in the House.

Mr Wilshire: I am sure our witnesses have had time to work out the next question so I will not ask it. I would just say that if we were to pursue the matter of how those costs are made up it would use the rest of the time. I wonder whether it would be appropriate if those who have given us a figure would be willing to submit a written note on exactly how those figures are made up to save us the time of wading through a lot of information.

Q48 Chairman: Would you be prepared to do that?
If you do not want any of it published you would have to make that clear when you give us a supplementary note.

Mr Franks: That is fine.

Chairman: We would need a fairly good explanation for why you did not want it published, so it is no use just saying “I don’t want you to say this”.

Q49 Mr Wilshire: What I want to ask is when we see that information I would like to ask, if those are significantly bigger figures than the costs some while ago, why have they gone up? Are there things that you are having to spend money on that you think you should not have to spend money on?

Mr Franks: Can I make one very important point about why I think maybe that is the case for First Group and National Express Group. I will let Mr Furze-Waddock answer for himself. One of the big differences for us is the Competition Commission costs. It seems every time there is a franchise proposition there is a referral to the Competition Commission and for us, in the number I quoted, that is almost £1 million estimated for the next round of franchising, so that is a big number and growing. That is one issue. The other issue is it is a competition, you do have to prove to the Department for Transport in the bid process that your bids are deliverable and to do that there is a very onerous requirement through the bid process. I have brought with me, and you may or may not have seen it, a copy of the South Western franchise evaluation process which actually amounts to nine pages of what you have to do to prove that your plans are deliverable. There are 22 plans in the South Western Trains’ franchise tender. Each one of those is measured on three different criteria and you have to set out very clearly how you are going to do that. As I say, that process has evolved over a period of time. I think it is like that because the Department are very concerned about the risk of a judicial review on its process and that is driving the requirements higher and higher and, therefore, the costs to us go up accordingly.

Mr Furze-Waddock: I would agree with most of that. There is a high level of competition costs in there. Very often it is a waste of time going through the Office of Fair Trading and that getting referred on to the Competition Commission itself, which does then handle things extremely professionally but it is an extremely costly process. We spent very nearly £1 million on one bid just going through that competition process.

Q50 Chairman: What changes would you ask for?

Mr Furze-Waddock: I think some recognition that the franchising process already identifies a service level that operators have to sign up to and there is no varying that without going back to the Department for Transport, that there is a high degree of fares regulation both directly and indirectly, that there is very little substitutability between bus and rail, apart from a very few exceptions where there are overlaps that could be substitutable, and also to recognise once and for all that the car is the big competition, which they singularly fail to do every time and they just look at the small picture of some small overlaps failing to recognise that our big competition is the car.

Mr Franks: Can I just add to that. I support everything Mr Furze-Waddock said there. What does not happen is there is no case law, no precedent. Every time you enter into another franchise competition, if you are referred to the Competition Commission you start again going through all the old arguments that you have used and gone through previously. If there was case law and it could effectively be taken off the shelf and actually used it would save an enormous amount of time and effort.

Mr Smith: Can I return to the question about bidding costs as such. The last franchise that we actively bid for was the integrated Kent franchise which was submitted a year ago. Each copy of our bid, and we had to supply six copies, consisted of 22 lever arch files, so it was very sizeable, it took up two rows of a normal cupboard, and I imagine my colleagues who bid on that franchise put in something very similar. That is driven by the Department’s requirements which in turn is the major driver of the costs. You asked are there areas that we think should be reduced and I think the answer to that is yes. I do not believe the Department needs a complete encyclopaedia of how to run a railway in order to evaluate a bid. It certainly needs detailed and robust financial information and it needs to be able to satisfy itself that a prospective franchisee, a bidder, has thought about the operational and commercial challenges of the franchise in question to a sufficiently robust degree to be able to pick up the threads of running the business and make a success of it and deliver their financial outcomes. I do not believe they need the volume they are requiring at the moment and personally I feel it has gone that way because the Department have allowed themselves to be consultant led, consultant driven, in terms of specification of requirements, and if they could weaken themselves off that I believe—
Q51 Chairman: It is not just the Department, is it? There is evidence from Govia saying bidders often spend £2 million on consultancy fees alone in the course of bidding for a franchise. Is that typical?

Mr Smith: Yes, it is. What I am talking about is what is it that has produced a system that requires us all, including the Department, to spend that much money. I believe it is the Department’s approach and specification of what they want in bids returned to them. If we could get back to some midpoint between where we are today and the very first round of franchising undertaken by OPRAF when bids were one lever arch file, if that, then I think—

Q52 Chairman: There were problems with that, Mr Smith, as you know.

Mr Smith: That is why I am not suggesting we go all the way back to it but I think there must be some middle point that reduces the burdens on the players on both sides of the industry and reduces the costs.

Mr Metcalfe: I would certainly endorse the point about some sort of equilibrium or balance because it has swung from one volume maybe half an inch thick to 22 ring binders and I think the answer lies somewhere in the middle. If you look at the straightforward example of KPIs, the original franchises did not have KPIs and current franchises have anything up to 122 KPIs. Again, I think it is the extreme swing and it is finding the right balance in the middle of all that.

Q53 Mr Wilshire: Could I ask Mr Lyons and Mr Austin a question that arises out of what we have just heard. Is this escalation of paperwork anti-competitive in the bidding process?

Mr Lyons: I have to be quite honest and say at this stage there is no evidence of that as you can see from the recent franchises. I think something has to be done about it just as a matter of sound process, not however to discourage people but to make sure that when you are tendering for franchise and the DfT is specifying it there is much greater clarity of what is required. I think the sheer bulk of information the DfT is asking for often gets in the way of that particular aspect.

Mr Austin: I think it is one of the barriers to entry or one of the things which make it more difficult for completely new operators to come into the industry because it is quite a daunting amount of information which is required. I think the answer to your question is yes.

Q54 Mr Leech: Just following on from that, is there not an argument to make completely the opposite argument by saying if you have all got to put in all the information every single time then existing operators who have existing franchises are not going to have a competitive advantage because they will have already given the background information about running franchises whereas a new operator might have to do all the existing work and all the pre-work that you have already put in?

Mr Furze-Waddock: In the new template franchise agreement the Department has modified it substantially to make it a requirement of the incumbent franchisee to provide all of that information on a very regular basis. That is probably something we will end up coming back to because, again, they have gone from one extreme to the other and we now have a monthly meeting with the Department to monitor performance, both financially and operationally, and as time goes by that is going to become extremely onerous for the Department to resource that and for us to resource it. Again, it has gone from one extreme to the other.

Q55 Mr Leech: What, in your view, is a happy medium?

Mr Furze-Waddock: We are now testing the new franchise agreement. Certainly in the early days—we are now in the first three or four months of two new franchises—meeting on a monthly basis is not unreasonable because there are so many issues to manage through and commitments that have to be managed with the Department, but as we get into a steady state to have to meet and the risk of micro-management on that degree of regularity with two franchises that are there to deliver premium, to generate revenue, that puts a tremendous onus on us to generate that sort of growth and put the quality into the business, is probably going to become far too difficult for both parties to manage.

Q56 Mr Goodwill: It is obvious there are many obstructions to new entrants coming in. Would you say that the reliance on track record in the pre-bidding process—that 70% of weight is given to track record—is another disincentive and obstacle to new entrants coming in as we have seen since privatisation very few new entrants coming, other than one or two from abroad maybe?

Mr Metcalfe: I think the whole issue of how existing incumbents are judged has moved around quite a lot over the last few years and there have been times when existing incumbents have had no benefit or real advantage over anybody else bidding for a franchise. There have been some changes to that to try and reflect the reality that the existing incumbent does have experience. I guess my wider worry about people bidding and new entrants is partially about the cost and complexity of bidding but it is also about the very tight, very competitive nature of franchises now and the very low margins driven by the very clear focus on lowest subsidy or highest premium and there is a wider question about the appetite and extent to which people will want
franchises going forward, and I think that comes back to the issue about balance and equilibrium in the cycle.

Q57 Mr Goodwill: You mentioned one of the major costs borne by the rail industry is the cost of Network Rail, particularly post-Hatfield. Have the operators looked at the possible feasibility of including the maintenance of the track by the primary operator running on that track within the franchise operations so that maybe you could be more successful in controlling costs and improving standards of maintenance and improvement than Network Rail which, once again, has come cap in hand to the Exchequer for £8 billion this week?

Mr Austin: Can I start off with a general point and then colleagues can come in with specific examples. In general, no, we have not. We are happy with a system which enables us to focus on the passenger rather than the engineering. I think that is the first point to make. The second thing is working together rather than taking over has been an important direction so the establishment of integrated control centres, or joint control centres, has been one area where a lot of the practical benefits of integration have been brought about without any transfer of structure or ownership.

Mr Franks: I would make a similar point that one of the real benefits of the franchising process is that our job is to look after the interests of passengers. That clearly is right at the forefront of our mind, it is what enables our business to survive and it is there for us to do. That said, in the past it was possible for any train operator or any other company to bid to do the maintenance of the infrastructure but that is not a possibility now because Network Rail by policy has decided not to let that be outsourced but to do it within their own organisation.

Q58 Mr Goodwill: Do you feel that Network Rail is a lean, mean machine that is delivering value for money in terms of the amount of improvements that we are getting for the amount of cash going in?

Mr Franks: I made a point earlier on about that. If Network Rail went through the same competitive process that train operators had to go through it would be probably leaner than it is now.

Mr Furze-Waddock: I would agree with that. I can give an example of a Network Rail system and which I think typifies an approach, which is the moment they cost projects it has to go through what is called a Grip process, Grip 1, 2, 3, 4, and up until the third stage of this they factor in a 35% contingency. You are talking about projects of maybe five million, 20 million, 100 million, and to have a 35% contingency within that sort of number might be prudent, it might be necessary in some cases, but it strikes me as being a very lazy way of coming up with quick, reliable estimates to put infrastructure change through. It takes a long time, it is a very cumbersome process, it costs quite a lot of money and even at stage three, which is what we would normally consider to be about to press the button, you end up still with a huge contingency built into the numbers so you cannot really rely upon it. I think that is an example of how they have got this cumbersome process.

Q59 Chairman: You do not think that is dictated by experience?

Mr Furze-Waddock: They would no doubt argue—

Q60 Chairman: No doubt.

Mr Furze-Waddock: —that might be mismanaging projects previously.

Q61 Chairman: Did you complain about Railtrack beforehand? Did you have the same problem with Railtrack or were they a lean, mean machine capable of carrying out astonishing, high quality services?

Mr Furze-Waddock: They were mean.

Q62 Chairman: One of you? Were you pleased with Railtrack? We all remember Railtrack, do we not?

Mr Metcalfe: I think that Network Rail have done a very good job in terms of concentrating back on the engineering.

Q63 Chairman: So they are actually doing what they are asked to do, like repairing the infrastructure and doing things that Railtrack did not quite bring itself to do?

Mr Metcalfe: I think Network Rail have very much focused on the engineering, on the assets and brought maintenance in-house.

Q64 Chairman: What they are supposed to do?

Mr Metcalfe: Yes.

Q65 Chairman: Astonishing!

Mr Metcalfe: Equally, I think we are all concerned about the scale of the cost that has brought with it and, therefore, we all think there are improvements that could be brought about.

Q66 Chairman: So you want it reviewed but you do not want it to cost anything.

Mr Metcalfe: We want it done efficiently.

Q67 Chairman: Oh, well, nothing changes. It has been argued that risk has not been transferred to the private sector through rail franchising, do you agree?

Mr Furze-Waddock: No.

Mr Smith: No, I do not think that is true. Risk is transferred to train operating companies. Each franchise agreement is a commercial contract with a balance of rights and obligations and attendant risks, but in general the common risks that are transferred to train operating companies surround patronage and revenue and operating costs. In addition, there are obligations on us that relate to performance, that is punctuality and reliability, and risks attached to those, and in certain franchises, which would include the ones that we hold, there are project or programme risks that we assume. We have to deliver certain things and if they are not delivered we will suffer either some liquidated damages that
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we are obliged to pay or some other commercial disadvantage, such as not getting the benefit of the investment that we have factored into our bid in terms of increased revenue. There is quite a range of risks that are placed on us and they are the ones that in our memorandum we have said are broadly at the right level at the moment. Having settled down from differing degrees of risk allocation in the past, they are the risks that we feel comfortable with and are happy to take.

Q68 Chairman: With respect, Mr Smith, train operating companies being comfortable is not always in the interests of either the passenger or the taxpayer, is it? Does the ‘cap and collar’ scheme place too much of the revenue risk with the public sector?

Mr Metcalfe: If I could give an example of one risk that we as an industry absorbed, which was the issue around the London bombs last year. Within the company that I am involved with, the impact of that was between £10 million and £20 million. The ‘cap and collar’ regime does not give any benefit because that only comes into effect after four years of the franchise. That is one example of a very significant risk that a franchise and its parent company has to absorb and you cannot really foresee some of those risks when you are bidding for a franchise.

Q69 Chairman: So you would say that when Christian Wolmar says: “80% of any large shortfall—or excess profits—will be borne by government”, he is wrong?

Mr Furze-Waddock: In my opinion.

Mr Smith: It sounds too simplistic.

Q70 Chairman: He says: “The formula is that First takes the whole risk of the first 2% shortfall . . . ” he is talking about a particular company, of course, “. . . then half the risk of the next 4% but only 20% of the rest”. It is not a lot of risk element for a big company, is it?

Mr Smith: I think it is if you set it against the margins that the TOCs are bidding and earning and what that represents against the percentages he is talking about there. I think it is a significant commercial risk.

Q71 Chairman: What would you expect to bid for as a proper rate of return? What rate of return are you expecting?

Mr Smith: This is something that is part of the competitive nature of bidding. In the most recent franchise that we have won—

Q72 Chairman: Let us use an Americanism: what ballpark figure?

Mr Smith: Below 5% in the early years of a franchise when the risk is less, which we recognise.

Q73 Chairman: And?

Mr Smith: Rising to no higher than 5% towards the end of the franchise.

Q74 Chairman: Does anyone else want to have a wild guess at that?

Mr Franks: That is in the region of bids that we have been involved with.

Q75 Chairman: So you are seriously suggesting that these are the sorts of figures that you are going for when you go for a franchise?

Mr Franks: Yes, and it is the ‘cap and collar’ mechanism that enables the margins to be kept at those sorts of numbers.

Q76 Chairman: Is there any particular reason why the taxpayer should indemnify train operating companies for losses incurred through industrial action?

Mr Franks: It does not.

Q77 Chairman: Well, who has got the £23 million that the Government has spent so far on compensation payments?

Mr Franks: I have no idea.

Q78 Chairman: Were they not train operating companies?

Mr Franks: It is not National Express Group.

Q79 Chairman: Oh, you have a shadow group somewhere with this highly successful franchise getting £23 million compensation out of the government that none of you know about.

Mr Franks: No.

Q80 Chairman: I see. So you do not think this exists?

Mr Franks: There is a provision within our agreement that enables the DfT at its discretion to actually provide some support but that support has not been forthcoming.

Q81 Chairman: Let us try a little game, shall we? Mr Lyons, have you had any compensation from the Department for industrial action?

Mr Lyons: No, we have not. I do not operate a train operating company.

Q82 Chairman: Then we will go down the line.

Mr Franks: No.

Q83 Chairman: Mr Smith?

Mr Smith: No.

Q84 Chairman: Mr Metcalfe?

Mr Metcalfe: No.

Q85 Chairman: Mr Furze-Waddock?

Mr Furze-Waddock: No.

Q86 Chairman: I know Mr Austin has not had any compensation.
Q87 Chairman: Well, this is interesting. We must ask around more. Have you taken into consideration the possibility of open-access operators in your pricing? We did ask you that before but that was in terms of space. Do you add that in?

Mr Franks: You certainly have to take a view and price it.

Q88 Graham Stringer: I would just like to know whether you think that PTEs should play a greater role in franchise design and specification.

Mr Franks: We work with Centro PTE. I think they add value. It is a DfT decision that they should not be party to future franchise agreements.

Q89 Graham Stringer: This is the 2005 Act?

Mr Franks: Yes. There is still a discretionary element to allow a PTE to be a co-signatory to an agreement in the future if they choose to. Our relationships with Centro PTE have proven to be very beneficial, we work together very, very well.

Q90 Graham Stringer: They have not changed since the 2005 Act?

Mr Franks: We have entered into a new franchise agreement to enable the new franchise mapping to take place and Centro PTE remained as a co-signatory.

Q91 Graham Stringer: So your relationship has not changed?

Mr Franks: No.

Q92 Graham Stringer: What about the other companies?

Mr Smith: We have no relationship with PTEs because of the location of our franchises.

Mr Metcalfe: The same.

Mr Furze-Waddock: We have a very strong relationship with Transport for Scotland through the ScotRail franchise, which works extremely well. We have relationships with several of the PTEs in the north-west and north-east through the TransPennine franchise but the TransPennine franchise obviously is not the predominant operator, that would be Northern.

Q93 Graham Stringer: Has your relationship changed since the 2005 Act?

Mr Furze-Waddock: Not discernibly, no. TransPennine is a relatively new franchise anyway.

Mr Franks: I guess the next opportunity to see if there is any change in the relationship will be when the new Midland franchises are let because that is the next time there will be a potential for a PTE not to be a co-signatory to an agreement.

Q94 Graham Stringer: The PTEs believe that the franchises are being drawn up in a way that does not take into account local needs, that basically they take into account national priorities and they fit into the national plan but do not fit into the local transport plans of West Yorkshire, Greater Manchester or the West Midlands. Do you think that is a fair criticism?

Mr Franks: I have some sympathy with that view. There is a balance to be had between what is right for local conurbations like Birmingham and the inter-city type operation and a balance has to be struck and it is of critical importance for the Department to make sure it listens to what the PTE believes is right in the Birmingham situation for Birmingham.

Q95 Graham Stringer: Is that your experience? Would you agree with that?

Mr Furze-Waddock: Yes, I would, very much so. When there has been a consultation process and the Department has to make some deliberations and make some decisions to arbitrate on some of the priorities between local and inter-city it is very important that they are then involved in the process of feeding that back to the stakeholders that they have consulted with to avoid any confusion over what the resultant timetable looks like.

Q96 Graham Stringer: Do you think that there will be a real threat to increased capacity in those urban areas in the rail system because the PTEs are not there?

Mr Franks: I think there is always a threat to capacity where you try to blend and mix stopping services with non-stopping services because it eats up capacity and that is the dilemma. If you are in the travel-to-work area of Birmingham, say, you are going to want to look after the needs of the local population, and you will have people passing through that part of the railway who are not resident or local people. That is always a tension and always will be a tension. I think the dilemma will be how you resolve conflicting needs.

Q97 Graham Stringer: You are rephrasing my question. What I really want to know is whether it has rebalanced that conflict. The conflict will always be there between people who want to go through and people who want to go two stops on the train to go to work in the morning. What I am asking is do you think that balance will be changed in favour of the inter-rail journeys compared to the local journeys?

Mr Franks: I guess there is no lever any more. Ultimately, in the past the PTE would have had to sign a franchise agreement and they had a lever to force through some changes and that lever perhaps has gone. It is going to have to come down to very tough dialogue between the PTEs and DfT in future to make sure the specification that is agreed, that goes out to tender, is right.

Q98 Graham Stringer: Can I have one last question. I have had time to go back to Professor Nash and get the details out. If I can bring him back from cloud-cuckoo land for a minute. He says that your costs have gone up by 47% but your kilometres travelled have only gone up by 6%. That is an indication of inefficiency, is it not?
Mr Lyons: I am sorry, I have not seen Professor Nash’s submission but I have great admiration for his work. The figure of a 6% increase in kilometres is not one I even begin to recognise. The generally accepted figure is total train mileage has gone up by 20% since privatisation. I think also Professor Nash is clearly focusing on the very substantial rise in infrastructure costs. If we look back to the immediate post-Hatfield period and the time when Railtrack was in administration they were even higher. At least the trend line is downwards. I think no-one would accept that the present infrastructure costs on the railways are at a desirable level. As we made clear in some of the TOC submissions, the fixed costs of the infrastructure loom very large in the train operating companies’ budgets and are costs that are arbitrated between the train operating companies and Network Rail by the regulator and the government.

Q99 Clive Efford: I would like to go back to the ‘cap and collar’ scheme. We have heard how the government indemnifies you against loss, but if you exceed your expected profits does the government also benefit from that?

Mr Metcalfe: It works in reverse.

Mr Furze-Waddock: The reverse works from day one, so the revenue share is there from day one. The support only kicks in in year five.

Q100 Chairman: Can I ask Mr Metcalfe, we have had an email which has pointed out that when it suits you do walk up your prices because apparently you have increased car park prices at Newark North Gate by 89%. Not surprisingly, this has not gone down very well with those people who use your services every day. This particular gentleman points out that he has to use the car to get to the station otherwise he would not get the train and he has to get the train to go to work otherwise he would not get paid, but he does not know how he is going to find an extra £50 a month. It is not an unreasonable remark, is it?

Mr Metcalfe: I do very much understand and recognise the concern being expressed. The reality is when we bid for the franchise we were very clear about what we would do in terms of investment and putting in the £125 million of investment, including £28 million investment into stations and car parks. What we have done is to bring car park prices up to the same prices as city centre/town centre car parking prices. We have looked at what other car parks charge in the vicinity and we have moved our prices in line. What we also say, however, is having done that we will now maintain our prices in line with inflation broadly going forward. We have brought them up to the market rate and we will maintain them in line with inflation.

Q101 Chairman: You do not think £4.50 to £8.50 a day is quite a large increase and might have been noticed?

Mr Metcalfe: It is a large increase but I think there is a degree of inevitability in terms of the commercial reality and focus of the franchise now and the premium that we now pay back to government.

Q102 Chairman: So it is not true that companies are seeking all the time to limit the amount of people using their services by making them more and more expensive, is it? That is not what any of you want to do, is it?

Mr Franks: No.

Mr Metcalfe: No.

Mr Furze-Waddock: No.

Chairman: No. I am sure Her Majesty’s Government would like to run the National Health Service in the same way with the same degree of efficiency! Gentlemen, you have been very helpful. Thank you very much.

Supplementary memorandum submitted by the National Express Group PLC

As invited, I attended the Transport Committee hearing at which a number of questions were asked in relation to compensation paid to train operating companies (see questions 76 to 86). I responded stating that no such payments had been received by the National Express Group. Since the hearing, I have been made aware that in fact a payment was received principally in relation to the ScotRail franchise. This related to a drivers and role of the guard dispute. Provisions within the franchise agreements enabled such payments to be made.

I apologise for the inaccuracy, but trust this correction will be reflected in the final report.

14 July 2006

Memorandum submitted by Association of Transport Co-ordinating Officers

INTRODUCTION

The Association of Transport Co-ordinating Officers (ATCO) represents those officers in local government responsible for the coordination of public transport. It has over 600 members from County, Metropolitan and Unitary Councils in England, Scotland and Wales as well as from Passenger Transport Executives and other transport related organisations. The Association exists to secure the association of persons directly concerned with the formulation and implementation of policies for the securing of public passenger transport services.
ATCO has a number of special interest groups one of which concentrates on rail related issues and meets on a regular basis with Department for Transport and Network Rail. This response has been produced by this Rail Sub-Committee of ATCO.

Our response to the questions contained in the consultation is set out below.

*What should be the purpose of passenger rail franchising?*

The purpose of passenger rail franchising should be to deliver the appropriate level of rail services at agreed levels of quality, punctuality and reliability in a way that delivers value for money and gives the operator freedom to innovate and develop the product.

*Is the current system achieving that purpose?*

It is felt that currently franchises are not putting passenger’s interests first but are driven by the financial objectives of the owning group and are constrained severely by DfT specifications, both of which restrict innovative thinking.

*How well does the process for awarding franchises work?*

*What input do operators, passengers and other interested parties have into the design of franchised services?*

The Association of Transport Co-ordinating Officers has a particular concern that local government transport coordination officers should have input into the design of franchised services. They have a responsibility for, or an opportunity to encourage:

— Co-ordination of public transport services.
— Publicity and marketing of public transport services.
— Provision of home to school/college transport.
— Obtaining funding for infrastructure improvements.
— Developing Community Rail Partnerships.
— Assisting dialogue between public transport operators.

Transport Co-ordination Officers have local knowledge about travel patterns for work, education, leisure etc which can make a valuable contribution to the design of franchised services. This knowledge is often not available to people based outside the local area. Involvement of local government officers can help to ensure that a franchise is appropriate to the areas it serves.

There is concern that franchising specifications sometimes conflict with regional and spatial planning aspirations and take no account of future housing allocation. An example is found in South Hampshire where proposals in the South West Trains franchise would halve the off-peak train service between Fareham and Eastleigh, a busy corridor paralleling the M27/M3 and which is earmarked for considerable housing development in the coming years, and discontinue through services between Winchester and Havant and beyond.

It is important that the specification of franchises reflect the aspirations of local and regional development plans and Regional Transport Strategies and do not conflict with or ignore what is contained in them. Consultation with local authority officers is the best way to achieve this.

*Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department of Transport?*

The Department for Transport do appear to be much more restrictive in specifying franchise terms than SRA with limited scope for individual solutions to challenges and capacity constraints.

Experience suggests that stakeholder consultation in the run up to franchises has been much more professionally organised and thorough under the DfT than it was under the SRA. There has been an openness and willingness to come out and meet local authorities.

*Are franchise contracts the right size, type and length?*

Franchise lengths are too short to generate real passenger benefits. Rail investment takes a long time to deliver and to produce benefits and short term franchises do not give enough time for this to happen.

It is felt that there is a strong argument for larger franchises including a spread of service types to enable “cross subsidy” between profitable and social railway lines and better integration at key stations.

Consideration should be given in all franchise specifications to the provision of dedicated rail feeder bus services to assist in the delivery of integrated transport.
What criteria and processes are used to determine the nature and length of franchises?

Problems can occur on the borders of franchises or where franchises overlap with a lack of consultation and cooperation between operators. An example is the lack of co-ordination between Arriva Trains Wales and Virgin West Coast services between Crewe and Holyhead and the poor connections at Crewe. Reducing the number of franchises can result in fewer opportunities for this to happen as has been done by concentrating services from London terminus stations in single franchises. However in very large organisations outlying areas can become remote from the centre.

What criteria and processes are used to evaluate franchise bids?

The criteria and processes used to evaluate franchise bids must take into account all relevant factors and not just the subsidy/premium in the bids. The franchise should not be awarded to the most financially attractive bid if there are doubts about deliverability, or if other bidders are offering significantly better outputs for similar levels of subsidy.

Following the award of a franchise, there should be a formal response mechanism to explain how stakeholders’ aspirations have been dealt with. There is also a case for an appeals mechanism where there is serious concern about reductions in the level of service.

Do franchise holders deliver value for money to passengers and the government throughout the duration of their contracts?

There have in the past been cases where franchise operators have been unable to continue with the franchise on the basis on which the bid was made. It can be argued that if this is because of over ambitious revenue estimates or cost cutting targets, the government should not be expected to “bail them out”.

Are risks suitably apportioned between the government and franchise holders?

It is felt that more risk should be placed on the franchisee but to offset this they should be allowed more freedom to innovate and develop the franchise.

What is the scope for improving services through franchise agreements?

Currently it appears that franchisees are severely constrained by franchise specifications which restrict improvement and development of services if not contained in the franchise specification.

Do we need more competition and vertical integration?

Is franchising compatible with open access operations?

There are differing views on this issue.

Current experience suggests that there may be a conflict between franchising and open access operations. It is likely that future bidders will have to include a contingency in their bid in case an open access operator subsequently commences operation and abstracts revenue. However it is felt that bidders are aware of the possibility of open access operators entering the market and should cost this into their bid. Existing open access operations have developed new markets not provided by franchises and this should not be stifled.

Should train, rolling stock and track operation be more closely integrated?

The separation of train and track operation should ensure that all train operators, passenger and freight, are treated fairly. It is important that Network Rail is able to exert its role as an impartial “honest broker” for train pathing and as overall infrastructure operator, it is able to maintain uniformity of standards across the network. It is important that the availability of freight paths is given appropriate importance and not excluded because of aspirations for increased passenger services.

There is concern that the ROSCO’s do control the availability of rolling stock and leasing costs of depreciated units are very high.

Conclusion

ATCO welcomes the opportunity to be involved in this process and would be happy to provide additional information or explanation verbally or in writing.

20 June 2006
Memorandum submitted by Passengerfocus

SUMMARY

1.1 Passengerfocus welcomes the opportunity to submit evidence to the Transport Committee’s investigation into franchising. Each new stage of the franchising process represents an important opportunity to spread best practice and procure better terms for passengers.

1.2 One of the main aims of franchising is to set out the minimum level of service a passenger can expect over the life of a franchise. It is equally important that the franchise sets out a clear and transparent way of monitoring performance against specified targets and the steps that will be taken to ensure compliance. It is right and proper that passengers be given a clear set of targets and expectations against which they can hold the train company to account.

1.3 One of the difficulties in reviewing franchising is the fact that there are several different franchise “models” in existence. These differ in terms of how tightly services are specified, the volume of targets and measures and the approach of the franchising authority. One of the criticisms of the original round of franchises was that they were let on a least-cost basis. The current trend is a move towards franchises paying increased premiums back to DfT. Under both models there is a real danger that passengers will suffer as operators strive to cut costs or meet premium payments.

1.4 The franchising process must take more notice of what passengers actually want. The voice of the passenger has hitherto seemed to carry little weight in the franchising process but, with the transition from SRA to DfT, there seems to be a more open attitude. Passengerfocus is currently carrying out research on route-by-route passenger priorities for the new Midlands and Central franchises and sharing the results with DfT.

RESPONSES TO THE COMMITTEE’S QUESTIONS

What should be the purpose of passenger rail franchising?

2.1 The purpose of franchising is to provide a level of service that meets the needs of passengers both now and in the future. The key passenger priorities have remained consistent over time:

Performance
Passengers want trains to run on time. Notwithstanding recent improvements in performance, this is still the top priority. Passengers also want to know how well their services are performing rather than be given the average performance of the entire train company. It is important that the franchising process ensures that challenging targets are set and that passengers have access to information relevant to their journey.

Value for money
Passengers simply do not feel that they receive value for money at present. Satisfaction levels lag significantly behind those for punctuality and most other service attributes.

Information
Passengers want accurate and timely information, especially in times of disruption. Franchising provides a mechanism not only for investment in new equipment but also for better monitoring of the quality of information provided.

Travelling environment
In addition some passengers are concerned at the travelling environment provided on board trains and at stations. Franchising can again help to deliver greater accountability and transparency for passengers through such things as:

— reducing overcrowding by specifying longer trains/more frequent services;
— requiring more frequent and accurate passenger counts;
— improving perceptions of security through the provision of CCTV, increased staffing or the compulsory use of the Secure Station and Secure Car Park initiatives; and
— monitoring the level and quality of services at stations.

Is the current system achieving that purpose?

2.2 The acid test is whether passengers are receiving the level of service they expect. Overall passenger satisfaction levels are improving. 80% of passengers are satisfied with their overall journey and 79% (the highest proportion of passengers ever recorded) satisfied with the punctuality/reliability of their trains. However, only 41% think that they are getting value for money for the price of their ticket—which equals the lowest ever rating for value for money. Car parking facilities at stations scored just 46% and only 35% of passengers are satisfied with the way train companies deal with delays.
2.3 It is difficult, however, to make a precise assessment of the impact of franchising on satisfaction levels. Differing starting dates and franchise lengths as well as the respective state of the railway at the point of franchising, makes like-for-like comparison between franchisees difficult and potentially misleading. The National Audit Office also acknowledged that value for money from the franchising process as a whole was dependent upon wider matters, such as the degree to which the restructured industry could secure improved efficiency and higher quality of service in the longer term.

2.4 Nonetheless Passengerfocus believes, from experience, that there have been some drawbacks to the franchising process:

- the emphasis placed on awarding contracts on a least-cost or, more recently, on ensuring a large premium payment to government creates risks for passengers. There is the danger that operators will cut costs to the bone or look to increase revenue streams by raising those charges which are left to their discretion. For example:
  - increasing cost of car parking. GNER has just announced significant rises in car-park costs [eg at Doncaster the cost has doubled from £4.50 to £9]; and
  - other methods include realigning reduced-rate ticket validities into narrower timebands to effectively price passengers off particular services, reducing demand at certain times of day. For example, First Capital Connect’s imposition of evening peak-hour restrictions on some cut-price fares. [Thus a same-day return from Cambridge to London, for passengers wanting to leave London between 16.30 and 19.00 has increased from £17.60 to £26.90].
- basing service levels on timetables that were in existence in the mid 1990s does not reflect changing commercial and social activity on Sundays and the increasing incidence of the 24-hour seven-day-a-week society.
- while franchise contracts have always specified targets there is not always clear evidence that these are being monitored and independently audited to ensure compliance, nor that there are incremental increases in targets from one franchise to the next. There has, for instance, been no step-change from one generation of franchises to the next in terms of minimum station standards, nor any consistent attempt to monitor performance at stations. The latter was something recognised by the NAO in its report Maintaining and improving Britain’s Railway Stations.
- the sense that targets contained within the franchise become seen as a maximum to be achieved rather than a minimum to be exceeded.

How does the process for awarding franchises work?

3.1 The voice of the passenger has hitherto carried little weight in the franchising process. Passengerfocus and its predecessor organisations have been consulted on each new franchise. Independent of this, we have over the last decade undertaken research and consulted other stakeholders on the key elements of franchise structure to best represent passengers’ interests. The reluctance of successive franchising authorities to take greater notice of the passenger representation viewpoint has been disappointing, especially given that far more than mere cost needs to be considered in the process.

3.2 We believe that the transition from SRA to DfT has been relatively seamless. We also note a new and more open attitude, with DfT generally making a greater effort to take account of passenger views. Research which Passengerfocus has undertaken on route-by-route passenger priorities for the new Midlands/Central franchises has been well received.

3.3 It is unclear why until recently a franchisee’s previous performance has not been taken into account in the rebidding process. A good record in areas such as performance and passenger service quality should count as cogent factors in assessing any re-award of franchise.

3.4 Passengers need franchises which are sufficiently flexible to take account of changes in demand, especially to cope with growth. Service level commitments, for instance, need to reflect demand and as passenger representatives we need to be consulted on any proposals to amend them. There is the danger that once let, franchises can freeze service and quality levels. Targets must be seen as minimums to be exceeded rather than ceilings to be reached.

Are franchise contracts the right size, type and length?

4.1 There was a consensus view among passengers in research commissioned by the RPC that fewer, but bigger, franchises would make for a more streamlined and responsive structure. It could also be argued that there is a need for longer franchises—currently many train companies have businesses “on loan” for only seven years, which hampers a longer-term view and innovation. However, any move towards longer franchises must be accompanied by an effective programme of franchise reviews in order to guard against the potential complacency inherent in any long-term contract; and ensure that there is continuing improvement throughout the entire life of the franchise, not just at the beginning.
4.2 Larger franchises also offer opportunities for economics of scale and of co-ordinating services within a wider area—eg in terms of connections policy and service disruption. This is co-operation rather than competition, but in such instances works in passengers’ interests. It also fosters best practice and a degree of standardisation.

Do we need more competition and vertical integration?

5.1 Train companies cannot function in isolation; they do not own the trains which they operate, the stations they stop at or the rails on which they run. In such a complex system, a high degree of integration from the top to the bottom of the industry is vital. We have continually advocated the need for a “joined-up” railway delivered through integrated control and partnerships. Passengers’ concern is less about railway ownership and more on ensuring that control is in capable hands. We should, however, have concern were lead TOCs entrusted with infrastructure assets whose lifespan far exceeded the likely period of tenure of the rail franchise; this aspect would be further complicated where a number of different TOCs, operating different types of rolling stock—and perhaps freight operators—had interest in the same stretches of track.

5.2 The creation of Network Rail has generally brought an improvement in integration at the wheel/track interface. Integrated Network Rail/train company control centres are a step in the right direction, as is the long-term decision to bring maintenance in-house. There are also signs that relationships are moving away from the earlier adversarial stance towards more collaborative and mutually-beneficial working. This will contribute to passenger benefit but it is crucial that the decisions are focused on what is best for passengers rather than what is best for the industry—a customer focus rather than an engineering focus.

5.3 A key element in the joined-up railway is the rolling stock market. The thinking behind the current structure was based on a market-led model of rolling stock provision that would lead to tight cost control and greater efficiency. We have consistently argued that this has not been the case in practice and have criticised the second-hand rolling stock market in terms of its efficiency, competitiveness and value for money, all of which have serious implications for passengers.

5.4 The existing structure of franchising means that rail’s competition is largely with other travel modes, principally the car, rather than between operators. There are some routes where competition does exist and in these areas passengers have the benefit of choosing between elements such as price, journey length or comfort levels. It is crucial, however, that competition does not undermine the concept of network benefits and the principles of inter-operability and inter-availability; for instance, the ability to make a through journey on one ticket, valid on any company’s trains rather than be limited to a single train company. In such cases it is collaboration and co-operation that is important. The importance of this is reflected in the way that the Office of Fair Trading has granted an exemption to anti-competitiveness legislation that permits train/bus operators to offer joint tickets, such as Travelcard and rail-bus add-ons.

Is franchising compatible with open access operations?

6.1 We understand that hitherto potential franchisees have bid on the assumption of exclusivity of operation on the route (except for those other known franchisees operating on common sections of routes and which will be factored in to bid proposals). Open-access operators, however, offer an element of choice—perhaps by offering more attractive fares and/or through services. Hull Trains has proven the success which open-access services can provide.

6.2 Passengerfocus generally welcomes extra services for passengers, but the recent case of an additional operator seeking access on the East Coast Main Line ECML raised serious issues for passengers. In this case, the interests of one group of passengers is potentially being played off against another. Sufficient capacity is required to meet all communities’ reasonable expectations. This event has accelerated the need for the capacity study on the East Coast Main Line to be undertaken without delay.

6.3 Part of the agreement for an open-access operator to enter the market should include a review of the incumbent franchisee’s business. Cherry-picking profitable elements of existing franchises is financially damaging to the incumbent train operator, which is not only responsible for the lion’s share of track access costs, but stands to lose farebox revenue through ORCATS allocation. The cost base arrangements favour the open-access operator at the expense of the franchisee. Open-access operators should be required to bear a fair share of the operating costs.

6.4 In the new round of franchises, where some franchisees are required to make major premium payments to government, any threat to the revenue stream will doubtless lead to reduced premiums, higher unregulated fares or in extreme cases, the franchisee surrendering the franchise. If open access is to continue, bidders need to consider the possibility of an open-access operator seeking to use that route when franchises are let—though this could make bids dearer as a result. We welcome the reference in DfT’s White Paper of the need to close this loophole.
REFERENCES

5. House of Commons Transport Committee: *Overcrowding on Public Transport 2002–03*. This acknowledged concerns with the existing Passengers in Excess of Capacity (PIXC) measure of overcrowding.
6. National Audit Office: *Maintaining and improving Britain’s Railway Stations*, July 2005. This called on DfT to encourage greater involvement of passenger representatives in monitoring TOCs’ performance at franchised stations and their compliance with the Code of Practice on access for people with disabilities, and publicise summaries of the results.
12. ORCATS, the ticket revenue allocation system, distributes income between operators on a particular route according to the number of services which they provide rather than by the number of passengers carried. All revenue derived from inter-available tickets is allocated through this method. Some companies had therefore been incentivised to run trains on some routes simply to qualify for a portion of this revenue, whether or not there was a commercial need for an extra operator.

29 June 2006

Memorandum submitted by Railfuture

Railfuture is a national voluntary organisation which has successfully campaigned for improved passenger services and station re-openings for over 25 years. Our members include a wide spectrum of local activists, professional planners and rail professionals.

In this memorandum we will first address some of the committee’s questions and then make some general points. In particular we will comment on the often imperfect alignment between regional transport strategies, PTE aspirations and franchise objectives.

PART I—THE SELECT COMMITTEE QUESTIONS:

What should be the purpose of passenger rail franchising?

1. The objectives of a franchise should be to provide a high quality rail service and modern station facilities for passengers. The franchise should also aim to maximise the opportunities for expanding and developing rail services in its area of operation with a view to achieving a significant increase in rail’s share of the travel market in line with published regional strategies.

Is the current system achieving that purpose?

2. At present the Department for Transport is being too prescriptive in the provision of rail services—as shown by their re-writing of the timetables for the new Great Western franchise. Detailed timetables should be a matter for Network Rail and the TOCs; in consultation with PTEs, County and Regional authorities. The role of central Government should be to define the minimum level of service.

3. There seems to be very little opportunity for creative change or the addition of new services in the new franchise specifications. Franchises should not simply be let on the grounds of running a basic service at the lowest cost. Bidders should also be encouraged to provide evidence of their ability and willingness to provide a high quality public service.
How well does the process for awarding franchises work?

4. After a traumatic 10 years the franchising process is still evolving. Re-mapping the Central Trains, MML and Silverlink franchises simultaneously has now created a huge overload on County and Regional Planning departments, voluntary organisations and within the industry itself; potentially displacing other important work. It is not obvious that the large cost of this process is commensurate with the rewards to either bidders, the travelling public or HM Treasury.

What input do operators, passengers and other interested parties have into the design of franchised services?

5. Transport is the life blood of the regions and most other aspects of regional planning involve genuine local consultation. We would like to see enhanced input from stakeholders included in the pre-franchise consultations similar to that which is starting to happen under Network Rail in the RUS process. In the circumstances it is not surprising that franchises in Scotland and Wales now appear to be more responsive to local needs.

Are franchise contracts the right size, type and length?

6. The DfT’s current proposals for a basic seven year franchise seem reasonable; any longer would potentially prolong the life of a poor management; any shorter would not give time for new managers to demonstrate their competence. However offering just a single three year extension for a well run franchise just mandates repeating an expensive re-franchising process every 10 years. Expensive that is in both Civil Service and TOC Management time.

7. The length of a franchise should be long enough to encourage long term planning yet contain breakpoints where a poorly performing franchise can be terminated. The successful bidder will be expected to make a substantial investment in enhanced station facilities and re-furbished rolling stock. Franchises should also be long enough for the incumbent to invest in permanent facilities for training their staff and to offer good prospects of career progression within the company.

8. There is a large and expensive overhead for both DfT Rail and the potential bidders in the franchise process which amounts to nothing less than a hidden cost on the whole industry. We therefore suggest that the current round of franchise renewals may be too short and that a larger maximum of 15 years may be optimum; preferably with more than one breakpoint.

9. Although there appear to be three types of franchise; InterCity, Cross Country and Regional, the distinction is not absolute and we would expect all operators to contribute to the national network and be prepared to provide some elements of both local commuter services and the social railway.

10. The failure of the West Coast franchise to serve Blackpool and Shrewsbury and of GNER to service Middlesbrough and Sunderland results directly from the artificial distinction between InterCity and Regional Railways. The absence of Cross Country services from either Cambridge, Hull or any indeed East Coast town south of Newcastle, is an historical anomaly that the current franchise has sadly not rushed to correct.

What criteria and processes are used to determine the nature and length of franchises?

11. We believe that the present number, and pattern, of franchise areas is about right; although experience may prove that some already cover too large a geographical area and could ultimately become remote from passengers in parts of their operational region.

12. Responsive local management is essential; but the new Northern franchise spans three local government regions and five PTE’s; was this an amalgamation too far? The new Greater Western may also find it difficult effectively to relate to the needs of passengers using the “social railway” in the rural parts of the West Country. However in other regions there may still be some potential for future mergers.

13. The reward for good performance should indeed be the prospect of a longer franchise. A first extension of five years and a second of three years giving a total of 15 years would be more appropriate than the 10 year maximum currently proposed.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

14. Assets on the railway, whether Rolling Stock or Station structures have a useful life of over 30 years. It is therefore unlikely that a franchise can ever fully justify the whole cost of such major capital investments. However, more modest investment in re-furbishment of rolling stock and enhanced facilities at stations can be made over a franchise lasting 10 years or more.
15. As the National Audit Office has recently reported, the lack of investment in Britain’s railway stations is a national disgrace. The requirement for most new franchises to establish a “Minor Works Fund” will go some way to address this shortfall; but must be accompanied by real dialogue on priorities between Network Rail, the TOC, Regional Planners and the Local Authorities.

16. As well as its record in delivering the contracted service, the past record of a franchise in upgrading the stations for which it has been responsible should also be critically assessed when reaching a breakpoint.

What is the scope for improving services through franchise agreements?

17. A generally unrecognised aspect of the franchising problem lies in the conflict between PTEs who, following local and regional development strategies, may wish to run lightly loaded early morning and late evening trains; keep fares low to encourage the use of the public transport network; provide staff at all railway stations from first to last train; and provide free or low cost car parking at railway stations to encourage modal shift as far as possible. All these legitimate aspirations impose additional costs or (in the case of car parks) a loss of profit for the rail franchisee which can be difficult to quantify.

18. Where they exist, PTEs have a vital role in planning and funding the provision of local services. There should also be a greater involvement of Local Authorities and other local stakeholders in planning future services and enhanced station facilities in advance of regional expansion. The recently announced plans to expand Milton Keynes Central station are an excellent example of what can be done.

Do we need more competition and vertical integration?

19. Sadly the well known capacity constraints on the current railway network mean that competition on any individual route is now the exception and regulation must perforce take its place. In public transport generally, integration between services is more important than competition irrespective of mode or operator.

20. Although perhaps a logical aspiration for the larger companies, vertical integration is unlikely to be a practical option for the majority of the current rail franchises. The capital cost of modern tracklaying and maintenance equipment dictates that this must be used over a wide area—larger than all but three of the franchised routes. Vertical integration on the railways would only create more barriers to competition and potentially restrict the growth of the successful rail-freight industry.

Is franchising compatible with open access operations?

21. In general open access is probably not compatible with passenger franchising as currently practiced. An open access service should only be permitted when it can be shown that there is a clear social need for the new service; that paths are clearly available; and that abstraction of revenue from franchised operators will be minimal. It will often be preferable to integrate the proposed service into an existing franchised operator’s network.

22. It should perhaps be asked whether franchised operators—who in principle have the skills, staff, and maintenance facilities—are now uniquely banned from bidding for open access routes additional to their franchise?

Should train, rolling stock and track operation be more closely integrated?

23. Whilst there does seem to be a role for ROSCOs in the funding, specification and supply of new rolling stock; it is arguable that older units—particularly those inherited from British Rail—should be held in a common “not for profit” pool for any franchise to use.

PART II—GENERAL COMMENTS:

Franchises and the Regions

24. Although franchises in England can never be as closely aligned to Regional boundaries as are those in Scotland and Wales, there should nevertheless be a much larger role for the English Regional Assemblies in funding and managing the rail franchises. The PTE’s have a good track record of investing in rail facilities and services but most do not cover the whole local government region; and many significant city regions—such as Bristol, Southampton and Teeside—do not have a PTE.

25. The recent success of Grand Central in gaining paths to Sunderland has highlighted one neglected aspect of the large Inter-City franchises; there is no obligation in their basic contract to serve the community within their “region” as a whole, even though they are likely to be the only operator providing services to London. This is not a unique case as the Virgin West Coast franchise has similarly ignored the manifest needs of Shrewsbury and Blackpool for direct services to London.

4 See also “Maintaining and improving Britain’s railway stations”, HC 535.
26. A second defect of the present franchising process is that there is no obligation on franchisees to maximise the social value of the services they operate. So long as a franchise is incentivised to maximise their revenue, services off the main route(s), such as to Shrewsbury or Sunderland will always come low down in their priorities. Similarly, socially desirable Cross Country connections to less affluent regions are likely to be given a low priority.

27. In this context the DfT’s proposed inclusion of some additional routes in the Cross Country franchise is welcome. Nevertheless, this will still leave large areas of the East and North East (notably Hull) without direct services to the South and West.

The Management of Stations

28. The inevitable mix of commuter and long distance/cross country TOCs running in most parts of the country sometimes throws up anomalies in the management of stations; with isolated, sometimes unstaffed, stations coming under the management (as SFO) of a distant TOC who happens to be the sole or dominant operator on that route; but is not the operator of other stations in the region. ( Lockerbie, where Virgin is now the only operator, is a recent example; but several other stations in the East and West Midlands could pass to Cross Country in the current re-mapping of the Central Trains franchise).

29. However, the new Cross Country franchise proposals, published earlier this month, suggest that where there are no other operators serving a station then an adjacent operator should be the SFO. It is not intended that the Cross Country franchise will manage any stations itself as the small number involved would be uneconomic. The possibility of more stations being managed directly by Network Rail would be worth examining but is probably outside the scope of this enquiry.

Passengers in Excess of Capacity

30. It appears to be DfT policy that a clause limiting the number of standing passengers (the PIXC limit) is only included in the so called “Commuter Franchises”. In reality standing is sometimes a regular occurrence on many other services in the regions and it is not obvious why this clause should be omitted from both InterCity and Cross Country franchise contracts.

31. The new West Midlands franchise proposals, published earlier this month, suggest imposing a “national” (ie London) PIXC standard in place of the existing WMPTE regional standard. We strongly suggest that whilst “no standing for more than 20 minutes” may be acceptable in the relatively mature London commuter market, it is not appropriate for the regional networks where rail patronage is still growing.

32. We note that the potential impact of changes to some long standing PTE powers in the 2005 Railways Act has been largely ignored and deserves further investigation.

PART III—CONCLUSION:

We are frankly not convinced that franchising is the only—or indeed the best—way of running the passenger railway. If however, franchising is to continue in broadly its present form we believe that there are still a number of ways that it could be improved. For example: by increasing the maximum length of franchises to 15 years; and by increasing local stakeholder participation in the design of the franchise specifications.

19 June 2006

Memorandum submitted by railfuture northeast

SUMMARY

The purpose of the passenger rail franchise operation is suggested in this submission to be the development of a national rail service network committed to continuous improvement and incremental growth as part of the Government’s overall intent to manage transport processes and their impact on climate change. A range of examples is given to illustrate the failure of the present and recent franchise agreements to deliver this purpose.

The franchise agreements let to date appear to have taken little heed of the needs of passengers and to have stifled the ability of operators to innovate in developing service improvements. Effective public participation in the design of the franchises has been minimal. In the North East at least, the DfT Regional Planning Assessment is fundamentally out of step with the Region’s Spatial Strategy and the regional transport strategy which it incorporates.

Franchise management has failed to prevent problems within specific franchises and franchise durations appear to be determined without thought to the need for operators to develop management processes and corporate cultures.

Open Access arrangements have evidently succeeded in establishing valuable new services; mechanisms must be provided to allow Network Rail to develop capacity for further such initiatives where they complement the franchise provisions. Overall, the franchises must be developed to promote the railway network, its interconnecting journey opportunities and the wider needs of the communities they serve.

1. **Preamble**

Within the Railway Development Society Ltd, campaigning as **railfuture** to promote the use of railways, the North East Branch, **railfuture northeast**, includes among its objectives:

*The maintenance of a constructive involvement in those commercial and political processes that may lead to an improvement in the quality and coverage of existing rail services.*

In this context **railfuture northeast** offers the following contribution to the Transport Committee for its consideration. The contribution has been prepared to address the questions asked in Press Notice 45/2005–06.

2. **What should be the purpose of passenger rail franchising?**

*Is the current system achieving that purpose?*

The purpose and practice of passenger rail franchises was reviewed in the Franchising Policy Statement issued by the SRA in November 2002. Much has been written, done and said on the subject since then and it is timely that the Transport Committee should seek to establish in clear, simple terms the current purpose of the process. As a contribution to this objective, **railfuture northeast** would suggest that the purpose is:

*To enable Government to commission others to operate passenger rail services as part of the national rail network within a financial framework reflecting the wider economic needs of the area served as well as the direct costs and revenues accrued from operating the service.*

Within that statement is to be included:

— The need to achieve and then continuously to improve upon minimum standards of service.
— The need to operate an initially agreed timetable and then continuously to develop the scope of the timetable to meet the changing and growing needs of the communities and passengers served.
— The need to reflect Government policy initiatives to reduce climate change, increase public transport modal share and reduce road congestion.
— The need to operate in an integrated way within the national rail network and with Network Rail under the jurisdiction of the Office of Rail Regulation.
— The need to demonstrate responsible financial management which does not require unplanned support, restricts the profits payable to shareholders and sets the return to Government at the minimum level necessary to exercise control.

Specifically, maximising direct financial returns to Government should not be an objective of the franchising process.

The current system clearly does not meet the purpose described. For example:

— Performance across the network is good and improving because staff are committed to their work unsupported by any positive incentive in the franchise regime.
— There are still very few areas of the network in which the railway can be said to provide a service seven days a week.
— Demand management techniques are too often used in a negative way to reduce peak time journeys rather than in a positive way to develop off-peak and weekend travel, as is evident from the recent First Capital Connect furore.
— The attempt by the SRA/DIT to terminate the 17.30 hour train from Kings Cross/Edinburgh train at Newcastle demonstrates not only an undue involvement in the detail of the provision but also a remoteness from the need continuously to develop the service.
— The detailed use of the Greater Western specification to impose cuts in the West Country services and the subsequent public dispute about responsibilities demonstrate a failure to recognise in the franchise, the need to nurture and grow the railway.
— The measurement and monitoring regimes of individual franchises encourage independence of operation and hence work against the provision and maintenance of connecting services and the integrated operation of the national network.
— The potential financial returns to Government of the current East Coast (GNER) & Greater Western (GW) franchises represent an excessive extraction of money from the railway.
It appears that narrow definitions of value for money have been allowed to overwhelm the greater need to recognise the role of the railway in developing wider economic benefits for the communities they serve.

The route franchising process is fundamentally flawed in that it fails to manage the need for essential national rail network provisions. To illustrate the point:

— There is no requirement for network-wide cooperation to manage service disruption; for example, there is no automatic revalidation of tickets for use by any reasonable alternative rail route.

— There is little evidence of a national standard for rolling stock facilities, for example for the carriage of cycles or increased cycle allocation on less heavily loaded services.

— There is little or no requirement for cooperation in the area of demand management from the provision of off-peak fares to the use of area cards and “rover” tickets.

However, the now excellent National Rail Enquiry Service has been developed in spite of the franchising process and the huge growth in patronage of the railway under the franchising regime appears to reflect not only the wishes of passengers to travel but also the willingness of the Train Operators to make the best of the franchises they have been awarded.

3. How well does the process for awarding franchises work?

What in-put do operators, passengers and other interested parties have into the design of franchised services?

Operators will no doubt speak for themselves but in short, the process is opaque, with little or no ability to see the comments made or the response of the SRA/DfT. The recent DfT Briefing Note on the High Level Output Specification (HLOS) gives great cause for concern when it states at Paragraph 32 that “DfT will not be consulting specifically on the HLOS but it will be informed by work already carried out or in progress on RPAs and/or RUSs”. In the North East this would be true of the RUS process but emphatically untrue of the RPA process. The detailed statement at Box A on Page 7 of the HLOS Briefing Note states that “full account is taken of regional and subregional strategies and plans”. This is not the case in the North East where the Submission draft of the Regional Spatial Strategy differs radically from the RPA. Significantly, within the North East RPA itself, the list of those consulted does not include any passenger group or other community groups with a legitimate concern for the railway. Evidently, the DfT view of a Stakeholder does not include those who use or are directly affected by the service provided.

That said, the evidence of recent events such as the retention of the West Country sleeper service, the outcome of the Northern Franchise Review and the retention of the 17.30 hour train from Kings Cross to Edinburgh (see above) all serve to demonstrate that the work of the DfT is now more sensitive to public pressure than was the case in the era of the SRA.

The consultation document for the Cross Country franchise has just been published; the management by the DfT of the responses to this consultation will be a good test of the “third generation” process. Among many contentious issues are likely to be the arbitrary imposition of changed service groups, the elimination of through journey opportunities from the North East to Southampton and Bournemouth and from Manchester to Brighton. Yet again, operational convenience appears to have overtaken the needs of passengers in the eyes of the DfT.

The duration of franchises is often seen as a constraint on financial investment. This may be true but at least as important is the stagnation during “the last year of the franchise” and the frustration of destroying a successful and improving operation.

The franchising process is fundamentally flawed in that it consumes major costs and diverts major resources away from the core task of running and developing the railway. The DfT retains to itself the task of developing the long term strategy for the railway; supporting such work is an area where the railway expertise deployed in developing franchise bids might be better used. The objective must be to ensure that franchises come to be seen in context as component parts of the overall national network of railway provision.

Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

The transition appears to have been smooth, albeit slow. However, the resultant involvement of the DfT in the fine detail of railway operation through the franchise specifications such as that developed for Greater Western is as well documented as it is unhelpful. If we are to persist with the present model of privatised railway then it has become essential to revise the terms of reference of the franchising process to ensure that the purpose as defined in Section 2 above is achieved. Specifically, there must be clear emphasis on the sustainable growth of the railway to meet the economic, environmental and social needs of the communities they serve.
4. Are franchise contracts the right size, type and length?

What criteria and processes are used to determine the nature and length of franchises?

What criteria and processes are used to evaluate franchise bids?

Others may be able to list the criteria and processes but for many, they too often remain hidden behind apparent or real “commercially sensitive information” claims. Frequently, the result seems to have been derived for the convenience of the process and too seldom for the benefit of the communities and passengers concerned. The proposal in the DfT’s base case for the New Cross Country Franchise, to terminate trains from Newcastle at Reading, requiring a change of train for those travelling to Bournemouth is a specific example. The complete mis-match between the DfT view of the North East, as exemplified by the Regional Planning Assessment, and the North East Assembly’s view of its own Region, as exemplified by its submission draft Regional Spatial Strategy, clearly illustrates the general point. From the short franchise duration which is currently in vogue, it is evident that insufficient recognition is given to the time a real operating entity needs to effect a culture change, to drive up operating standards or to establish robustly the key areas of potential for growth and development. For example, the CrossCountry franchisee has driven that franchise from a poor relation to a highly valued, well performing operation over the last five years or so. No rationale has been presented for putting the resulting expert team at risk by submitting it to the refranchising process. In an adequate way, the franchise remapping process is proffered as an excuse; whilst any reduction in the number of franchises is to be welcomed, the tiny reduction which the re-mapping will deliver does not appear to have been considered adequately in the balance of the disruption which will be caused.

Fundamentally, there is a conflict in the franchising process between the need to specify in advance the detail necessary to sustain a valid competitive bidding process (and subsequent contract) and the need to provide the flexibility and freedom to develop operational flair that the privatised railway was intended to deliver.

The evidence available from the recently awarded GNER and GW franchises suggests that whatever window dressing may be applied, the evaluation of franchises is now dominated by direct financial return to the Government. This is unhelpful not only because the return is so far into the future that some may consider it illusory but also because it fails to give adequate recognition to the wider economic needs of communities or to the qualitative benefits of supporting services needed and offered.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

Historically, it is clear that franchise holders do not always deliver value for money throughout their contracts. Whilst few severe sanctions such as termination or fines have been enforced, the position is well illustrated by the former northern trains franchise in the North East. Here, the holder went from delivering a service perhaps best described as dire in its earlier days, to the service provided by Arriva Trains Northern towards the close, which was worthy of the hard earned accolade of excellent. There are few enterprises that could claim to deliver value for money from their inception to their termination. Start-up and close-down processes are notoriously inefficient and, to spell out the obvious, the shorter the franchise the greater is the proportion of start-up and close-down time.

Are risks suitably apportioned between the Government and franchise holders?

Because the recent franchise specifications have attempted to control the detail of service operation, corporate initiative is inevitably suppressed and the risk of the operation quite properly reverts to the Government. There is a clear need for a better balance between specifying broad outcomes rather than detailed processes and procedures, between contained profits which may be taken and between contained direct financial returns to the Government. It is unlikely that a meaningful shift in risk and benefit to passengers will be achieved until that rebalancing is implemented.

What is the scope for improving services through franchise agreements?

Many of the services provided require improvement in quantity or scope; currently the measures indicate that much of the network provides a railway service of good quality. All of the services could be improved in all three ways were the DfT to see its task to be to grow, develop and improve the railway. For example, every new franchise could include rolling stock refurbishment and renewal requirements, station facility enhancement, timetable strengthening at weekends, route development review etc Clearly, the scope for improvement is very limited if the DfT pursues its apparent policy of awarding the franchise to the lowest cost bidder, offering the highest direct financial contribution to Government.
5. Do we need more competition and vertical integration?

Is franchising compatible with open access operations?

The Hull Trains (HT) experience demonstrates that from the point of view of the passenger, open access operations are highly successful; the service to Hull is no longer constrained by the decisions of the franchise holder and DfT with the consequence of a many-fold increase in service quality and quantity. From the resistance to Grand Central Railway (GCR) displayed by both the DfT and GNER, it is evident that they feel their monopoly position to be threatened; this may be considered to be the whole point of providing for open access. Both HT and GCR are providing for communities and people neglected by DfT/GNER and this provision must take precedence over any reduction in the direct financial return to the Government. It was of course open to DfT/GNER to provide the services to Hull and Sunderland.

The HT/GCR services make the point very strongly that if the franchise process is to specify the procured service in great detail then the necessary room for growth and development will best be provided, at least in part, by open access operators. Clearly, these operators are not cherry picking but they are providing for a demonstrated need not catered for by the franchised operator. The question then is perhaps not so much whether the open access operation is compatible with the franchising process as to whether it is compatible with Network Rail’s funding and ability to provide the necessary capacity. It may be that some modification to the funding mechanisms will eventually be needed but this should not do other than ease the path for open access operators to take part in the development of the railway and the provision it makes for growing and developing communities, their economies, environment and quality of life.

Should train, rolling stock and track operation be more closely integrated?

Clearly, there are advantages to be gained from integration of the provision of track, rolling stock and operating services, just as there are advantages to be gained from a closer integration of operations alone, to re-establish the network of connecting services which could and should be a hallmark of the railway. Network Rail in its current form has increased its credibility considerably, by taking full responsibility for its actions and by recognising increasingly that passengers and freight operators are its ultimate customers.

Closer integration of train operations is a clear need as the pressure to improve journey opportunities by re-establishing the credibility of close connecting services increases. The recent trend towards the integration of control centres is a clear improvement but much could be done in the contractual context of the franchise to support cooperation between companies in the interest of the passenger. For example, it should not be difficult to amend the rules of the Public Performance Measure regime to exclude delays to first and last connecting services and those on routes where services are infrequent, where such delays are caused by the incoming service.

The ROSCOs remain remote and are perhaps rightly perceived as a major cause of high operating costs across the railway. The Regional Planning Assessment for the North East comes to the conclusion that any shortage of rail network capacity could be overcome by train lengthening; however it does not address the more difficult question in the un-integrated railway of who should pay for the extra carriages or indeed of how such a need should be identified. Thus, “integration” needs necessarily to involve the DfT in working in direct partnership with the railway, if coherent planning is to be developed.

Perhaps the key area in which greater integration of the work of the Operating Companies and Network Rail would benefit passengers is in the management of maintenance and renewals; in short in the rapid re-establishment of a seven-day railway. Too many passengers are today, turned away from the railway permanently by the unpredictable, extended possessions demanded without adequate provision of diversionary routes. The cost to the railway of the loss of current and future passenger revenue should be a key factor in determining maintenance programmes and the upgrade of available diversionary routes to a reasonable passenger standard should be a priority. As but one example, the Stillington Branch offers a diversionary route from Northallerton to Durham when the ECML is closed; the speed restrictions on this route, however, are unacceptable for a passenger service. Upgraded, this route could also be developed to use diverted trains constructively to provide occasional enhancement of the journey opportunities to and from selected stations on the route, in this case for example, Eaglescliffe and Stockton on Tees.

19 June 2006

Memorandum submitted by Railfuture London & South East

PASSenger RAIl FRanchising—Is the new regime working any better?

Railfuture London & South East, the Railway Development Society, is pleased to submit evidence in response to the Committee’s request for evidence on Passenger Rail Franchising. Due to the tight schedule several Branches are submitting responses expressing many similar concerns while reflecting regional issues.
This paper answers the Committee's questions where possible, but as a consumer lobby group, some technical aspects of the franchising process may not be within our professional experience or research given the short lead-in time to this inquiry. Nevertheless, we look forward to attending evidence sessions and the report.

Before responding, various members met to consider the Committee's brief, several core points and concerns regarding the administrative structures emerged. This in turn raised some other questions where the Committee might like to make further inquiries. These are shown with a bullet point.

In posing these points for debate, such questions do not necessarily reflect Railfuture’s current policy, which is to work where possible within the existing structures, and to influence and inform where we can.

A. The Future of Rail—the Government’s 2004 White Paper

1. The Government’s view was set out in the White Paper, The Future of Rail. (July 2004). This was light on the role of Passenger Franchise Contracts, as it appears the Government was still thinking out its definitive strategy and policy.

2. It states “... train companies ... will sell tickets ... and retain revenue ... so they will still be incentivised to increase passenger numbers on the services they run while keeping their costs down” (section 4.3.24). However the policy is prescriptive in that “... companies will bid to operate a defined timetable ...” (section 4.3.27)—our italics!

3. One of the problems is that franchise duration has swung from one extreme to the other (and back) under the successive control of Roger Salmon at OPRAF, the Strategic Rail Authority (SRA) under Sir Alistair Morton’s leadership—longer with greater incentives and freedom to invest—to Richard Bowker—shorter and more prescriptive—to the Department for Transport (DfT) approach—variable length franchises that are virtually management contracts. Hence many people see a perceived problem of a centrally “defined timetable” and organisational structure not meeting the real needs of local communities.

— Does the Government, through its DfT Rail Directorate, now have a coherent uniform policy for assessing franchise bids and ensuring these fully meet local aspirations and needs?

B. Franchising is inefficient

4. If four potential Train Operating Companies (TOC’s) bid, three will be unsuccessful, so 75% of the effort to win the contract is wasted. This is an inordinate waste of management time and resources that should be devoted to running the franchises they already have.

— What costs are incurred in bidding for a franchise? Should these be investigated and how might the process have greater transparency, including publication of the winning bid?

C. Franchising encourages short-termism

5. A TOC is not going to make long term investments that cannot be re-couped during a seven to 10-year franchise period. In reality there is no right duration, but too short a period stymies any significant investment in either infrastructure, facilities or rolling stock.

— What has been the real value of TOC’s investment in infrastructure, passenger facilities or rolling stock, when contrasted to subsidy levels or out-turn profits?

D. Detrimental effects of financial or operational failure

6. Was it difficult to remove failing franchises, particularly if they were long ones? It seems there were relatively few problems removing Connex, but there were costs. MTL and Prism, appeared financially unstable and were bought out by other industry operators. Nevertheless the need for significant additional funding to maintain services was clearly unsatisfactory.

— What has been the cost to Government of propping up ailing and failed franchises? Can the Government or DfT clarify exactly what it will do in future if a franchise fails financially?

— Is the Government/DfT now able to set out clear criteria by which it will remove errant franchisees? What structures are in place to put a publicly owned operator in place, on a temporary or permanent basis, following on from the Connex—South Eastern experience?

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6 The Future of Rail, Department for Transport, July 2004, sections 4.3.24–30. May we suggest the Committee’s members and advisors renew an acquaintance with the White Paper and see whether current policy is significantly at variance with what was set out then? The White Paper was the response to the Committee’s report The Future of the Railway HC 145.

7 The Office of Rail Passenger Franchising was subsumed into the Strategic Rail Authority under the Transport Act 2000.
E. Franchising pushes up fares

7. Despite frequent assurances to the contrary, it is clear that the “bottom line” is the crucial factor in determining the successful bidder. It appears that the process has gone back to the bidders aiming for the lowest subsidy or highest premium payment in order to win.

8. The Committee’s timely report expressing concern at excessive fare rises, or extending restrictions on ticket availability or peak services, noted these policies are undesirable as they deter passengers from using rail in preference to road or air. Inevitably the winning bidder seeks to recoup money through fare increases or tariff changes.

9. GNER, First Great Western (GW) and Capital Connect-Thameslink-(CC) are manifest recent examples. First CC has stopped the use of many day return tickets between 16.30 and 19.00 north of London to suppress demand and increase revenue, also fit their present heavy peak loadings and contain growing levels of demand within an inadequate rolling stock fleet.

— Why are franchising agreements so loose that a passenger facility can be altered or removed at the whim of a new train operator?

— Did First Group’s Capital Connect bid include and set out these changes to ticket availability and fares for former Thameslink and WAGN services, and did the DfT endorse this change?

Our response now considers the Committees specific questions.

F. What should be the purpose of passenger rail franchising?

10. The Future of Rail 2004 White Paper was not clear on what the Government saw as the purpose of a franchise, beyond the fact that it appears the only mechanism by which services can be operated.

11. From the users’ perspective the incumbent operator is supposed to push up service quality and delivery and pull down costs. Clearly it is not achieving the latter, at least not for passengers who use rail primarily for essential journeys to work, education or other personal business.

12. Some franchises have delivered good service quality improvements, the better TOCs include Chiltern, GNER, and the former Anglia Railways, but even these operations had shortcomings, particularly on issues like ordinary open, all route fares.

— Could some franchises have developed better as Social Enterprise Companies, like Network Rail, particularly in the regions, following the Welsh Water model? Many argued cogently for South-Eastern to follow this model after removing Connex; why was this not pursued?

— Is it pertinent to ask whether such improvements might equally have been achieved under other privatisation models—such as management contracts, or a BR plc or Big 4 type model? (The latter might have been a Big 6, to accommodate Wales Rail and Scottish Railways.)

G. Is the current system achieving that purpose?

13. As well as delivering an acceptable standard of service, the other purpose should be achieving value for money for both the fare-paying passenger and, where subsidy is necessary, value for money for the taxpayer. The failure of the present structure to bring down costs significantly remains a problem as in real terms unit costs are significantly higher than under the British Railways (BR) structure. This is borne out in the frequent reports prepared by Roger Ford in the journal Modern Railways.

14. Others franchises leave much to be desired. The falling o

— of standards on the National Express’ (NatEx) London Eastern Railway “One” operation is noted. First Great Eastern achieved good standards, Anglia Railways were satisfactory and innovative and West Anglia (WAGN Railway) eventually consolidated its much criticised operation on their outer suburban routes.

15. Another problem is the hiatus caused by the transfer from one operator to another, where a resource problem emerges, such as a shortage of staff or rolling stock, and often both. Service reductions by NatEx “One” means local London area services on West Anglia routes now have irregular service frequencies and some gaps up to one hour, even on busy routes. This is a failure by both DfT Rail and the TOCs management to ensure the franchise is adequately equipped.

16. Also the allocation and availability of rolling stock is disorganised. The sidelining of 28 class 458 Juniper trains, apparently unsuitable because the DfT has decreed an information visual display system is the wrong size and type is unacceptable. This stems from inadequate organisational structures and management within the industry as a whole. This simply should not happen.

— What changes are the DfT making to ensure all viable rolling stock fleets are fully utilised, and that new operators have adequate resources in place to run their operations from “Day 1”.


H. **How well does the process for awarding franchises work?**

17. It is difficult for a user organisation to give a detailed analysis of this as too much is shrouded in “commercial confidentiality”. There needs to be greater transparency, and appropriate information put in the public domain so that Parliament, the legislature can scrutinise properly and effectively.

— Under the present regime, can MPs even overcome the difficulty of gathering and assimilating the facts from Ministers and their civil servants, to perform their crucial scrutinising role in Parliament?

J. **What input do operators, passengers and other interested parties have into the design of franchised services?**

18. There is a draft franchise consultation stage at which Railfuture members, often through our relevant regional groups, respond to concerns in the draft specification.

19. There is greater concern as to how much credence is given to responses received from local user organisations, and even local authorities, other quangos or NGOs, during the refranchising consultation. In the case of Great Western, many local concerns were ignored.

— What is the DfT’s policy commitment to ensure there is meaningful consultation, and new opportunities are acted upon, to avoid the kind of criticisms raised against many GW changes?

— How is the DfT linking up its consultation and franchise strategies with consultations and outputs for Route Utilisation Strategies (RUS), now undertaken by Network Rail?

K. **Has there been a smooth transition of franchising arrangements from the SRA to DfT?**

20. It remains unclear what processes are followed at the DfT to evaluate bids, so it is difficult at this stage to establish whether the DfT is tackling it in a more efficient way than the SRA.

21. From the user’s viewpoint this manifests itself at the sharp end; what happens to services and fares. A new franchisee may not deliver any significant or tangible benefits, or get worse.

L. **Are franchise contracts the right size, type and length?**

22. This has become more muddled where several franchises have been merged but others split. Theoretically bigger franchises seem preferable as this reduces the number of interfaces.

23. NatEx’s “One” operation merged two and a half franchise areas, and Great Western has merged three. Further north, redrawing franchise areas has juggled and redistributed, creating a Trans Pennine Cross-Country network, radiating mainly from Manchester and Leeds, with a Northern regional operation for local networks focused on the various PTE centres. This does not seem ideal.

24. Meanwhile the revised Cross-Country franchise retains the Birmingham focused network (mainly Table 51 in the National Timetable) while the local Midlands networks are split in two, serving West and East Midlands’ centres respectively. The East Midlands unit includes a merger with Midland Main Line, one a half old franchises, while West Midlands is two halves making one. These splits are again contentious as some local issues on developing new services have been side-stepped.

25. Experience will show whether these franchise areas work any better than the previous ones. Over the last 10 years, PTE involvement has been diluted by a Government whose earlier incarnations set up and developed the PTE’s role under the Transport Acts of 1968 and 1974. By contrast Transport for London (TfL) is slowly strengthening its role in managing both rail and bus services, despite the less definitive GLA Act 1999 and Railways Act 2005.

— Do TOCs give equal importance and value to all services they are required to provide, and are they given sufficient freedom and encouragement to develop untapped markets?

M. **A special case for local networks or microfranchising?**

26. There is considerable support for separating out Merseyrail Electrics and North London Railways, as both networks primarily provide local services. The major concern is how the relationship will work out with the adjacent operator if these networks want to expand? The revenue conundrum is further complicated by the use of prepaid ticketing systems like Oyster.

27. The North London concession will later embody the East London Line, which in turn will operate into South Central territory. It is not clear how these extensions will fit into the existing franchise set-up. Merseytravel also has plans for extensions beyond their existing boundaries, into the Wirral towards Shotton and Wales, and towards Skelmersdale and Burscough.

— How will local network changes be developed separately from existing franchises?

— Is the PTE’s/TfL’s understanding of the process for developing their local networks on the “same wavelength” as the DfT’s? How will these interface problems be resolved?
N. Community Rail Partnerships and local development strategies

28. There should be scope for micro-franchises or sub-contracting on rural routes using models promoted by ACoRP and the Community Rail initiatives. Potentially there could be a number of “units”, for either a single branch or groups of lines, where local authorities and businesses could be involved with promoting use and giving some support, including bus integration.

29. At the simplest level, the success of the Stourbridge trial using the Parry railcar is noteworthy. In cases where branch operations can be isolated from a main line or if signalling were suitably modified, this unit, or some of the continental tram-train vehicles, could work safely to carry smaller short distance flows more economically and trials should continue.

30. In Greater London, relatively few branches come into this category. However local authority support gave a big lead to promoting improvements on the Gospel Oak to Barking Line. Smaller branches like West Ealing to Greenford and Romford to Upminster could benefit from local initiatives.

— How does the Government and DfT plan to help develop and take forward local initiatives?

P. What criteria and processes are used to determine the nature and length of franchises?

31. Policies on franchise lengths has changed over the last 10 years (sA3 above). Sir Alistair Morton wanted greater operator involvement, with a commitment for investment from the TOC through “Special Purpose Vehicles”. However it appears the more cynical view of certain Treasury staff and advisors may have prevailed to play down the role that TOCs may have in producing major investment projects, other than for Chiltern’s 20 year franchise, which follows the Morton model.

Q. What criteria and processes are used to evaluate franchise bids?

32. It is still unclear from the DfT’s own guidance as to what weighting is given to particular factors. We do not have the relevant information to answer this in detail. There is still too much emphasis on the financial aspects, including costs, subsidy and premiums, with both the DfT and the TOCs looking at the “bottom line” before delivering the public service people want and will use.

— Why is there such a lack of transparency in the bidding and evaluation process, and what issues are actually evaluated and compared in the process to ensure delivery of a quality public service?

R. Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

33. Both passengers and the wider public perceive an administrative and industry structure that has pushed up unit costs and then charges very high fares to cover them. This perception of rail travel is the subject of much criticism from the media, politicians and opponents of rail investment.

34. This is an issue where successive reviews by both the Transport and Public Accounts Committees have expressed concern at spiralling costs within the industry. While some criticisms are not justified, the franchising process is still not giving best value.

S. Are risks suitably apportioned between the Government and franchise holders?

35. Again the 2004 White Paper was not clear on this issue and now each franchise has different elements. Therefore without publication of the analysis of the bids, it is difficult for a user body to give an informed answer on risk taking, except that this should not cause fares to rise.

— What risks do the Government and DfT consider should be borne by the franchisee and does this risk-taking impose additional costs which a bidder may recover in their revenue stream?

T. What is the scope for improving services through franchise agreements?

36. This is increasingly limited given the position set out in the White Paper of bidding to a “... defined timetable ...” This bears out the criticisms of the GW franchise where the DfT’s micro-management has impacted on service cuts throughout the network.

37. Others will comment on the very unsatisfactory situation in Devon and Cornwall, where some journeys to and from work or school have been made more difficult. However even in London, there are still stations such as Hanwell with only half hourly services for most of the day, and little scope presently for even TfL to pay for extra services. This is unsatisfactory.
38. Presently the only significant plans for service improvements are coming from TfL. It is interesting that Government Policy is now moving towards a position proposed by Railfuture. In 1999 a Railfuture member drafted an amendment to the GLA Bill, which was debated on an opposition motion, on behalf of several lobby groups, proposing that:

"...Transport for London shall prepare annually a Greater London Franchised Rail Network Service Plan in which it will give directions relating to the provision of railway services operating entirely within Greater London and also those railway services that operate and serve railway stations predominantly within the Greater London area but continue on to destinations up to 15 miles from the Greater London Authority boundary and to Stansted Airport..."

39. This principle was discussed but regrettably not then adopted, however the original provision for the Mayor and TfL to give “guidance” became “directions and guidance”, which had a rather stronger meaning. This role has developed steadily over the last six years.

— What is the scope for improving services by agreement with either regional transport bodies (TfL and PTEs) or TOCs? Are such initiatives given full evaluation with appropriate consultation rather than being dismissed by the DfT (and previously the SRA)?

U. Do we need more competition and vertical integration and track operation?

40. With all public transport, service integration is more important than competition. But vertical integration will be problematical while the operational side is fragmented. In a genuine open access situation, vertical integration becomes more problematic, but historically this was not impossible when revenue was allocated manually through the Railway Clearing House.

41. It is disappointing that the Merseyside initiative to maintain their “Electric” network has not gone forward. This seemed an obvious common-sense workable test bed. Merseytravel could set their agenda for infrastructure maintenance and improvements to their system. Since so little other traffic uses the Merseyrail Electric lines, transfer is still a sensible option. This could show how the system might operate, firstly on a lease-management basis, with full transfer of ownership a possibility for the future if the arrangement worked satisfactorily.

42. This aspect should be fully evaluated as TfL maintains some route infrastructure used by Chiltern Railways over the Metropolitan line. This could be a sensible way forward for some parts of the proposed North London Railway operation, eg the local Watford DC lines.

V. Is franchising compatible with open access operations?

43. The debate whether open access for passenger operations is (or is not) desirable continues. Franchising seems incompatible with Open Access, but the present structure has thrown up one major success, Hull Trains, which found a major gap and a new niche in the market.

44. Apart from Hull trains, few ventures have endured, like Rugby to Brighton, and some worthy ones have been strangled by either the SRA or DfT. Anglia’s Cross-London Link served another niche market that could not be made conveniently on existing services, including some commuter trips.

45. If the recent GNER versus Grand Central debacle demonstrates anything, is it unreasonable to expect bidders to bid confidently for franchises if they have to allow for the un-quantifiable factor of an open access bidder? However a more sophisticated revenue allocation and ticket collection system could allocate fare revenue to the open access operator and the incumbent franchisee in a more equitable way. This is an issue for the industry to resolve.

46. Offering paths to Grand Central to serve Sunderland and the Durham Coast shows one omission from the larger Inter-City type franchises. There is no obligation in their basic contract to serve communities fully within their “region”. Latent demand is not being met at many places where an existing inter-city TOC is the core service operator towards London.

47. There is genuine concern that GNER has not developed and served potential markets “just off” the East Coast route and provided trains to meet that latent demand. The Virgin West Coast franchise similarly neglects the needs of Telford and Shrewsbury, also Blackpool and Barrow in Furness for direct services to London.

W. Could train, rolling stock and track operation (see U40–42 above) be more integrated?

48. Integration between RoSCos and TOCs is probably incompatible with franchise operation as Stagecoach found in their decision to dispose of Porterbrook Leasing. There surely must be scope for better regulating the role and charges of RoSos. Policy must ensure there is an effective transfer or cascade of rolling stock to provide adequate capacity, from the rolling stock that is available, to meet passenger demand. This is not being achieved at present.
49. Reducing the leasing cost of older vehicles is one area where the DfT clearly requires a strategy to assist franchisees to procure suitable stock to deal with peaks. The use of older diesel locomotives and coaches may seem incongruous, but this practice was often used by British Railways to make the best use of available resources. The present franchised TOC to RoSCo relationship inhibits this.

50. It is interesting to hear that TfL is exploring ways of procuring stock in a more cost effective way for its own service network development, possibly by setting up its own Social Enterprise RoSCo. Many have suggested the Government might sponsor a “Network RoSCo” set up, taking on older stock that is fully written down but not life-expired, which could provide low-cost vehicles to facilitate provision of marginal local services or provide additional peak capacity.

X. Conclusions

51. Many problems remain with the franchising system, from uncertainties about open access to making realistic projections of future revenue streams. Fragmented organisational structures mean that costs are still not under control, and the cloak of “commercial confidentiality” means that even Government, MPs and civil servants may not be getting the full facts about costs and expenditure.

52. The original franchise map was based on old BR operating area cost centres, set up hastily in the 1990s to fulfil an ill conceived political remit to privatise the railway system. Experience has shown the goal of cutting costs to reduce and even eliminate Treasury support has failed. The present structure, which embodies franchising as a core principle, seems to perpetuate this fundamental flaw.

22 June 2006

Witnesses: Mr David Blainey, Chair, Rail Sub-Committee, Mr Kevin Williams, former Chair, Association of Transport Co-ordinating Officers; Mr Colin Foxall, Chairman, Mr Michael Hewitson, Senior Policy Adviser, Passenger Focus; Mr Peter Cousins, Member of Passenger Committee, and Mr Richard Pout, Secretary, Railfuture, London and South East Branch, gave evidence.

Q103 Chairman: Good afternoon. Could I ask you to identify yourselves for the record?
Mr Pout: Richard Pout, Secretary of the London region of Railfuture.
Mr Cousins: Peter Cousins, acting Secretary of Railfuture’s Passenger Committee and also a member of the West Midlands branch.
Mr Hewitson: Mike Hewitson, Passenger Focus, Senior Policy Adviser.
Mr Foxall: Colin Foxall, Chairman, Passenger Focus.
Mr Blainey: David Blainey, Chairman of the Rail Sub-Committee of the Association of Transport Co-ordinating Officers. Could I just say I have got a problem in that I said when I said I could come that I had a prior meeting with the North Wales MPs at 4.30, so could I do a swap with my colleague, Kevin Williams, at half past four?

Q104 Chairman: They are a very ferocious lot, the Welsh MPs, we would not like you to come to a bad end.
Mr Blainey: Yes, I know.

Q105 Chairman: Would you like to sit at the table and identify yourself?
Mr Williams: I am Kevin Williams, I am the former Chairman of the same group.

Q106 Chairman: So you are going to box and cox for a minute. Does anybody have anything they want to say to start off?
Mr Pout: May I just make a very quick observation. I am also a member of the Institute of Logistics and Transport Strategic Rail Group and I believe they are seeing you next week. I have seen their submission, although I have not been a party to it, and I am aware of the work that has been done by Professor Chris Nash through that group.

Q107 Chairman: Thank you, Mr Pout, that is helpful. In what way is the current franchise system better than a unified state controlled railway system?
Mr Foxall: I think it is very difficult for us to judge. It is difficult to know what we are comparing. The present system is an opaque one, it is very difficult to know what is in those franchises, how they are run and precisely how they are negotiated. What we do know about the present system, at least so far as passengers are concerned, is that until very recently there has not been a direct interest fed into the process of determining franchises by any passenger organisation. We have recently been, I suppose, elbowing our way into that process and trying to get more consideration for what passengers want.
Mr Blainey: I think it would be fair to say that the current system has introduced a degree of innovation that perhaps was not there before. Again, we do not know if that would not have happened anyway, but I think it would be wrong to say there have been no improvements and certainly getting down from Chester in two hours is something that you could not have done prior to the present franchising system coming in. I think you have got to recognise that there has been some innovation, some new thinking, which is of benefit.
Mr Williams: There have been innovations indeed, but I think one of the problems is the involvement of users’ organisations like us, who are now delightfully called the third sector. There is very little involvement with this third sector, whether it is the funded third sector or organisations like ours which are entirely subscription-led.
ourselves are not in the statutory lists of consultees, which you find in the back pages of the franchising documents. There are very few of those kinds of organisations and the only one I have consistently found is ACoRP, building on the work that was done by Paul Salvesen. Whether this can be developed regionally, through the role of transport user forums, and I say this with greatest respect to Colin, obviously the demise of Passenger Focus in its regional network creates problems. They are doing their best with what they have got but regionally there is a very serious problem with consultation. There are a number of examples that I could give you.

Q108 Chairman: Mr Foxall, is there any difficulty with the business of not having the regional set-up that you had before?

Mr Foxall: I would not say there is in the sense that we have passenger link managers all over the country and they have links with those organisations. Clearly it is not the same as it was before and we have never claimed that it would do exactly what was done before. Those passenger link managers, for example, and Passenger Focus at its centre, have been organising wide and proper market research and analysis on what customers have wanted on the Cross Country, on East and West Midlands franchises, and produced that information, and that information has gone into the DfT and we have had extensive discussions about it. I am not claiming it is perfect but—

Q109 Chairman: You are saying it is a different format?

Mr Foxall: It is a different format and I have substantial evidence that we are inputting. I am not arguing we have been listened to but I am arguing that we are putting information in.

Chairman: Mr Foxall, you and I both know that getting yourself listened to is rather different from actually getting the chance to say something.

Q110 Graham Stringer: I cannot resist Mr Pout’s lead-in. I would ask him to give the Committee his interpretation of whether Professor Nash’s work about the costs of the franchises should be taken seriously?

Mr Pout: I do not have that much experience in dealing with that aspect of the industry, I am more a users/consumers’ representative, but, from what I have seen, there does seem to be a very serious problem over the increasing levels of cost but without necessarily that being translated through to service delivery.

Q111 Graham Stringer: I am going to paraphrase the case put by the train operating companies. They were saying, “We are getting more efficient, the reason the costs are going up is because the increased costs of transport infrastructure is being put on to us”. Do you think that is fair or do you think there are inefficiencies within the train operating companies which in themselves are contributing to the cost of £5 billion to the Treasury which the railways are costing us all at the moment?

Mr Pout: As an economist I would say that the present structure reduces economies of scale, therefore there are certain diseconomies from the fragmented organisation of 22, or however many it is these days, railway operating companies as opposed to 12 years ago when there was one and it was called British Railways, which for all of its inefficiencies achieved very important economies of scale in certain areas. Now with rolling stock refurbishment the same train can go through two different workshops and have two completely different refurbishment packages, so there may not be those same economies. They may be done at a reasonable price, they may be getting reasonable value for money, but I do not see the same structures within the industry achieving the best value necessary for however many companies it is now. Is it 15/16?

Q112 Graham Stringer: That is a reasonable qualitative answer. Would you be able to quantify the cost of that inefficiency into the system as a contribution to that £5 billion or is it just a gut feeling that is how systems that are this complicated always operate?

Mr Pout: I have not got that knowledge, Mr Stringer. Ask Professor Nash or my colleagues from the Institute when they come.

Q113 Graham Stringer: A final question along these lines, and it is one I asked the train operating companies, is the opposite argument to the economies of scale. What people in Merseyside are saying is, “Give us the choice locally and we will take 33 million out of the costs”. Do you think that is a reasonable assertion?

Mr Pout: Yes, I do. Again, this is from my own personal knowledge of Liverpool. This is an example that is rather like a small version of London Transport. It is a very specific type of operation with one or two types of trains and, therefore, it can be maintained to meet a local need. There will be exceptions to the rule, so I would hope the Committee, as you move on, will look into that one. I think that is one case where vertical integration could work and Merseytravel could achieve savings. I have certainly put that in my evidence and I think colleagues have as well.

Q114 Mrs Ellman: What would you say is the ideal length for contracts, the length of time they should be let for?

Mr Blainey: If I could start. I think it needs to be a long time, maybe 20 years, to give the incentive to invest money with the opportunity to make a return on it. Within that 20 year period you need to have, perhaps every five years, a review to make sure that the franchise is working and that the train operator deserves the extension for the remaining period. I think ATCO would favour a longer rather than a shorter franchise period.
Q115 Mrs Ellman: What other views are there?  
Mr Foxall: I think it is difficult to see the sort of average franchise period coming down, being shorter, producing a satisfactory railway from the point of view of the passenger simply because if you think of the number of things that would change, you could imagine the fares systems might change, bits and pieces of timetable might change, and if you do not change those things and shorten the process what you let is a management contract and that is a different thing. I suspect where it is now may well be reasonable. The arguments for a longer franchise are there partly because of investment experience with someone perhaps who is doing well, but it only works if you have those reviews. Whether a five year review would be too soon or not, I do not know, but the review is an important part of the process in any longish franchise.

Q116 Mr Leech: I think a number of you were in the audience when we had people from the train operating companies. They were not asking for 20 year franchises. Why do you think they were suggesting that the optimum period was 12-15 years?  
Mr Foxall: I do not know and I cannot guess. It is their business. If you ask me to guess I would suspect it is because it gives them an opportunity to change arrangements which might or might not be satisfactory to them and gives them a chance to move on and renegotiate. From one point of view, I am not sure I think 20 years is a good idea either because people get stale and there is a good reason for changing them. If you do think 20 years is good for any reason, if you are convinced that there is an investment argument, and there is some but I think I agree with Members of the Committee who are questioning how high that is, but there is some, you definitely need the reviews in the process, it would be wrong to go ahead without those reviews.

Q117 Clive Efford: What should determine the length of the contract? I would be interested to hear the views of others about what we would miss out on. You started to say fares, Mr Foxall, but what would we miss out on if the contracts were shorter, bearing in mind that the investment is in rolling stock that would outlive the lifetime of the contract, it is not owned by the train operating company?  
Mr Cousins: One of the problems with a short franchise is that there is inevitably a period at the end when the company ceases to invest. One of the things that we as passengers expect to get from a rail operator is continuing investment in refurbishing rolling stock and in refurbishing stations. They are obviously not going to get very much back for their money in the last year of a franchise, or even the last two years.

Q118 Clive Efford: Could you not specify that in the contract so that you would not allow that pattering off of activity or investment?  
Mr Cousins: It does not seem to work that way. I think we can appreciate that it would be difficult to transfer an appropriate value with that investment on to a new franchisee who might want to do things differently.

Mr Foxall: If you change the leasing arrangements with the ROSCOs maybe you could create the sort of situation so you effectively deliver to the train companies the kit they are going to use in a refurbished state. What I think you end up with then is a management contract. If they are in the business partly of specifying the kind of trains they want and the standard of refurbishment they want and so on, I do not want to end up speaking for them—there is a danger of that—if you are not careful they get such a short period to amortise that in terms of the relationship with the ROSCO the annual price goes up too high.

Chairman: I think they made that argument. I want to come back to Mrs Ellman.

Q119 Mrs Ellman: How common is under-bidding where companies submit bids that are too low and then renegotiate?  
Mr Hewitson: We do not get that type of information so it is very difficult for us to know. We do talk to bidders and bidders are very interested in getting our views but they are rather constrained and unwilling to let too much out in return. Some of the evidence of train companies getting their cost base and their assumption wrong is well-documented; the question is could that have been avoided. Some of the first round franchises were bid on the assumption of a static, declining railway and look what has happened. It is very difficult sometimes to look into the future.

Mr Pout: We have only got to look at Mr Efford’s home patch and the famous case of Connex, who simply did not deliver and went back twice cap in hand, and in the end Mr Bowker said “enough is enough”. This was a case where they just did not realise what the revenue flow and their costs were going to be. That impinged on passengers where there were appallingly poor declines in service and the condition of the stock, with both the franchises that Connex operated. They were dire.

Q120 Mrs Ellman: The operators have told us that the current system has led to a better service for passengers and more innovation. Do you see that in terms of the passengers that you represent?  
Mr Foxall: There is some evidence, but only some evidence. We have evidence of standards being set for stations and so on, but we have to bear in mind in this when we are talking about franchises—my colleagues have mentioned it—there are lots of different styles of franchises from the very first to the current ones. There is some evidence of improvement but it is hard to say that those improvements would not have arisen in other ways in other circumstances under other systems, but they are undoubtedly there. On the other hand, there is evidence of other difficulties arising. If we look at the high premium franchises that are now in vogue that
have been put in place, they are clearly putting under pressure benefits that passengers are going to get. They are putting fares under pressure. The Chairman raised the question of the car parking charges, a very good example of something being put under pressure. Car parking charges have been raised and the train operating companies have said absolutely openly to us, and they have said to you, "We have to do that because that is part of the consequence of a high premium franchise". We have seen some benefits and we have seen some disbenefits.

Mr Blainey: I think I would agree it is very dependent on the franchise. There are good franchises where things have improved but we still have a lot of stations with very poor security, poor lighting, lack of information, poor car parking, and very often it seems that it is left to the local authorities to find the funding to improve those elements because the franchise operators say they have no money to do that.

Q121 Mrs Ellman: Do you think that the PTEs or local authorities should have more involvement in the specifications?

Mr Cousins: We have benefited very greatly in the West Midlands for the last 20 years from Centro's involvement. They have invested a great deal of money in refurbishing stations and providing access to their stations throughout their region to the extent that there are now very few stations that are not up to a good standard. They also specify staffing ratios and that staff should be on duty from the first train to the last train. As soon as you go outside the old West Midlands' PTE area, which was the West Midlands County originally, that starts to change. The Shire Counties have not had the funding to invest in a similar manner and, sadly, the train operator has not been able to keep in step either. Parking is a particular problem because as you go over the boundary you hit car park charges for the first time and the result is that people just go over the boundary you hit car park charges for the first time and the result is that people just go over the boundary driving miles farther than they need to.

Q122 Chairman: Was it Mr Blainey who said something just then? Do you want to come in?

Mr Blainey: I did, but I cannot remember what I wanted to say now!

Q123 Mrs Ellman: How do you think passengers could have a greater input into letting franchises or specifications? Do you think it is time to let passengers have a louder voice?

Mr Foxall: What we wanted to do was exactly what we have done, which is do research on what passengers want, ask them what services they want, ask them how the current franchises are working, survey their priorities and get those into the franchise process. I would like to see us become more involved in that. I do not want to get to the point where I am getting involved in negotiating a franchise because that is not our job and it is dangerous for us to get into that area, but I think it is important that we should be a major consultee. I think it is true that we have been encouraged to become that, so we ought to give some credit to the new system, that is there, and I hope it works out in practice and I hope it works out more and more. We have to have the funds to do that and we have to have the invitation or the access to do that. We can help in that way. I think this is very important: we are very ready to involve the other groups. Passenger Focus is a focus, that is the point, so we can focus what the other groups are saying and help to get those messages through. I am all in favour of getting passenger groups more involved in specifying franchises, after all that is the purpose of the franchise, it is to deliver services to passengers.

Mr Williams: Basically, from the local authority perspective in the Shire Counties we do have a perspective on passenger needs because we are consulted by the Department for Transport on the franchise specification, but it goes no further than that. We do often act as their eyes and ears out in the regions where they do not have that sort of information, yet we still cannot specify it unless we are prepared to pay for that ourselves, which seems bizarre. We do not want to get involved in the actual letting of the franchise completely but we do not have any extra locus even though we put money in the system.

Q124 Chairman: The same point?

Mr Pout: No, slightly different insofar as the DfT appear to do rather less consultation work within England. My Welsh colleagues are telling me that they have been far more positive under the direction of the Welsh Assembly towards specifying and consulting in those areas rather than in England. Again, it may be a route the transport user forums which are being set up informally can use, to ensure that they have some recognition, so there is a channel through which to work. At the moment there is no channel.

Q125 Mr Leech: I just want to ask Mr Foxall whether or not his involvement in talking to passengers about things in relation to new franchises has made its way into any new franchises yet and whether he thought that the involvement he had would make a positive difference in terms of the franchises that are going to come about in the future?

Mr Foxall: It is difficult to say. I would have to not do it and then compare. There is no control, so I cannot be absolutely certain. I think there is some evidence that the answer is yes, it has, but how much I do not know. So far it is encouraging.

Mr Hewitson: The two that we are focusing on is the Midlands franchise and, of course, Cross Country that are ongoing, so it is almost too early to say. We will know when we see what we have listed as the priorities reflected in the new franchise, then we will be able to assess.

Chairman: Gentlemen, where you agree I would be very grateful if you would not repeat what somebody has already said.
Q126 Mr Leech: Have you actually been receiving any positive feedback from the Department?

Mr Foxall: Yes.

Mr Hewitson: Yes.

Q127 Clive Efford: It has been argued that risk has not really been transferred from the public sector to the private sector under rail franchising. Do you agree with that?

Mr Foxall: There is a limited amount of transfer. You were right to draw attention to the arrangements which protect the companies in certain circumstances, although we do not know in detail what those are or how they work out. Clearly there is a transfer of some risk. They run a certain level of commercial risk in terms of the volumes that they attract and so on in normal circumstances, and they gave the example of 7/7, so clearly they bear some risk. The amount of risk they bear is going to be commensurate with the amount they are going to invest and the amount they are going to get out of the whole thing, and until we can expose that whole we cannot judge how much risk they are properly bearing.

Q128 Chairman: Mr Pout, do you want to add to that?

Mr Pout: No, thank you.

Q129 Clive Efford: Does the ‘cap and collar’ scheme place too much revenue risk on the public sector? Do you have a view on that?

Mr Foxall: No, I do not. What I cannot tell you is how much risk the government is seeking to avoid by putting the collars there. It works to the advantage of both parties in a sense.

Q130 Clive Efford: We have been informed that £23 million has been handed over to the train operating companies to compensate them for industrial action. Is anyone aware of money being paid to them to indemnify them against loss due to industrial action?

Mr Pout: No.

Mr Hewitson: No.

Chairman: Someone is walking away with a lot of money. It is quite interesting that none of you know who it is.

Q131 Mr Goodwill: To what degree are there differences between the level and standard of service and prices between routes where a number of franchisees are operating in competition either on the same track or between the same locations, and other routes where there is in effect a virtual monopoly where one franchisee has control over that route to a greater or lesser extent?

Mr Hewitson: There is some competition on the Brighton Main Line, Gatwick Express, Thameslink and Southern. There is a common fare structure, so they compete largely on train company specific prices. Certainly we have seen new fares come in because of that. It is an advantage to those passengers who can get hold of them but it has made a very confusing fare structure down to Gatwick. It has its pluses and minuses. Because we have a regulated fare structure it is quite hard to plan some of the impacts of competition. It does tend to create this Apex, pre-book type ticket culture and you can get some really good deals, but you can get some immense complications as well.

Mr Williams: I would endorse that but also add that some franchisees are more focused towards increasing their patronage and not just trying to get as much money out of the commuter or business passenger. I am from Derbyshire County Council and we have had instances of people driving from the West Coast Main Line on to the Midland Main Line to save themselves £50 difference in fare from a similar distance from London.

Q132 Chairman: Did they actually give you a detailed breakdown of the cost or is this done on the basis of what the petrol cost is as opposed to the real cost of motoring?

Mr Williams: I think it was down to the petrol cost rather than the real cost.

Q133 Chairman: But it was a genuine case of people saying they do that in order to save 50 quid?

Mr Williams: Yes, absolutely, but people are very fickle and they have gone back if the fare structures change, of course.

Q134 Chairman: Can I ask you very quickly: Railfuture Northeast has argued—this is particularly for Passenger Focus and ATCO, of course—the financial returns to Government of certain franchises represent an excessive extraction of money from the railway. Is that right?

Mr Foxall: It poses a risk and a threat because it poses a risk in terms of the pricing structure, the fare structure and overcrowding. I cannot say whether it is excessive or not, but what I can say is that it poses a threat because if you have to deliver premiums they have to come from somewhere and the only place they can come from is by cutting back on costs, and we have heard that quite a lot of their costs are fixed in terms of the ROSCOs and Network Rail, or increasing their charges. The revenue opportunities are relatively limited in the sense that once a train is overcrowded it is overcrowded.

Q135 Chairman: What is your alternative to that, Mr Foxall?

Mr Foxall: The alternative clearly, it seems to me, is that we concentrate on relieving the overcrowding. That is where pricing off in order to resolve overcrowding is something that we are very obviously opposed to. We are realistic enough to know that you have to manage demand to some extent; that is understandable, but going for a crude policy of pricing off is something we would oppose.

Q136 Chairman: And you think there is clear evidence that the companies do that?
Mr Foxall: There is enough evidence to make you think the companies could be doing it. I think it is too soon to say they are certainly doing it. They have made it quite clear that discounted fares have been withdrawn during periods because of the overcrowding. That is clear enough.

Q137 Chairman: They have also withdrawn some fares during times when presumably the trains were not overcrowded. Have you got evidence of that?

Mr Hewitson: The withdrawal of cheap day tickets from First Capital Connect services blankets trains that are crowded and equally trains that are not so crowded, so it is a rather blunt measure at times.

Q138 Chairman: Mr Williams, did you want to come in on that?

Mr Williams: I just wish to endorse what the gentleman on my right has just said but also that there are certain issues that we have highlighted before which are not regulated by the Department for Transport, such as car parking charges, and then you do see the excessive increases on those car parking charges brought in because they are not regulated by anyone.

Q139 Clive Efford: This brings us back to the question of who we subsidise the railway for. Do you think that the Government should be more specific around issues like discounted fares in the contracts when they issue the franchising?

Mr Foxall: We would want the Government to make sure that the nature of the railway we have is not changed by all kinds of factors like overcrowding. There is a danger the railway will be changed. If discounted fares start to disappear on a walk-up-and-go basis that will change the nature of the railways. The answer is yes, I think we need to be clear. I would like these sorts of arrangements to be more transparent and I would like us to be clearer about what we are trying to achieve. There is a danger after all surely that the Treasury will be able to get more money out of these franchises and less will be delivered to customers. If we are clear this is a public service being delivered privately let us leave it like that.

Q140 Chairman: The department has actually indicated in the pre-application process that they give 70% weight to track record, 25% to plans for mobilising and operating the franchise and 5% on the applicant’s approach to bidding. Do you think that is a correct way of looking at it? Are those the right percentages?

Mr Hewitson: It is difficult to comment on the precise percentages, but certainly every survey that I have ever seen of passengers puts punctuality performance top of the list, so I think it is quite right to factor it very highly in terms of the bidding process. There has certainly got to be a lot of scope in there for innovation as well in new services and new products.

Q141 Chairman: Should there be greater emphasis in the criteria on bids for innovative proposals?

Mr Hewitson: It depends to a degree on the amount of flexibility in the specification process. If you are being asked to cost a fairly tightly defined list of services it is very hard to add it in. If you have got a bit more flexibility, if the departments are generally willing to look at spending a little bit more money up front to get some benefits down the line, then yes, we should factor it in.

Q142 Chairman: So do you think newer companies are being excluded because of the emphasis on track record?

Mr Hewitson: If you look at the core companies that are bidding there are very few. Whether that is because there are barriers to entry or whether it is because other companies do not see it as a good enough return is very difficult for us to say.

Q143 Chairman: Do you accept these suggestions that their costs are between £2 million and £5 million to bid for a franchise?

Mr Foxall: I would not be surprised at those figures personally but that is speaking from experience of other fields of business. Can I just add to this point that you were following earlier? I have got here a quote from the SRA. I will not read it out but the substance of what it says is that the SRA, when reviewing its franchising policy, concluded that the policy of relying on commercial incentives to encourage TOCs to improve the quality of passenger services and station services and so on was not going to work and you had to put them into the franchise and had to specify them. I do not stand that up or anything, but it seems to me there is one piece of evidence. People had looked at it before. In other words you do have to specify what you want in the franchise. I think there is a danger to which my colleague has just drawn attention in terms of innovation. You pay for it in other ways.

Q144 Chairman: Do you accept that there is a fear of legal challenge and that has contributed to the spiralling costs?

Mr Foxall: I have no way of judging, I am sorry.

Q145 Chairman: No impression?

Mr Pout: No.

Q146 Chairman: Do you think it is true that these bidders often spend £2 million on consultancy fees?

Mr Williams: That is probably quite true, or partly true in relation to some of the issues they wish to bid for, and they do have to set up franchise bid teams to go through all of these—

Q147 Chairman: It is not quite the same as using large numbers of consultants, is it? If that really goes on consultancy fees alone it is not really surprising that the franchise bids cost so much money.
Mr Williams: No.

Q148 Chairman: Have you got any evidence of that through ATCO?
Mr Williams: No. Unfortunately, those costs are not exhibited by the Department for Transport after the process has been completed, so we do not get anything evidential in this at all. It is just anecdotal.

Q149 Chairman: Do you think risk has been transferred from the public to the private sector through the franchising?
Mr Williams: A limited amount, yes.
Mr Pout: A limited amount.

Q150 Chairman: Mr Pout—a limited amount? Do you want to try and quantify that?
Mr Pout: A limited amount but only where an operator is allowed to experiment with a new service. Chiltern, for example, did take a risk in developing their competing service to Birmingham against the parallel operator which was the long established one, for better or worse. Therefore, they have taken some level of risk but there again they have a 20-year franchise in which to bring the money home. With a shorter franchise there will be less risk, and if we go to something like the proposed North London Railway contract, that will almost certainly be a management contract rather like the DLR arrangement that TfL have already, so there may be very little risk to put into that.

Q151 Chairman: Does the current system provide adequate co-ordination between specification and award of franchise contracts by the department and the open access rights that the ORR has responsibility for?
Mr Pout: That I think is very difficult to judge. Because of the sub judice over one case we can only look at, say, an existing successful case, which is Hull Trains. That has delivered a very good service to a city which I spent three years in and it was a nightmare to get there, particularly from the south. I think Mrs Ellman did slightly better from Manchester, but it is not an easy place to get to. Therefore, if it is fulfilling a specific demand then open access can help, but at the moment it is still a very grey area in that users do not know what criteria the ORR or the department may apply. There are a number of comments in various of our evidence to comment on this, that it is still a very grey area. We do not understand how it works either. Does the department?

Q152 Chairman: I want to know whether you think the department has enough people monitoring the work of the various companies.
Mr Williams: No; only on the basis, it seems to me, that the monitoring seems to be very London based. I am not aware that the department has anybody out in the provinces checking—

Q153 Chairman: Perhaps you did hear before, Mr Williams, the evidence that they seem to think they are being called in on a regular basis much too often and are being required to give too much detail. Does that seem to chime in with your experience?
Mr Williams: No. It may be on other factors of the train operators.

Q154 Chairman: I want to know whether you think the department has enough people monitoring the work of the various companies.
Mr Williams: No.

Q155 Chairman: Mr Foxall?
Mr Foxall: I think it is difficult to judge. The answer to this is that we would like to see the department monitoring those things which it can easily monitor, the sorts of things that are specified in the franchise. That is a good thing to monitor. I think the difficulty comes in, and I would have some sympathy with the TOCs, when you get to micro-management and day-to-day services because I am not really convinced—and I run the risk of arguing this with the Secretary of State later on—that politicians are best placed necessarily to run the railways. I think it is a good thing that the railways should be run by people who understand running railways and when it comes to day-to-day running of them it may not be a good idea for politicians to get involved day-to-day. In terms of monitoring the things in franchise, I think we would like to see that followed up more vigorously.

Q156 Chairman: That is interesting. To what extent does an artificial distinction between long distance and regional franchising lead to omissions, if you think of something like London to Middlesbrough or Shrewsbury or Sunderland?
Mr Pout: Very seriously. There is no doubt about it, that certain regional centres are not well served. We cannot talk about the North East, but again it is back to Hull.

Chairman: Gentlemen, you have been very helpful and I am very grateful to you. Thank you very much for coming.
Wednesday 12 July 2006

Members present:

Mrs Gwyneth Dunwoody, in the Chair
Clive Efford
Mrs Louise Ellman
Mr Eric Martlew
Mr Robert Goodwill
Graham Stringer

Memorandum submitted by Merseytravel

INTRODUCTION

Merseytravel believes that the Transport Committee’s inquiry into passenger rail franchising is necessary and timely. With the Department for Transport now taking responsibility for the awarding of franchises, and three new franchises being recently issued, it is important that current best practice and the experience of other franchises are used to better inform new franchises.

We very much believe that the model advocated and managed by Merseytravel offers some valuable lessons for the rest of the Industry. Only through innovation will the highest level of service, security and value for money fares be delivered to passengers.

ABOUT MERSEYTRAVEL

Merseytravel is a public body comprising the Merseyside Passenger Transport Authority (MPTA) and the Merseyside Passenger Transport Executive (MPTE), acting together with the overall aim of providing a single integrated public transport network for Merseyside which is accessible to all.

In planning and procuring major elements of the public transport system, Merseytravel funds socially necessary bus services, oversees local rail and bus services, owns and operates the Mersey Ferries and the Mersey Tunnels, provides a range of prepaid and concessionary tickets, produces and distributes timetables, and prepares and implements the local transport plan for Merseyside with our district council partners.

We have a good record of delivery across all aspects of the transport system in Merseyside and have been recognised for our high level of customer care, professionalism and innovation, winning the Joe Clarke Award for PTA of the Year for the second year running. We also recently claimed the Northwest regional “Award for Skills and Workforce Development”, one of a handful of awards announced as part of the British Chamber of Commerce and Microsoft sponsored “Chamber Awards 2005”.

The Merseyrail electrics network covers 66 stations and 140 route kilometres within Merseyside and a further 11 stations outside the County served by Merseyrail services. Over 34 million passenger journeys are made on the network each year. Merseyrail is an electric urban third rail system which feeds into an underground network serving Liverpool City Centre. The network extends as far as Southport, Ormskirk, the Wirral and Chester.

By working closely with the Serco-NedRailways, the operators of the network, we are pleased to have consistently delivered the most punctual and reliable major railway on mainland Britain.

QUESTIONS

What should be the purpose of passenger rail franchising?

The purpose of passenger rail franchising should be to contribute to the development of a single integrated transport network, which is accessible to everyone, delivering punctual services at a reasonable price to passengers.

The record of delivery since services were franchised outside of Merseyside has been patchy to say the least and there have been some high-profile and obvious examples of failure. However, failures can be attributed to the franchising process and the terms of the franchises offered.

After securing agreement from Government, Merseytravel was given control of the Merseyrail electric network franchise, taking over from the Strategic Rail Authority. This meant better prioritisation and local decisions for the railway based on a strong partnership working on the concession.

Merseytravel took a very different approach when offering its franchise for the Merseyrail electrics network in July 2004. We offered a 25 year contract because we believed that it was essential to provide the incentives needed to encourage investment and a level of commitment from the private sector operator.
With a 25-year arrangement in place we have already:

- Achieved 94.2% of trains running on time in 2004–05—making it the most punctual and reliable major railway on mainland Britain;
- Maintained total control over rail fares and have, as a result, announced the smallest fare rises of any UK train operator for the next year in 2005—an average of 2.9%;
- Completed the refurbishment of all the rolling stock on the Northern and Wirral lines;
- Continued to deliver improved facilities and enhanced Park & Ride at stations as part of the Local Transport Plan;
- Installed automatic ticket gates at the five underground stations, as well as Southport and Conway stations;
- Obtained Secure Station Status for 40% of the stations on the Northern and Wirral lines;
- Ensured that every stations is staffed from before the first train arrives until after the last train leaves helping to provide a more secure and welcoming environment for passengers;
- Seen a reduction in the number of attacks on both passengers and staff, the only network to achieve this in 2005;
- Invested in modernising stations including installing lifts and rebuilding ticket offices; and
- Prioritised improving accessibility. Wheelchair users only have to give one hour’s notice to travel on Merseyrail compared with 24 hours elsewhere on the rail network.

We are, however, not complacent. We believe that more can be done and over the next five years will be looking to:

- Ensure that at least 99.3% of scheduled journeys run;
- Increase the number of rail users by 1.3% each year; and
- Continue to improve security, both on trains and on stations.

We have recently opened the “state-of-the-art” Liverpool South Parkway Interchange, Europe’s most modern station, which provides a vital link to the expanding Liverpool John Lennon Airport and we also have plans to electrify the Bidston-Wrexham line and to reopen lines to Bootle and Aintree. All parties recognise the role that rail, and transport more generally, has to play in the further regeneration of Merseyside.

Localised decision-making, tying in with the Local Transport Plan priorities, the Regional Spatial Strategy, the Regional Economic Strategy, Regional Transport Strategy and Northern Way, has delivered new stations which have boosted regeneration and linked the jobless with the jobs. For instance, the new Brunswick station in Toxteth enabled 120 people to take up jobs. Liverpool South Parkway—Merseytravel’s biggest project at £32 million—will provide access to up to 11,000 jobs planned for the area. The eco-friendly futuristic interchange has already won awards and accolades for its design, use of building techniques and its potential contribution to the regeneration of the Speke and Gartson Pathway areas.

The major features of Liverpool South Parkway include:

- A single integrated booking office and passenger information and enquiry point for bus, rail and airport journeys; incorporated bus station and taxi rank;
- High frequency bus shuttle to Liverpool John Lennon airport;
- A 240 space Park-and-Ride car park free to users of the facility;
- A secure and safe environment with CCTV and customer information systems;
- Secure motor bike and cycle storage; and
- Fully accessible facility incorporating 32-person lifts.

The list of achievements, alongside impressive plans for the future, provides a clear demonstration of what is possible if the right relationship is in place.

**How well does the process for awarding franchises work?**

Operators, passengers and other interested parties all have a role in the design of the franchised services. However, we are concerned that without a fundamental look at the way in which franchise arrangements are designed, including the length of contracts, then feedback will only ever lead to cosmetic change.

The Department for Transport, in some of its recent franchises, has been looking to insert requirements demanding secure stations accreditation or minimum levels of station security alongside investment and punctuality. Whilst welcome, we do not believe that these moves go far enough and without the right incentives may simply lead to money being shuffled around the network rather than genuinely increased investment levels.

There is also a danger that franchises are designed to reflect the latest concerns, or political priorities, rather than the long-term future of the rail network and the needs of passengers.
Are franchise contracts of the right size, type and length?

In July 2003 responsibility for the Merseyrail Electrics network was transferred from the Strategic Rail Authority to Merseytravel. In awarding the franchise to operate the system we decided to move away from the existing practice of offering short term franchises. We did not believe that so short a contract would provide the right incentives for private sector operators. We have been proven correct. Whilst the rest of the system has struggled, Merseyrail is now being looked at by Transport for London as a model for its Silverlink franchise.

Many decisions in transport take time to implement, often several years. This is not because of unnecessary delay or deliberate feet dragging but is a consequence of dealing with many stakeholders and a complicated and often high-profile issue. For the “normal” concession holders, taking and implementing one major decision may take most of the life of the franchise. One major project may also remove much of the profit in the franchise agreement. There is a danger that if too many targets are set or too many demands made in such a short franchise, which is currently the norm, then bidders will not come forward. A further danger is that profits are pared down to such an extent that if any unforeseen problems arise then the franchise could, in effect, cease to exist.

However, Merseyrail and Merseytravel attribute their good performance to a combination of factors:

- A sophisticated, long-term, concession agreement which incentivises Merseyrail to perform, and provides the right framework for a stable partnership to develop between Merseyrail and Serco-NedRailways;
- Local management and control of the network replacing remote control from London; and
- Attention to detail, with a host of measures introduced to target a specific reliability problem. For example, we have vastly improved the maintenance of the rolling stock, some of which was inherited from the previous franchise.

Due to the length of the contract we have been able to build and develop a constructive partnership with Serco-NedRailways and this means that we can resolve any problems that arise quickly, with minimum fuss and the lowest impact on passengers. We do not get into a “blame game” which often happens in other areas, we take a joint focus seeking to resolve any problems together.

Of course, with that length of contract we have written in periodic reviews to ensure that targets continue to be met and if performance is poor we retain the right to revoke the franchise.

Within the terms of the contract, we also established a Benefit Share. Under this provision a share of any operating profit generated by Serco-NedRailways in each Performance Review Period, in excess of forecasts, is paid to Merseytravel. This provides Merseytravel with extra resources which we invest in further development of the single integrated transport network.

More generally having contracts of a longer period on offer should encourage more bidders, enhance competition between bidders and, most importantly, encourage more investment and increased standards/performance levels from the bidders. The rising cost of franchises means that money is not available to spend elsewhere, on other aspects of transport. These costs would obviously be reduced if the contracts were for longer periods.

Do we need more competition and vertical integration?

Merseytravel is an advocate of full local decision making (FLDM), or vertical integration, for the rail infrastructure on Merseyside. We have developed proposals under which Merseytravel would set up a joint venture “InfraCo” with Serco-NedRailways to maintain and renew the infrastructure. The aim is to replicate the success of our operating franchise, Network Rail’s operational responsibilities for track and signals would pass to Merseyrail, enabling the InfraCo to work solely on maintenance and renewal, and the train operator to introduce more efficient integrated management.

These proposals were developed in conjunction with the Office of Rail Regulation (ORR) and attempts were made to fully involve Network Rail but they withdrew co-operation in October 2005. Yet despite numerous requests by the ORR, Network Rail has provided only limited information and failed/refused to provide the further information asked for. Network Rail claimed that it did not wish to invest further resources in the project until it was clear that the DfT was satisfied that there was a clear business case. We do not even know what level of investment has been made by Network Rail in the network over the past few years and whether it has increased or decreased. The DfT was kept informed of developments throughout discussions about the Business Case.

We presented the detailed Business Case to the Department for Transport in February 2006 but it was rejected by Network Rail. It appears from parliamentary answers given by Lord Davies of Oldham, that Network Rail has the final say on whether to transfer parts of its network, not the DfT or the Secretary of State despite the Government giving a commitment to examine FLDM in its “Future of Rail” White Paper. In other words, a monopoly provider, Network Rail, has the power to decide whether or not to transfer control of its infrastructure and enable benchmarking which could help achieve greater value for money across the entire national rail network.
Again, according to parliamentary answers, Network Rail was “unconvinced by its (our) case and its (our) figures”. When the FLDM Business Case was submitted it included, because of the lack of detail supplied by Network Rail, a number of assumptions on Network Rail’s avoidable costs. These were discussed and agreed with the ORR who accepted that they were reasonable. It is the role of the ORR to decide on the appropriate level of avoidable costs and since there have been no discussions between Network Rail and the ORR on this then the DfT is in no position to conclude that the Business Case assumptions on avoidable costs are inappropriate.

Unfortunately, Network Rail has never formally replied to our Business Case and if it is “unconvinced” it has yet to tell us why.

The Business Case demonstrated many benefits such as those to passengers including:

— Improved performance (reliability and punctuality).
— Clear lines of responsibility leading to greater control and accountability.
— Confirmed investment and refurbishment of existing assets.
— More responsive maintenance works through shared information and joint training.

The Business Case also projected a net saving of around £33 million over the life of the project in Merseyside alone. FLDM provides clear benchmarking opportunities with Network Rail for the ORR as part of its Periodic Review process. As it is currently a monopoly provider, Network Rail appears unwilling to allow the creation of any body which would help the ORR to evaluate its Business Plans and costs more effectively in the future.

Merseytravel recognises the benefits that Network Rail has brought and works closely alongside it in delivering these benefits. However, we still face:

— Significant failures on the Merseyrail Electrics infrastructure (over 70% of all failures on the Merseyrail system are caused by infrastructure defects which are the responsibility of Network Rail); and
— Duplication of roles between the TOC and Network Rail (which would be eliminated by FLDM).

We are disappointed that Network Rail does not recognise the opportunities that FLDM for Merseyrail would provide for Network Rail in trailing innovations and improved working practices. The ORR sees this as an important benefit of Merseytravel’s FLDM proposals.

Despite this, we will continue to work with Network Rail to ensure that performance is enhanced but we remain convinced of the benefits of FLDM and will continue to champion it.

19 June 2006

Memorandum submitted by NedRailways Ltd

I am delighted that you have invited NedRailways to give evidence in your inquiry in Passenger Rail Franchising from the Dutch experience.

The Dutch have taken a gradual approach to franchising, which is still under development today, with the aim of introducing competition against a background of certainty and stability. This will reduce risk in the market and deliver greater value for money.

For the benefit of the Committee we would draw your attention to the following key issues, which summarize in a broad manner some fundamental differences between the Dutch and the UK’s approach to franchising.

1. Core Network Versus Devolution

Contrary to the UK system, the Dutch have taken the approach of defining a core rail network with one operator to secure the benefits of franchising and avoid the complexities of too much fragmentation. The core network is regarded as socially and economically crucial to the well being of the Netherlands. Government wants to have a clear role in the development and operation of this network, including the High Speed Link to Belgium and France which will be fully integrated.

Apart from the core network the government’s rail policy is to fully devolve powers, including financial control and service specification, to regions and the large cities. This has led to some important improvements, for example:

— Syntus has an intermodal 10 years franchise for the eastern part of the Netherlands. This approach has been successful in delivering better integration of services and delivery so that costs could be reduced, while at the same time passenger satisfaction has been substantially increased. Based on this same model also all public transport in the South has been recently franchised to Veolia.
— Responsibility for two major rail lines has been given to the city councils of Rotterdam and The Hague. These will be converted to light rail and integrated with local tram/metro systems. To accommodate this the major railway station is being redeveloped to offer strongly improved service shaped around local needs.

2. APPROACH TO COMPETING WITH THE CAR (END TO END JOURNEY)

The Dutch government plays an important role in developing end to end journey optimization, which is believed to be the best way for rail to compete with the car. In this respect the government has driven and promoted a number of strategies:

— The government strongly promotes and provides incentives for station development, aimed at short and efficient passenger transfers, coupled to integration with local economic and social needs. Stations are regarded as drivers for regeneration. The tools government uses for this are direct central government investments together with investments by the station facility operator and the local authorities.

— The government has initiated, in close cooperation with all stakeholders, the introduction of a unique nationwide smartcard scheme for all modes of public transport including rail. The benefits will be ease of use for passengers and expected growth of patronage. Introduction will be phased in over the coming three years. The whole development is industry led by a consortium of five parties (including NS as one of the founding fathers) and is a good example of public-private partnership.

3. FRAMEWORK FOR CONTRACTING THE CORE NETWORK

Since the separation of operations and infrastructure in January 2002 the core network has been franchised. Currently NS has a 10 years concession contract running until 2015.

— The contract is a framework contract with an annual specification review which has to be agreed between operator and government. This specification includes investment levels, detailed service specification and improvement targets. This approach allows greater flexibility and stimulates innovation from the operator. This is manageable because of the integrated nature of the core network.

— To support the delivery of this contract the government agrees annually an operations contract with ProRail, the infrastructure operator. Subsequently ProRail and NS agree a track access arrangement which includes charges for the variable costs.

— NS is an investment led company. Levels of investment are demanded by government under the terms of the contract in concert with specific government investment initiatives in infrastructure and certain station and transfer facilities. This culture of investment improves services and capacity anticipating further growth. There is also an obligation to invest in Rolling Stock.

— The concession for the core network is under development. The Government has indicated that it will propose in 2008 plans to introduce competition. The government is looking for a public private partnership approach under which contract flexibility and cooperation between industry groups will reduce the burden of risk on any one party and should encourage innovation and investment.

4. LONG TERM INDUSTRY VISION ON GROWTH

The long term vision for rail as outlined in our submission to the committee in 2003, is a shared strategy for delivering major growth opportunities over the next 20 years both for passengers and freight.

— This industry led strategy offers value for money as through close cooperation it is possible to achieve the targets with 40% of the originally planned investment (€18 billion versus €34 billion).

— The first step of this programme has been executed since 2003 and mainly involves the improvement of reliability of both the fleet and infrastructure (additional government investment is €2.9 billion until 2009). Within this framework NS is also investing in new longer double deck trains (1,500 passengers per train) and regional trains (an investment of €2 billion).

— The second step will be a completely new timetable in 2007 which will deliver additional services through:
  — Simplification from a three tier to a two tier system allowing more trains per hour moving towards turn up and go (six trains between the major cities);
  — Creating independent corridors to increase punctuality and reliability of the services;
  — Introducing “green waves” through the network for freight including in the peak hours.

— These first steps are, with limited investment, the basis for further growth through capacity enhancements.
In summary, although the development of the Dutch system is very much geared towards the specific requirements of the Netherlands, themes such as innovation and partnership, as described above, can deliver value in any market, as demonstrated in our operations in the UK with Merseyrail and Northern.

**FACTS AND FIGURES**

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<thead>
<tr>
<th>NS</th>
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<tr>
<td>Traffic plan</td>
<td>40 KPI’s</td>
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<tr>
<td>Punctuality 2006</td>
<td>92.5%</td>
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<tr>
<td>Income per passenger km</td>
<td>10 eurocent per passenger km</td>
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<tr>
<td>Duration NS concession</td>
<td>10 years, 2005–15</td>
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<tr>
<td>Duration HSL concession</td>
<td>15 years, as of 2007</td>
</tr>
<tr>
<td>Number of stations</td>
<td>390</td>
</tr>
<tr>
<td>Number of passengers</td>
<td>More than one million per day</td>
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**ProRail**

| Duration ProRail concession | 10 years, 2005–15 |
| Network length in kms       | 2,813 kms         |
| Cargo train kms             | 9.7 million train kms |
| Passenger train kms         | 117.4 million train kms |
| Licensed TOC’s              | 10 companies—four passenger/six freight |
| Major stations under construction | six stations |
| Yearly fixed maintenance budget infrastructure | 1.0 billion euro |
| Yearly variable maintenance budget infrastructure (track access charge income) | 200 million euro |

10 July 2006

**Memorandum submitted by Network Rail**

1. Further to the Committee’s announcement of its inquiry into passenger rail franchising, Network Rail would like to take the opportunity to respond. It is not appropriate for Network Rail to comment on many of the issues raised about franchising. However, the Committee has also invited views on vertical integration and Network Rail is pleased to have the opportunity to set out our position on this important issue.

2. We now believe that the industry structure and priorities are largely correct and that this has been borne out by the significant progress made in the last five years. Punctuality continues to rise and costs continue to be reduced.

3. Last year 86.4% of trains were on-time, compared with 83.6% the previous year, and 78.6% when Network Rail took over the railway infrastructure in October 2002. In the last six months, our Public Performance Measure (PPM) has been 90%. Similarly, delay minutes have fallen by 28% to 10.5 million minutes since Network Rail’s inception, the risks from signals passed at danger (SPADS) are at their lowest ever levels, and the company has already made 20% savings against the ORR’s 31% target. These successes have been delivered within the current industry structure.

4. With regards to the Committee’s interest as to whether franchising is compatible with open access operations, we believe these are compatible, subject to the availability of capacity and non-abstraction of revenue. The open access process should primarily be about using spare capacity without undermining franchise operations.

5. As an independent network operator, Network Rail was given responsibility for timetabling, and industry planning as a result of the rail review. This has enabled overall performance and reporting to be placed in the hands of a single body. It also allows us to work with both franchised and open access operators and to help deliver the government’s increased targets for passenger and freight traffic.

6. The Committee invited views on vertical integration of track operator and train running. Network Rail is wholly opposed to this notion. We believe it would undermine current industry efforts to improve performance across the whole of the UK and reduce costs. Moreover, it would fragment the railway just as industry partners are successfully making it work more successfully together. Under the present structure, we operate a closely integrated railway in the key area of daily performance through our Integrated Control Centres. This in itself achieves one of the key benefits of vertical integration.

7. Vertical integration would reverse the considerable benefits a single national network is best able to deliver in terms of developing technical best-practice and asset knowledge, driving down unit cost, and balance the competing interests of different operators including franchisees (and bidders), freight, and open access operators.
8. In terms of technology, our ability to pool the industry’s research and development activity would be severely curtailed and the opportunity to invest in the sort of pioneering technology that has made Network Rail a recognised world leader in remote sensing and rail detection would be lost.

9. In cost terms, the benefits Network Rail is able to deliver in terms of reduced costs are marked. Network Rail obtains significant discounts through nationally negotiated contracts with principal suppliers. The framework arrangements put into place by Network Rail have and will continue to generate significant efficiencies for the company, with £74 million saved in operating expenditure in the last year alone. Vertical integration would eradicate these economies of scale.

10. In a multi-operator environment, vertical integration would be hugely complex in practice. The industry needs a single, central independent controller of the rail infrastructure in order to operate a viable multi-operator network.

11. Vertical integration would also prove hugely damaging to our freight customers. In the past 10 years, the rail freight market has grown by almost 50% and now moves around one third of metal products in Britain and 80% of the stone used for construction in London. With vertical integration, train operators would have no incentive to allow freight operators access to the network and thereby threaten an industry which currently represents 11.5% of all surface transport.

12. Whilst the physical benefits of a single infrastructure company are, we believe clear, Network Rail supports the principle of greater local input in specifying network outputs and increased transparency of activities and plans on a disaggregated basis. However, this does not require vertical integration. It is also possible to achieve the benefits of integration though more effective collaboration between Network Rail and train operators focused jointly on passengers and freight users.

13. In Scotland, some disaggregation has followed as a direct consequence of the devolution of parliamentary power to the Scottish Executive as set out in the “Future of Rail” White Paper in 2005. The ORR conducted a consultation process to determine the best method of achieving disaggregation and noted that although there would likely be an increase in costs, disaggregation was consistent with the higher parliamentary power. However, significant protections were made to preserve network benefits such as a single Network Rail company, retaining one overall debt issuance function and a single Regulated Asset Base.

14. There remain a number of opportunities for the closer integration of rolling stock and track. The management of the wheel-rail interface was separated at the time of privatisation; and this relationship now exists in a way which applies separate financial considerations to the network operator and the train operator. The nature, use, upkeep and maintenance of rolling stock all have a bearing on their impact on the network, and Network Rail will continue to investigate opportunities to input into the maintenance of rail vehicles in order to improve the overall efficiency, performance and affordability of the railway as a whole.

15. Network Rail’s core business is the operation, maintenance, renewal and enhancement of the network. Our decisions are aimed at the long-term best interests of a railway asset base with a history of more than 150 years rather than the immediacy of returns on a seven year franchise. Network Rail is therefore best placed to provide asset stewardship for our national rail infrastructure.

16. We trust that this response provides an informative contribution to the Committee’s inquiry and would be happy to provide further evidence, either in oral or written form.

4 July 2006

Memorandum submitted by the Passenger Transport Executive Group

pteg welcomes the opportunity to submit evidence to the House of Commons Select Committee Inquiry into Passenger Rail Franchising. This evidence is presented on behalf of the English Passenger Transport Executives: Nexus, Merseytravel, Greater Manchester PTE, Metro, South Yorkshire PTE & Centro.

What should be the purpose of passenger rail franchising?

Passenger rail franchising should be the mechanism by which the public sector can specify the standard and quality of passenger rail services it can afford. The process as a whole should secure for the public sector the best value for money rail service that meets both national and local objectives. The process should drive up quality in particular through:

— Improved train service performance.
— Improved quality of train services (in terms of both capacity and quality of passenger environment).
— Improved safety at stations and on trains.
— Improved integration with other rail services and other modes.
— Improved facilities on trains and at stations (including in the longer-term all facilities brought up but to be fully accessible).

It provides an opportunity to import best practice and innovation particularly through allowing private sector operators to make reasonable returns, act commercially and be innovative in delivery mechanisms. The overall aim of passenger rail franchising should be to deliver consistent and improving standards across the network.

**Is the current system achieving that purpose?**

To a considerable extent but with caveats relating to specification and funding constraints.

The franchising process has evolved significantly since the first franchises were developed by OPRAF. They, the SRA, and now the DfT, have had to balance the extent to which services are tightly specified with allowing Train Operating Companies sufficient incentives to exercise innovation. This has led to swings between quite tightly prescribed franchises and the emerging DfT approach which is more focused on outcomes. pteg believes that services in its areas often need a higher degree of specification than elsewhere as the commercial incentive to deliver service levels and quality can be lower. Conversely, for more commercial franchises, such as East Coast Main Line, the base specification can be less prescriptive in those requirements.

The process that the DfT is putting in place through its work on Regional Planning Assessments (RPA), Route Utilisation Strategies (RUS) and the Higher Level Output Specification (HLOS) should lead to greater clarity in what the public sector expects to secure for its investment in the rail network. It will, however, take some time to get these aligned. These steps and wider involvement in the franchising process through the SRA and DfT are leading to better franchises than those that were originally let. The first round of franchising in the conurbations that the PTAs represent led to over-ambitious bids, poor performance and ultimately failure.

The franchising process has to address the inherent tension between national and local objectives. The letting of the Northern Franchise in 2005 illustrates this tension. The basis of its letting was with no additional investment and therefore implicitly on a no or limited growth basis. On the other hand the Local Transport Plans, the statutory planning document of the constituent authorities within the Northern Franchise, contain targets for rail patronage growth which require greater capacity. In West Yorkshire the franchise was without enough capacity to cope with even existing passenger numbers, ie some trains already had more passengers than national standards and some routes were overcrowded to the extent that passengers were regularly left behind. It is likely that such an approach does not lead to best value for the public sector and it is to be hoped that the improvements that the DfT have made, and which are set out above, will be reflected in the forthcoming round of franchises in the West and East Midlands and on Cross-Country.

As referred to above, there is an emerging high level strategic planning framework established by the SRA and reinforced by the DfT which sets out a clearer route for defining franchise specification—Regional Planning Assessments followed by Route Utilisation Strategies which in turn feed into individual franchise specifications. This is a good theoretical process but the problem has been that in practice the process so far has been slow and disjointed. For example, the RPA in Yorkshire and the Humber has only just started and that for the North West has yet to be published. A Route Utilisation Strategy for the East Coast Main Line was started by the SRA, abandoned and restarted by Network Rail, alongside the Yorkshire and Humber and North West Route Utilisation Strategies. The East Coast Main Line franchising process was carried out amid this process. Subsequent to its completion, competing bids for track access have been received and decisions have had to be made without the benefit of any strategic framework.

The ECML access issue highlights a failing of the strategic planning and franchising process. GNER is seeking to provide additional services to Leeds and Grand Central is seeking to fill in gaps in the current service provision (through providing through services between Bradford and Halifax to London). Both of these are priorities to support the economic growth of the Leeds City Region. In part, this situation is as a result of the failure of the franchise specification to properly reflect local needs but it also highlights a significant flaw in the industry planning process. The SRA/DfT has let a franchise yet others (such as ORR) are taking decisions apparently without the benefit of a strategic framework and without reference to impacts on franchises.

There is also an issue surrounding the South TransPennine service between Liverpool, Manchester, Sheffield, Nottingham and Norwich which are currently part of the Central Trains franchises. Merseytravel, Greater Manchester PTE and South Yorkshire PTE all expressed a strong preference for this service to be transferred to the TPE franchise to provide an integrated service on the South TransPennine route. However, the baseline specification it currently proposes is that it is part of the East Midlands Franchise on cost grounds.

Until the Railways Act 2005, the PTEs were co-signatories to franchises in line with our wider transport powers under the 1968 Transport Act and the Railways Act 1993. The co-signatory process has worked effectively to enable PTEs to continue to invest in improving rail services since privatisation. The PTEs
lobbied strongly against the loss of automatic co-signatory rights during the passage of the Railways Bill. We still believe that the proposed new arrangements as outlined in the Draft Guidance Note between the DfT and PTEs will make it harder for us to deliver better rail services.

The management style contract approach, which is effectively what the Northern Franchise has, allowed greater control of cost and some degree of best practice to be developed, for example, Rolling Stock Maintenance. However, the length of the franchise and other aspects do not necessarily create the optimum opportunity for investment. Merseytravel, who have submitted separate evidence, have operated on a different basis. The Merseyrail concession is a 25 year franchise. This has already shown the benefits of investment in refurbishment of rolling stock.

What input do operators, passengers and other interested parties have into the decision of franchised services?

The DfT have set out a clear inclusive consultation process for franchises which so far they have adhered to. Relevant PTEs have been involved in the current East Midland and Cross Country Franchises. The DfT has been consulting Centro on the proposed new West Midlands Franchise and they have had the opportunity to influence the design and specification. Negotiations are on-going currently on detailed issues. However, there will inevitably be areas of disagreement (such as on crowding standards) where it is likely that the DfT’s financial constraints will mean that Centro’s current specification in the Central Trains Franchise will not be transferred into the new West Midlands Franchise.

The Draft DfT/PTE Guidance Note outlines a process of increment/decrements whereby a PTE can alter the DfT’s specification. This process has yet to be properly tested, and the PTEs are concerned that the complexities of contracting directly with the DfT for the provision of enhanced services will lead to difficulties for both parties, particularly where the PTE is prevented from being a co-signatory to the franchise.

Has there been a smooth transition of franchising agreements from the SRA to the DfT?

In general, there has been a smooth transition from the SRA to the DfT and the consultation process appears to be more transparent.

Are franchise contracts the right size, type and length? What criteria and processes are used to determine the nature and length of franchises?

The main thrust of the former SRA approach was that fewer franchises were better. This led to the creation of the Northern Franchise and separation of the TransPennine Franchise on the grounds that it was an Intercity-type franchise. In general, fewer franchises would seem to be better and to date there do not appear to have been any adverse issues arising out of the amalgamation of two franchises into Northern Rail. Indeed, there has been a number of benefits. Similarly the TPE Franchise has allowed a focus on that route but it is a relatively small franchise and as indicated above PTEs believe it would benefit from taking over the Liverpool, Manchester, Sheffield, Nottingham service. pteg also believes that there are distinct differences between Intercity-type franchises and local franchises. It, therefore, believes that combining the Lincolnshire services of Centro Trains with the Midland Main Line Franchise to create the new East Midlands Franchise potentially creates a franchise with unclear objectives. There is no reason why in the longer-term this could not have been subsumed as a separate business unit within the Northern Franchise.

There may also be circumstances where a more locally focused franchise could be appropriate, for example, coinciding with the emerging City Region agenda where the provision of rail, bus and tram services could be integrated under one provider.

As set out in its separate evidence the longer franchises, such as the Merseyrail concession, can provide greater opportunity for private sector investment. This is evident in the Merseyrail and Northern Franchises, both of which are operated by the same company. The forward plans of Northern Rail—who have performed to a very high standard over the first 18 months of their franchise—seem to be tempered by the realisation that their franchise has only seven years left to run. Given that the conventional capital investment horizon is 30 years, the duration of franchises gives franchisees little incentive to make speculative investment over and above their franchise commitments. This is particularly relevant given rolling stock issues such as Pacer replacement.

What criteria and processes are used to evaluate franchise bids?

Experience on the Northern Franchise is that the SRA/DfT have a very robust and rigorous process for evaluating franchise bids. The criteria are based on value for money and certainly unsustainably cheap bids (as with the first franchises) are not encouraged or accepted. The process must adequately balance the subsidy/premium with other factors, and allow the franchise to not necessarily be awarded to the most financially attractive bid if there are doubts about deliverability, or other bidders are offering significantly better outputs for similar subsidy. However, it is clear that in recent awards the overriding criteria has been affordability. This has limited the base franchise specification (ie reduced the ability to influence the base)
and meant that options put forward by the bidders (or requested by DfT or other third parties) have not generally been taken up. The Virgin Group has already expressed its concern that the new Cross Country Franchise may have a substantially lower cost base than its predecessor and has threatened not to take part in the bidding process should this turn out to be the case. This emphasis upon cost containment at the expense of service quality will reduce the ability of the railway to cope with increasing levels of demand. There is clearly a significant cost to bid development and evaluation (the SRA/DfT relies heavily on the use of consultants). Whilst rigorous evaluation of such large procurement contracts is right and proper, this does need to be balanced against the number and length of franchises, ie fewer, longer franchises would cost less to develop and evaluate.

The PTEs were fully involved in the process of the award of the Northern Franchise and have no concerns about the way in which that was done.

**Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?**

In general, franchise holders do deliver value for money. Where there have been problems these have often been rooted in the lack of robust original bids, for example, in the case of Arriva Trains Northern and First North Western. Generally, if a TOC is operating in a financially viable environment then they are able to focus on service quality and are more able to invest in improvements. However, if a TOC is struggling financially, this can lead to behaviour that is not in the best interest of passengers.

Tighter specification of franchises (in terms of outputs) is likely to lead to better value for money for the franchising authority (DfT) and, in general, the increased focus on performance in the latest franchise specifications has contributed to the overall rise in performance. However, value for money for the franchising authority is not always the same as value for money for passengers. For example, the GNER franchise achieves over £1.3 billion in premium payments for DfT but, as a result of this, GNER is increasing unregulated walk-on peak fares significantly. This is likely to lead to poorer value and issues of social exclusion.

The relatively short duration of franchises does tend to see most investment and improvements occurring early on as a TOC can rarely make a business case when there are only a few years left on which to make a return. The DfT needs to ensure that any good ideas for improvements towards the end of franchises are not stifled as a result.

**Are risks suitably apportioned between the Government and franchise holders?**

Risks vary widely according to the characteristics of individual franchises. GNER would no doubt claim that their franchise is highly risky, given the emergence of an open access operator. However, where there are substantial payments to the franchisee, such as with the Northern Franchise, the level of risk appears to be substantially skewed against the Government, with the franchisee more or less guaranteed success on the basis of meeting specified targets, rather than as a result of displaying entrepreneurial flair.

The balance between risk and reward needs to reflect the circumstances of each franchise. On a franchise which requires high subsidy (and thus low dependence on farebox revenue) and few delivery risks, then the risk profile would be different to where an operator would be taking high commercial risks and is funding committed service improvements through predicted revenue growth. On routes such as the West Coast Main Line, where significant public funding has been invested in improvements, it is not unreasonable that the Government should ensure that it can benefit from the financial returns.

New franchises include risk and profit sharing between franchisees and the DfT which is an improvement on previous franchises. In general, however, franchisees are not incentivised to take risks, particularly as base profit margins have been squeezed. This is particularly apparent when PTEs are implementing enhancements where franchisees are often unwilling to take risks unless they are suitably rewarded or “insured” against risk. There are also problems where “risks” overhang the end of a franchises (eg procurement of new rolling stock) and DfT is often unwilling to pick up any residual risk.

**What is the scope for improving services through franchise agreements?**

The PTEs have actively used franchise agreements to improve services in their areas. Whilst we are keen to continue to do this, much will depend on the contractual and funding position in future. Over-focusing on costs will give relatively little scope for further improving services through franchise agreements. Whilst the overarching requirement by the DfT to drive down costs and get a proper control of industry costs was clearly essential, this has led to stagnation of some franchises, for example, the Northern which was let on the basis of no growth.
Do we need more competition and vertical integration? Is franchising compatible with open access operations?

Recent events such as the ECML and Grand Central Trains issue have highlighted a tension between franchising and open access passenger and freight operations. Ultimately this comes back to how the Government takes a view over what it wishes to buy for its public sector input. It is not easy to see how there can be a mix of franchises specified by Government and open access operators, particularly on a network whose capacity is constrained. If future franchises are properly specified through a route that takes into account regional and local objectives fully then there should be no need for open access operators to have to plug the gaps. In summary, the DfT through the HLOS process should decide what sort of railway it wants and then specify it clearly through franchises.

Should train, rolling stock and track operation be more closely integrated?

The recent transfer of responsibility for performance to Network Rail and development of integrated control centres has led to clear benefits in terms of improved performance. Network Rail now has more incentives to improve customer service, but they could be given even more incentives (such as growing passenger numbers to drive enhancements).

The PTEs certainly consider that the rolling stock market is not working effectively and have experienced franchised services being potentially undermined at the end of a franchise by a ROSCO trying to transfer rolling stock away to where it could earn greater returns. There appears little incentive on ROSCOs to invest in improving PTE commuter rolling stock and the limited franchise length, and uncertainty over long-term usage, are often cited by the ROSCOs as a reason for not investing.

ROSCOS currently do not have incentives to necessarily behave in the interests of passengers. Their incentives are mainly financial and lead to perverse decisions such as the inability of train operating companies to rid themselves of unsuitable rolling stock, or to employ vehicles currently stored out of use for short periods of time. Improved horizontal integration is also required.

Where a station has a fairly infrequent service provided by a number of operators, there can be a reluctance to take responsibility for the consequences of service disruption. As an example, Chester-le-Street station is served by Northern Rail, First TransPennine and Virgin Cross Country services in roughly equal proportions. When services are cancelled, there tends to be a lack of information or bus replacement provision. There is a perception that this is as a result of a lack of “ownership” on the part of any one Train Operating Company.

Merseyrail have recently sought to achieve a vertically integrated railway and this is specifically dealt with in their response.

20 June 2006

Memorandum submitted by Transport for London

1. Summary

1.1 Transport for London (TfL) welcomes the opportunity to respond to the Transport Committee’s inquiry into rail franchising. TfL’s response is based on a need to tailor those franchises serving London to meet its diverse needs. These include not only the mainstream commercial and economic drivers but also those of improving social inclusion and accessibility of the transport system. Therefore franchises must be structured accordingly. The differing requirements of franchises with a majority of long distance traffic against those with a customer base of suburban traffic must be taken account of to meet London’s future growth requirements. Thus the franchise structure must be capable and flexible enough to deliver the specific requirements for a particular sphere of operation whether it has a commercial basis or is founded on the need to achieve efficient, effective integrated transport to, from and within a major conurbation.

1.2 In terms of process TfL believes there should be improved engagement between the Department for Transport (DfT), potential operators and major regional and local stakeholders. It is essential that the relevant principal transport planning authority (such as TfL, in the case of Greater London) is able to influence outputs and selection of franchises where these play a key role in the effective provision of multi-modal transport in densely populated urban areas.

1.3 TfL believes that the franchise renewal process and relevant terms, conditions and duration must be geared to ensure that public funds are not wasted through the franchise process requiring costly and repetitive start-up costs for operators. This could be addressed by a more appropriate allocation of responsibilities and variable franchise terms. Risk allocation must take account of the relative costs between different options and the need for private investors to achieve a satisfactory rate of return. In some cases this indicates that responsibilities for longer-term investment (eg in stations) should rest with funding authorities rather than the franchisee.
1.4 In terms of competition, TfL advocates that where capacity is scarce or where investment has been specifically provided to meet specific needs (eg on London’s radial and orbital routes) it would be inappropriate to promote active competition to the detriment of those services performing socially necessary and general transport accessibility functions particularly in urban areas and conurbations. The first call must be to provide an integrated, sustainable transport system geared to promote modal shift to public transport and the achievement of challenging environmental targets. TfL believes there is a good case for examining the benefits of vertical integration where sole-user operations are in place (eg community lines) but on multi-user railways the case is less strong.

2. INTRODUCTION

2.1 The challenges facing London’s transport over the next 20 years are significant; London is forecast to grow significantly in population. Employment is also forecasted to grow, particularly in the high productivity cluster within central London. Enabling this growth is critical to supporting London’s position as the capital city and its contribution to national economic output. The existing rail services and infrastructure have severe constraints and there is a pressing need for more efficient delivery directly linked to multi-modal planning.

2.2 TfL believes there is a need for a cohesive, integrated transport planning approach for London and those major population centres which lie just outside the Greater London Authority (GLA) boundary. Our modelling shows that there will be employment growth within London of at least 0.9 million up to 2026 and that this is concentrated in central London and the inner Thames Gateway. Population growth (predicted at one million to 2026) is more evenly distributed and thus rail is the only mode which will be able to meet this increased demand, particularly on the radial corridors to and from the centre.

2.3 There are also large regeneration and development proposals planned for areas just outside London, eg the Thames Gateway and along the London-Stansted (Lea Valley) corridor. This growth will place additional demands and requirements on the existing public transport infrastructure and especially rail.

2.4 TfL is developing Rail Corridor Plans covering each of the London-based rail franchises and routes and is working in close cooperation with Network Rail in the development of their route plans. Longer term, TfL is also developing a Rail 2025 plan for London and thus there is a framework of both medium and longer term proposals for rail which the franchise structure must be capable of working with.

2.5 Nearly 70% of all UK rail journeys are made to/from or within London totalling over 502 million in 2003–04 and of these, 48% (244 million) were wholly within the London region. Furthermore, 64% of rail journeys per year (129 million allocated to the South East region are made to or from London. Therefore the franchise mechanism must recognise the importance of rail to the economic benefit of London and that it must also work within an integrated planning framework which will require outputs different to those of pure commercial benefits focussed on a single rail mode.

3. What should be the purpose of passenger rail franchising? Is the current system achieving that purpose?

3.1 TfL believes the objectives of a franchise must reflect more closely the requirements of sub-regions and traffic served. A “one size fits all” approach is not sufficient to meet the diverse requirement of rail operations in Great Britain. The franchising purpose must recognise the difference between longer-distance (revenue generating) operations and shorter distance suburban operations focused primarily on work and societal needs.

3.2 TfL would emphasise that operators’ strengths need to be more focussed towards meeting the diverse economic, social, cultural and transportation needs of an area, particularly important in London. Franchise specifications must therefore be capable of recognising that the purpose is to deliver an effective, efficient transport system integrated with other modes and offering value for money to central and local government and users. Thus an additional requirement of franchising must be that it should work under a governed planning framework, at both national and regional levels. In conurbations the planning framework must primarily focus on improving the efficiency of integrated transport rather than, for example, maximising farebox revenue on an individual mode.

3.3 Service specification itself will also have different requirements. Services at stations in terms of comfort, safety and security (and ease of interchange with other modes in the case of urban multi-modal stations) are different to those of train services where the focus will be on journey time and frequency. Again, the drivers for “Metro” type services in conurbations will be different to those of long-distance services where station and on-train facilities will have quite differing requirements.

3.4 The current system of franchising is not achieving the correct delineation between these differing drivers. In London, where the Mayor is seeking further specification responsibilities over rail, including possibly fares setting responsibilities there is, under the present system, confusion on where risks lie and the relationship of franchise outputs with other service modes (eg London Underground). There has been widespread confusion for rail passengers relating to the introduction of the Oyster “Smartcard” ticketing.

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8 Source—National Rail Trends Yearbook 2004–05 (amended) SRA/ORR.
system. Part of this is due to the present inability of the Mayor and TfL to influence operators through the franchising system, although the Mayor’s responsibilities in this area are now under review. As a result, under the current system, passengers have not been presented with the integrated transport provision that is a core requirement within London.

3.5 Therefore inner-suburban franchises serving cities and major conurbations must be focussed on providing a good quality, efficient and sustainable transport mode designed to stimulate modal shift to rail working within an integrated planning framework where risk is properly targeted and which is designed to maximise operators’ strengths and capabilities in effective and efficient delivery. Revenue risks for inner-suburban franchises may well be better managed by public, regionally-based stakeholders. Possibly this will require a clearer delineation between commercially viable services and those which have to perform a societal function. There is no reason why such services cannot co-exist within the same franchise. However the specification and purpose must be clear and matters such as, for example, obligations to prioritise resources or track access must be clearly defined in the franchise.

3.6 Overall, the purpose of franchising must be to provide rail passenger transport which is capable of meeting current demand and growth needs in an effective and economic way, provides a framework and certainty for improving efficiency and promotes improved integration of, and accessibility to, the public transport system. There is no firm evidence that the present system is achieving this.

4. How well does the process for awarding franchises work? What input do operators, passengers and other interested parties have into the design of franchised services? Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

4.1 The engagement of TfL into the design of franchised services is, at present, limited particularly regarding discussions with bidders. Whilst liaison with the DfT on planning matters is improving, TfL’s direct influence over franchise specifications has been variable. It should be clearly understood that TfL, whilst a major stakeholder, has no grant funding from central government for investment in rail services. Recent franchise changes, particularly on the Great Western line have seen plans for a significant deterioration in some services which were completely contrary to TfL’s submissions through the formal consultation process. However the more recent proposals for the South Western franchise have seen better engagement and more account taken of the needs of London in the process. At present the Mayor or TfL have no influence over the selection of bidders or on the viability and effectiveness of the outputs proposed by bidders in the final process. Whilst the Mayor is due to gain further responsibilities over rail at present this is not intended to extend to the franchising process itself except in the case of the North London Railway. TfL believes this hinders the delivery of efficient outcomes for London’s public transport planning and wishes to see a more formal engagement with DfT and bidders in respect of those franchises supplying the majority of London’s rail services within the GLA boundary. This is particularly important at the ITT stage, to ensure that London’s requirements are adequately reflected in bids.

4.2 The transition from the Strategic Rail Authority (SRA) to DfT appeared to be achieved relatively well. The arrangements for working with DfT are certainly no worse although in some areas (eg Great Western—see above) there are judged to have been some inconsistencies in communicating changes to key stakeholders and these may need further attention.

5. Are franchise contracts the right size, type and length? What criteria and processes are used to determine the nature and length of franchises? What criteria and processes are used to evaluate franchise bids? Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts? Are risks suitably apportioned between the Government and franchise holders? What is the scope for improving services through franchise agreements?

5.1 TfL has not been formally included in the evaluation of franchise bids and the relative apportionment of risks and value for money of existing franchises. Therefore it is difficult to comment on some of the committee’s questions in this area.

5.2 However, TfL believes that there needs to be a clear understanding of what franchises are expected to deliver and the length of a franchise must be commensurate with achieving that delivery in the most efficient and cost-effective manner. In 3.1 and 3.2 (above) TfL has already drawn attention to the fact that specifications must be tailored better to local and regional needs.

5.3 TfL’s view is that franchise operators are not resourced to undertake the longer term planning or economic forecasting essential in developing and delivering transport strategies for large cities. As a result there is a compelling argument for these matters to remain within the scope of funding/planning authorities who are able to take the longer term view. In turn this dictates that franchises need to be of a management contract nature and thus there is less necessity to let these as longer-term contracts.

5.4 Against this, shorter-term franchises do not incentivise longer term capital investment and planning because operators are seeking to maximise shareholder returns over the shorter life of the franchise only, and not beyond. Accordingly, overall margins sought under these shorter franchise periods increase. In our view, where shorter-term franchises are contracted to invest, the higher financing costs inevitably deliver worse value for money than a longer term franchise or Government borrowing option. Shorter-term
contracts also have recurrent bidding costs estimated at between £2–4 million for each bidder and similar amount for the DfT. Assuming that most bidders are working within the franchise system somewhere it is fair to state that these costs will eventually be borne by the franchise funding arrangements.

5.5 Individual start-up costs for any new operation will also be significant. New branding, signage, uniforms, staff transfer costs—some of which does little to improve the product—costs in the region of £2–5 million depending on the size of the franchise. For London, with nine franchises undertaking suburban operations this could equate to over £30 million every seven years, money better focused on improving the quality of stations and services. This reinforces the belief held by TfL that rail in London should have a single brand identity which does not change with every new operator/franchisee.

5.6 There appears to be little risk borne by franchisees under current arrangements, evidence so far has seen commercial deals rescued by the SRA, in the case of South Eastern Trains or by reversion to management contracts. In both cases, Government has taken on board the risks whenever franchises are failing to deliver against their commercial objectives. This must be changed and contracts must reflect a fair balance of risk between franchisee and funder.

5.7 The scope for improving services is now extremely limited under the current arrangements. Franchisees are expected to deliver to a service specification tightly defined by DfT and with stringent controls on changes. Whilst this gives greater certainty and arguably gives better control on matters such as performance it takes out the entrepreneurial aspect and questions whether all franchises supported by public funds should be based on the management contract model with specification and investment in the hands of the funder.

6. Do we need more competition and vertical integration? Is franchising compatible with open access operations? Should train, rolling stock and track operation be more closely integrated?

6.1 TfL’s view is that in London, with infrastructure capacity at a premium, high forecasts of demand growth and a pressing need for more investment in the railway, it is not acceptable to allow “cherry picking” of valuable capacity. TfL expects to invest significant amounts of capital in improving London’s railway infrastructure; it would be unacceptable for works paid for by the public purse and designed to improve public transport in London to be used for commercial gain by operators who have made no contribution to the investment. Whilst open access is a cornerstone of EU policy on rail this should only be undertaken within the framework of a robust regulatory system which takes full account of public and social interests and accepts the need for investors to have first call on the utilisation of the enhancements they have paid for. Furthermore, the national system of revenue allocation (ORCATS) can allow disproportionate apportionment of ticket income, particularly where open access operators are granted rights over route sections where established franchised operations are in place. If open access is to continue, an improved method of revenue allocation must be put in place which recognises the role of the incumbent franchisee and its investment in the core business.

6.2 In certain circumstances TfL believes that it would be appropriate for closer integration of operations. TfL’s findings are that rolling stock procurement and operation may be more cost efficient under the direct management control of the funder (eg TfL) and/or train operator rather than through the current practice of utilising Rolling Stock Leasing Companies. In terms of train and track integration there may be instances where closer integration will deliver improved efficiencies, particularly where there is a sole train operator and the role of the railway is purely to address societal needs. However, where a number of operators run over the same infrastructure and this has a mix of commercial and socially necessary operations, the existence of a separate infrastructure controller to manage delivery and performance is likely to represent the best option given the present structure of Great Britain’s railways and the split between franchised and commercial (eg freight) operations in existence.

6.3 It must be noted that the recent changes to Network Rail’s role in taking a greater lead in medium-distance planning through the Route Utilisation Strategy process has improved the industry’s overall approach in this area and has already started to deliver benefits which were assumed to be only capable of achievement through vertical integration. Operational integration between Network Rail and train operators has also improved and would suggest that enforced vertical integration may not achieve a significant benefit over the service delivery being enjoyed at present.

7. Conclusion

7.1 TfL is firmly of the opinion that the current policy on franchising is in need of review and change.

7.2 The present arrangement where London’s rail franchises are expected to deliver a mix of commercial and societal requirements is confusing. There should be a clear demarcation of commercial and social requirements with the latter closely specified by local transport planning authorities in the major conurbations and regional authorities of Government outside of those areas. The contribution of rail to the mobility of urban areas and the role of transport authorities such as TfL must be recognised in franchises. Their purpose should be designed to better reflect and engage with the overall transport planning process and to promote integration of public transport.
7.3 There needs to be better and more formal engagement with stakeholders on the process, particularly with investors such as TfL, and the outputs must reflect the local planning objectives for the cities and regions rather than being defined wholly by central government.

7.4 In terms of the size, type and duration of franchise TfL believes that there must be clarity between the societal service requirement and commercial service initiatives and the type of franchise could go further to reflecting this. Depending on what the type of franchise is will indicate the optimal length for a franchise. TfL has highlighted that frequent bidding and start-up costs will inevitably increase the overall charge to the taxpayer.

7.5 Open access operations are likely to deliver little added value to suburban train operations based on societal service provision and will thus result in abstraction from franchised operations rather than add to the overall value of rail as a mode of transport.

7.6 Vertical integration of track and train operations, given the present split of franchises and the existence of commercially-based train operations, is assessed to present no major advantages at the present stage but there may be instances (eg community rail) where such changes may give economic benefits. However integration of rolling stock procurement and train operations may deliver benefits and is deserving of further examination.

20 June 2006

Witnesses: Mr Neil Scales, Director General and CEO, Merseytravel, Mr Anton Valk, CEO NedRailways, Mr Iain Coucher, Deputy Chief Executive, Network Rail, Mr Peter Sargant, Assistant Director Rail Services, Centro and Mr Peter Field, Director, London Rail Development, Transport for London, gave evidence.

Chairman: Good afternoon to you, gentlemen. We do have one or two little bits of housekeeping. Members having an interest to declare? Mr Efford.

Clive Efford: Member of the Transport and General Workers' Union.

Chairman: Mr Stringer.

Graham Stringer: Member of Amicus.

Chairman: Gwyneth Dunwoody, ASLEF. Mrs Ellman.

Mrs Ellman: Member of the Transport and General Workers' Union.

Q157 Chairman: Good afternoon to you, gentlemen. You are all most warmly welcome this afternoon, with the emphasis on the warm, I am afraid. Can I ask you firstly to identify yourselves, starting from my left?

Mr Scales: I am Neil Scales, Director General, Merseytravel.

Mr Valk: Anton Valk, Chief Executive Officer of NedRailways.

Mr Coucher: Iain Coucher, Deputy Chief Executive Network Rail.

Mr Sargant: Peter Sargant, Assistant Director Rail Services for Centro and representing the Passenger Transport Executive Group.

Mr Field: Peter Field, Transport for London and Director, London Rail Development.

Q158 Chairman: Thank you very much. I think most of you know that there are certain hazards to this room, so remember that the microphone in front of you is not a lot of use. Did anybody have anything they wanted to say before we began?

Mr Scales: No, thank you, Chairman.

Q159 Chairman: In what ways is the current franchise system better than a unified, state-run railway system? Mr Sargant.

Mr Sargant: From the experience that I have had working with British Rail in its Section 20 days, when we had an agreement with British Rail to provide local rail services, for us to now have a contract with a private company which actually specifies in a great deal of detail the service levels which we want gives us far greater control over the specification of our services. So from our point of view, having a proper contract in place rather than the previous rather woolly agreement, has seen advantages, but has had a big impact on the cost of operation which has led to difficulties funding the services locally.

Q160 Chairman: So you are saying that the detail required costs you a lot of money to comply with, is that what you are saying?

Mr Sargent: I am saying that the restructuring of the rail industry that happened at the time created a significant difference in costs because previously PT Rail Services were marginal users of the network and therefore did not pay significant track access charges, for example, and a lot of the routes in the West Midlands, for example, are our intercity routes and therefore under the previous British Rail arrangements intercity services effectively paid the full infrastructure costs of those routes, whereas currently obviously it is through access charges, and that was the structural change that pushed up the cost of rail services.

Q161 Chairman: Mr Scales, in what ways are your objectives different when you let the MerseyRail concession as compared to the objectives of the Department of Transport?

Mr Scales: I think we have a long-term partnership, a long-term certainty with our operating partners, Serco-NedRailways. We have fares, for example, fixed to RPI for 25 years, and we are able to match our investment to the Local Transport Plan, which has been very generous, to match our investments
that we are getting from Serco-NedRailways. So I think working in concert helps us a lot and in fact there is no extended time delays between making decisions and having to go off somewhere else like London or elsewhere: all the decisions are made on Merseyside and that means that if we have any operating problems we can sort them out really, really quickly and give a better service to the people of Merseyside. So it is faster on its feet, it is more cohesive and it is pointing in the same direction as our operating partners, which is unusual, but it works really well.

Q162 Chairman: Mr Valk, you have bid for and won all sorts of franchises both at the national level and with Merseytravel. Did you experience the objectives of the two processes in a different way? Are they different in any way?

Mr Valk: Yes, they are.

Q163 Chairman: Would you be kind enough to tell us how?

Mr Valk: I think the way we work with MerseyRail and with MerseyTravel and the PTEs in the north is very much a local approach, an integrated transport approach aimed at the local users while working with the government in London is much further away, of course. Therefore I believe that it is a good way of working.

Q164 Chairman: Is it more difficult? Are you telling us that because the government is more removed it is more difficult to get what you want out of the franchise, or is it in operating terms? Where do you think the real problem lies?

Mr Valk: I believe that the transport is integrated and you look to integrate the transport from a user perspective. When you are a local it is much easier to look to it from that point of view than when you are centrally in London.

Q165 Chairman: Mr Field, do you have a view?

Mr Field: Certainly from the devolution of responsibility for decision-making it makes multi-mode integration within the urban railway network much easier; certainly in our specification for the London Rail concession for the North London Line, East London Line we are able to specifically specify the requirements, which therefore match the passengers’ needs when travelling on by other modes, recognising that 50% of all passengers arriving in London by rail go on to use another mode of public transport.

Q166 Chairman: The Association of Transport Coordinating Officers has said that franchises are not putting passengers’ interests first, they are driven by financial objectives and they are constrained severely by DfT specifications, and all of this restricts innovative thinking. Is that your view? Is that a correct description of what happens with the franchises?

Mr Sargent: I believe that in some franchises that is the case. I think each franchise has different characteristics. In PT areas which are heavily dependent on subsidy there has to be a very tight specification and that potentially means that they cannot always act in their commercial best interests, but we have to act to try and protect the passengers’ interests through tight specification. Whereas I think I would argue that a longer distance is city-type franchise, which more relies on fare box revenue, then there is more freedom on the operator to innovate and to improve services for passengers that way.

Q167 Chairman: So what are the innovations you would like to tell us about?

Mr Sargent: I think on a heavily specified local franchise the innovations have to come in ways of delivering services more cost effectively and in comparison with, say, British Rail, the train operators have had to tackle things like how you employ staff more effectively, and looking at some of the restrictive working practices.

Q168 Chairman: Can you quantify any of that, Mr Sargent? Employing staff more effectively is a marvellous phrase and it is the sort of thing I would use if I were seeking to sell my services to someone who did not know me very well.

Mr Sargent: Yes, you become more focused on your resources and you look at different ways of delivering a higher efficiency out of those resources, whether it is trains or staff, but I am afraid I cannot quantify them as I am a train operator and therefore I am unable to.

Q169 Chairman: No, Mr Valk.

Mr Valk: May I go back to the Netherlands and how the system in the Netherlands works? There is a more flexible contract in the Netherlands than there would be in the UK and these flexible contracts are called framework contracts for the long-term and that is combined with regular reviews on an annual basis. Because it is a more flexible contract there is a possibility for innovation and cooperation between the industry partners. That is the way it works.

Q170 Chairman: So what happens in the Netherlands is that there is a clear set of rules but then within that there is much more room for flexibility; is that what you are telling us?

Mr Valk: There is more room for flexibility but it is not a very defined long-term contract; the long-term contract gives the directions which the government wants it to take of growth, of overcrowding, and within that contract there is a short-term agreement between the parties to deliver it and to deliver it on an annual or bi-annual basis.

Q171 Mrs Ellman: Mr Valk, in the Netherlands there is the core system and then there is a great deal of devolution to the cities and regions. What proportion of services constitutes the core service and what proportion is devolved?

Mr Valk: The core service is basically the service between the four big cities in the Netherlands, and it is regarded as essential for the economy and for the social well being of the Netherlands. What is not
part of that network has been devolved to either the regions or the provinces, the provincial assemblies or to the city operators. The central system is treated differently because of its social and economic importance for the Netherlands. The whole system in the Netherlands is aimed at liberalisation, also in a more gradual way than the UK. When you look at the UK system from abroad it has been privatised and liberalised in one step and after it I would say that a lot of work has been done to modify it. In the Netherlands it is a much more gradual approach but should lead or will lead to the same situation, which is liberalisation and privatisation.

Q172 Mrs Ellman: What proportion of the network is constituted as a core service?
Mr Valk: I think the core service is 1,500 kilometres and the whole network is 2,850 kilometres, but the core services are the majority of the services and the majority of the train services.

Q173 Mrs Ellman: Who is responsible for coordination of services at the boundaries?
Mr Valk: The coordination of services at the boundaries is done by the provinces, who are responsible; it has been devolved. It is difficult to compare to the UK but these are provincial assemblies which could be compared to regional assemblies in the UK, and they are responsible for that service. There is of course an issue of expertise and in the Netherlands we have a national expertise centre to help them to do franchising.

Q174 Mrs Ellman: What changes would you like to see here as a result of your experience in the Netherlands? What benefits would you be able to bring to Merseyside as a result of that?
Mr Valk: That is a difficult question to answer. We are very happy with the franchises we are operating, we are happy with the partnership we have.

Q175 Chairman: You do not have to be entirely diplomatic all the time, Mr Valk!
Mr Valk: I try to be because I am a guest in this country, of course.

Q176 Chairman: I thought the Dutch had been running this for so long we had not noticed!
Mr Valk: I think the partnership approach, which we very much value, brings a lot of benefit and we have that with Merseytravel and we have this with PTEs, of course, and I think it brings a lot of benefits to the franchises which are running very well. In general the franchising system in the UK, should give room for innovation and give room for investment. It should also find a structure where you can look at the long-term on one hand, so that you can set a long-term objective of growth, because in the UK rail is also very essential. Put in those objectives, and try to give room also to the operators to innovate and invest.

Q177 Mrs Ellman: Mr Scales, Network Rail opposed you getting the sort of integration that you wanted in for Merseyside. Has the area lost out, or what do you think could be done?
Mr Scales: We think that because of our unique arrangements on Merseyside with MerseyRail Electrics we could do a more effective job at controlling the track and the stations, and we spent a lot of time and effort in putting a business case together on that. Of course we were not successful, but it was because of the unique arrangements that we have—and Anton Valk has mentioned how we have the framework and the partnership—but we also have a 25-year concession, which is pretty unique and that allows our private sector Serco-Ned partners here to invest in the network. I will give you an example that is happening now, they are investing over £2 million on a wheel lathe, which is a specialist piece of kit to turn the steel tyres round, and that has taken our colleagues here—despite the fact that they are Dutch and move really quickly—three years to put in. If it were a seven or eight-year franchise they just would not be able to make that investment and get a return back. So I think because we are faster on our feet, because we have more direct control we could have made some real savings, but because MerseyRail Electrics is the second most intense service in the UK—it is more intense anywhere apart from London Underground—we think we could have shown benefits to our colleagues in Network Rail which then could have been rolled out across the rest of the UK for the benefits of UK plc. So we were very disappointed. But we are working very closely with our colleagues, and Mr Coucher will also be able to bear that out. We are just opening a new state of the art £32 million interchange on Friday on Merseyside, and that was with Network Rail’s help; and this morning we opened a refurbished station at Hoylake for the golf. So we are still working in partnership with them; we just think that if we had detached them from the process we would have been even faster on our feet and delivered more benefits.

Q178 Mrs Ellman: Mr Coucher, Network Rail has been blamed for impeding progress, and you have heard the Merseyside issue, and it has also been said that Network Rail are interested in punctuality but not in innovation and looking at passenger needs beyond punctuality. Do you have anything to say on that?
Mr Coucher: If I can stand back slightly? The position of Network Rail is that we take a lot of decisions, not only on a daily basis when we are operating trains and seeing the need for trains, but we take decisions which are in the medium term and the very long-term when we invest in railways, and our decisions last for 40, 50, 60, 80 years. A new bridge, for example, would have to last 100 years and a new station 50 years. So the decisions we take have to be in the long-term and we have to really think about passenger needs in the very long-term, and we genuinely believe that by having a strong central national infrastructure management looking at all parts of the infrastructure we can bring greater
There was a disagreement about the quantum of saving over the next two or three years as well. So there was a disagreement about that. First of all, that was a projected saving until the year 2028, so a very long-term saving over 25 years. Secondly, it was against Merseytravel’s estimates of what our costs were, and we said our costs were a lot lower to start with. Our costs are projected to go down over time; we work under a regulatory framework and the regulator every year insists that the costs come down, and we have taken 20% out of the costs of running a railway in the last three years, and that is about £1 million every day, and we are projected to make a similar saving over the next two or three years as well. So there was a disagreement about the quantum of savings. But, more importantly, in the Mersey area we want to work much more closely with MerseyRail and Merseytravel and we have proposed new arrangements with them, which involves the introduction of a new integrated control centre, which we have elsewhere in the country, and drives performance; and we have the proposal of the introduction of joint performance improvement plans, which is a methodology we use elsewhere in the country, which has not yet been introduced into Merseytravel. So we think that all of those will result in a better performing railway, although Merseytravel already operates at the highest levels in the country anyway, and at lower cost as well.

Q179 Mrs Ellman: Did you dispute the savings on the economies of scale that MerseyRail said they could make, or was it to do with the impact on MerseyRail?

Mr Coucher: There was a disagreement about the level of efficiencies. There was a figure that has been quoted, about £33 million saving. There are two points about that. First of all, that was a projected saving until the year 2028, so a very long-term saving over 25 years. Secondly, it was against Merseytravel’s estimates of what our costs were, and we said our costs were a lot lower to start with. Our costs are projected to go down over time; we work under a regulatory framework and the regulator every year insists that the costs come down, and we have taken 20% out of the costs of running a railway in the last three years, and that is about £1 million every day, and we are projected to make a similar saving over the next two or three years as well. So there was a disagreement about the quantum of savings. But, more importantly, in the Mersey area we want to work much more closely with MerseyRail and Merseytravel and we have proposed new arrangements with them, which involves the introduction of a new integrated control centre, which we have elsewhere in the country, and drives performance; and we have the proposal of the introduction of joint performance improvement plans, which is a methodology we use elsewhere in the country, which has not yet been introduced into Merseytravel. So we think that all of those will result in a better performing railway, although Merseytravel already operates at the highest levels in the country anyway, and at lower cost as well.

Q180 Mrs Ellman: Do you think that the PTEs should be more involved in designing franchises?

Mr Coucher: Yes.

Q181 Mrs Ellman: Are there any views about how that might be done? Do you have any proposals?

Mr Coucher: Because the best people to know about understanding passenger needs, passenger flows, local demographic changes and things that are coming up in the short, medium and the long-term comes from the PTEs. As you are aware, we are responsible now following the implementation of the Railways Act last year responsible for producing re-organisation strategies, and when we develop those it is the long-term view about the railway needs, and we get heavily involved with the passenger transport executives and they provide a very useful and detailed understanding of the needs of the area, and I think they are fundamental in letting franchises as well.

Q182 Mrs Ellman: Are there any current specific proposals to do that?

Mr Coucher: I think that the change in the franchising after the last Railways Act did give PTs more involvement in setting up franchises. I am slightly out of my depth here, Chairman.

Mr Sargent: I would disagree that we got the greater involvement in the franchises, as one of the key aspects of the Railways Act was our removal as co-signatories from the franchise. Currently, to give you an example, Centro is a co-signatory to the Central Trains franchise. Effectively all the specification of the rail services in the West Midlands is defined by Centro through that process and we fund Central Trains, the subsidy, to run those services. In the future, although we get a rail grant from the DfT to underwrite that cost, the DfT will determine what it feels is the appropriate level of services for the PT areas, and they are currently out for consultation on the new West Midlands franchise, which includes the Centro area. They are determining what service levels and what service quality they wish to fund and under the new arrangements they are expecting us to specify either increments, if we feel we want to specify more than they are specifying, or decrements if we feel that we want to take away services that they are specifying to give us a funding stream for other transport improvements. So effectively the key specification now is with the DfT and our role is very much on the margin in terms of specifying changes to what they feel is appropriate.

Q183 Mr Goodwill: Mr Valk, the Northern Rail Network, which you operate, for every 20 pence you get in the fare box you get 80 pence in subsidies. Does that reflect the situation in the Netherlands? Is that why you were interested in that particular franchise, or is it different from the situation in the Netherlands?

Mr Valk: It is different from the situation in the Netherlands because NS does not get such subsidy at all for their core network.

Q184 Chairman: Mr Valk, I am sorry, we cannot hear you very easily. I never thought I would have to tell a Dutchman to speak up!

Mr Valk: When you look to the Northern Franchise there are of course the commuter services, which are around Leeds, in particular, which are very intensive and in other parts of the network it is not, it is a rural network or a regional network. But that is the characteristic of the network. It is different from the Netherlands; however, a number of innovations, of issues that we do in the Netherlands we can apply also in Northern. As an example, better maintenance of the trains and with that we can reduce the subsidy.

Q185 Mr Goodwill: Northern is the biggest franchise in terms of the size of the network in the country. Do you think that that is an appropriate size or would there be advantages to breaking it down and having...
maybe more community type railways within that, or do you think it is a tenable size to maintain in the future?

**Mr Valk:** We have organised the Northern management team in such a way it can manage this large franchise, with regional directors, because you are absolutely right that it is a very big service—2,800 kilometres of track. So we have organised ourselves to manage that properly and up to now we have done well, so there is no reason why it should change, I think, at this moment in time. You can always think of other ways of organising those franchises, but at this moment it goes well. Performance went up last year considerably. Passenger satisfaction goes up. The passenger growth is very substantial—more than 12% last year. So from that point of view it has been a good choice to merge West and East.

**Q186 Mr Goodwill:** You have mentioned that this 80% level of subsidy hides some profitable commuter lines as well as other lines which are less profitable than the 20% from fares. Would you see your role when you come to the end of the franchise as a role of suggesting routes that maybe are not viable, because there must be routes where only 5% of the income actually comes from fares and 95% is subsidy. Do you feel that you would have a role in actually suggesting where maybe the network could be curtailed or cut back?

**Mr Valk:** Without being polite, I think it is the government who should tell or think about what they want to do with the service, and they specify it. We have helped government, of course, with the information which they need for that but it is not up to us to say what government should do.

**Q187 Mr Scott:** I would like to ask about consultation with passengers. How could passengers have a greater input into a process of franchise specification and letting? This is a question for everybody.

**Mr Scales:** We engage with the passengers a lot. We have five advisory panels, one for each district, we have a women's forum and a disabled transport forum as well and we have something called the Integrated Transport Forum, which works on a three-monthly basis and we engage with the passenger forums a lot. So what we tend to do is to listen to their views and then put them into the Local Transport Plan, and what we have arranged with our colleagues in Serco-Ned Railways is that our reviews of the franchise performance are actually timed to fit with the reviews of the Local Transport Plan. So the first one is after seven years, which is at the end of the next Local Transport Plan in 2011, and then five years, five years, five years, three years. So we actually capture the views of the local passengers through our information line and we feed it back into the system and we feed it back to Serco-Ned Railways to see what improvements we can make. A lot of it is concerned with safety on the system and 40% of MerseyRail Electric stations are now secure stations. A lot of it is about staffing, so we staff the stations five minutes before the first train arrives and five minutes after the last train leaves. So there is the safety issue there. The next bit is on access and our next big plan, which we are now working with Serco-Ned Railways with, is replacing the existing rolling stock to make a level boarding instead of one that has a step. So we take all these views in from the users, feed them into the process and it comes out in the Local Transport Plan and our colleagues in Serco-Ned Railways sit alongside us in the Integrated Transport Forum, and our politicians are involved every six weeks in a real passenger forum there, where Anton's operating manager, Patrick Verwer comes along and listens directly to my politicians on the passenger transport authority and we put the points directly to Anton and Northern Rail and our colleagues from Network Rail on a direct basis. So we have real front-end engagement on what is happening on Merseyside. That is how we do it and it works for us anyway, Mr Scott.

**Mr Field:** If I could perhaps say what we are doing in London with our new London Rail concession. We believe that the heart of the specification is the customer need, and that is not only the user but also the non-user who has not yet discovered the benefits of train services in this region. So we undertook a very detailed, what we call a route corridor plan, which actually feeds into the Network Rail route utilisation study. That report went into the community and we have consulted widely, not only with each of the boroughs but also with the user groups and also with Travel Watch and Network Rail, and that is the heart of the specification of the concession which we are about to let. Going onwards, we are going to adopt the best practice we believe exists with Docklands Light Railway, where they have engaged with the local community to ensure that the total journey is safe and of high quality and not just the DLR element, and we will be following that practice. There are a lot of people who do not use the rail network because they feel unsafe getting to the station or from the station and we are addressing that through our community partnerships.

**Q188 Mr Scott:** Anyone else?

**Mr Sargent:** In terms of the West Midlands franchise, which is currently going through the process of being specified by the Department of Transport, I do not think there are any specific consultations occurring with passengers. However, in the West Midlands, as Mr Scales says, the PTs are very close to knowing what the passenger needs are, but we have commissioned joint research with Passenger Focus, for example, into doing surveys and to understand perhaps what their priorities are and what we need to be pushing for as part of our input into the specification process. So I do not think there is anything specific, but stakeholders more generally, including the local authorities, are feeding their views into the specification process.

**Mr Scott:** Do you believe it should be statutory to talk to your passengers as part of the franchise agreement?
Chairman: Mr Scales, do you think you ought to talk to your passengers?

Mr Scales: I believe it should be statutory and we took that action on MerseyRail Electrics because when we put the order through Parliament it actually chopped out the Rail Passengers’ Forum because everything went back to the Passenger Transport Executive as operator of last resort. So we had to put another order through Parliament to give them the statutory right to do that, and the Rail Passengers’ Forum and their successor organisations have all been invited along Integrated Transport Forum. So, yes, I think it should be statutory; you should talk to your customers; you should take notice of what they are saying and then have a dialogue with them, and if you can do things quickly do it and if you cannot explain why, and I think that usually works.

Mr Scales: Patronage went up last year, Mr Stringer, by 3.7%, and that ended on 31 March this year. So MerseyRail is now carrying 35.3 million people. We have pegged fares to inflation for the life of the concession so they can only go up by RPI for the two lines, the Northern Line and the Wirral Line. Individual fares can go up by RPI plus two, but our colleagues here will chose the fares or agree it with the Passenger Transport Authority and then implement it, so fares are flat in real terms. Chairman, I can give the Committee a note on the new arrangements on Merseyside, which we are working very hard to implement, so fares are flat in real terms.

Mr Scales: Yes, that is over a week, that is over a seven-day period. So we lose about 100 trains a week. About 70% of those are down to infrastructure problems, which could be power supply failures or signalling problems or track defects, points’ failures, that sort of thing because we have a little underground part of the network as well, and that is why it is unique. As well as being a third rail system we have five underground stations as well. So we have 40% of the stations are secure under the secure stations regime and we have reduced crime on the network year on year and it is our third anniversary of having controlled the network on 20 July this year. But I can provide all the statistics, Chairman.

Mr Scales: It is 700 trains a day.

Mr Scales: My view is that should be 25 years, Mr Stringer, and the reason for that is—and I made the point about the wheel lathe, which is a particular piece of engineering kit, that our colleagues, even with their speed of operating have taken three or four years to have the wheel lift implemented. If you only have a 10 or 12-year franchise you will not get the payback on that. So I think that long-term franchises allow two things: they allow certainties for setting things like fares, and our investment strategies, but as far as the Dutch model is concerned and my colleague, Mr Valk, here, it allows him to innovate as well and they are doing things like putting retailing into stations, and that is launched in a fortnight’s time and we are piloting them in four stations. They have put the same sort of gates as you have on the Underground on five stations, which cut down overriding, so overriding has gone down from 14% when they took over to less than 3% now, which is measured. So it just allows the private sector to make the investment and we think, on Merseyside at least, that a 25-year franchise is the right length, and we can then put it into the same long-term investment strategy that we have with the Local Transport Plan process which is a brilliant way to allocate cash because you have a 10-year strategy and a five-year delivery going forward. So our review periods on the railway are matching the Local Transport Plan.

Mr Field: There are certainly are. From the Transport for London perspective, as you will be aware, we have very successfully tendered our bus routes on a five-year programme and I think few would doubt that there has been a major improvement in quality. We believe for the London
Rail concession, the new rail franchise for London, that TfL should make the direct investment. The investments in the national rail infrastructure generally last longer than even a seven or ten-year franchise. We believe that our cost of capital, particularly using prudential borrowing, is likely, and indeed always will be, more cost effective for us to make a direct investment. In our London rail concession investment we are buying the new trains, we are paying for the cost of the station upgrades directly. The operator we use is innovation to operate and maintain those assets for us, but we strongly believe that the investment requirement is cheaper and better focused coming via Transport for London, and therefore we believe that the length of concession does not need to be as long. In our length of concession that we are offering for the first, which will be seven years, the reason it is seven years and not five is because we want to span the period of the Olympics to give that certainty and continuity. But we are not wedded to the idea of long-term concession at all. We believe certainly from our DLR experience that to keep the idea of long-term concession at all. We believe certainly from our DLR experience that to keep the idea of long-term concession at all.

Mr Coucher: We would like a reasonable length of beginning, and our experience is that often they are valid at the end of the concession as they are at the which may be valid on day one in year one, are as operator live and refreshed one needs to tender these certain from our DLR experience that to keep the idea of long-term concession at all. We believe certainly from our DLR experience that to keep the idea of long-term concession at all.

Q198 Graham Stringer: They might be constant but they might be constantly too large.

Mr Coucher: If I could say that in the last three years since we acquired Rail Track we have taken nearly £1 million a day out of the cost of running the railway—some £400 million in day to day savings in how we do that. We have done that by centralising a lot of the processes and by centrally getting a cognitive scale. We internalised the whole maintenance operation, bringing some 15,000 people into the organisation, and that act alone saved the cost of running the railway some £264 million every year. So all of those savings go into reducing the costs of running a railway, which eventually is passed on to passengers and to the taxpayer.

Q199 Graham Stringer: Why then, if you are so efficient—and the train operating companies tell us that they are efficient—are we not seeing the savings from franchising that we see in the bus industry? There are figures that have been provided for us by academics that say that the costs are going up efficiently—are we not seeing the savings from franchising that we see in the bus industry? There are figures that have been provided for us by academics that say that the costs are going up considerably more than the miles travelled. Why is that?

Mr Coucher: I cannot comment.

Q200 Graham Stringer: I will put it another way. There is a mystery, is there not? We look at the net figures and it is £5 billion going into the railways this year and everybody tells us their part of the system is ever more efficient and effective, yet the bottom line is £5 billion. Can you explain that?

Mr Coucher: Yes, there are day to day efficiencies coming out of both the train operations, through the franchising process: they negotiate hard and get efficient costs out of the train operators and the costs are coming down, although to some extent the variable element of a training operating company’s costs are quite small. They have a fixed number of drivers to run a fixed service, you cannot take drivers out and you need to provide a certain level of staffing; the train leasing costs are largely fixed in the long-term and our track charges, as I have explained remain constant. On the Network Rail side we are saving a huge amount of money in the operating and maintenance costs, which is our signals and our maintainers, and those have come down by some £400 million. Where there has been a significant increase in expenditure—expenditure not efficiency—is we are doing three times the volume of...
work in renewing a very tired and exhausted asset, so we are renewing some 800 miles a year on track and in the last year with Railtrack we did 100 miles. We are replacing signalling systems and we spent some several billions of pounds investing in West Coast and Southern paths. There is a lot of new money going in to provide better serviced and that is where the increase in subsidy has come from.

**Q201 Graham Stringer:** There is a tendency for franchises to get less long. You have given a preference for seven years—and the government seem to want to have shorter franchises. Mr Field, do you think that the cost of franchises, which seem to be about £3 million for the bids, do you think that is a reasonable cost to have? It would be smaller if the franchises were longer? Is the taxpayer, the passenger getting fair value for money out of that system?

**Mr Coucher:** I cannot comment on the cost of bidding franchises.

**Q202 Graham Stringer:** Anybody else?

**Mr Scales:** I think the cost of bidding franchises, if you do it properly you have to take a long time, you have to do all the work so they do cost millions and that is one of the reason we have gone for a long franchise because we have sunk that cost now and we do not have to repay it every year for 10 years. So I think if you do it once and you have a long franchise, that is fine. That is part of the reason, Mr Stringer. I disagree with short-term franchises because you have to get the bidders on board and put in a lot of time and effort and it does cost millions to mount one of these bids, and if the private sector loses that money and it does not reinvest it in the railway.

**Q203 Graham Stringer:** Can somebody square this circle for me before I finish? There is a stack of arguments which say that the private sector will innovate and change given the time and there will be efficiencies from that. But when I listen carefully to what everybody has said today you are talking about spending large amounts of time specifying the franchises, leasing costs being constant, the costs of access to the network being constant. How can I square that circle? It seems that what is being offered is more like a licence rather than a franchise and I cannot see, particularly after what Mr Coucher said, how you can save money when anybody running a train service has all those costs fixed. How can I marry those two views?

**Mr Coucher:** I am speaking from the infrastructure side. We do quite a lot of innovation. We are investing very significant amounts of taxpayers’ money and we know that we have a very significant responsibility—

**Q204 Graham Stringer:** Mr Coucher. I accept that you are spending a great deal of money on signals and the rest, but what I am really interested in is can the train operating companies, given all those fixed costs, whether they have a three-year, seven-year or 25-year license/franchise that is very heavily specified, even to the level of catering. I understand, in some cases on the trains, can they really make significant savings, whether it is three or 25 years? I am perplexed by the answers you are giving.

**Mr Valk:** A point there, of course, is what do you expect from train operating companies? If you expect innovation from train operating companies or even investment from train operating companies then you should specify the franchise in such a way that that is possible and not specify it in too big detail because then you only execute a franchise. So that is one. Secondly, if you need a period or a length of the franchise where you can do that I think the length of the franchise is important as long as there is continuous improvement. Railways need continuous improvement, the passengers expect continuous improvement, and the length of the franchise should be such and the conditions should be such that it gives continuous improvement. That can be long or it can be short, depending on the franchise. So I believe very much that you need to give the room to the private sector or to the operators to innovate, invest, otherwise you are getting non-execution of contract.

**Q205 Graham Stringer:** In your experience, Mr Valk, what is happening? Are you getting more detailed specification in the bidding for the franchise, or are you being given more space to innovate and change?

**Mr Valk:** The UK franchising regime has come a long way since the beginning and at this moment in time it is a very detailed franchise specification. In the Netherlands the franchise specification is much less detailed, it is a much shorter specification and therefore it allows much more room to innovate and invest.

**Q206 Graham Stringer:** So you think that moving more to a licensing system?

**Mr Valk:** In this way you do and therefore you do not capture the innovation. Another thing, if you will allow me to say, that the railway is the system and what you get by not attracting innovation from the operators and keeping them on a short-term licence situation, is that operators stop thinking about the long-term any more. Therefore the railways start to be very much driven from Network Rail or from the infrastructure, and I believe that there should be a good balance between government who specifies, the operators who are very close to the passengers and the customers, and Network Rail, who is very good in the way they are running the network. There should be an equal partnership, an equal balance, and by shortening the franchise and by making the train operating companies only executing you do not have balance any more. In Holland that balance delivers good results in the long-term. I mentioned in my note the long-term view in the Netherlands, ‘Using and Building’ which is developed in partnership by the industry.

**Q207 Mr Martlew:** Just on that point, surely if the government have put in £1 billion, and I think it is due to go up to a £1.5 billion, into the companies...
then the public are going to say to the government, “You are paying the bills, you must have some say over the operation of the timetable.” So how do we get out of that particular argument?

**Mr Scales:** You have directly accountable politicians in my area that are accountable to the population of Merseyside that have that very right to specify the timetable on MerseyRail and that is why we have done it like that. So we recognise the fact that the government is putting tens of millions into our system and our local politicians have the last say on what happens, and at the end of the day the operator of last resort if anything goes wrong as well. That is one of the attractions that my politicians and my Chairman went for.

**Q208 Chairman:** Mr Valk, I just want to ask you one thing. You do say that in the ten-year framework in the Netherlands there is an annual review and you think that that stimulates flexibility, but does that also affect stability, because you are making the point on the one hand that the franchise has to be reasonably long, but if it is reviewed every year does that not act as a counterbalance?

**Mr Valk:** No, because the framework contract is giving the direction and every year the parties sit together, including consulting with passenger organisations to give the direction for the year. So it is not completely different but it acts in such a way that you have next year plans which are revised.

**Q209 Clive Efford:** Can I just go back to Mr Scales, on the investment that you made in the rolling stock? If you are investing in rolling stock is it not the rolling stock companies that are investing the money and therefore taking the risks? So why is it affected by the length of the contract that the train operators hold?

**Mr Scales:** What we would like to get to is that we are making the direct investment and buying the vehicles ourselves because we are a local authority risk, we can borrow money cheaper than a bank, so what we want to do is have again local determination, local control because we have no shareholders—we do not have to make a profit—we have stakeholders. Anything that we make on the network on that sort of arrangement we just reinvest for the benefit of the people of Merseyside. So what we are trying to do is to again involve local people—local solutions to local issues by local people really—and the powers that we have as a PT under the 1968 Act probably give us the powers to put a person on the moon as long as they start and end in Merseyside, so we have massive powers still there. We do not have to make profits like a bank because we have stakeholders rather than shareholders. It was no good us getting to the point on MerseyRail Electrics, where we just changed all the badges on the staff, we had to refurbish the rolling stock as well and that is what we did, so they looked like new vehicles, so you can see a step change. It has worked because five years ago it was called “Misery Rail” and now it is seem as an exemplar rather than a joke.

**Q210 Clive Efford:** This is a question for all of you, about the transfer of risk. We have had evidence suggests that the transfer of risk is only theoretical, from public to private sector because the rail service is so essential to the economy that the government could not allow the railway to close down. Would you care to comment on that?

**Mr Field:** Certainly from the London perspective you will know from the London Rail concession that we intend to take revenue risks; we believe that the revenue generated in suburban rail travel is London is large driven by the economy and the success of the businesses in London. We believe, therefore, that the risk transfer for suburban operation for the revenue should clearly lie with London.

**Chairman:** The Committee is adjourned for 10 minutes. Thank you very much gentlemen, I will allow you all to escape.

*The Committee suspended from 3.38 pm to 3.46 pm for a division in the House.*

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**Supplementary memorandum submitted by Merseytravel**

During my recent appearance before the Committee as part of their inquiry into Passenger Rail Franchising, I promised some additional details on Merseyrail’s fare structure and some key statistics on the network.

**FARES**

Merseyrail comprises the Northern and Wirral Lines. Our regulated fares can be increased overall by RPI only, and individually regulated fares by only RPI + 2%. By specifying this arrangement in our agreement with Serco/NedRailways, we have maintained total local control over rail fares and have, as a result, announced the smallest fare rises of any UK train operator for the next year in 2005—an average of just 2.9%. The average cash fare on the Merseyrail Electrics system is currently £1.95 in peak time and £1.48 for off-peak travel.

With fares being governed by Merseytravel, we have the ability to deliver some limited demand management on the most popular services. Merseyrail Electrics’ fares policy has also ensured that rail is a feasible alternative to bus as a regular mode of transport in the region.
Services outside the Merseyrail Electrics service are governed by the national fares policy, making them more vulnerable to higher cost increases. On the Northern Rail service and other services into the region, an overall fare increased of RPI + 1 is allowed with individual fare increases of up to RPI + 6. This makes fares more varied compared with those offered on the Merseyrail Electrics service.

The Merseyrail Electrics ticketing structure provides a fair structure for local people, and the policy to maintain fares at RPI levels ensures accessibility to everyone, regardless of their economic circumstances.

**Statistics**

**Number of stations**

There are 66 stations on the network.

**Number of stations with “Secure Station” accreditation**

40% of Merseyrail stations have Secure Station accreditation. 10% of all secure stations in the country are on the Merseyrail network.

Stations granted such status include:

- Aigburth
- Hoylake
- New Brighton
- Aintree
- Hunts Cross
- Old Roan
- Aughton Park
- Kirkby
- Orrell Park
- Birkenhead Central
- Kirkdale
- Ormskirk
- Bromborough
- Liverpool Central
- Port Sunlight
- Bromborough Rake
- Liverpool James St
- Rice Lane
- Brunswick
- Liverpool Lime St (low level)
- St Michaels
- Cressington
- Liverpool Moorfields
- Town Green
- Eastham rake
- Maghull
- Wallasey Grove Rd
- Fazakerley
- Manor Road
- Wallasey Village
- Hamilton Square
- Meols
- Walton
- Hooton
- Moreton
- West Kirby

The Safer Car Parking Scheme is sponsored by the DfT in association with the British Parking Association and is similar to the Secure Station Scheme.

10 car parks have been accredited with Safer Parking Status:

- Brunswick;
- Ormskirk;
- Old Roan;
- Formby;
- Freshfield;
- Ainsdale;
- Birkdale;
- Aintree;
- Town Green; and
- Maghull.

**Punctuality**

Typically before the concession agreement was in place, punctuality had been as low as 86 PPM (Public Performance Measure) but we are now delivering a PPM in excess of 95.

**Trains**

There are 59 units in the fleet covering the Northern and Wirral Line services, of which 47 are required for peak period operation. The entire fleet has recently undergone a major refurbishment programme which was completed during 2005.

All trains now have new interiors and seats, passenger information displays, CCTV, additional bicycle spaces and better facilities for disabled passengers.
Passenger growth

There are now over two million more passenger journeys per year since Serco/NedRailways took over the 25 year concession.

Passenger journeys for 2002–03, the last year before the Concession and for the subsequent years.

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<th>Merseyrail Wirral</th>
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Delays

If we consider the cancellation attribution data over the past year, it is clear that there remain problems with the infrastructure which come under the control of Network Rail. Most of the delays on the Merseyrail network can be attributed to infrastructure failures.

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Investment

As I explained during the course of my oral evidence, one of the key benefits of the awarding of a 25-tear franchise is the amount of locally-focussed investment which we can deliver. Not only does the franchise length provide an incentive for Serco/NedRailways to invest, as they have a long enough period to make a return on their money, but we also ensure that the investment is directed to where it is needed — local decision making.

The tables below provide a brief overview of the projects which Merseytravel has been involved with over the past few years and the improvements delivered on the Merseyrail network.

Liverpool South Parkway £32.0 million
Refurbishment of Merseyrail Fleet £34.2 million
Station Design £400,000
Formby Interchange £550,000
Kirkby Interchange £600,000
Maghull car park* £600,000
Birkdale car park £500,000
Hoylake improvements £750,000
Underground station concourse upgrade £750,000

* In progress, completion shortly.
City Line Improvement

Whiston Interchange £300,000
Refurbishment of St Helens Central Design £1 million
and initial work construction work*
Lime Street CCTV £100,000
Lime Street Gateway** £1.5 million

* A further £5 million will be spent on St Helens Central.

** Commences in September 2006.

I would like to thank the Committee for allowing Merseytravel to give evidence as part of this inquiry and should the Committee require any additional information then please feel free to contact me.

2 August 2006

Supplementary memorandum submitted by NedRailways Ltd

As I indicated to your committee, I would like to submit a limited amount of extra information which I feel is relevant to your deliberations but which we were unable to cover due to time constraints. Therefore, I have provided a concise note relating to the features of both the Dutch core and regional contracts.

CORE NETWORK

This section covers four broad areas relating to the way in which the core network, currently operated by Nederlandse Spoorwegen (NS), works in the Netherlands. These are:

1. the public service ethos;
2. the degree of flexibility;
3. the level of control which the Dutch state exerts on the railways; and
4. the nature of risk and investment under the concession.

1. Serving the public interest

NS has a 10-year concession for passenger services on the core network, granted by the Dutch Government, since 1 January 2005. Government policy is oriented towards facilitating and promoting rail transport, particularly in areas where rail provides the most efficient modal solution, such as urban and inter-city commuting routes during peak periods. The Dutch core network is in this respect regarded as key to the Dutch national economy as is freight by rail.

In addition the Government believes in providing a basic level of transport provision as a social necessity in sparsely populated rural areas, where providing such a public service promotes economic development and enhances people’s social and cultural life. The responsibility for these services has been passed to the regional authorities. Regional rail services are tendered as an integral multimodal package which includes rail, bus and hire vehicle provision. (see “Regional Tenders”)

The Dutch legislation envisages an institutional framework for transport, including the railways, in which precedence is given to providing services that run well and meet these economic and social goals. The basic principle underlying the legislation is that the quality of rail transport, as experienced by the passenger, is the end result of the efforts of the rail sector as a whole. In the institutional arrangement, the relationship between the controller (ProRail—the organisation responsible for managing the national rail infrastructure) and the train operator is key: together they promote the railway. This is not dissimilar to the UK situation in principle. However there are two essential differences to be noted:

1. For the core network close and full cooperation between the rail infrastructure provider and the major passenger operator (NS) and freight operator (Railion) is fostered through governmental policy (as an example jointly owned tools and systems). In addition NS can draw from a wider breadth of expertise than the UK TOC’s (as an example stations and station development) resulting in less fragmentation.

2. The regional networks benefit from enhanced understanding of local service requirements which includes multimodal transport solutions. For city operations which will currently go through a process of tendering the same will apply.
2. A flexible approach to managing and operating the concession

The Government’s is keen to ensure a properly operating railway system, judged on results. This requires a stable operating environment in which all the parties involved can maintain a focus on delivery. The relationship between the Minister and the operator has to be clear and stable, which can best be guaranteed by a concession that is future-proof—ie one where there is a clear understanding of what is required over the duration of the concession.

There is, however, a tension between long-term stability and meeting short-term performance goals. The Minister wants the operator to meet its annual performance targets, whilst the operator wants as much certainty as possible about the duration and conditions of the concession—all this takes place against a background of an operating environment which is still relatively new to everyone involved, and a developing relationship between Government and the operator. These conflicting aspirations are resolved through the balance of a long-term (10-year) concession and a transport plan which contains performance indicators which are monitored and reviewed on an annual basis. Also, there is specific guidance within the concession which aims to foster a professional understanding of the appropriate boundaries between Government and the operator.

3. State involvement in the railway

The Government exercises broad strategic direction over operators and judges it according to results, rather than becoming involved in micromanagement and the underlying business processes.

Although NS is judged by annual performance indicators which are set out by ministers in the transport plan, there is an acceptance that much of NS performance in output terms can be affected by third parties (including ProRail) and external factors; so NS’s performance is also judged on inputs, which demonstrate commitment in improving performance on essential parameters. A practical example of this is a project to improve the closing mechanism on train doors, which has a positive effect on service reliability and punctuality, both key parameters in the annual plan.

The Government’s “hands-off” approach also can be seen in the way close working amongst the different organisations in the industry is encouraged. As a result, NS, Railion, ProRail and all the operators have all equally committed to establishing an agreed improvement plan. Whilst the objectives for this process have been set out in a long-term plan, there is a focus on setting and achieving short-term results.

Underlying the improvement plan is a partnership approach where knowledge, information and support systems are widely shared as well as a management ethos which promotes understanding of the business processes. This is cascaded throughout each organisation, indeed the whole industry. One aspect of this is building up the professional skills of staff in the operating companies to gain a better understanding of the relationship between financial resources and performance. Through this experience NS and ProRail have deepened their mutual understanding of the relationship between operational goals, activities and results.

4. Risk and investment

NS runs the concession at its own risk and at its own expense. Therefore good business practice is key to NS’ continued improvement. Often this is about getting the basics right: for example, ensuring that the assets retain their Value, that sufficient rolling stock is well maintained, that the workforce is well-trained and motivated.

The Minister imposes a duty of care on the train operator for running the concession—this translates into an obligation for NS to design and implement a transport plan to provide the levels of service the Government requires. The concession also contains a number of specific obligations, including:

- the quantum and frequency of services provided;
- the timetable;
- travel information;
- fares;
- range of tickets/passes and conditions of carriage;
- through ticketing and the availability of tickets;
- bicycle storage;
- consultation with regional and local tiers of government, passenger organisations and other community stakeholders; and
- carrying out a customer satisfaction survey, an evaluation and an international benchmarking exercise.

Along with taking the revenue risk without direct subsidy, NS is responsible for investment in its assets—a major part of this commitment is the rolling stock, but there has also been significant investment in other areas, including station improvements, expanding parking facilities, passenger information systems and smartcard ticketing and gating technology. Some of these investments are undertaken on a commercial
basis. In this respect, the larger-scale investment, particularly the rolling stock, represents a challenge, as NS would find it impossible to recoup the cost given the length of its concession. The Dutch government has given clear assurances that at the end of the concession there will be a financial settlement which adequately compensates the company for its risk. The precise nature of this solution has yet to be established, but NS and the Government are in constructive discussions on the issue.

**Regional Tenders**

The authority for railway lines that are not part of the main rail network has been transferred from the national government to the various levels of regional government which have had responsibility for transport provision devolved down to them, namely: cities, provinces and the “framework act areas” (in parts of some provinces and cities there has been a further stage of devolution, where one of the devolved responsibilities is public transport).

These devolved tiers of government have the authority to put these lines out to tender. They often choose to put them out to tender by means of an intermodal concession, including bus transport and contracted taxi services. They have responsibility for negotiating with ProRail over the number of services they want and their desired timetable. ProRail has to abide by specific guidelines to ensure this is done in an even-handed and non-discriminatory manner.

As the main carrier, NS often holds discussions with regional carriers and/or local authorities in order to match up preferences and possibilities. However, ProRail makes the final decision as to the allocation of service provision, although effective communication between the core network operator and the regional carriers and/or local authorities ensure that regional preferences and priorities are met.

9 September 2006

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**Memorandum submitted by the Halcrow Group Ltd**

1. **Summary**

We should state at the outset that passenger rail franchises have, in our opinion, been one of the notable successes of rail privatisation. They have reduced costs (those under their control), significantly grown revenues and introduced a wide variety of innovative products. There is, however, room for improvement whilst the energies of those responsible for administering and monitoring the wider rail system will always benefit from being focussed on where they can have maximum benefit.

We have attempted to address each of the questions posed by the Committee. Our main points are as follows:

- We consider there to be two main purposes of rail franchising:
  - The delivery of value for money from the public funds invested in the rail sector; and
  - Development of a rail system to meet the nation’s strategic needs.

There is good evidence that the franchising process is achieving the first purpose; the second is not being effectively met:

- The franchising process is working reasonably well and the change from SRA to DfT Rail has been relatively smooth. DIT Rail has made a number of significant improvements to the process. One major concern is over the cost to bidders and possible barriers to entry for new bidders.
- Competition is critical to the success of franchising in particular and the privatised rail system in general. By this, we refer to competition in the procurement of franchises and not rail-rail competition for the carriage of passengers. In general, a good level of competition has been maintained over the past few years and this remains a strong argument for not reducing further the number of franchises or lengthening their terms.
- A case for greater vertical integration within the industry may exist. This must, however, enhance and not reduce levels of competition which we believe are key to ensuring value for money.

2. **Introduction**

Halcrow is delighted to have this opportunity to contribute to the Committee’s inquiry into passenger rail franchising.

Halcrow has been involved in the privatised rail industry since the early 1990s, indeed, Halcrow acquired the first part of BR to be privatised when it bought Transmark, BR’s transport consultancy, in 1993. Since the mid-1990s, Halcrow has worked with a variety of public and private sector rail clients providing a range of services in support of the franchising of Train Operating Companies (TOCs). Halcrow also works with Network Rail, Roscos, and other industry clients. In 1996, Halcrow bid in its own right (unsuccessfully) to
operate the Cardiff Valleys Railway Company, one of the smaller TOCs to be franchised. Halcrow is currently providing technical support to DfT Rail on the re-franchising of South Western (currently South West Trains and the Island Line franchises).

The following sections of this memorandum address each of the Committee’s questions in turn.

3. **Main Response**

3.1 *What should be the purpose of passenger rail franchising?*

We have interpreted this question as pertaining to the franchising process and not rail franchises *per se* (which are concerned with safe, efficient and reliable operational performance). We consider there to be two main purposes:

— The delivery of value for money from the public funds invested in the rail sector; and

— Development of a rail system to meet the nation’s strategic needs.

There is good evidence that the franchising process is achieving the first purpose and has been doing so for some time. Subsidy levels have continued to fall over the past decade, notwithstanding changes to the accounting procedures and investment needs of the infrastructure owner. The number of franchises moving out of subsidy and into premium payments is steadily increasing, whilst passenger numbers have grown by over 25% since privatisation. Maintaining a high level of competition amongst bidders has been central to achieving value for money goals. This will be a critical issue going forward.

We believe that the second purpose has been less well achieved. There have been many effective and innovative developments within privatised TOCs over the past decade, including more flexible fares regimes, customer service improvements, procurement of much improved rolling stock, etc. However, franchisees have limited control over the wider rail system, which is characterised with a number of interfaces. The franchising process has not been particularly successful in enabling working across these interfaces to bring about material strategic development of the system. The high cost of the West Coast Route Modernisation, failure to deliver Thameslink 2000 and ongoing capacity constraints in SE England are put forward as evidence of this failure.

The SRA under Sir Alasdair Morton (1999–2002) attempted to drive strategic network development through TOCs but this attempt failed amid the general upheaval following Hatfield. It also failed to recognise the importance of public sector leadership of major transport strategies and over-estimated the ability of the private sector to deliver strategic rail development.

The rail system is now approaching the point at which strategic development is key to future growth and success. Therefore this second, strategic, purpose is of growing importance as the system approaches capacity and the need grows for greater patronage of sustainable public transport.

The decision to take back franchising within the DfT provides an opportunity to address some of the strategic failures of the last decade. However, rail is a notoriously complex and demanding industry. Strategic development will require a coordinated approach to the industry as a whole (not just franchising) along with considerable investment of time and capital.

3.2 *How well does the process for awarding franchises work?*

The process seeks to achieve a balance between allowing the market latitude to determine how it will operate and develop a franchise and providing clear leadership on those policy objectives that the franchise is expected to achieve. To some extent, changes to the franchising process over the past decade have reflected changing emphasis in this trade-off.

The process, as it stands, works reasonably well and has improved in a number of important ways (eg: through being better aligned with the EFQM process used in other areas of Government procurement), although there is concern about the cost and complexity of the bidding process. There is now evidence that, under the DfT, lessons from other areas of Government involvement in PPPs, such as the Pfi programme, are being applied (eg: through the transfer of staff from other Pfi departments to DfT Rail).

Bid costs and complexity are a concern, as these have the potential to pose major entry barriers and foster duopolies, to the detriment of competition within the market.

*Inputs of various stakeholders into the design of franchises?*—The formal consultation process mirrors that carried out in other fields of Government transport planning. Stakeholders have the opportunity to put forward views, though there is no guarantee that these will be reflected in the design of franchises. This is probably right and we consider it more important that clear policy leadership is provided than franchises be over-sensitive to the needs of various minority groups.

*Has there been a smooth transition to DfT Rail?*—The transition has probably proceeded better than many expected and appears to have been reasonably effective.
3.3 Are franchise contracts the right size and length?

We see this key issue as seeking a balance between the efficiencies and scale economies that result from, perhaps, fewer, larger, longer contracts and maintaining an active and competitive market, with opportunities for new entrants. We believe strongly that the interests of the Government and the wider community are best served by, first and foremost, ensuring that competitive forces are as strong as possible. We would counsel caution over further reductions to the number of franchises or increases in their length.

Criteria and process to determine length—The current process attempts to foster competition at the bidding stage and to reward good performance with an extension to franchise length.

The maximum franchise length has been reduced over the past few years from 15 to 10 years. We would support this move as something likely to increase competition and enhance value for money.

Franchises have an element of performance management built in, with good performance having the potential to be rewarded with an extension of several years (normally up to three). Our observations suggest that this approach is successful in incentivising franchisees to perform and, if anything, should be enhanced and strengthened.

What criteria and processes are used to evaluate franchise bids?—Bids are evaluated against a set of researched operating criteria (ie: factors that DfT would like bidders to provide) within an EFQM appraisal framework. The operating criteria are a mix of general and franchise specific items covering those issues of particular relevance to each TOC, such as crowding, rolling stock procurement, staff management, revenue generation, etc. The EFQM framework provides a strong link with OGC best practice and represents a robust and transparent method for scoring each bid. We believe this is an effective and fit-for-purpose approach. Our only comment is that, after several years of significant changes to the evaluation methodology, a period of stability and consistency would be of benefit.

Do franchise holders deliver value for money?—Reasonable evidence exists that most do, although there are a number of areas of concern. Declining subsidy levels and growing passenger numbers suggest that the UK rail network is delivering greater value for reduced State inputs. Performance is also improving (in general) whilst investment is also starting to grow.

Areas of concern are as follows:

- Fares are rising, in particular peak fares, and this could have a detrimental economic impact in the absence of compensating fare reductions (eg: off-peak). We would favour minimal increases to the average “basket of fares”, with increases in some areas being compensated for by significant reductions elsewhere. Smart cards allow significant potential in this respect. We strongly recommend that economic evaluation be used to ensure that major changes to fares always generate net benefits to society at large and are not simply mechanisms to raise revenue at the expense of overall value for money.

- Franchisees are constrained by the capacity and performance of the infrastructure network. The point is approaching at which major investment in and significant improvements in performance of the infrastructure will be required if the system at large is to continue to generate economic benefits. We believe Government and DfT will generate increased benefits from greater focus on these issues than more marginal improvements to operating franchisees.

Are risks suitably apportioned?—In general we believe risks are well apportioned. We believe some additional scope exists for strengthening and broadening performance management of franchises, for example, by including a wider range of quality factors in the formal performance management system (eg: in addition to service reliability). These may include “soft” measures such as passenger attitudes, and “harder” measures such as station cleanliness and booking office performance.

Scope for improving services?—As noted above, enhancements to the performance regime may be beneficial. However, greater focus on infrastructure performance and development will, we believe, deliver a growing return over the coming decade.

3.4 Do we need more competition and vertical integration?

Open access—We have major reservations about the net benefits of open access operations. There is not strong evidence that rail-rail competition is a significant factor in delivering greater value. It also tends to divert and dilute scarce industry resources. Franchisees may also begin to build the risk of open access competition into their bids, which could reduce value for money. We believe the rail industry as a whole should be viewed as an integrated system that is primarily in competition with other modes such as car and air.

Integration of operations, rolling stock, etc—This is a complex issue that does not lend itself to a simple answer. We would suggest the following:

- Franchisees are one of the successes of rail privatisation and are delivering growing value.
- ROSCOs have been less successful and the high cost of rolling stock is a serious constraint on further development of the rail system.
— Infrastructure management has not been a success to date, the assets being expensive to maintain and develop and the performance of a single monopoly owner being difficult to gauge.

— Infrastructure development has also not been a great success, with WCML Route Modernisation being significantly over budget, late and possibly over-specified whilst other major projects, such as Thameslink2000 remain at the planning stage.

— We are not convinced that competitive forces are maximised in either the rolling stock or infrastructure management markets, or that regulatory forces are adequately compensating for this.

— Greater integration could be of benefit if the benefits of the operating franchises can be retained and spread to the management of rolling stock and infrastructure. In particular, if greater direct (or indirect) competition can be introduced to these areas through more integration, we believe a case could be made.

4. Conclusion

We have attempted to address each of the questions posed by the Committee, however, we make two major points on a number of occasions that deserve prominence in this summary:

1. competition is critical to the success of franchising in particular and the privatised rail system in general. By this, we refer to competition in the procurement of franchises and not rail-rail competition for the carriage of passengers. In general, a good level of competition has been maintained over the past few years and this remains a strong argument for not reducing further the number of franchises or lengthening their terms.

2. whilst significant improvements and value for money have generally been achieved by the operating franchises over the past decade, the point is approaching at which the network infrastructure will become the principal constraint on any further material enhancements to the quality of service or capacity. The ability of the franchises to drive further significant improvement will become severely limited. The focus of Government and the wider industry should therefore move to the area of network development.

A final significant point is that the transition from the SRA to DfT Rail appears to have gone well, probably better than many expected. However, the main criterion of success will be DfT’s ability to address the significant issue of major network capacity enhancement upon which the long-term success of franchises will ultimately depend.

26 June 2006

Memorandum submitted by Mott MacDonald Ltd

1. What should be the purpose of passenger rail franchising?  

Is the current system achieving that purpose?

1.1 The fundamental principles of passenger rail franchise should remain delivering a quality of service that offers value for money within the financial constraints of the government. Increasingly this means that the passenger must pay for network enhancements to compliment the significant network maintenance investment funded through Track Access Charges.

1.2 Within the growing UK economy, transport congestion is increasingly affecting economic efficiency. All urban transport networks (particularly in London and the South East) are operating at saturation levels. The importance of protecting our natural environment is generally recognised and therefore the sustainable land-use and transport policies will continue to influence national transport policy. The Victorian railway assets have been utilised to their optimum level without appropriate renewal and investment, particularly over the last 30 to 40 years. There are only limited opportunities for significant capacity enhancements as the network continues to balance the needs for urban commuting, inter-urban travel and freight. One critical area for possible review through the High-Level Output Specification [HLOS] will be the trade-off between performance and capacity—as recent timetable changes has seen the introduction of lower train frequencies and therefore capacity, for example, South West Trains and one Railway, to improve performance.

1.3 The inclusion of the Base Case Specification for service provision in the franchise Invitation to Tenders, leads DfT Rail to take responsibility for assessing this performance and capacity trade-off, and ensuring appropriate capacity for growth is built into the specification. With the rail industry framework for regional and corridor strategies (the Regional Planning Assessments for the next 10 years) and detailed plans (the Route Utilisation Strategies for the next 20 years) on-going, it is not clear that DfT Rail will be able to fully address the capacity needs currently for franchise renewals (for example, the Consultation Document on the New Cross Country Franchise, DfT, June 2006, does not include forecasts for the franchise period to confirm the adequacy of the service pattern specifications).
2. **How well does the process for awarding franchises work?**

*What input do operators, passengers and other interested parties have into the design of franchised services?*

*Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?*

2.1 We believe that the current system is cumbersome and onerous, both on the bidders and DfT Rail. It is unclear whether there is sufficient and appropriate information available in a timely manner to bidders—an external audit (possibly by the National Audit Office) of the information made available may be an effective process in the short-term. A process of Supplier Accreditation for all franchises for a fixed period (three to five years) as opposed to Accreditation for each individual franchise may be an appropriate simplification of the process.

2.2 There is a concern within the industry that the financial bids (which in the initial franchise process it is understood showed significant variation between bidders) are narrowing as the market matures. With all bidders invited to tender meeting high quality levels in operations and service, the process must be able to differentiate between relatively small differences in the offers, without being open to legal challenge, which may put increasing onus on DfT Rail in the procurement process.

2.3 The transition from the Strategic Rail Authority to the DfT resulted in a short (though noticeable) delay in the franchise process, though there has not been perceived any significant change in the implementation of the process between the two organisations. Key decisions, such as the procurement of the new rolling stock for the domestic services on the Channel Tunnel Rail Link within the Integrated Kent Franchise appeared to have been delayed as a result of the transition.

3. **Are franchise contracts the right size, type and length?**

*What criteria and processes are used to determine the nature and length of franchises?*

*What criteria and processes are used to evaluate franchise bids?*

*Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?*

*Are risks suitably apportioned between the Government and franchise holders?*

*What is the scope for improving services through franchise agreements?*

3.1 Short (seven year) franchises clearly reduce the forecasting risks inherent in the franchise process with an appropriate revenue risk and reward mechanism. Short franchises afford the Government and bidders a sound basis for the short-term development of the network. Bidders investment will remain low in this approach, as there is generally insufficient time for the necessary financial rewards to be delivered in a seven year franchise. It is unclear how major new schemes can be funded through short franchises, and therefore may require bilateral agreement between DfT Rail and Network Rail to ensure capacity and performance schemes are developed and implemented.

3.2 If this duration is retained, DfT Rail will need to take appropriate leadership in the national rolling stock strategy (including rolling stock cascade between franchises) and procurement (including investment). Unlocking the reported high profits for re-investment in the rail industry from the rolling stock leasing companies should be a key objective of the next round of franchises.

3.3 This leads to a trade-off between franchise length and DfT Rail investment and leadership. The longer the franchise, the less public sector investment may be required and possibly less direction on the implementation of the UK rail strategy will be required by central government.

4. **Do we need more competition and vertical integration?**

*Is franchising compatible with open access operations?*

*Should train, rolling stock and track operation be more closely integrated?*

4.1 It remains unclear whether there is sufficient income within the industry to attract new Open Access Operators—where these have gain access rights (such as Grand Central) there have been very serious concerns raised on the viability of existing franchises. Therefore, we believe that competition should primarily be through the franchise process rather than the franchise map.
4.2 The contractual complexity of UK rail industry (irrespective of the financial implications of profit on profit with each supplier) leads to the natural conclusion that vertical integrated businesses may offer a more efficient operation and probably financial return. We believe that it is worth investigating the intermediate position (as implied by the question) to integrate operations (signalling and control) and rolling stock delivery with the franchise, retaining the separation of the infrastructure from the train operations.

21 June 2006

Memorandum submitted by MVA Consultancy

1. INTRODUCTION

This paper is a response to the Transport Committee’s request for submissions to advise on its Inquiry into Passenger Rail Franchising.

MVA is exceptionally well placed to provide informed comment, as we have been involved in rail franchising from its outset up to the present day, having advised both the Strategic Rail Authority (SRA) and many bidders on franchises. Our advice has covered the whole range of issues from demand and revenue to costs and rail operations, and included franchise bidding strategies.

The following sections respond to each of the main questions asked by the Committee; the last section is a summary and conclusions.

2. What should be the purpose of passenger rail franchising?

Historically, there has been wide variance in the “success” of franchisees; from GNER’s customer focused approach, to Connex’s operationally based approach. However, rarely has the enthusiasm of the bidding phase been carried through to implementation for the benefit of the rail traveller. This has largely been because franchisees have not been sufficiently encouraged to see franchising as an opportunity to improve their part of the railway network during their tenure of the government owned asset.

Government objectives from franchising have changed markedly over the 11 year period. It started as minimum cost subject to meeting a specification, moved through “investment, investment, investment”, and has now come close to full circle back to minimum cost.

It has certainly achieved some successes. A very strong growth in demand, although a significant element of this has been due to fares regulation at RPI + 1% (later RPI +1%) compared to the previous British Rail (BR) increase of approx RPI +2%. The overall cost of the railway is, however, substantially greater than under BR.

We would suggest that the purposes of rail franchising should be:
— To provide best value for money—government needs to be explicit over how it measures value for money.
— Continue to bring private sector flair and disciplines into the railway industry.
— Apportion risk appropriately to those best able to manage it (franchise holders/government).
— Remove as much as possible bureaucracy.

We would suggest that the current system fails to deliver any of the above objectives fully.

3. How well does the process for awarding franchises work?

The current process is very prescriptive in terms of many elements, especially the timetable to be operated. In none of the cases we have seen has the specified timetable been the best, measured by almost any appropriate criteria. Indeed, in some cases it has been inoperable. Yet the base case which has to be on the specified timetable is the one that is evaluated. In theory no credit is given for operating an improved timetable if this is even slightly non-compliant.

The change from the SRA to the DfT has not had a major impact. We have some concern that a substantial amount of expertise has been lost, but it is too early to say what, if any, the impact of this has been. We do note that since responsibility has passed to the DfT, the quality of information in the dataroom has declined, possibly due to the DfT not having the level of expertise required to control the provision of data by incumbent TOCs.
4. *Are franchise contracts the right size, type and length?*

Geographical structure of franchises

Recent changes in the geographical structure of franchises has been to merge Intercity, London and South East and Regional TOCs. This is driven by the relationship with Network Rail and is effectively engineering led. There must be a concern that there will be a loss of market focus, as a TOC concentrates on commercial action in the larger revenue areas to the neglect of regional areas. This was identified by BR as an issue many years ago when sectors were introduced; care will be needed to ensure the benefits of market focus is not lost. It is too early to see any evidence either way on this.

Franchise length

A key driver behind the debate on franchise length has been influenced by a consistent and mis-guided view that the length of franchises dictates the amount of investment a TOC is willing to make. In truth, as was proved by the SRA, TOCs do not have balance sheets able to support capital investment. Capital investment is either undertaken by the franchisee, Network Rail or some form of bank or finance house. Where investment of this kind is made, the funder merely needs to take a commercial view as to whether the asset will be of use beyond the length of the current franchise, and therefore lease payments made, or whether it needs a government underwriting to protect its position. In either case, there is no additional cost or risk to the TOC.

The length of a franchise should therefore be judged purely on the basis of minimising upheaval, whilst maximising commercial advantage. As a living operation, disruption of any kind has a serious impact on the railway. Only now is the railway regaining pre-Hatfield performance levels and although not as dramatic, morale and efficiency are affected by staff morale being influenced during the bidding process. Handing a franchise over for a longer period also gives the franchisee a greater sense of “ownership” and therefore being more likely to undertake revenue investments, such as staffing levels, to maximise its advantage.

However, from a taxpayer’s perspective such long term contracts do not represent value for money, as the longer the franchise the greater the risk to the franchisee, which in turn it “prices” into the bid. Especially where the disruption and implementation of a major project interacts with a franchise, the length of the contract should be such as to minimise the potential interference.

Finally on this point, the franchise process leads to change only occurring (or being determined) at the commencement of a franchise, as any subsequent changes (unless they are financially positive for the TOC) are sole source negotiations between government and the TOC, which rarely lead to value for money for the government.

We would probably recommend franchises of about 10 years length, but with clear breakpoints which would depend on continuous monitoring of quality as well as financial indicators.

Franchise Evaluation criteria

Essentially the current criteria is lowest subsidy/highest premium subject to meeting a quality threshold. Only in the event of close to a tie is the relative quality of bids taken into account. Furthermore, the evaluation is based only on the base case. It is possible therefore for a brilliant franchise bid to be rejected if the base case was not as good as that of another bidder; this is clearly not optimal for either the government or the passenger.

The evaluation should be based on the bidders’ preferred proposal, with the base case being required, but only used for comparison purposes.

Service improvement and on-going value for money

Once a bidder has won, it is no longer incentivised to deliver either value for money for government or improvements for passengers. It merely needs to deliver what it is contractually bound to. If track record played a higher part in the chances of winning future franchises, then franchisees would be incentivised to continue to deliver improvements—clearly a methodology would be required to ensure new bidders had the ability to win, perhaps by demonstrating track record in other countries.

Risk

The nature of franchising means that the winner will always have the most optimistic forecasts (highest revenue/lowest costs) subject to plausibility and quality thresholds. This means that the winner will almost certainly have a significant risk of failing to achieve its forecasts. This risk will have been built into the cost of the bid by bidders, as in the long term must the bidding costs. Over the first franchise period, economic prosperity was significantly higher than would have been forecast at the time of bidding. Yet, several
franchises got into financial difficulty. Economic growth is the single most important driver of demand in most if not all franchises; the franchise process means that TOCs take the risk for this, even though they have no control.

The government has said that it will not bail out a failing TOC; this may work in the context of a specific TOC, but if the failure is a result of a downturn in the economy, then many (maybe all) TOCs will be in a similar position, and if the government is true to its word, then it will have to relet all franchises at the same time, and will get lower bids for all of them. It must be remembered that the money invested in a franchise is small—perhaps £10 million of cash plus a performance bond from the parent company. After a few years, if all goes well, the owning company will have substantial retained profits, and if the finances going forward look poor it will be prepared to hand back the franchise. Thus, whatever it says, the government retains risk associated with significant economic impacts.

5. Do we need more competition and vertical integration?

Open access operation and franchising are incompatible. Value for money and improvement should be managed within the franchised environment, otherwise the taxpayer will lose out. Open access competition is inevitably abstractive to the franchised railway as a whole and the additional access charges sought do not adequately recompense Network Rail for the additional asset usage. The reasons that fundamentally structured the franchise railway in the shape it is remain, and further de-regulation should be avoided.

The interface between train, rolling stock and track operation has improved substantially since the early days of franchising. However, more can, and must, be done by senior managers to align the incentives of their staff. The industry itself may still require more discourse in order to understand whether changes to the highly divisive performance regimes could bring benefit, but in the meantime the focus should be on delivery rather than contractual disagreement. Vertical separation is required by EU law; it may not have been implemented well in the UK, but it is now being made to work, and we would not recommend another contractual change.

6. Summary and Conclusions

— The primary objective for rail franchising should be to provide best value for money—government needs to be explicit over how it measures value for money;
— The current system fails to deliver the above objective fully;
— The evaluation should be based on the bidders’ preferred proposal not the base case which it is currently; the base case is required, but only used for comparison purposes;
— Track record should play a higher part in the chances of winning future franchises so as to incentivise TOCs to continue to deliver improvements;
— Care is needed to ensure the benefits of market focus is not lost with the transfer from sector based (Intercity/London and South East/Regional) to geographical based franchises;
— We recommend franchises of about 10 years length, but with clear breakpoints which would depend on continuous monitoring of quality as well as financial indicators;
— It is inevitable that the government retains risk associated with significant economic impacts however it structures franchises, as TOCs can have no control over this;
— Open access operation and franchising are incompatible; value for money and improvement should be managed within the franchised environment;
— Vertical separation is required by EU law; it may not have been implemented well in the UK, but it is now being made to work, and we would not recommend another contractual change.

23 June 2006

Memorandum submitted by the Railway Consultancy Ltd

1. Introduction

1.1 The Railway Consultancy Ltd is an independent railway planning consultancy which works with Government, Train Operating Companies (TOCs) and other rail industry participants. Our wide range of experience has enabled us to draw some conclusions about the efficacy of the privatised railway and the range of franchise types which have existed over the last 12 years. In addition, two members of staff have particular expertise in this area. Nigel G Harris co-authored the first analysis of the impacts of rail privatisation, whilst James M Watts recently completed a PhD in rail franchising policy. This submission therefore includes both our own views, and those canvassed during research.
1.2 First, however, one critical observation must be made. It is invalid to allege any simple correlation between rail industry structure or franchise type with traffic growth. Whilst some franchises have undoubtedly been more successful than others, the main determinants of rail demand in Britain are Gross Domestic Product (GDP) and employment in Central London. Other non-rail industry (“exogenous”) issues such as road congestion and petrol prices are also relevant, but sustained economic growth over the last 10 years has been the driving force behind the growth in rail traffic, a renaissance not foreseen by those who originally drew up the plan for the privatised railway in the early 1990s.

1.3 Once they had decided on a franchising model for passenger rail services, however, it still remains critical to clarify the details of this process. For instance: How are bids to be assessed? What objectives are sought for both Government and franchisee? This response is designed to assist the Transport Select Committee’s Inquiry into improving this process.

2. THE PURPOSE OF FRANCHISE RAIL FRANCHISING

2.1 A number of benefits of the rail franchising process have been adduced in the past. These include (Wolmar, 2006):
- greater efficiencies accruing with private sector management;
- the flair and marketing ability of the private sector;
- easier access to capital;
- greater incentive to invest;
- transfer of risk to the private sector;
- to reduce Government expenditure/provide Value For Money;
- to reduce political involvement; and
- to minimise the impact of industrial relations.

The assumed underlying aims of these are, one would hope, increases in passenger numbers, revenues and satisfaction, but these latter aims are not necessarily coincident. They need to be examined in turn.

Greater Efficiencies in the Private Sector

2.2 Although British Rail was widely criticised by the media and politicians, early entrants to the privatised rail franchise market quickly found what academic research at the University of Leeds had already found, viz. that BR was one of the most efficient railways in Europe (eg in terms of train-kms per member of staff). The possibilities for greater efficiency, in particular, were grossly over-estimated by some of these early players, a number of whom subsequently either went bankrupt or left the industry.

Flair and Marketing Ability in the Private Sector

2.3 The ability of the private sector to market itself is indeed in contrast to what Government agencies might feel appropriate; for instance, it is difficult to conceive of a Government department laying on the types of event that Virgin has, in connection with the West Coast Main Line upgrade. However, local marketing flair is of less value in a network industry such as the railways, where some degree of consistency between franchised elements has benefits to passengers. The detailed knowledge required to develop successful local (fares, service) initiatives is, we believe, better provided locally, which has implications for the type and organisation of franchise.

2.4 The degree to which the private sector has been able to take advantage of its skills in this area has also varied. In the early years in which franchises were only broadly-specified, a number of franchisees took advantage of this flexibility to reduce services. This was entirely to be expected. Within the current financial situation of the railways, competing against a road network taxed in a different way, most train services are simply not profitable. Conversely, during 2005, the Department for Transport specified some franchises (eg Greater Great Western) so closely that it is difficult for the franchisee to take forward any service development proposals.

Easier Access to Capital

2.5 Although the Government should in theory have virtually unlimited access to funds for rail investment (and at low interest rates), in practice this is limited by the Public Sector Borrowing Requirement. In addition, there is competition for this money against other alternatives eg hospitals and schools. In contrast, whilst the private sector must pay higher interest rates, there genuinely is a huge potential for borrowing for investment—especially when a key sector of the rail industry (the Rolling Stock leasing companies) are in the hands of major banks. This therefore is a benefit of the current arrangements, although somewhat by default.
Greater Incentive to Invest

2.6 Franchisees, however, have limited incentives to invest. There are relatively few commercial opportunities for investment in the railways because current operations are largely unprofitable, which is itself a consequence of wider transport policy (e.g., the lack, as yet, of road pricing).

2.7 Although in some cases the Government might require a franchisee to develop a franchise through investment, this is largely using only the project management skills of the private sector. Investment by franchisees on their own initiative has been rather limited, a key factor in this being the relatively short length of franchises. If a project takes two years to complete, then there are only five years of payback within a typical seven-year franchise; it is therefore unsurprising that relatively little such investment has occurred, except in the 20-year Chiltern franchise.

2.8 Moreover, the fragmented state of the railway means that many projects founder. Greater effort is needed to bring all parties to the table, whilst all participants are looking (not unreasonably) for a financial return. Compensation of a disadvantaged franchisee by one making a super-profit gain from a project is only likely if the Government intervenes to encourage them. Alternatively, a developer (unlikely) or PTE (only where appropriate) may have to shoulder the capital cost—for instance, at the recently-opened Liverpool South Parkway, where original discussions included up to seven different train operators.

Transfer of Risks to the Private Sector

2.9 In practice, risks have not been transferred to the private sector. This is partly because of the importance of the railways in providing services for the City of London and Central Government to get to work. More widely, however, one must consider which risks really are within the ambit of the franchisee to control. With GDP and Central London employment two of the key drivers of rail demand, and both outside franchisees’ control, transferring risks associated with these is only possible if the private sector prices in their impact (i.e., increases the price offered to Government) within their bids.

2.10 Recent franchise types with break clauses may also effectively limit risk transfer. If a franchise is re-examined after (say) five years, and the franchisee wishes to exit because the franchise is a commercial disaster, it is in a relatively strong position relative to the Government. The franchisee can limit its future losses by foregoing the exit penalties, whilst the Government is likely to have to pay a higher subsidy/receive a lower premium from an alternative bidder, and it may decide from the position at that time, that renegotiating with the incumbent is more cost-effective.

2.11 A further constraint on the transfer of risk is arising through the Department’s use of “cap and collar” type arrangements. These are designed to avoid train operators making excessive profits or losses, thereby returning a proportion of these to the Government in circumstances in which (implicitly) the franchise payment regime was miscalculated. When times are good, this is equivalent to a form of taxation on these excess profits; however, some of the effective marginal values are rather high (e.g., as much as 87.5%), at which point there is no real incentive for a TOC to make investments. When times are bad, however, this system further reduces the risk actually incurred by the private sector.

Reduction in Government Expenditure

2.12 Because of the difficulties in improving efficiency, but the requirement to make a return to shareholders, there has not been a reduction in Government expenditure on the railways. In fact, our early analysis showed that the additional costs of the over-complex privatised industry structure appeared to dominate the benefits, by about £5 billion pa (Harris & Godward, 1997). The two largest categories of extra cost are interface costs (e.g., the requirements for companies to administer arrangements with another external body) and profit margins along a chain of command (any improvement in efficiency through specialisation has to exceed the “slices” of profit taken by sub-contractors).

2.13 That estimation took place prior to Railtrack’s mismanagement of the infrastructure, which led to the Hatfield accident and the response to it, and Network Rail’s subsequent extra effort and expense in bringing the system into a fit state. With net annual franchise payments to TOCs reaching around £2 billion by 2003–04 (excluding additional payments to Network Rail), compared to payments to British Rail of around £1 billion, we can be absolutely sure that the objective of reducing Government expenditure has not been met.

Reduction in Political Involvement

2.14 It is also sometimes claimed that franchising has the benefit of distancing the Government from day-to-day problems, be these of industrial relations or poor operational performance. There is some credence in this argument, although there is increasing criticism of the Government’s lack of a holistic transport policy in which the railways might function to their maximum advantage.
Minimisation of Industrial Relations Problems

2.15 It is thought that some Conservatives believed that rail privatisation would break the power of the railway trade unions, largely through the fragmentation of the industry and the consequent reduction in bargaining power. In fact, the picture has been mixed. Whilst national rail strikes are less likely (unless, as currently occurring, the dispute is between workers and Network Rail), wage levels have risen substantially in real terms for some grades. In particular, one must acknowledge the tactics of drivers’ union ASLEF, who have used comparison with other train operators to force up salaries. This has been made possible by the relative difficulty of training up new drivers, and the relative ease of drivers transferring from one operator to another. Where TOCs have been poorly managed, there have been problems with insufficient staff—even though it is possible that spare staff existed elsewhere in the country.

Maximising Passenger Volumes

2.16 Whilst this might be an appropriate strategy for a Government seeking an environmentally-sustainable transport policy, it is clearly not an automatic outcome of the franchised railway. Now that many of the obvious “quick wins” have been gained, capital investment is often needed, in order to permit increased traffic volumes. As this is generally not likely to be commercially-viable, the additional funds potentially provided through direct project funding (eg of the Channel Tunnel Rail Link), Government’s Community Infrastructure Fund and Network Rail’s £400 million discretionary fund are to be applauded.

Maximising Passenger Revenues

2.17 With many train service costs effectively fixed (underpinned by minimum service specifications), this is certainly a key area for TOCs. It is also potentially helpful for the industry as a whole, because it maximises the income needed to sustain both operations and investment. On the other hand, it does not take into account expenditure and investment decisions taken in other transport modes (nor, of course, the externalities of any mode).

2.18 Some TOCs have apparently been slow in managing issues such as minimising fare evasion, but most have exploited loopholes in the fares regulation system, in order to maximise income from groups of passengers without a real alternative. First Capital Connect’s recent decision to impose ticket restrictions during the evening peak is a classic case of this.

2.19 However, a potential problem here is that existing franchisees may benefit from positive short-term responses, whilst passengers’ longer-term negative responses (eg buying another car) may fall on the next franchise incumbent. It is not necessarily the case, therefore, that revenues are being maximised in the longer-term, nor that this is desirable.

Maximising Passenger Satisfaction

2.20 It might appear, at first sight, that maximising the satisfaction of one’s customers was a pre-requisite for any commercial business. However, this is not strictly the case—some of the expenditure required to achieve that satisfaction may not be commercially-worthwhile. Some passenger needs are still clearly unmet (eg addressing peak overcrowding), whilst others are becoming more important, as public expectations rise.

2.21 How passenger needs might be incorporated into a franchise specification depends upon the nature of both the type of franchise and passenger needs themselves. Nevertheless, the current franchising process does include a feature whereby bidders are asked to price up options beyond the base franchise specification. Passenger needs can be incorporated into these options and subsequently reviewed during the franchise; this approach was initiated under the 15-year enhanceable franchise for Wales & Borders. Value for Money and affordability are clearly both important considerations in the assessment of such bids.

3. THE PROCESS OF FRANCHISING

Franchise Types and Objectives

3.1 The franchising process has, over the years, varied significantly in the aims of franchises, and the types of agreement set up to achieve them. Since 1999 the strategies have included:

— Long–term 20 year franchises (2000–01) where operators committed to Infrastructure Upgrades (IUGs) and, where appropriate, rolling stock replacement.

— Short-term two year extensions (2001–) (the maximum franchise extension permitted under the 1993 Railways Act, without having to go out to competitive tender).

— The Enhanceable Franchise concept of 15 years (2001–02).

— Management contracts of two years during merging of franchises or at the end of franchises whilst they are being re-negotiated (2001–).

— Short-term five to seven year prescriptive service delivery contracts (2002–).
— Early termination and forming of an interim SRA controlled holding group, with the possible objective of returning the operation to the private sector (2003–).
— Devolvement to a PTE in relation to administration and operator selection for a 25-year Enhanceable Franchise (2003–).

3.2 The diversity of approaches adopted has not been entirely through choice, since the industry has had to react to numerous crises, eg the collapse of Railtrack in 2001 and the growing realisation of TOCs’ financial fragility, due to over optimistic bidding from the first round of franchising. Little in the way of underpinning evidence exists in the public domain as to the rationale used by the awarding authority in formulating the ground rules for a franchise competition or changing the format of a franchise during the bidding phase, as seen with both the South Central and South West Trains franchises (both originally supposed to be 20 year franchises, subsequently reduced to operate under the Short-Term Prescriptive Service Delivery style contracts (Watts, 2006)). We believe that the lack of public accountability of the awarding authority as to the strategy underpinning the franchise process is unacceptable, since taxpayers’ money is being used to fund rail services. This was supported by local stakeholders and bidders alike, during consultations/meetings undertaken as part of the research.

3.3 In addition, there has, from time to time, been comment from potential bidders as to the difficulty of bidding against criteria which are both unclear and vary over time. We observe from the variations in this process differences in the level of service development in the railway, and believe that it is inequitable that these should be dependent merely upon the depth of the Government’s budget at the time of letting.

3.4 The different types of franchise are thought inherently likely to provide different types of outcome; Harris (1999) described a number of different types of competitive strategy which bidders might adopt. However, in responding to any bid process, it should be noted that there is a potential for the process to generate sub-optimal outcomes. Franchisees making unrealistically-optimistic bids (in order to win the franchise) may suffer bankruptcy later on, whilst those with a better understanding of the real situation may not win in the first place.

3.5 We would not recommend the overly-prescriptive type of management-only contract. We believe the benefit of private-sector involvement is reduced, when the contract is reduced to one of management only. Moreover, there is a danger that civil servants based in London will take decisions which would better be taken with more locally-based railway staff with a better knowledge of local conditions.

3.6 Where franchises have been set up to assume that existing service levels and numbers of trainsets will continue throughout the period, problems are arising where growth is occurring owing to exogenous factors. This is because some marginal developments (such as the addition of extra vehicles for peak period traffic) are not actually profitable, so the TOC has no incentive to act, and there are limited other options. If crowding penalties are not in place, the quality of travel will fall; it is unclear to what extent significant real fare increases can be used to deter demand, within the overall “RPI + 1” fare increase limit.

3.7 It should also be noted that the industry has been forced to muddle along for 10 years with the inherent incompatibility of franchising and open access competition, an issue which has only really come to prominence with the GNER/Grand Central debate of 2006. Either one has protected franchises for the operation of part of the network, or one has competition for particular train services; the only sensible ways out of the current impasse are through legal decision or a compromise organised by Network Rail as infrastructure provider, and neither of these are entirely satisfactory.

4. THE ASSESSMENT OF BIDS

4.1 Analysis of the criteria and processes used in the franchise bid evaluation process was the underlying element of Watts’ research (2006). Since 1999 there have been numerous sets of franchise selection criteria, outlined in documentation from the sSRA, SRA, DETR, DTLR and DfT. An inherent weakness of these documents/press releases has been the failure to specify in any detail the selection criteria requirements (including their respective weightings in the bid evaluation process) in any depth, beyond that best value for money and affordability issues are primary criteria. Typical requirements placed upon bidders as seen in “The Statement on Passenger Rail Franchising” (December 2001) included commitments to:

(a) better performance and reliability;
(b) reduction in overcrowding;
(c) better services and facilities;
(d) improved safety and personal security;
(e) improved accessibility for disabled people;
(f) putting passengers first; and
(g) improved passenger information and retailing (DfT, 2001).

However, not all of these generic concepts have been quantified, although most of them could be, an issue we first raised with the SRA about five years ago.
4.2 There has been some discussion about the quality and quantity of information required for bids, and the extent to which the information being supplied does really enable accurate assessment to occur. These criticisms were perhaps most forcefully expressed during a period a few years ago when a number of apparently-perverse franchise decisions were made. Whilst it is indeed true that bids cost around several million pounds, successful bids normally include a degree of planning for the franchise which would have to occur in any scenario.

4.3 Reducing the number of franchises probably reduces the amount of administration associated with franchise letting and bidding. This is in addition to the economic benefits of larger franchises, which follow the logic initially suggested by Preston’s (1994) analysis. However, some of the economies of scale have subsequently been secured across owning groups eg through the provision of training centres.

4.4 However, there are some variables which do not appear to enter the franchise assessment process. Despite employment law protection, staff morale can still be affected by the uncertainty surrounding their future under a new owning group. Administrative costs are also incurred by many other parties (suppliers etc) when a franchise changes hands. There is, therefore, a case for giving the incumbent a slight advantage over competing bids.

Other Recommendations and Directives

4.5 The Transport Committee should be aware of two strands of previous relevant work concerning the management of rail franchise awards.

4.6 The Welsh Affairs Select Committee has undertaken two separate inquiries into the award process for the Wales and Borders franchise: “Transport in Wales” (Session 2001–02) and “The Provision of Rail Services in Wales” (Session 2003–04). The 2003–04 inquiry revealed (based upon a written memorandum from the SRA) that, for the Wales and Borders franchise that the franchise selection criteria were:

(a) Rail passenger services—outputs and constraints;
(b) Delivery and mobilisation;
(c) Revenue and costs;
(d) Finance and costs;
(e) Legal; and
(f) Supplementary.

4.7 The inquiry also noted that there appeared to be two sets of criteria:

(a) Set 1: Criteria which are displayed in the “Invitation to Tender” (ITT) documentation, SRA objectives etc that are in the public domain and which bidders are expected to meet in submitting bids; and
(b) A second set of criteria for evaluating bids (once received) that are unrelated to fulfilment of the first set of criteria and withheld from the bidders in the franchise competition. This contravenes DfT Directions and Guidance to the SRA of 2002, in that bidder must be made aware of the government’s objectives and franchise bid assessment criteria (HOC, 2004a).

4.8 There were two significant recommendations stemming from the Committee’s Inquiry (HoC, 2004a).

First, the DfT’s Direction and Guidance had not been followed due to the split by the SRA of the criteria and scoring and marking system; these should have been combined to enable bidders to understand the objectives set by the DfT and what was required of a bidder for a franchise. Secondly, the SRA should publish a full summary of the negotiations concerning the award of the Wales and Borders franchise including the level of services offered by Arriva at each stage; this would allow taxpayers to be aware of funding levels for existing services and the cost of providing improvements.

4.9 The Government’s response to these recommendations (HoC, 2004b) was that the SRA had the responsibility for ensuring that bidders were made aware of criteria and it was the SRA’s decision whether or not weightings of criteria were made public. Government noted that it would be not in the SRA’s or bidding parties interests, to disclose information concerning franchise negotiations since it could weaken both parties’ negotiating positions and the SRA’s position in future franchise competitions. In light of the transfer of franchising responsibilities to the DfT it is recommended that the Committee investigates to what extent the above mentioned recommendations have been taken into account by the DfT in the existing franchising regime.

4.10 In May 2004 and June 2005 the SRA published documents entitled “Strategic Rail Authority Franchise Replacement Process”. Both documents outlined in some depth the mechanics of franchising. This included flow charts of typical criteria and sub-criteria utilised in evaluating bids, including some indication of weightings. Criteria include: Service performance (50%), Service quality (20%), Other passenger service obligations (12%), Franchise management (11%) and Migration (7%) (SRA, 2005). Despite this information being provided, a number of weaknesses could be cited with both documents, in that:

(a) the criteria and weightings provided were for illustrative purposes and these would vary on a franchise by franchise basis;
4.11 The impact of EC Directive 2004–17 (31/03/04) upon the re-franchising process is significant in terms of the contracts award procedure/criteria used. The specific requirements of Section 55 of the Directive are set out in an Appendix to this note. Interpreting this in the context of the UK rail franchising process suggests that key requirements placed on the awarding authority include:

(a) Disclosure of the exact nature of the criteria being used in the bid assessment process.
(b) Disclosure of the weightings/rankings of the criteria for the UK franchising regime in relation to the assessment of bids.

4.12 Despite the Directive stipulating the need for transparency and clarity of the weighting/ranking of criteria used in bid assessment measures, a number of potential shortcomings can be cited with it. First, no specific requirement exists compelling awarding authorities to provide the exact weightings of the criteria. The clause allowing them, at their discretion, purely to provide a ranking of priorities to bidders, fails to provide the stated transparency of the bidding process. Secondly, no requirement is placed upon the awarding authority to disclose the weighting/ranking methodology for each criterion. Therefore a criterion may be assigned a specific percentage value, yet the scoring methodology in meeting such a percentage is unclear. Again, this represents a lack of transparency. Thirdly, the application of the Directive towards the private franchising of rail services within the UK and Europe is very unclear, and no specific mention of its application directly on the UK rail franchising market is provided. However, the SRA’s documents may be seen as a response to this directive.

4.13 Nevertheless, consultees to the research expressed a number of criticisms:

— The weightings/requirements for the “technical” and “financial” assessments are not currently transparent and can be subject to market manipulation. 77% of consultees were unhappy with this.
— The existing bid evaluation process sees different elements being assessed by different people (often independent consultants, appointed by the awarding authority). 69% of consultees expressed a concern at this, in that the existing arrangement fails to enable a central consensus to be made concerning the overall quality of a particular bid.
— The existing franchising regime possesses too many Key Performance Indicators (KPIs). 62% of consultees felt that this represented excessive micro-management by the awarding authority.
— Criteria and KPIs should not be too specific, as this stifles innovation in the bid design phase for the bidder.
— Indicative costs of compliance with franchise criteria/KPI should be clearly indicated.
— KPIs, where provided, should not be pre-determined, due to the differing franchise base conditions.

4.14 There are contradictory views about the requirement for standardisation of franchise agreements. Many consultees felt that the agreements often did not take into account the vastly differing base conditions and operational environments of different UK rail franchises. However, it was accepted that many areas of the agreement could not be altered, due to the common legal requirements placed upon operators. Moreover, experience with track access contracts (which are often negotiated “back-to-back” with franchise agreements) has demonstrated that a consistent style is essential if other parties (eg Network Rail) are to perform in a non-discriminatory way, for instance in the allocation of train paths. Despite this, it is not to say that service improvement requirements could not be written into new franchise agreements. Any improvements included in franchise agreements would need to ensure that VFM was still maintained and were presented in a manner that did not constitute excessive micro-management from an operator perspective.

4.15 Examination of the German franchising process (Wettbewerb), where tendering for regional lines occurs at a regional level by the Länder, revealed vast differentiation in franchise agreement content. This is despite guidance concerning the Wettbewerb process, having been issued by Federal Government.

5. Competition and Vertical Integration

5.1 Whilst the EU Directive of 1991 specified that infrastructure and railway operations should be accounted for separately, Britain and a number of other countries have actually split these responsibilities between different companies.

5.2 The underlying consensus amongst both local stakeholders and a number of senior figures within the franchising environment who were canvassed, was that total vertical (re-)integration of franchises raised a number of potential operational difficulties such as:

(a) arrangements for maintenance;
(b) operational integrity—prioritisation of rail services at major junctions/delay attribution issues;
(c) cost impact upon franchisees—the need for additional subsidy to maintain franchises; and
the economic viability of undertaking any infrastructure upgrades when the return on investment would exceed the franchise length.

5.3 We can understand these difficulties, and would generally agree with them. However, it was noted that franchise areas where the incumbent operator was the sole operator, vertical integration can be appropriate; this has effectively happened on the Isle of Wight.

5.4 In the meanwhile, there was strong support for greater integration between TOC and Network Rail operational staff, through creation of Integrated Control Centres (ICCs). Integrated Control Centres (ICCs) were deemed as an important mechanism for trying to reduce delays per operational incident. Greater integration is, however, not seen as helpful; indeed, 79% of consultees were against greater vertical integration within franchise specifications, although 57% of them welcomed the possibility of investing in train service performance, which was seen as the TOCs' core business.

5.5 Short of renationalising the whole railway, therefore, it appears to us that only minor “tidying-up” is likely to be worthwhile. This needs to address the current confusion on the East Coast Main Line (where the Department appears to have let a franchise to one operator, and ORR approved access rights for another, without consultation either with each other or Network Rail), but we believe that such situations can be managed through negotiation—especially if the criteria are made public and transparent. Renationalisation would also need to retain the benefits being generated in the railfreight sector, where competition does appear to be providing the desired outcome, but where track access on a predominantly-passenger network is a key issue.

6. CONCLUSIONS

6.1 There have been a wide variety of franchise types since rail privatisation in Britain in 1994. Although the importance of exogenous factors such as the growth in GDP means that one should not infer a simple direct relationship between the type of franchise and its outputs, particular franchise types make some actions more or less likely. For instance, longer franchise periods are more likely to encourage investment, whilst the risk to Government can be minimised through the insertion of break clauses.

6.2 There are a number of reasons which underpinned the original choice of the passenger rail franchising model, but for most of them the outcome has been at best patchy.

6.3 There is a balance between the necessary commercial freedom of franchisees and the need for Government to specify services. We believe that there is a sensible point at which benefits can be had by both parties, but the pendulum has swung in recent years from too much freedom to being overly prescriptive.

6.4 The franchising process until now has not been transparent, but this is necessary, for a number of reasons. First, it should reduce bidding costs and uncertainty; secondly, it should maximise the likelihood of achieving the desired objectives, and thirdly, it has been recommended by both the Welsh Affairs Committee and the European Union.

6.5 Some tidying-up of arrangements with the current franchised railway would be helpful, but we cannot see any alternative within the current general framework which would be significantly better.

6.6 Meeting end user needs can be achieved through the specification of options in franchises, but is subject to Value for Money and affordability constraints.

Annex

REQUIREMENTS OF EC DIRECTIVE 2004–17, SECTION 55

(a) Contracts must be awarded on the basis of objective criteria which are transparent, non-discriminatory, offer equal treatment and ensure tenders are assessed in conditions of effective competition. Therefore the primary criteria must be “the lowest price” and “the most economically advantageous tender”.

(b) To ensure equal treatment in the award of contracts, based upon established case law, it is necessary to ensure transparency and that all tenderers are reasonably informed of the criteria and arrangements which will be applied to identify the most economically advantageous tender.

(c) The awarding authority is responsible to indicate the criteria for the award of the contract and relative weighting attached to each of those criteria. This must be done in sufficient time for tenderers to be aware of them, when preparing bids.

(d) The awarding authority may refrain from disclosing the weighting of the selection criteria in fully justified cases, where the weighting cannot be established in advance, due to the complexity of the contract. In such circumstances, the authority must indicate the descending order of importance of the criteria.

(e) Where the awarding authority decides to award a contract to the most economically advantageous tender, tenders should be assessed to determine which bid offers the best value for money.
(f) The awarding authority should determine economic and quality criteria which must help it
determine the most economically advantageous tender.

(g) Determination of criteria depends on the object of the contract since the awarding authority must
assess the level of performance offered by each tender against the specified contract objectives and
value for money measured.

(h) To guarantee equal treatment, selection criteria, such as meeting social/environmental
requirements, may enable the awarding authority to meet the needs of the end users, as outlined
in the contract documentation (OJEU, L134/9, 2004).

Witnesses: Dr Mark Brown, Development Director, Consulting, Halcrow Rail, Mr Peter Norgate, Division
Director, Mott MacDonald, Mr John Segal, Director Rail, MVA and Dr Nigel G Harris, Managing
Director, Railway Consultancy, gave evidence.

Q211 Chairman: Good afternoon to you gentleman; I am sorry to keep you waiting. We will try not to cut
down your time. Would you be kind enough to identify yourselves for the record, starting with you,
Dr Brown?
Dr Brown: I am Mark Brown, I am the Development
Director of the Halcrow Consulting business.
Mr Norgate: Peter Norgate, Director of Mott
MacDonald, responsible for rail planning.
Mr Segal: John Segal, Director Rail of MVA.
Dr Harris: I am Dr Nigel Harris, the Managing
Director of the Railway Consultancy.

Q212 Chairman: Thank you very much. Did any of
you have anything you wanted to say? No? You are
going to be brave and go for questions. Do you want
to give us a general snapshot of the franchising
process from start to finish? Who wants to give us
that? The child’s guide to franchising—Dr Brown?
Dr Brown: If I kick off?

Q213 Chairman: Please.
Dr Brown: You are asking, Chairman, for our views?

Q214 Chairman: Yes, we promise not to have you
hanged drawn and quartered if we do not agree—at
least not obviously!
Dr Brown: I would say fairly firmly that the
passenger rail franchising part of rail privatisation
has, on balance, been quite a success. Like anything
else in this world there are areas which have been
more successful than others and there is room for
improvements, opportunities and threats facing us
going forward. But it has been a success both in
terms of the material benefits I believe it is now
generating.

Q215 Chairman: Like what?
Dr Brown: In no particular order accommodating
very significant passenger growth over the last 10
years.

Q216 Chairman: Would that not have happened in
any country where there was an economic upturn?
Dr Brown: It has not happened at the same rate as it
is happening in the UK and there have clearly been
a lot of innovative approaches.

Q217 Chairman: Like what?
Dr Brown: Like ticketing.

Q218 Chairman: Ticketing. In what way?
Dr Brown: Tickets that are focused on various
market segments and provide a wider range of
opportunities. For example, one particular operator
sold an off peak ticket which allowed four people to
travel for the price of one on trains where there was
capacity.

Q219 Chairman: They did not do that for very long,
did they? Who was that?
Dr Brown: That was Midland Mainline. Other
operators have formed deals with taxi companies,
for example, to allow users to book taxis in advance
through the railway ticket and have taxis waiting for
them at their destination.

Q220 Chairman: How many of those?
Dr Brown: I am aware of one or two, and part of the
point is that the measures are focused on particular
market segments, whereas in the past marketing was
largely at a national level and did not allow for
particular market segments or particular regional
operators to target particular market segments.

Q221 Chairman: Does anybody have any other
examples of innovation or responses?
Dr Harris: Can I express a slightly different view? I
think you have to judge railway privatisation, or
indeed any policy on the basis of knowing what your
objectives are, and I think that one of the whole
weaknesses of the system we have is that many of us
are not entirely sure what this week’s objectives are,
and if someone would care to define what the
strategic overview was and what those objectives are
then I am sure we could answer your question more
carefully.

Q222 Chairman: I think that sounds like a very
revolutionary idea and we cannot possibly follow
that! Mr Segal?
Mr Segal: I think I would not be quite so positive.
There has been some innovation, quite clearly, but
one of the key reasons demand increased was that
fares were held down. Had fares been held down
under British Rail then some of the demand growth
would have happened without that. You have to
balance the innovation, something that is good—
and the introduction of single priced advance
purchase tickets has been quite a good strong
innovation—against some of the diversity and confusion that is caused amongst the public with fares levels. It is a balance, which I think is probably being addressed now.

**Q223 Chairman:** Is there a difference in objectives between the present system and the previous state-run railway? And, if so, what is it?

**Mr Segal:** I think the previous state-run railway was probably to maximise some sorts of benefits in terms of passenger miles within the given budgetary constraint. I think the current one tends to set a very fixed—and I overheard people talk about “detailed specification”—specification, and I suspect that the franchises are almost too detailed now because it actually restricts the innovation ability of the private sector in some areas.

**Q224 Chairman:** There was not a lot of innovation when they were not restricted was there, Mr Segal? Do not misunderstand me, I am very anxious to learn about all this innovation but so far all we have heard about are taxis. I am sure I am missing something.

**Mr Segal:** There has been some innovation in terms of timetable increases in numbers of trains. The Midland Mainline was mentioned, and there is a huge increase in the number of trains. The cross-country network was completely re-written and substantively improved in terms of the frequency of services. There have been some quite substantial ones in the past, and it has always been fairly well specified, fairly detailed.

**Q225 Chairman:** So we are not really doing anything that we were not doing at the beginning of the franchise? We might be doing it slightly more perceptively but not noticeably, is that right?

**Mr Segal:** The detailed timetable specifications today for franchises are extremely detailed and in fact one of the weaknesses of the franchise process today is that it is only your response to that detailed specification which is taken into account. If you have some great brilliant idea which is not quite formally compliant it technically does not form part of the evaluation process.

**Q226 Chairman:** What would you advise somebody who had some brilliant idea, great light bulbs come on and suddenly we are responsive to the customers and we are looking at really expanding the service, really doing something that has not been done before. How would I then deal with that, if I were in that position?

**Mr Segal:** The government has full ability to evaluate that through its evaluation process and to determine whether it is a good idea, but I have known cases where evaluations have not been done even though the government adviser implied, “Yes, we think this is a good idea, but it cannot be part of our evaluation process because our evaluation process is set down beforehand on this basis.”

**Mr Norgate:** I am very concerned that the industry is currently is going, or we offer more capacity.

**Q227 Chairman:** Are you saying that you do not necessarily approve of the trade off between performance and restriction on development?

**Mr Norgate:** No. There is a very important trade off to be made on service quality. Either we offer a high level of performance, which is the way the industry currently is going, or we offer more capacity.

**Q228 Chairman:** Are you saying that, at the moment, that decision has not been made and they are trying to do both?

**Mr Norgate:** No. At the moment, the decision is very firmly on the side of performance and not on capacity for growth.

**Q229 Chairman:** You feel that capacity is the concern?

**Mr Norgate:** I firmly believe that the economic growth of the UK is being constrained and will be constrained more and more if we cannot get more capacity back in.

**Q230 Chairman:** To be devil’s advocate for a minute, you are not advocating we have more and more trains and the conditions on them get worse and worse, are you?

**Mr Norgate:** No. I am advocating more trains on the existing infrastructure but that will compromise to some degree the level of performance of the network and I think that is a better approach.

**Q231 Mr Martlew:** Surely one of the problems is that there is more than one franchise running over the same track? That is why you have to have a prescribed timetable. The essence is that because more than one franchise runs on the track that inhibits innovation by a particular franchisee. The individual franchisee is only concerned about that and will be giving scant regard to freight, for example. Is that not the reason why you have a very prescribed timetable now, to suit everybody?

**Mr Norgate:** That was one of the things I was listening to in the debate you just had with the PTEs, on the level of involvement of specification by the PTEs into the local network. My concern with a higher level of local specification is getting this balance right between the local, regional services, the intercity services and, as you rightly say, freight services. There has to be oversight for the whole network. The timetable development has to be
coordinated, but there is a mechanism for franchisees to bid for changes to the timetable today and that process works reasonably well.

**Dr Brown:** There is certainly a trade off between allowing the operators to be excessively innovative and the need to optimise what is a very scarce resource, which is network capacity. That is something I hope to have a chance to speak about at some point. Four or five years ago, Alistair Morton and the Strategic Rail Authority as it then was did encourage a great deal of innovation in the private sector to come forward with what in some cases were quite large infrastructure schemes to help develop the routes on which their trains ran. This process, whilst it was looking to elicit innovative bids including funding from the private sector, failed. One of the reasons it failed was a lack of public sector leadership. I do not think we can overlook the need for clear public sector leadership in setting objectives for a very complex system like a railway and just leave it to the private sector to innovate. The private sector has certain things to bring, including efficiency of operations, but unless we have some form of over-arching coordination at the moment we probably have clearer objectives for each franchise than we have had over the last 10 years from the public sector. Unless we have these kinds of objectives we are not going to be able to optimise the scarce resource.

Q232 Mr Martlew: Can I come to the length of the franchises? Recently, the franchises have been eight to 10 years with a possible extension. What do you think is the best length of time for the taxpayer and for the passenger?

**Mr Segal:** I feel that is probably about right.

Q233 Chairman: Which one of those?

**Mr Segal:** About eight to 10 years. The first thing to note is that franchisees do not have huge amounts of capital. Some of the owning companies may have a lot of capital but the capital tied up in a franchise is typically only £10 million or £20 million. If big investment is to be made, it has to be made outside that structure and there is no reason it cannot continue on, beyond the length of the franchise, if some sort of mechanism can be found. The government needs to be involved in that, in saying, “Yes, we will support that investment which will last 30 years and include it as a franchise asset.” There is no reason for investment to have longer franchises. Therefore, it is just a balance between the costs of franchises, the cost of the bidding process and the costs of management change at the time versus the ability to innovate, which is principally at the beginning of the franchise. There is a bit of an argument about that. If it is going to be eight to 10 years, there need to be some break points earlier on which are not just on financial issues but on quality issues, to ensure that the franchisees keep up to scratch. Another area which would be important to incentivise franchisees to offer good quality as well as to make capital for their shareholders is if their past performance in previous franchises was taken into account in the franchise evaluation process.

That does not have a major part in today’s evaluation process. Against that you have to allow new entries into the market. Just because somebody has not had an opportunity to demonstrate good performance, you need to take into account how they perform in some other environment. I think we had somebody from NedRailways here in the previous session. They can probably offer quite a lot to the UK franchising market. It is good to have Dutch experience in. We would like to involve some other countries as well perhaps.

**Dr Harris:** Again referring to the previous session, Merseytravel had a 25 year franchise on offer. Some of us get involved in the science and possibly art of demand forecasting. It is extremely difficult to be able to look into the future, 25 years out, and give any client advice about what might be happening. The only response therefore a bidder can have is through the price mechanism, to say, “If you want me to operate this 25 years in advance, I do not want to go bankrupt. Therefore, I will be looking for more money in the future.” Something that did not come out earlier was the amount of risk. We all have a reasonable chance of understanding what a five year outline would look like or even a 10 but if we look back 25 years and see what we might have forecast for now in 1980 most of us would have been wrong.

Q234 Chairman: Could you not deal with that through a break clause though? The point that Mr Valk was making was that there is an annual assessment of performance, precisely the point that you are making. If you had a 25 year with five year break clauses, would that not deal with the problem?

**Dr Harris:** I am not sure at whose expense. As I suggested in my written evidence, if you are in an area where things are going extremely badly, you might as a franchisee want to exit the process. The government is in a strange position where an alternative company might need even more money than the current people. Break points might be good for the franchisee. I am not convinced it is the best policy for the government.

Q235 Mr Martlew: What we have had said so far is that long franchises do not bring extra investment, which the TOCs disagree with, and that the companies do not want long franchises because they cannot guess that far into the future.

**Dr Harris:** They might want them but the only way they can do that is by saying they will need more money. The companies might want a long franchise but I am suggesting that it might not be—

Q236 Mr Martlew: It might not be a good idea for the passenger and the taxpayer?

**Dr Harris:** Yes.

**Mr Segal:** The alternative is that some companies might choose to buy the franchise in the knowledge that they could walk away after five or 10 years with some money in their pocket and leave the problem with the government. There is always a temptation to do that.
Q237 Chairman: It has been known.  
\textit{Dr Brown}: There is a strong argument in favour of shorter franchises and that maximises competition amongst bidders. It is healthy for the government in terms of generating maximum value for money from a franchise, minimum subsidy or maximising premium payments to maximise the amount of competition within the bidding forum. Long and larger franchises undoubtedly bring benefits in terms of economies of scale, greater investment from the franchisees, but those have to be weighed against—

Q238 Chairman: Are you saying eight to 10? What are you saying exactly?  
\textit{Dr Brown}: I think the current seven to 10 is about right. I would be quite concerned about longer franchises because there would be a significant loss of competition. There would be fewer bidders and fewer opportunities to throw out poorly performing franchisees and to take account of the latest economic forecasts and the latest economic situation and get a revised bidding line from bidders which would maximise value for money for the country.

Q239 Mrs Ellman: We are told that it costs the operators between £3 million and £5 million to bid for a franchise. Do you think that is excessive?  
\textit{Dr Harris}: That sort of money involves several things. I would like to give a different answer for the different categories. One of the things involved is a form filling process which probably does not add a great deal of value. Most franchise bids more recently have involved substantial programmes of research, either looking at the demand forecasting consequences of putting new trains on or detailed ways of operating the railway. We would hope that that sort of thing was done for each part of the network every few years anyway. Your question should really be: which part of that is wasted. A nationalised railway would say, “Let us look at East Anglia and see what we can do with East Anglia. We might be there for five or 10 years.” That stays the same. It is a question of whether the administrative bits are too much and that is not quite the same question.  
\textit{Mr Norgate}: One point that concerns me is that we are all consultants. We regularly have to tender for work, not at this level, and many organisations have a framework association and you have to qualify onto that framework. Then you are invited to tender for specifics. If there was that sort of parallel process in rail franchising, it could save a lot of form filling.

Q240 Chairman: Surely that sort of thing must happen now? I would have thought, if somebody was tendering for a franchise, they should have done their own research anyway, irrespective of what the government asks them to do. Presumably they are investing their money in whether or not they get the work. Surely they must have some idea of what they are tendering for or is that an old-fashioned idea?  
\textit{Dr Harris}: The point I was trying to make was that the bidders will themselves work out what—

Q241 Chairman: This is a very large amount of money, three to five million. I think what Mrs Ellman is asking you is about what a bidder does, whether it is something that is new or unusual or different. Mr Norgate is making the point that if you are applying for work anyway you would have to do the basics.  
\textit{Mr Norgate}: I would guess about a third of the cost is on straight administration which is form filling. If that could be simplified with bidders accredited for all franchises for a period of time, because you have certain status as an operator already, that to me makes a lot of sense. Then you are only bidding for the specific franchise which is where the added value should come in. We should be looking for the thinking from the private sector on the specific franchise each time and not having to repeat standard information.

Q242 Mrs Ellman: £2 million is for consultancy fees. Would you say that consultants have an interest in keeping this going?  
\textit{Mr Norgate}: The answer must be yes, if we are honest. I am sure we all want to be professional as well. I would much rather be working on real projects, delivering real benefits to UK plc than bidding in the franchise process.  
\textit{Mr Segal}: The structure of franchising means that the franchising bidding process is where much of the innovation takes place. All the franchise bids I have been involved in have involved market research, some innovative looking at what the market looks like, forecasting, innovative ways for trying to reduce costs. In all the ones I have been involved in, £3 million to £5 million for each year of the ongoing franchise has been saved by reducing costs or increasing revenue or some combination of the two. In a sense, it is a very worthwhile investment because that is when the changes and the ideas are coming in.

Q243 Mrs Ellman: What proportion of your work is involved in work for franchise bids?  
\textit{Dr Brown}: 1% at most for the division of my company with 600 staff. These are very big businesses. The annual turnover of the sort of franchises which are on the market at the moment is £200 million to £500 million per year and these will grow over the next 10 years. I do not think we should be balking at spending several million pounds on helping organisations to make the right decision to bid or helping the government to make the right decision to acquire them. These are very significant parts of the economy. There is one other counter point I would like to make, to go back to my point about competition and the importance of maintaining a high level of bidder competition. There is a concern that high bid costs will act as a deterrent to new bidders entering the market. Therefore, there is an incentive, notwithstanding the fact that a good deal of due diligence needs to be done, to ensure that these costs are not excessive because they will act as a barrier to entry to new bidders in the market. It is in the market’s interest and the government’s interest to maximise those potential bidders.
Q244 Mrs Ellman: Has the government got it right between the base contract specifications and the room for innovation?

Mr Segal: At the moment I think the government is being too precise and specific in what it demands and too restrictive on innovation. The timetable is set almost totally precisely, for example. Clearly, there are some things the government has to specify. We do not want a particular town having no trains per day. That has to be specified. Perhaps the broad level of frequency of service needs to be specified. The government needs to regulate fares where there is a monopoly position—commuter fares, for example. There seems to be too much detail which does restrict innovation, in my view.

Q245 Mrs Ellman: Does everyone agree?

Dr Brown: No. I would take a different view. I think it is important that there are clear government objectives, making it clear what each particular franchise is for and what it expects from that franchise. That is important in order to extract maximum value from the franchisees. I do not think the public sector can walk away from its responsibility to state quite clearly what benefits it wants to derive and what its strategic objectives are for that franchise. That is the role of the public sector. It should be prescriptive. Secondly, the network is at capacity. The railway is probably the most complex mode of transport that I am aware of. There is not that much room for innovation in many of these areas unless you start to focus more on expanding the capacity of the network and perhaps less on the marginal changes to the franchising system which I could argue is largely working okay at the moment. Unless there is a shift of focus onto how we expand the capacity and the infrastructure, I do not think we have a choice. The public sector has to be prescriptive because we are too constrained. We do not have the options.

Dr Harris: Somebody needs to be prescriptive about the timetable but in my view that is not a role for the department. Network Rail is responsible for the infrastructure. It is more appropriate for them to tell a franchisee that a train should be at 23 minutes past an hour than, in some of the latest franchises, where it specifies a particular train time. I would be worried that that could potentially reduce the capacity of the railway in the future if Network Rail has to go back to try to argue with the department to have it changed. Specifying that there should be an hourly train service from A to B on this line is fine but some of the more recent documents have been much more prescriptive.

Q246 Mrs Ellman: We have had evidence that Network Rail do exert influence on franchises and are unduly restrictive and stop developments. Have you any evidence of that?

Dr Harris: Someone else referred in the past to a pendulum over the last 10 years where, straight after franchising, people offered all sorts of train services. When Network Rail came in with costs and performance for their objectives, they put a stop to that. There are some signs that, whilst Network Rail might have been a bit negative about things two or three years ago, they are now also being able to take some of these business decisions with TOCs and the government. I am persuaded of the view that we should still keep an eye on the problem.

Q247 Mrs Ellman: Are there any other views on Network Rail's influence and whether it is for good or bad?

Dr Brown: I would agree with Dr Harris's comments that we are seeing the interfaces between different parts of the railway on the whole better managed in more of a spirit of partnering than there has been over the last 10 years when there was a good deal of conflict between different parts of the network, perhaps because of the different objectives that they were set. Whilst Network Rail has the responsibility to manage costs and performance, they would appear to be embracing the need to support franchising and, where possible, the implementation of new services.

Mr Segal: I broadly agree.

Chairman: If you broadly agree, if you forgive me, we will move on.

Q248 Clive Efford: Mr Segal, you said that when the government carries out an assessment or the Office of the Rail Regulator or whoever does an assessment of the performance of a franchise that any innovation they have done that is outside the specification within that franchise cannot be taken into consideration in that performance. Is that true?

Mr Segal: That is not quite what I said, I hope. You have to put in a bid which is absolutely compliant with the base specification. You can add some things on top. If you include them in your bid they will be taken into account. If you want to change something in the base specification, even though everybody will say, "Yes, that is a beneficial change", that cannot be taken into account if it is taking anything away from that base specification.

Q249 Clive Efford: If there is a form of innovation that responds to shifts in the market and meets the passengers' needs more effectively, there is no leeway for going back and saying, "We need some flexibility"?

Mr Segal: The government may choose to take that but in terms of the evaluation—is your bid better than his bid?—they have to go on response which includes and is perfectly compliant with the base specification.

Q250 Clive Efford: Once the franchise has been—

Mr Segal: Once the franchise has been issued and let or agreed that it will go to party X, there is the opportunity for changes.
Q251 Clive Efford: It is not fixed for a period of time?  
Mr Segal: No.

Q252 Clive Efford: There is that flexibility there.  
Mr Segal: Yes, to agree changes.

Q253 Clive Efford: There is the opportunity to innovate within this system.  
Mr Segal: There is some opportunity, yes.

Q254 Clive Efford: How detailed should a franchise contract be? On the issue of who benefits from all the public money that is invested in our rail system, who should access it? Should a franchise be specific in the number of turn up and go tickets that are available at a discount? Would you agree to a franchise being detailed in that way?  
Mr Segal: It is a question of the balance between the strategies set by government. The specification does need to protect individuals and members of the public because it is government money which is going in there. Also, there does need to be freedom to respond to market conditions. The example you give of availability of turn up and go cheap tickets is fine if there is a large capacity. If on a Friday afternoon the train is already full and there may be 100 people standing on it, what is the real benefit of saying, “Yes, but anybody else can still turn up and buy a ticket” which adds further to the standing on that train? I am not sure there is a benefit and I think probably the train operator is best able to manage that process, although clearly there need to be some constraints to ensure that there are turn up and go facilities on trains as long as it is done in a balanced way and not to make any monopoly profits.

Q255 Clive Efford: Does anyone else agree?  
Dr Brown: I broadly agree with that. The specification as it stands identifies the objectives, the “why”. They normally specify 15 to 25 plans that are required from franchisees covering issues like man management, crowding, personnel management, rolling stock maintenance et cetera, which is the “what” part of the franchise. These requirements are specified but how these things are delivered is left for franchisees to determine. The approach to pricing and ticketing and what is the specification of new rolling stock are generally left for franchisees to determine. There is reasonable leeway within the specification for innovation. Most of the specification is timetable related.

Q256 Clive Efford: Who bears the risk of investing in new rolling stock? Is it train operating companies, the ROSCOs or is there a grey area of overlap?  
Dr Brown: I guess it is a mixture of all three. The long term residual risk will be borne by the funders of the rolling stock. The medium term availability and maintenance risk will be borne by the ROSCO and the short term risk which is built into the lease, which might be five to 10 years, is borne by the operator. The risk is apportioned over the various parties who, it is thought, are best able to carry that risk.

Mr Norgate: You probably saw me smile when you asked the question because this is exactly what the department has challenged the ROSCOs about at the moment because of the high level of profit within the rolling stock industry as it stands. Implicitly, the residual risks are being put back into the leasing charges in a way that I do not understand and I think the risks are borne by the industry rather than the ROSCOs themselves.

Q257 Clive Efford: We have received evidence that suggests that risk has not been transferred from the public sector to the private sector on the railways because of the fact that it is so essential to the economy. The government could not ever let the railway collapse. Would you care to comment?  
Mr Segal: I essentially agree. Some risk is borne by the operators but it is a relatively small amount. They have £10 million to £20 million invested in this. If it is making £400 million turnover, that is a hugely small investment and they can walk away from it if necessary. They lose some credibility but they can walk away. The government would have to make sure the train services run and it can refranchise and relet it. The big risk is, if there is a downturn in the economy, almost all the train operating companies will find great difficulty on their revenue line and that means the government will end up bailing it out. As the saying goes, if you owe the bank five pounds you can walk away. The government must have freedom to determine, although clearly there need to be some constraints to ensure that there are turn up and go facilities on trains as long as it is done in a balanced way and not to make any monopoly profits.

Mr Martlew: Can you think of any way that the franchisees could be made to take more responsibility for risk? Should they put a bond in?  
Mr Segal: They do put a performance bond in and that does help a bit. Do you want them to take more risk, because if they do they will price it into their bid and the base bid will be more expensive. The reason the returns and the percentage returns are so low is because there is not much risk.

Q259 Chairman: It is not exactly minimal, is it? Any railway system that costs five times more than it did when it was a state run system is not exactly a small innovation, is it?
Mr Segal: No.

Chairman: I am sure it is fantastically innovative, brilliant and produces very high standards which somewhere along the line I have not noticed but nevertheless it costs five times more than it did when it was that poor old, state committed, held together with string organisation called British Rail which actually worried about customers.

Q260 Clive Efford: Transport for London has suggested that a publicly and regionally based stakeholder is better placed than private companies to manage revenue risks in inner urban areas. Do you have a view on that?

Dr Harris: I have one particular concern which is not with the actions of any particular local area. The boundary issues which Mr Valk mentioned a bit in the Netherlands are much more likely to be severe here. I think both TFL and Merseytravel are paying in terms of subsidy per passenger much more money per person than central government is for the rest of the network and questions arise because you have people with completely different objectives.

Q261 Chairman: Are you saying that is because of this interface problem, because they have a restricted area and their responsibilities do not go as wide as some of the other railways?

Dr Harris: Yes. If central government wishes to spend a pound per passenger and local people in Liverpool vote for politicians who wish to spend five pounds that is fine until you look at the detailed problems of what happens at the boundary. If you look particularly in the north of England where there are lots of PTEs, the fare system disintegrates somewhat because fares for some quite short journeys are very cheap and the next station two miles away has a very expensive fare because it may be a link from one to the other. We have to be quite careful about what happens at the margin. We may end up with a very poor level of service being offered in the shire counties which generally do not have the same views. This is the danger.

Q262 Clive Efford: That exists now under the current franchise system. Even on the same lines you can have quite significantly different ticket and fare charges from one franchise company to another.

Dr Harris: Yes. You have to be careful though as to which of those are genuine, deliberate responses to passenger demand and which are just due to who happens to be paying for which bit of the railway. The first of those there may be a case for. I am worried about the second.

Q263 Mr Goodwill: We have been talking about the franchising operations as if all of these were very similar but there are dramatic differences, both in the size of these businesses that have been franchised and even more markedly between the ones which are bidding funds to have access to a profitable business and those who are bidding for subsidies. Do you feel there is a case for having different franchising templates for the subsidy and non-subsidy franchises?

Dr Brown: Probably no. The objectives of, on the one hand, value for money and, on the other hand, improving various aspects of passenger service, whatever they are, to do with network improvement, performance, reducing crowding, etc, can all be covered within the same template. The key is what objective you set for the franchise at the start of the process and from that should trickle down the specification for that franchise. The current process as a whole can accommodate a wide range of specifications, in my opinion. It does not need a different process to cover different needs and different specifications. Fundamentally, the process is helping to drive greater value for money and I think a single process is quite capable of doing that.

Q264 Mr Goodwill: We heard from the operators of Northern Rail, when I asked them a question about how they saw their role for identifying the most loss making parts of the network, and the answer was, “It is not our job to say it would be cheaper to put a taxi on to take people on that particular journey.” They said it was the job of government and ministers to make these decisions. Do you feel there is a role somewhere in these very highly subsidised franchises and maybe the operators themselves should be looking at alternatives to rail in some cases or even curtailment of services as part of their job in delivering better value for money for the taxpayer?

Dr Harris: I need to challenge the basis of that question. The fixed costs of infrastructure are currently dealt with by Network Rail. If you look at what a train operator does, although rural lines may have costs up to about five times the passenger income, because there are not many trains, the amount of money is not particularly great. What you must realise is that a very large proportion of the national rail subsidy goes into subsidising commuter operations in the smaller urban areas. I am afraid that by “smaller” I mean most urban areas, because commuter operations, despite what we might understand, are not profitable because many of the resources used do not make many journeys. A train may be used once in the morning and once in the afternoon. Quite a big proportion of the subsidy is going into the urban services in Leeds, Manchester and Liverpool for getting people in those important cities to work. I suspect as a country we would regard that as an important thing to happen. We might save a million by taking off a couple of trains but out of a five billion total that is not a great deal.

Mr Segal: I think it is right that it is a government decision. There are some rural lines which do make a big loss, particularly taking into account the infrastructure costs. Some very rural lines make a big loss. It is a government decision whether it wishes to operate those services. It should be able to ask the train operators what is the cost of this and what are the revenues but it is clearly a government decision.
Q265 Chairman: Do you think the department’s views on franchises are driven primarily by wanting to minimise subsidies and maximise premiums paid by train operators?

Mr Segal: The present franchising process is if the bid meets a minimum quality threshold. It is quite a high quality threshold but once you jump that threshold the decision process is almost entirely on the subsidy premium line.

Q266 Chairman: In a sense, quality does not come very high on that scale.

Mr Segal: You have to meet a certain threshold.

Q267 Chairman: That is a minimum.

Mr Segal: It is a moderately high threshold but once you have met it it is no longer a distinguisher. Somebody who is one inch above the threshold is just as likely to get it as somebody who is a foot above the threshold.

Q268 Chairman: Do you think there is a serious problem in over-zealous bidding?

Dr Brown: Time will tell.

Q269 Chairman: You are beginning to sound like Ernest Bevin. As to that, we will have to think about it.

Dr Brown: There is a rationale for the process which Mr Segal has outlined. There is a desperate need for greater funding and infrastructure enhancements. If an argument could be constructed so that a franchisee that achieves the minimum quality threshold, which I would agree is reasonably high, there is an argument to go with the franchisee who offers the least subsidy or the maximum premium because that is the best way of improving the network in the long term.

Q270 Chairman: Some railway commentators have said that firms use what they call “low ball” tactics to underbid for contracts because they know they can come back and have a second bite at the cherry. Is that right?

Mr Norgate: There have certainly been examples of that in the rail franchising area in the last few years. If you go back to the first round of franchises, in the first two or three there were some very ambitious bids put in with very high revenue forecasts that were never going to be achievable and these bids were there to buy the franchises. My understanding now is that the bids are coming in on a far more consistent basis in terms of the relativities in the financials and there is almost very little to choose sometimes between them.

Q271 Chairman: In other industries such as local buses, contracting out has led to significant reductions in operating costs but that has not happened with the franchising of rail services. Why is that?

Dr Harris: You need to look at where the money goes. If you run a bus company, a very high proportion of the costs are going on drivers’ wages and this kind of thing. The railway is a capital intensive industry. Whilst British Rail did a very good job, I think you yourself mentioned string and Sellotape. You can only do this for a certain amount of time after which, particularly if you have several years under Railtrack where nothing much happens at all, you end up with a huge backlog of infrastructure investment that you have to make. We have to be careful. Comparing five times the subsidy now is not comparing apples with apples. A lot of the costs are going into “catch up” and improving the network.

Q272 Chairman: Train operators tend to moan about Network Rail’s escalating costs and say that is a significant contributor to their own overheads. Is that a genuine complaint or is it something that they are using to say the equivalent of, “Not me, guv”?

Dr Harris: If we go back to a few years ago, there were certainly cases where costs being quoted were more than was reasonable. We are at a point in the railways where we are now having to spend significant sums of money because we are using up most of our capacity. All the cheap and easy things we needed to do we have done. If you want to put an extra train on now and that requires laying extra track, that is going to cost you money. We are necessarily at an expensive point. Whether that is directly related to franchising or not is not obvious.

Mr Segal: I agree with a lot of what Dr Harris has said. British Rail was exceptionally good at keeping costs down, which perhaps the bus industry had not been. I was there at the time. The expectations for being able to cut out costs were false. That is one of the reasons. Some of Network Rail’s costs that have been perhaps inherited from Railtrack were too high. Because of the way of the process, it does not have the integration which British Rail used to have to say, “How can we modify the specifications to cut out the costs to get 80% of the benefit for 20% of the cost?” That is not there so easily and transparently in the process.

Q273 Chairman: When Mr Coucher says, “We are taking consistently a certain amount of money out each year” that is genuine?

Mr Segal: It is getting better, yes.

Q274 Chairman: When somebody like the National Express Group says, “If there was the same rigour and competitive challenge to Network Rail the costs to the industry would be lower” they are just doing the normal whinge bit, are they?

Mr Segal: The rigour is coming from Network Rail. Under Railtrack it went very bad. It is getting better but I think it has quite a long way to go.

Q275 Clive Eelford: 11 years after privatisation, we are worse at keeping costs down than we were under British Rail?

Mr Segal: Yes. That is the evidence.

Chairman: On that cheerful and interesting note, can I thank you very warmly for coming, gentlemen. I am grateful to you and you have been very patient.
Memorandum submitted by the Chartered Institute of Logistics and Transport

The Chartered Institute of Logistics and Transport in the UK—CILT(UK)—is the premier institute for professionals working in transport planning, operation and administration. Its 20,000 members include directors, managers and other individuals working in and around the rail industry. The Institute is uniquely placed therefore to comment objectively on the issues raised by the Committee’s Inquiry.

The Institute’s submission is structured around the specific questions asked by the Committee in their formal notice.

1. What should be the purpose of passenger rail franchising?

The purpose of franchising

In the Institute’s view, railway passenger franchises should deliver a stable, safe and efficient service to the customer and at an affordable price consistent with any wider social or planning objectives. The franchising of those services should transfer much of the associated provision risk to the franchisee, but only as far as this is consistent with achieving good value for money for the franchisor.

Is the current system achieving that purpose?

Rail franchises grant monopoly rights to operate specified services on specified rail routes and are awarded by central government to private sector franchisees for a specified period of time. The franchise either carries the right for the franchisee to receive subsidy or a requirement to make payments (premium) to the public sector over the life of the franchise. Franchises are about the operation of domestic (not international) passenger services, generally on the national rail network.

The franchise operator deals direct with the travelling public—and is responsible for the sale of tickets, the setting of some fares, promoting information about rail services, operating stations and running trains. The franchisee’s incentive to maximise its fare revenue, coupled with the requirements of the franchise agreement, should encourage it to improve the quality of its service and to meet customer demand. At the same time it gets a commercial benefit from controlling cost. If a train operating company (TOC) manages a franchise well, its reputation is enhanced.

The franchise operators are the main customers of Network Rail which is responsible for the operation and maintenance of the national rail infrastructure. The franchisee is to some extent dependent on Network Rail’s quality of performance of that role.

— In contrast to other utilities such as water and energy, it is not expected that rail passengers can bear the full cost of service provision in all cases. Both Conservative and Labour governments have assumed that continuing subsidy will be necessary.

— Outright sale at privatisation would have meant “selling o(U1) the family silver”. Arguably, by granting short- to medium-term franchises, Government is able to extract more value.

— Franchising allows for both payment of subsidy and of a premium. In its current form it also allows for the sharing of revenue with the public sector.

— There may be a difference between the model which could be used for long distance and commuter services (both of which can generate revenue surpluses), in contrast to regional services (which do not). So far government has chosen to use the same model for all types.

— Periodic competitions give government more scope to monitor and specify performance than would be the case with outright sale. This meets politicians’ concerns that passenger train service is a public service.

— Franchising is also flexible in that government can relatively easily “remap” the country, ie divide it into different geographical areas to be the subject of franchises and thus increase or reduce the number of franchise operations.

— This flexibility allows for the specification of a single purpose operation such as an airport service, (eg Gatwick Express) or a mixture of services (eg Greater Western) which combines London commuting with intercity travel.

— Shorter-term franchises are less likely to attract private capital investment than the 20-year franchises launched in 2000, of which Chiltern is the only example.

In the view of the Institute, there should be an examination of the effect of relatively frequent changes of employer on the performance of operator’s employees (although we recognise that TUPE and provisions in the franchise agreement ameliorate these). Also, there should be an examination of whether relatively frequent changes in franchise owners and in the contractual terms of franchises have any effect on safety or whether the safety regime deals adequately with this.
2. How well does the process for awarding franchises work?

What input do operators, passengers and other interested parties have into the design of franchised services?

The process for awarding franchises in this second round of franchise letting has improved considerably. Early awards were notable for slippage in timescales principally brought about by changing specifications issued by the Shadow SRA and the SRA and by changes to the process. More recently strong emphasis has been placed on meeting laid down timescales and the process had become more consistent. A remaining, but declining, issue has been the lack of precision in the specification and seeking alternatives. This distracts bidders from refining their core offer to achieve the best price for the Government.

The process has now refined to an “Accreditation” Phase, whereby bidders seek to be shortlisted on the basis of their track record, and a bid phase, when those shortlisted submit their prices for the specified services. With greater, and comprehensive, specification by the DfT, the focus is now on offering the best price for delivery of the services.

The form of the franchise agreement has become much more standard, reducing the opportunity for bidders to renegotiate the terms and change the risk profile as bid, and thus reducing the uncertainty of the contractual position.

What input do operators, passengers and other interested parties have into the design of franchised services?

The DfT prepares a service specification founded on the current service pattern/level with alterations to reflect current concerns over the affordability of the rail network. Thus services which appear to be poor value for money (generally those with low usage) are likely to be considered for withdrawal. This specification is then issued for consultation to “Stakeholders” and is published on the DfT website. Representations are then considered and a final specification issued to bidders within the invitation to tender. Given the emphasis on net cost reduction to the DfT, the extent of changes is generally limited. This even seems to apply where the franchise is premium paying, suggesting a reluctance to reinvest some of the premium in supporting low-use services rather than franchises generally. There appears to be no cross-subsidy between premium-paying and subsidy-requiring franchises and we are unsure whether the DfT intends to net one against the other.

Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

This appears to have been managed satisfactorily as many SRA employees transferred to DfT and industry knowledge was thus retained. The processes and procedures set up by the SRA were well-founded and thus remain fit for purpose. There does not appear to have been any “change for change’s sake”.

3. Are franchise contracts the right size, type and length?

Size, type and length

Size. The cost of bidding/letting a franchise is broadly similar whatever the size. Thus the overall cost to Government and industry is less the fewer franchises there are. So there is a benefit in fewer, larger franchises. Operationally, the rail network works better the fewer inter-organisation interfaces there are. This again favours fewer franchises.

Type. Franchises are normalising on the current model of contracts with highly specified services and with franchisees taking most revenue risk. Thus:

- Round one franchises were let on the philosophy of allowing franchisees to increase services where commercially worthwhile but that filled the available line capacity. Further opportunities are now extremely limited without capacity-enhancing schemes, which require major investment.

- Rebalancing of the risk/cost issue whereby some risks (such as GDP growth) are more cost-effectively retained by the letting authority (ie the risk premium sought was perceived as poor value for money).

Length. Latest round franchises are generally in the seven- to 10-year length, similar to the first round. Some franchises are for longer periods, generally associated with long-term investment commitments (trains, infrastructure (Chiltern)) although the Wales & Borders franchise was 15 years to achieve stability of relationship with the Welsh Assembly Government and the Merseyside rail concession was 25 years.

What criteria and processes are used to determine the nature and length of franchises?

This is really a question for DfT policy. It is assumed to be a balance of

- More frequent re-letting increases letting costs.
— More frequent re-letting provides the opportunity to capture the benefit of better than anticipated financial performance by a franchisee.

— Longer franchises increase forecasting uncertainty and thus, potentially, the risk premium sought by bidders (and hence offer value to DfT).

— Franchisees will generally wish to see their efforts in investing in the railway rewarded by their “enjoying” the results. This can result in a reluctance to be innovative and risk-taking in the later years of franchises. Arrangements are beginning to be put in place for the DfT to “buy” the remaining life of the investment from the franchisee—albeit this can create a contingent liability for the DfT which they have been traditionally reluctant to accept.

— It is often difficult to identify, at the time of bidding, the likely enhancements to be implemented after the first five years, partly because enhancements identified as a result of need ought to be implemented earlier. This results in few committed schemes for the latter part of the franchise being agreed and included in franchise agreements—especially as cost projections are more difficult for spend that far ahead.

What criteria and processes are used to evaluate franchise bids?

Short-listing—the questionnaires submitted demonstrating bidders’ track record and management processes are scored and the highest scoring bidders go forward subject to there being between three and five bidders. The rationale appears to be that fewer than three does not provide adequate competition and more than five is unmanageable and makes the bidding cost unattractive to bidders.

Bids—This has recently been published (for SWT) on the DfT website and is broadly:

— Best price, subject to assurance of deliverability of the specification.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

This can only be a matter of opinion. The Government, as the letting agency, will seek the best value at the time of letting the franchise, measured over the life of the franchise. If the franchise price is renegotiated, this is because the Government wishes to vary the contract, eg because circumstances have changed. The current template agreement has a variation mechanism embedded in it which seeks to ensure that the negotiated price is consistent with that which would have been obtained had the change been incorporated at the time of bidding.

It is Government policy that franchisees retain most of the revenue risk and have control over many of the fares, believing these should be set on a commercial basis. Where there are wider social/economic political considerations (as for season tickets), these fares have been subject to regulation.

Are risks suitably apportioned between the Government and franchise holders?

This has changed since privatisation with a realisation that better value is likely to be gained if the Government retains certain areas of risk where the cost to Government of franchisees taking such risks would be high. This is typically where the risks are outside the control of the franchisee and/or within Governmental control. Thus recently there has been some amelioration of the long-term revenue risk arising from reduced GDP growth where risk is shared with Government. This has been balanced by the Government being entitled to share revenue where it is higher than anticipated.

What is the scope for improving services through franchise agreements?

The franchise agreement allows for additional services to be run, initiated by either the franchisee or the DfT, provided Network Rail considers adequate capacity exists. The process requires the DfT formally to adjust the service specification which will trigger a change to the franchise premium/subsidy, allowing the franchisee the same “margin” on the additional services as on the core services—thus retaining the incentivisation to seek such improvements. Where commercial service opportunities are identified, a mechanism exists for these to be run without a change to the subsidy/premium level, at the DfT’s discretion.

It may be noted that the additional revenue derived from increasing capacity to reduce service overcrowding can often be less than the cost of the additional works/vehicles required. This is an area where further thought is required on how to meet passenger aspirations for comfortable travelling conditions.
4. Do we need more competition and vertical integration?

Is franchising compatible with open access operation?

Open access applies to both freight and passenger operations. The concept was introduced in the Railways Act 1993, at the same time as franchising. EU law currently requires freight open access and the requirement is expected to extend to domestic passenger services in due course. Given this context, passenger open access needs to be recognised, not ruled out, when considering compatibility.

The Office of Rail Regulation (ORR) requires an open access applicant to pass a number of tests before obtaining track access rights:

- There must be adequate network capacity, taking into account the impact of new or additional services on performance.
- The applicant must demonstrate that its new services will not primarily abstract revenue from existing franchised operators. The business case needs to establish that the new service will primarily generate new business and new revenues.

There have been a very limited number of passenger open access new entrants since privatisation, the most successful being Hull Trains.

Over the network as a whole the opportunities for new passenger open access businesses which will pass the ORR tests are thought to be limited and therefore open access is not expected to have a material impact on the franchised industry.

The current industry structure raises particular concerns for franchise operators about passenger open access which could be addressed by changes to the structure. Thus the DfT as the franchising authority appears to expect existing franchise operators to take the risk of new open access operation. Since the risk is not easily quantifiable this risk allocation is likely to result in a risk premium (ie increased subsidy or reduced premium). This would be avoided if DfT agreed to take separately the specific risk of revenue abstraction (although the compensation mechanism would not be straightforward).

Another issue is that the operation of ORCATS (the industry revenue allocation model) results in an attribution of revenues to all passenger operators, including new open access operators, based on timetable factors. It is therefore relatively easy to predict the ORCATS allocations at the outset of new services. It is more difficult to predict the generative effect of new services. However, the ORCATS allocation could be changed and the modelling of revenue generation improved.

The access charging regime applied to open access operators (freight and passenger) is based on the EU minimum requirement of recovering marginal cost so that open access operators pay variable but not fixed charges. As currently applied this means that open access operators have a lower operating cost than franchised operators with whom they share routes. However, franchise bids take into account the access charges which apply to the franchise specification and so the amount of franchise subsidy or premium already reflects this. If those access charges change as a result of a regulatory review, any increase or decrease is to the account of Government and not the franchisee. The position of open access operators is quite different as they do not receive subsidy nor pay premium and are not state subsidised if their access charge increases as a result of a review.

A change in the access charging regime would need to be consistent with EU law, which seeks not to price open access out of the market. Such a change would not on its own remove the very different risk profiles of franchised and open access operations.

Should train, rolling stock and track operation be more closely integrated?

The Institute would observe that this is not strictly a franchise question, but one related more to the historical development of Britain’s railways. Over the years, the concept that any type of rolling stock can go anywhere has gradually been extended, but there are still notable exceptions. The most obvious of these is electrification and whether or not it is installed; other limitations relate to line curvature, the weight bearing properties of underbridges, and so on.

But other developments have seen the emergence of more specialist railways, the Docklands Light Railway (not part of the national system) being one. Here, a cursory glance will demonstrate how different the technical (not safety) standards are, to enable it to meet a specific purpose. It might be that parts of the national network could also benefit from similar treatment, and that this might include a new north to south high speed line should that ever come about.

In the case of specialist railways, the full integration of train and infrastructure becomes far more desirable, to avoid what could be very considerable costs incurred in attaining standards which are irrelevant to its purpose. It is thus inconceivable that the DLR could ever carry freight traffic, but that means that the infrastructure need not and should not be built for trains with 25 tonne axleloads.

For most of the national system however there are a number of operators, passenger and freight, using the same routes and the arrangements put in place at privatisation (such as what is now the Network Code and Network Rail’s licence conditions) are reasonably successful in managing track operation, rolling stock...
and train operation in an integrated way. The Institute believes that while integration is important, at an operational level it can be achieved within the existing structure. The Institute would suggest that the case for full integration becomes much stronger on the lines, such as they are, which need not (or cannot) be considered as part of the national system. It would also note that railway assets have a long life by their very nature, and 30 years or more is commonplace. This means that change can only be brought about slowly.

19 June 2006

Memorandum submitted by Roger Ford

INTRODUCTION

Passenger Rail Franchising has evolved significantly since the first franchises were let in 1995. I hope this submission will help the committee’s understanding of the factors which have produced the current process.

1995 Version 1.0 Ideological Purity

Franchising was intended to bring competition to the passenger railway. Initially it was believed that operators would compete with rival services on the same route—for example for commuter traffic. This was epitomised in Roger Freeman’s separate trains for “toffs and typists”.

To encourage competition operators would bid for “slots” (paths in railway terminology) on an eight weekly cycle—the “Peterborough process”.

It soon became apparent that railway operation was more complex than the political theorists thought and that competition in a novel and untested market could deter bidders or inflate subsidies.

As a result Moderation of Competition (MoC) was introduced. It was intended that the initial franchises would be let as monopolies, but that competition would be introduced gradually over time.

The Treasury was unhappy that this meant that the effects of competition, needed to increase efficiency and reduce costs, would be weakened. Competition on the track was replaced by competition for the franchise. The Treasury wanted frequent re-bidding to keep franchisees keen and proposed five year franchise terms or even shorter. The Office of Passenger Franchising argued that some stability was needed and the standard term became seven years.

Where investment in new trains was part of the franchise commitment, for example LT&S (now c2c) West Coast and Cross Country, 15 year franchises were granted. It should be noted that franchises do not own assets and so do not “invest”. The assets are owned by the infrastructure company (Railtrack/Network Rail) and the Rolling Stock Companies. Access and train rental charges represented roughly two thirds of the costs of a franchise. The train operator was responsible for operating costs—mainly sta.

Franchises bid against the 1994 timetable. In the case of heavily subsidised routes, a minimum level of service was specified—the Public Service Requirement. It was expected that franchisees would be commercially incentivised to run additional services.

A majority of these first generation franchises was bought by bus operators. Based on their approach to bus Regulation they had assumed that the secret of success was to cut sta.

For this and other reasons, some 50% of first generation franchises failed and had to be rescued. In some cases failing companies were bought up by larger operators. However, during this period subsidies had fallen, as expected, but largely through over-optimistic bids, particularly with the later, Regional, franchises.

1999 Version 2.0 Strategic Vision

Transfer of responsibility for franchising from OPRAF to the new shadow Strategic Rail Authority coincided with the arrival of Sir Alistair Morton as Chairman. Government policy was also changing and, in the 10 Year Transport Plan published in 2000 would be based on long term investment in the railways by the private sector.

Morton set out to implement this. He believed that the key to increasing investment was to involve the Franchisees. As remarked above, a franchise was an asset free zone and the standard seven year term meant that it would be impossible to generate a return on long term railway assets.

He proposed 20 years franchises in which Franchisees would invest in infrastructure upgrades through “Special Purpose Vehicles” (SPV). I could never really work out how an SPV would operate, but Go-Ahead (Southern) and Stagecoach (South West Trains), spent several millions trying to set up and fund SPVs jointly with Railtrack/Network Rail.

Laing with Chiltern was the only franchisee able to make the SPV work. But this was a simple franchise, infrastructure investment was simple and the owner was in the construction industry.
2002 Version 3.0 Restoring Stability

With appointment of Richard Bowker as SRA Chairman, the Morton vision was finally abandoned and franchising reverted to the original asset free/seven year term model. The year before the mechanism for funding the infrastructure provider had also changed.

In his Access Charge Review the Rail Regulator increased Railtrack’s income. In response, the Government chose to pay some of the increased funding as direct grants. Previously all Railtrack’s income had come through track access charges paid by the TOCs.

Since that decision the subsidy for franchises has failed to reflect their true costs. Direct grants increased substantially in the Access Charge Review which came into effect in April 2004 I would advise the committee to treat all references to the cost of franchising with caution.

At the same time, Railtrack’s financial problems were affecting franchises, notable Virgin. Failure to deliver the improved infrastructure on time meant that in mid 2002 both Virgin franchises had to be rescued.

SRA decide to run these, and other rescued franchise, as management contracts. An annual budget was agreed and the franchise was run with the franchisee being paid a percentage of the revenue as a management fee.

2004 Version 3.1 Incorporating Benefits

Under Richard Bowker SRA considered the subsidy profile as an increasingly insensitive criterion for evaluating franchise bids. The aim was to pick companies that would deliver but also look beyond the basic cost and take into account the marginal benefits in socio-economic terms of each bid. The Intercity East Coast franchise, with its additional Leeds services based on a small electrification “infill”, is a classic example.

This is best categorised as value for money versus lowest cost.

2005 Version 1.1 Ultra-fundamentalist

With the abolition of SRA, DfT Rail took over responsibility for franchising. The new policy, which has emerged this year, brings the passenger railway under more-direct control from Whitehall than ever before.

1. DfT Rail specifies the timetable to be run in great detail.
2. Companies qualify to bid against an Accreditation Questionnaire with a heavy bias towards European Quality Management practice rather than demonstrating appropriate railway experience.
3. Bidders must demonstrate that they can deliver the specified timetable. Selection is then based on lowest subsidy/highest premium.
4. There appears to be no scope for service innovations, proposals for additional capacity (more trains or improved infrastructure), or other incremental enhancements.
5. If a franchise runs into difficulties there will be no rescue. The option is take the financial pain or hand in the keys.

Conclusion

A key concern

We now have the worst of all franchising worlds. Service levels are set for a seven year term, based on the lowest cost bid to run the specified timetable. This sets the existing railway in aspic.

Traditionally the railway in Britain has advanced in incremental steps based on improvements in technology and commercial policy.

For example, under British Rail, there was one main line “modernisation” project each decade. The 1960s—West Coast electrification; the 1970s—Great Western and InterCity 125; the 1980s—East Coast electrification.

On a 30 year cycle (the typical life of railway assets) West Coast should have come around again in the 1990s, but this was deferred because of privatisation. Great Western would then have followed in the current decade.

Great Western has been deferred to after 2010, but there is no coherent plan for its development to meet new needs in the 21st Century—for example electrification or providing more capacity in the London-Bristol/South Wales corridor.
DfT Rail lacks any strategic view and seems happy to let a series of seven year franchises based on the existing railway. The contrast with the expansive attitude in what I consider the golden age of the 1980s is at odds with talk of a wider role for railways in future transport policy.

4 July 2006

Memorandum submitted by Professor Chris Nash, Institute for Transport Studies, University of Leeds and Rail Research UK

1. My colleague Dr Andrew Smith and I recently reviewed the British experience of Passenger Rail Franchising for a conference organised by the European Conference of Ministers of Transport. I have also recently reviewed Europe wide experience of rail reform and presented the results in another conference paper.

2. I see the aim of franchising as being to use the forces of competition for the franchise to achieve the best value for money possible for the money made available for passenger rail subsidies. Broadly we found that a number of different approaches to franchising has already been attempted in Great Britain, but that there was not really sufficient evidence to determine their relative success.

3. In the first years of passenger rail franchising it appeared that the process was being very successful, with passenger traffic rising faster than would have been expected simply from the favourable economic conditions at the time, and with costs and subsidies falling. More recently costs have grown substantially however, offsetting all the early benefits. This remains true even after allowing for changes in track access charges and in payments to ROSCOs. There are many possible explanations for this increase in costs, including more tightly defined quality standards in franchises, the costs of introducing new more sophisticated rolling stock, including a period when it would inevitably be running in parallel with the old stock, increased pensions liabilities and the costs of running services on infrastructure which was subject to a very high level of renewal activity and therefore disruption. We have been unable to quantify these effects from published data and therefore are unable to say whether this cost increase is due to factors outside the control of the operators or whether it reveals a failure of the franchising process over this period.

4. It has been suggested that one cause of the cost increase has been the willingness of the Strategic Rail Authority to place operators on management contracts or otherwise to renegotiate franchises where operators have hit financial problems. We found no evidence that the cost increases had been any greater for these operators. However, whilst this approach may have been necessary in some cases in the circumstances following the Hatfield accident, I welcome the statement from DfT that it does not intend to follow this approach in future except in clearly defined circumstances.

5. Broadly we see two approaches to franchising. In the first, the franchisee is charged with operating a clearly defined set of services to fairly precisely set out specifications and heavily regulated fares. This has been the general approach in those continental European countries where franchising has been (generally successfully) used, and is essentially the current approach in Britain. With this approach, it is clear that the franchising authority is taking the key decisions regarding services, and therefore it should also be responsible for key investment decisions, including rolling stock, and for bearing a large part of the revenue risk (although obviously incentives must be built in to the franchise agreement for the operator to deliver high quality services and seek to attract maximum patronage).

6. In these circumstances franchises may be relatively short (certainly less than 10 years) in order to keep up the competitive pressure. Such franchises are most appropriate for urban or regional services, which are generally unprofitable, and where integration into the transport network as a whole is an important factor.

7. Under the second approach, the franchisee would have much more freedom to develop services, subject to minimum requirements. The franchisee in this case may be responsible for rolling stock investment, and indeed for negotiating over infrastructure developments. In this case a long franchise, at least 20 years (with appropriate break points for poor performance) is appropriate to provide adequate incentives for the long term development of services, and it is appropriate for the franchisee to bear a greater part of the revenue risk. However, difficulties would still occur should there be a significant downturn in the state of the economy in that time; I suggest that this risk should still be borne by the franchising authority, using an agreed formula to explain the impact of GDP on traffic. This approach may be more appropriate on inter city services, where services are largely profitable and where commercial approaches to yield management are an important part of providing a good quality service with little or no subsidy.

8. European evidence suggests that there are costs associated with vertical separation but that there are benefits associated with competition. I do not believe that it is possible to secure competition in the freight market and competition for passenger franchises without a degree of vertical separation of infrastructure from operations. However, this might be compatible with a much closer relationship between regional passenger operators and the infrastructure manager, possibly even extending to the operators taking responsibility for day to day operations and signalling. I see this as the most problematic area for vertical separation, and do not consider that third party operators would necessarily suffer seriously from such an arrangement provided that strong regulatory control was maintained. It would also be sensible to align such
operations with a reform of infrastructure charges, whereby franchisees with long franchisees were charged essentially the “prime user” costs of the infrastructure they use (with other users simply being charged avoidable costs) and were in the lead on issues of how the infrastructure should be developed over time.

9. I consider that in general open access in passenger operations is unlikely to secure significant benefits and could lead to poor utilisation of track capacity and increases in subsidies as competitors seek to abstract revenue from franchisees. However, I believe it is appropriate for open access entry to remain possible in cases where the entrant can show that its services represent a good use of track capacity and will mainly offer improved services for particular groups of customers rather than abstract revenue from existing operators. They should however pay an access charge which reflects not just the marginal wear and tear costs they impose but also the opportunity cost of any track capacity they use which is desired by existing operators.

20 June 2006

Witnesses: Ms Mary Bonar, Chair, Strategic Rail Forum, Chartered Institute of Logistics and Transport, Mr Roger Ford and Professor Chris Nash, Institute of Transport Studies, University of Leeds, gave evidence.

Q276 Chairman: Good afternoon. May I offer a special warm welcome to you, Ms Bonar, because you are unique this afternoon for no other reason than gender if you will forgive my saying so. Could I ask you to identify yourselves for the record?

Professor Nash: I am Chris Nash. I am professor of transport economics at the University of Leeds.

Ms Bonar: I am Mary Bonar. I am the chairman of the Strategic Rail Forum at the Chartered Institute of Logistics and Transport and I am also a transport lawyer.

Mr Ford: I am Roger Ford, industry and technology editor of modern railways and also a founding editor of Rail Business and Intelligence.

Q277 Chairman: In what particular ways is the current franchise system better than the unified state run railway system?

Ms Bonar: The very big difference between the way in which British Rail was operating—and I have a great deal of respect for the way in which British Rail operated—and the current system as I believe it is that the introduction of franchising required the government to contribute to improving the infrastructure in a way it had never been required to do before.

Q278 Chairman: Surely it assessed that before it put the cash into British Rail? Are you saying it did not do that exercise before?

Ms Bonar: The interposition of contracts between government and franchise groups who were under the terms of the contracts initially meant that they could require the government to pay the charges which the regulator set, which meant that using the concept of independent regulation we moved from a system where budgets were set taking into account some infrastructure projects and levels of fares that were generated to a system where the cost of effectively improving the network was something the government has been forced to pay year on year. There are lots of debates about whether we have value out of that but we have had a great deal of expenditure on the network which we were not getting before the system came in.

Q279 Chairman: Do you agree with that, Professor Nash?

Professor Nash: I do but firstly I think in the 1980s in particular British Rail achieved a substantial improvement in efficiency. That is one reason why in Britain the benefits of franchising have not been as great as in some other countries where it has been used. I would accept in principle that competitive bidding for franchises gives an incentive to find ways of increasing traffic and revenue and cutting costs. In the early days, that seemed to be happening. What worries me is that post Hatfield we have not just had this massive increase in infrastructure costs that we know about, but putting that to one side there has also been a very big increase in train operating costs. Over this period the franchising process does not seem to have been working. It has been a very turbulent period and there are all sorts of explanations but all the cost reductions of the earlier years have been lost in the past few years.

Q280 Graham Stringer: When I put the point in your written evidence to the train operating companies last week, they said it was nonsense and you did not know what you were talking about. They were as crude as that. Can you back up what you are saying about the current inefficiency of the franchising process with hard figures?

Professor Nash: Yes. We have figures taken from company accounts. Company accounts are not always totally transparent so I would be the first to accept that our figures will not be precisely right, but I would be surprised if they were not in the right ball park. The second issue is what has caused these cost increases. There are clearly a whole lot of factors totally outside the control of the train operating companies which have led to cost increases. Again, I do not have firm evidence but it does not seem to me that they should have led to as big an increase as has happened.

Q281 Graham Stringer: What I am interested is hard numbers that disaggregate the inefficiencies, the extra costs of franchising for lack of improvement in the costs from the transfer of the infrastructure in costs through the franchising process. Can you give me those figures?
**Professor Nash:** Yes. The figure we have for the four years directly post Hatfield are that, having stripped out track access charges and payments to the ROSCO, train operating costs appear to have gone up 47% in real terms.

Q282 Graham Stringer: What do you believe the reasons are for that 47% increase?

**Professor Nash:** There are a lot of exogenous factors such as energy prices, what has happened on pensions and so on. My suspicion is that a situation in which quite a lot of train operating companies are on management contracts with payments negotiated annually—others were coming to the end of franchises—simply reduced the pressure for cost control. Hopefully as we get into a more stable position with refencing that pressure will resume.

Q283 Graham Stringer: Can you do a bit better than suspicion? A 47% increase in costs. Some of it is energy; some of it is pensions. Can you put figures on that?

**Professor Nash:** What we have managed to quantify does not come near to explaining that. A substantial part of that increase is increases in staff and labour costs way above the rise in traffic and revenue within the train operating companies. Beyond that on published data I cannot go. It seems to me it is something that badly needs looking at.

Q284 Graham Stringer: You do not think that one of the potential causes is that franchises have been more heavily specified and they are for shorter periods so there is less possibility of innovation in the train operating companies?

**Professor Nash:** I think that is right. With the emphasis on performance we have seen staff put back simply to improve performance. That may be totally justifiable. Also, the extent of the introduction of new rolling stock and some of the problems that have accompanied that must have raised train operating companies’ costs just in handling the introduction of new rolling stock and reliability problems. There is a whole host of reasons but even so a 47% real increase in costs in four years has to be worrying.

Q285 Chairman: The latest work by your colleague, Dr Smith, suggests that since Hatfield operating costs per train kilometre for companies that have moved to cost plus negotiated contracts have increased by 33%. For other train operating companies it looks like it is 14%. Does that not suggest a large proportion of the cost increases is due to the franchising policy?

**Professor Nash:** It does. The figures are not conclusive. Those figures include payments to ROSCOs, for instance, and for some of the operators there is a difficulty in separating everything out. It does appear that particularly in the case of cost plus contracts there has been a reduction in pressure on costs as one might expect.

Q286 Chairman: Mr Ford, do you have a comment?

**Mr Ford:** On cost plus contracts what happens is that the department agrees a budget with the train operator and that depends on how astute the department is in understanding the train operator’s business. We see in the latest Virgin results the profit has fallen. A lot of that, I suspect, is down to the fact that the department people who do this sort of thing have a better handle on how the Virgin franchises are run and have set a much keener budget. Therefore the opportunity for profit has not been there. We also see that historically in the South West Trains franchise where Stagecoach renegotiated the South West Trains franchise with the Strategic Rail Authority and freely admit that they took them to the cleaners because they were not all that sharp at negotiating.

Q287 Chairman: Would you say that is a good reason why we should have retained a franchise that gave us a benchmark against which to test other train operating companies?

**Mr Ford:** A benchmark franchise would be very hard to define. Would it be an intercity one, a regional one or whatever? I would have thought the basic flaw would be that they were franchised at all in the first place.

Q288 Mrs Ellman: Has the department got the balance right between the specifications in the base contract and the allowance for scope for innovation?

**Ms Bonar:** I would argue that it is not. Over the period of franchises since privatisation the terms of franchises have become tighter and tighter in terms of how train operating companies need to run their businesses. That may be a factor. There have been a number of models of franchise contracts during that period of time and they have tended to become more and more highly specified, not only in terms of whether the train service is specified but in the way in which the business is run. Doing that the effect as far as a franchise bidder is concerned is that the scope for controlling their cost is reduced because they are constrained as to what they have to deliver. The opportunities for the upside are also constrained. We may have brought down the margin because the risk is lower but we have probably shifted the balance of risk more back to the public sector.

**Mr Ford:** I have heard a lot about innovation sitting at the press bench this afternoon and I just wondered what people were meaning by innovation. Innovation is a good thing but it is risk. You innovate; it may work; it might not work; it may take a long time to work or whatever. Are we talking about one pound tickets? That is innovation. In terms of a rail business, I do not think we know what innovation means now. You cannot innovate. You bid to run that service. As you saw with Great Western, the DfT’s timetable was dubious. It had to be restructured and, as a result of cap and collar protection which takes away some of the risk, it was brought forward two years in compensation. If we talk about innovation, I do not know what
Chairman: I think, Mr Ford, you have that in common with all of our witnesses. We have heard a lot about innovation. What we have not heard is what it was, but if you know do please tell us.

Q289 Mrs Ellman: Have you seen anything that you would call innovation?

Mr Ford: Customer service, bringing in Wi-Fi for computers on trains. You have got Megatrain, the one pound train, off Megabus that South West Trains has introduced but that is about it. New trains are new trains, a timetable is a timetable.

Ms Bonar: Arguably, with the 20-year franchises, of which there is only one example, the Chiltern, but I worked on the South Central one, there was scope for innovation. It may be worth carrying out a project to see whether that method of developing station platforms and signalling or track enhancement is actually innovative. It is a completely different way of doing it but it is not open to operators to do anything like that any more.

Q290 Mrs Ellman: Professor Nash, do you have any views on what is innovation capacity, anything that you would advise on innovation, and why?

Professor Nash: I think the points have already been made. I would also say some of the ticketing systems, particularly the growth of advanced purchase. All of these were really just carrying further things that were already happening. I do think to some extent there may be some benefits there. If I could go back to the original question, it does seem to me that in dealing with the crisis we were in post-Hatfield having a very tightly specified franchise has made sense in simply getting performance back to something reasonable, but in the long term it seems to me curious if the detail of rail services is specified by DfT and then it is translated into a timetable by Network Rail, neither of whom are very close to the customer. Particularly in the more commercial parts of the market it does seem to me that in the long run it would be better to go back to a situation where the train operating company has more ability to exploit its knowledge of the market.

Q291 Mrs Ellman: We have been told that Network Rail interfere too much in the franchises in saying what can and cannot be achieved. Do you have any knowledge of that?

Mr Ford: I think that Network Rail is the only real bit of railway we have got. They deal with real things, they own real assets, they run the signal boxes and so on. The train operating companies are asset-free zones. They just manage a business. Someone has to make the decisions on what trains run. When the King's Cross box recently was put out of action because of a fire alongside I think it was Network Rail that started to get the trains running again, not First Capital Connect. We do have operators in some of the train operating companies who would stamp around and try to make things happen. They understand that Network Rail needs managing and I think that the TOCs that complain about Network Rail interfering are possibly the ones who do not understand the operation of the business enough to go in and tell Network Rail what to do.

Chairman: I think there is a lot of it around.

Q292 Mrs Ellman: What about involving passengers more and dealing with passengers' expectations? What change could be made so that passengers were more involved and felt more satisfied about what was produced?

Ms Bonar: If you start where we are with a tight specification by the Department with a great deal of public consultation in relation to the services that are planned to be provided and hints at least as to rolling stock with which it is expected to be provided, plus you have rail user groups that are outside the ambit of Passenger Focus a Government-sponsored passenger-focused organisation, passengers actually have quite a lot of scope for saying what it is they want in relation to particular services theoretically. They are just as constrained as everybody else who has been talking this afternoon by the fact that we have a very constrained capacity network. We have replaced most of the rolling stock that we are likely to replace for the next few years, so we have a fairly static fleet, and the differences that can be made in terms of the number of trains that can be run and where they can be run are not very great unless we put more investment into the network.

Mr Ford: Could I pick that up from Mary and carry on with that thought? A seven-year franchise puts the railway into aspic on this basic specification. How on earth can you do something like a mainline electrification programme? The Great Western franchise has said, “Run this with these trains”. Who is going to say what happens with the Great Western mainline which is now 30 years old since its last modernisation? How on earth can you have a coherent railway strategy? Network Rail is not going to embark on upgrades or electrification because the train operator is running to this basic strategy. There is a separation between the two and my concern is that the highly specific details that you bid against mean that you are just perpetuating the as-is railway as it goes on and, looking forward to the high level output specification which is going to come up in 2007–08, that is simply going to say, “Run the existing railway better with a bit more capacity”.

Q293 Chairman: Is that not inevitable given the existing franchising system? On the one hand Network Rail do not have that degree of flexibility to specify to the Government how the system should grow. They may be in need of it but they do not have that responsibility at the moment, that the system should grow, that new capacity can only be brought in by expanding particular points. Do you not feel that the difficulty is because of the existing system?

Mr Ford: Yes. The existing system means that whereas in the eighties there were endless projects going on—Thameslink, the East Coast mainline

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1 Reference to Laing/Chiltern’s Project Evergreen.
electrification, signalling schemes and so on. Network South East, because it was an integrated railway, now we have very few big projects. The main ones are in London where the Mayor has put lots of money in. Signalling simply stopped happening and has started to build up again. The Great Western mainline, which is now overdue for modernisation, is in aspic, as I say. Yes, it is a fundamental problem.

Q294 Chairman: Professor Nash, do you want to comment on that?
Professor Nash: Yes, please, Chairman. I think when it comes to franchising there are two radically different approaches you can take. You can have reasonably short, very tightly specified franchises, in which case it is really the franchising authority that has to drive the strategy. In the situation we have now it is really the Department for Transport that needs to be looking at what sorts of long term improvements for the system might be made. There is a totally different model. It probably works better at the more commercial end of the business but where you have long franchises the train operating company has much more scope to develop its own ideas, much more involvement with Network Rail on the infrastructure side, whereas at present it is protected from the charges and really does not have much control over its major supplier. That is another model that I think needs a lot of careful thought to get the incentives right but is certainly worth considering.

Q295 Mr Martlew: Can I pursue that? A comment has already been made about the Chiltern line. It appears at the moment that the Department are settling for eight to 10 years and we have heard from the operating companies that they do not particularly want 20 years. What do you think is the best solution with regard to the taxpayer and the passenger?
Professor Nash: I think for the services which are predominantly social, where the franchising authority clearly is going to want to specify very tightly what should be run, so commuter services, local region services, probably eight to 10 years is right. It is more where there is commercial development of services that it would certainly be worth thinking about how a 20-year franchise might work.
Ms Bonar: I also support looking at the types of business which are being franchised and seeing whether they should all be done under the same model. There is clearly a very large difference between intercity businesses and I do not think the fact that other businesses run on the same routes interferes with this. There are businesses which are in competition with road and with air and arguably they could be left far less specified because there would be alternatives for the public. It would still be possible to get to Scotland if it were not possible to do it on the East Coast or West Coast mainline. Those could be treated as businesses and they could be given a great deal more flexibility and taken out of the amount of subsidy which even they get in terms of the way the access charges work.

Q296 Mr Martlew: The question was about the length of the franchise. I am sorry.
Ms Bonar: Yes, but I think in terms of franchises generally the Institute for which I am speaking would accept that the seven to 10 year model is probably about as long as you would want to go, but I think you do the first step, which has just been identified by Professor Nash, of looking at whether all of these different franchise businesses are the same sort of business that should fit into that and I would be inclined to look at the intercity businesses with rather longer franchises, but on very different terms.

Q297 Mr Martlew: In earlier evidence we heard from the train operating companies that they did not want to take the risk of a longer franchise.
Ms Bonar: However, if you launch them in the market that does not mean to say that they cannot take a risk on them. At the moment they are used to a particular type of bidding structure and a particular length of franchise. That was not the case at privatisation when Virgin, for example, was looking for a much longer franchise.

Q298 Mr Goodwill: If I may I would like to ask you about vertical integration. A picture seems to be emerging of the train operating companies as sort of the meat in the sandwich between Network Rail, which may or may not be becoming more efficient, and the ROSCOs who have been criticised for making excessive profits, and they have very little wriggle room in the middle to innovate or improve the structure of their businesses. One answer to this could be a degree of vertical integration. Do you think that could work on the model we have in the UK?
Professor Nash: There certainly are things that are done more easily and probably better in a vertically integrated railway in terms of day-to-day operations, planning of the timetable, the flexibility to adjust things, and indeed perhaps planning investment as well. On the other hand I do think that there are benefits of competition in the passenger system mainly in terms of competitive tendering, so one has to trade those off against each other. In terms of where we are now I do not think anyone very much has a wish for another radical change but I do think that over time one might develop into a model where the train operating companies certainly, if some of them had longer franchises, had more control over the infrastructure.

Q299 Mr Goodwill: 20 years perhaps?
Professor Nash: This is not changing the structure, not saying that they would own it, but they could have more day-to-day control over the infrastructure.

Q300 Mr Goodwill: Does anybody else have a view on that?
Mr Ford: Yes. I would have thought that the radical approach would be to consider vertical integration upwards from the rail rather than downwards from the train. As I say, Network Rail is extremely concerned about the trains that have been bought since privatisation which are heavy, chuck out lots more CO2, damage the track and so on. They have produced a timetable. Perhaps there might be a case for Network Rail acquiring trains and running a franchise themselves. That would give you a lot of continuity and it could have break points in it at which the Government could say, “You are doing a good job or a bad job”, but the train operating companies seem to be getting a bit lukewarm on vertical integration. They were very keen on it some time back.

Q301 Chairman: Is that so because many of them have got what are in effect management contracts?
Ms Bonar: One of the problems is that the industry by my calculation has been through four restructurings, including privatisation, since 1994 and during the Rail Review the operators did make a number of suggestions around vertical integration and were interested at that stage. At the present time I think it is unrealistic to expect those organisations to be welcoming further radical change. If we are going to redesign something, which I believe and the view of the Institute is that the present system works and can be made to work, and there are arguments either way, I would argue that we should spend some time looking at a number of different models to work out where the benefits are and where the risks are in those models. We run a number of different models in this country already. London Underground is split on the basis that operations only are carried out by the operator and the provision of the rolling stock and the railway and the timetable comes from the InfraCos. Tram systems tend to be integrated. The DLR is separate in terms of the extensions. We have got lots of things we can look at. It would, I think, have been quite useful if we had allowed Merseytravel to go ahead and see whether on their bit of the network, which would not have interfered very much with other people, they could produce reductions in cost and meet what passengers were looking for. That experiment could have been going on and given us something to look in a UK context but I would argue very strongly against radically changing the system for the next few years.

Q302 Mr Goodwill: So you think it might be useful for Mersey Rail or in Scotland, for example, to run a pilot and see how it worked?
Ms Bonar: Yes, I do.

Q303 Mr Goodwill: Based on Mr Ford said about Network Rail themselves bidding for franchises, do you really think it is appropriate for a company underwritten by the taxpayer to be competing with companies which are not in that fortunate position for the provision of services on the railway?
Mr Ford: With respect, that is an entirely artificial constraint. We have management companies which are bidding to either take a subsidy or run a basic specification. As I say, they are mere shells with operating skills, management skills, customer service skills but they own no assets, they have no weight and they only stand to lose their bonds or whatever. Network Rail is an organisation strong on engineering, strong on operations. They are the engineers and as a former engineer myself I can see great merit in bringing both sides of the wheel and the rail together.

Chairman: There’s an old-fashioned idea!

Q304 Clive Efferd: Can I go back to something Professor Nash said earlier on? What did you envisage when you said that train operating companies should be given more freedom to exploit their knowledge of the industry? What did you envisage them being able to do?
Professor Nash: Design timetables that are more attractive to the customer, balance those with fares policies that fill empty seats and do not over-fill full trains. If they had long franchises then concern about lifecycle costs would be a lot higher. I am also worried at what is happening with rolling stock. Why are we getting much heavier trains that cost much more to run but do not always give a better service?

Q305 Chairman: Do we not know why that is, Professor Nash? Is it not in the interests of the ROSCOs to do what they want to do irrespective? They do not own any infrastructure.
Professor Nash: But the train operating companies do not have to go to the ROSCOs to secure new rolling stock.

Q306 Chairman: Have you explained that to them recently?
Professor Nash: They have got to get finance from somewhere but they can go direct to manufacturers. The ROSCOs have managed to maintain their position but again I fear in the current climate nobody is looking closely enough at the long term implications of what we are investing in in rolling stock.

Q307 Clive Efferd: But if I were a train operating company with a seven to 10 year contract would I go straight to the manufacturers and buy rolling stock?
Professor Nash: It would be a case of finding alternative leasing arrangements. Some of the manufacturers lease rolling stock themselves.

Q308 Clive Efferd: Can I pursue that for a minute? Is it the structure that is the problem? If you replace one rolling stock company with another rolling stock company, whether it is somebody who has bought from the manufacturer or it is the manufacturer themselves, is it the structure of the system that is wrong?
Professor Nash: Maybe there just is not enough competition in the whole system, including amongst manufacturers. To my mind to a large extent the problem with the ROSCOs is more that to some extent they have a monopoly of the existing rolling...
stock rather than when you come buy new rolling stock. There are other ways of doing it when it comes to new rolling stock.

Ms Bonar: From what I have seen of rolling stock leasing and in the context of franchise bidding, the franchise bidding process has had a large impact on the selection of rolling stock because bidders, particularly those who were acquiring Mark 1 replacement stock, were doing so in a time frame where the things that mattered to them about the choices they had to make amongst two or three European rolling stock manufacturers—and this is nothing to do with the ROSCOs—were to do with cost of the kit and the delivery schedule and the general performance of that manufacturer’s trains. From those deals that I have seen the decisions were around those key factors. They were not around whole life cost. They were very much pushed by things which were to do with the pressure of the franchise bidding process. Again, we are a very small island in terms of the rolling stock market. We inevitably buy from manufacturers who manufacture stock for railways which do not run under the same constraints that we do, the railways in France and Germany particularly. We are not deliberately going out to buy heavier rolling stock and rolling stock that costs more to run. We are buying the rolling stock which is being designed and run in Europe, and the European passenger happens to expect to have air conditioning and so we have ended up with air conditioning and we have ended up with heavier trains, but these are to do with the market from which we are buying and I think they are very little to do with the ROSCOs.

Mr Ford: On this subject, the air conditioned trains that were built at Derby in the 1980s are something like perhaps 17 tonnes less than the air conditioned German trains which are running even now on the Transpennine Express. Those vehicles each weigh over 50 tonnes and if you compare, as I did, the fuel needed to get up to 100 miles an hour, the German trains need about three litres of fuel just to get up to 100 miles an hour. That is CO2 going in the air.

When I say, “Why are these trains heavier?”, the Germans say, “You will have to come and see what it would take to run one of the older German air conditioned trains from London to Brighton. I think the additional energy consumption would benefit from it?”

Mr Ford: No. It was a bad specification on the Pendalinos. Virgin thought they were going to have three classes. The Railway Vehicle Accessibility Regulations say you have to have a separate toilet per class, so therefore they had to have three toilets in a train, which obviously takes up a lot of space and puts up the weight per seat. The Pendolino per se is not that heavy a train. It is the weight per seat that is high and that is because they had to put in more disabled toilets than common sense would dictate.

Ms Bonar: From what I have seen of rolling stock the replacement for the high speed train is going to be a lighter weight train rather than a heavyweight train as it might appear at the moment.

Q310 Graham Stringer: So you think in relation to the Pendalino trains on the West Coast mainline, which have very large disabled toilets that work from time to time it is just bad design that gives that extra weight?

Mr Ford: I would not know, Chairman.

Q312 Chairman: Do you not know about the Hitachi trains either? Are they the same?

Mr Ford: The Hitachi trains being built for Channel Tunnel Rail Link will weigh more per seat than the Electrostar trains built at Derby.

Q313 Mr Martlew: Just on the issue of the weight of the trains and going back to yesterday when we had the Energy Review, is the reality not that the heavier the trains the more energy it takes to shift them and we should be going to lighter trains not just because of the wear on the track but also because the environment would benefit from it?

Mr Ford: This morning I had a phone call from an engineer who ran a computer programme comparing what it would take to run one of the older air conditioned trains I mentioned and one of the new German air conditioned trains from London to Brighton. I think the additional energy consumption was something like 28%. If you are moving a lot of mass around, a lot of heavy weight, it takes fuel and energy to get it up to speed and unless you have got regenerative braking that just disappears into the atmosphere so in addition to CO2 giving you global warming you get disc brakes warming the air as well.

Chairman: That is very helpful. Thank you very much.

Q309 Graham Stringer: Just on that point, is not one of the reasons trains are heavier the requirement to have disabled access to toilets?

Mr Ford: It is not a significant factor. If you look at, say, the Networker fleet, which are the shiny trains built in the late eighties, they have got disabled toilets, they have got various other features and they are significantly lighter than the trains being delivered today. Trains have just got heavier and there is no one particular reason in my view. What it needs is somebody, a really good engineer, to say, “We are going to have lighter trains and if you do not make them lighter they will not run”.

Q314 Clive Efford: Is it your argument that if you were the people who care for the track you would put more consideration into the design of the rolling stock than is currently the case under the franchises?

Mr Ford: That is indeed happening. Network Rail is part of the working group responsible for the high speed train replacement and they are adamant that the replacement for the high speed train is going to be a lighter weight train rather than a heavyweight train as it might appear at the moment.
Q315 Clive Efford: Can we ever really transfer risk from the railways, given the importance of the railway network to the economy et cetera? Is it ever going to be possible to transfer risk in reality to the private sector from the public sector?

Ms Bonar: We had a very interesting example of this, did we not, with Government deciding to allow Railtrack to become insolvent, so we saw private investors lose money as a result of investing in a privatised railway? One of the ways the Government seems to measure risk in the private sector is if they lose money when things go wrong, so they did. We then went to administration during which Government was in a position where it basically had to pay what the administrators thought they needed in order to fund the infrastructure controller, and part of the cost base which Network Rail inherited had in fact been inflated as a result of that process in my view, and I think this is the problem, that public transport by railway tends to come back to being something which Government and politicians feel they are responsible for and therefore they are reluctant to both see it go wrong and stand back and have no provision for the public.

Q316 Clive Efford: Is that a fair comment? Is it not that the public perceive it to be a public service and therefore with the amounts of subsidy going into it they would want some sort of accountability for that type of investment?

Ms Bonar: I do not think that is the same as the question you asked. There is risk with the public sector. Perhaps the risk is with the public sector for that very reason. What I have been trying to think about is, do we feel the same way about buses? I think the scale and cost of railway operations tends to put them into a different position from public passenger vehicles running on the highway. We can see there that the bus companies could go bust and nobody would do anything about it and somebody would come along and another bus would appear, but it is very much cheaper to get that off the ground.

Q317 Chairman: In fact, that does not happen though, does it? What happens now when private companies fail to provide a service is that a local authority will be almost forced to step in and replace it.

Ms Bonar: That depends, Chairman, on whether we are talking about a bus company which is running a contracted service or whether we are talking about a non-regulated bus company which is simply running and decides that the competition is better than it is so it withdraws from the market.

Q318 Chairman: I am just interested in this because in fact the experience is that that is a very nice distinction which is not obvious to the public. The public will simply say, “I require a bus service”, and if a bus company has gone bust and that bus service is not there they will then require the state to provide one.

Ms Bonar: They require a bus service and if the service which has gone bust is a non-regulated service then the first thing that is likely to happen is that the private sector takes up that route.

Q319 Chairman: Would that it were so.

Ms Bonar: Otherwise, because of the way that the obligations of local authorities work they are required to provide a service.

Q320 Chairman: I think you have made your point. We will not agree on this.

Ms Bonar: I think we are agreeing actually.

Q321 Clive Efford: Transport for London believe that a regionally based stakeholder is better placed than the private sector to manage revenue risks in inner-urban franchises. Do you agree with that?

Professor Nash: Broadly, yes. It is pointless to pay the private sector to bear risks that are totally outside their control anyway because the point was made in an earlier session: you will pay them a lot of money and it does not reduce the risk, so certainly, to the extent that revenue growth is dictated by external factors, the state of the economy or Transport for London’s policy, route pricing or whatever, paying private companies to bear that risk does not make sense. Where you do need a private company to bear the risk is in the risk related to the things that it can control in terms of its costs and the quality of service it provides. The appropriate approach is to design contracts which give incentives on that side but the purely exogenous risks are borne by the public sector.

Q322 Chairman: I am sorry; I really want to let you escape in a civilised time but I do need to talk to you about open access. What is your view on open access? Do you feel that there has been a view in the Department that certain franchises could be offered in order to maintain the fiction that some other companies could be brought in or do you think there is a specific commercial reason behind open access?

Mr Ford: Open access gets around the freezing of the status quo railway, that somebody might conceivably, like Hull Trains or Grand Central, think, three years into a franchise, that there is an opportunity there. The existing franchisee is busy running inside his hamster wheel desperately trying to meet the amount of money he has promised to give the Government. His eyes are totally on what he has got to run. In contrast, somebody outside their control anyway because the point was made in an earlier session: you will pay them a lot of money and it does not reduce the risk, so certainly, to the extent that revenue growth is dictated by external factors, the state of the economy or Transport for London’s policy, route pricing or whatever, paying private companies to bear that risk does not make sense. Where you do need a private company to bear the risk is in the risk related to the things that it can control in terms of its costs and the quality of service it provides. The appropriate approach is to design contracts which give incentives on that side but the purely exogenous risks are borne by the public sector.

Q323 Chairman: I am sorry; I really want to let you escape in a civilised time but I do need to talk to you about open access. What is your view on open access? Do you feel that there has been a view in the Department that certain franchises could be offered in order to maintain the fiction that some other companies could be brought in or do you think there is a specific commercial reason behind open access?


**Professor Nash:** We did some modelling work earlier on open access and our conclusion was that if you had completely free open access it would be wasteful. People would simply cream, skim and duplicate the most profitable services. On the other hand I agree with Roger Ford that having the possibility for someone to come in with a totally new idea to serve a bit of the market that is not well served at present is something that should be preserved. Basically, a policy of saying, “We will examine each case on its merits. We will not allow open access unless we believe it really provides new consumer benefits to justify it,” is about right.

**Ms Bonar:** There are parts of the country which, from the franchise mapping exercise which the Department has carried out, are not provided with, for example, direct rail services to London. That was pretty well the case in relation to Hull and there are some other examples around the network at the moment. Given that the regulatory process, and Professor Nash has just touched on this, requires evidence that the revenue generated is not primarily abstractive, and there is quite a lot of explanation as to what that means, and that performance will not be affected and that the capacity is there, it would seem to be difficult to say that if the private sector are prepared to take the risk to service those areas there is a lot of disbenefit in that; in other words there could be argued to be quite a lot of benefit, but it is not significant. I think there were some statistics floated last week that something like 19,000 trains run on the network every day which are franchised and about 10 currently which are open access passenger trains, so I think we are in danger of getting open access out of proportion.

**Q323 Chairman:** So you are not saying fundamentally that the theory is wrong? You are simply saying that the passengers exist and therefore the real benefit would be minimal?

**Ms Bonar:** No, I am not saying that. I am saying that if, for whatever reason, the Department has decided that an area of the country should not be serviced, that the private sector are willing to take that risk, there is a benefit in their being able to do so.

**Mr Ford:** And I think Hull Trains makes the point. Hull Trains started off in a small way with some little 100-mile-an-hour trains and by focusing on their market and quality of service they have gradually built it up. They have now got five trains and they are running 125-mile-an-hour trains, they are very reliable, and Hull has undoubtedly benefited.

**Q324 Chairman:** Should open access operators pay any of the structure charge which reflects not just the marginal wear and tear costs but also the revenue foregone by the franchise operators?

**Professor Nash:** I think they should pay more than purely the marginal cost if they are abstracting significant amounts of revenue or taking up scarce paths which other operators, in particular the main franchisee, want to use. The current system has a very low charge for entering in those circumstances and I think it should be higher.

**Mr Ford:** I might argue from the other point of view. It is very easy to get confused between subsidy and premium. If you pay a subsidy a lot of your subsidy is going towards paying your fixed track access charges. If you are paying a premium you are not paying as much to the Government as you might because of the money that is going on access charges. If you want to run your trains you run that at the variable charge only, although you are not likely to, so I think it quite reasonable. Freight, for instance, is open access. Freight does not have to pay a fair share, and if you said it had to pay a share of fixed costs presumably it would take away some of the total fixed costs so that the franchised operation would pay less and you can imagine what a lawyers’ and accountants’ market it would be juggling what money goes where. You would probably need another department in Marsham Street.

**Q325 Chairman:** That might be to the advantage of the public service unions; you never know.

**Ms Bonar:** Chairman, there are in fact two variables, are there not? There is the way the access charge is fixed or is sorted out in terms of whatever open access operators pay in this country compared with franchise operations which basically bear the fixed costs of the network as they are currently designed, and there is also the way that the ORCATS (revenue allocation system) system works to allocate revenue. We are tending, I think, to focus only on one and not on the other as if it were God-given and nothing would ever change. Clearly, if the economics of running open access operations moved to the point where it is no longer commercially viable for them to be run then they will not be run, end of story, so the people of Hull will not get their trains any more and then the Department will have to consider whether it is in fact prepared to provide the equivalent service through franchising and how much that will cost.

**Q326 Chairman:** I think that is a good moment. Can we just ask you one question, Mr Ford? I think you are the first person that has put the elephant in the corner very firmly into our discussion because what you are really saying is that unless someone takes a very radical view of the future of the railways, way beyond just maintaining an effective system at the moment, we are going to continue to have what is in effect an ossified service. Is that right?

**Mr Ford:** Yes. One of the things that depresses me intensely is that in the 40 years that I have been in the railways it has always been getting better. When I started writing in 1976 there was always something new and exciting to write about—125-mile-an-hour trains in 1976, in the eighties there was the East Coast mainline, Thameslink, all that sort of thing. There were always exciting new projects to write about. Now I spend my days dissecting regulatory documents, occasionally going to see a new train and writing about ROSCOs. Yes, the railway is not going forward. I was encouraged to see in the latest Network Rail business plan that they have made Thameslink a priority, but Thameslink happened. I think, within about two years under Network South East with Mr Green. Yes, I am deeply concerned...
that the railway is just stuck the way it is and that the new procedure with the high level output statement will just perpetuate “The same railway but run it better, chaps”. I do not think it is really very encouraging.

**Q327 Graham Stringer:** If the Rail Minister was here he would say—I know this because he says this to every question he is asked—that the railways are doing very well because there are record numbers of passengers now using the railways, so it is at the level that the railways were at 40 years or so ago. Is he fair to take credit for that? Can franchising take any credit for that or is it, as Professor Nash said, really to do with external factors, the growth of the economy, congestion on the roads and other things?

**Mr Ford:** We saw exactly the same growth in the eighties under Bob Reid. We saw the same rate of growth and it all only ended because the Thatcher/Lawson boom wrecked the economy. Growth in the railways has been coped with before. I suspect, and I agree with Professor Nash, that it is largely all exogenous and the railway is coping remarkably in handling this growth without any of the big projects, the improvement in part of the West Coast route modernisation that have seen throughout my professional career.

**Chairman:** Mr Ford, I give you a personal undertaking that it will be my one strong view in life that I should find all sorts of exciting things for you to write about. Thank you all very much for coming. We are very grateful to you. Your evidence has been extremely interesting.
Wednesday 19 July 2006

Members present:

Mrs Gwyneth Dunwoody, in the Chair

Mr David Clelland
Mr Jeffrey M Donaldson
Clive Efford
Mrs Louise Ellman
Mr Robert Goodwill

Mr John Leech
Mr Eric Martlew
Mr Lee Scott
Graham Stringer

Memorandum submitted by Grand Central Rail Company

1. Grand Central is an Open Access rail operator, and would like to submit the attached information for the Committee’s consideration.

2. Because Grand Central, at the moment, does not bid for franchises (and hasn’t done so since the first round in 1995), we can only have a limited input into the questions you pose concerning purpose, process, size and length etc.

3. However, it is clear that operators like Grand Central are not in a position to be considered acceptable bidders due to the emerging size of the new franchises, and the relevant size of our Company. And if the figures quoted often by recent/current bidders are to be believed on the cost of mounting a bid, then it is unlikely Grand Central would consider the risk involved as reasonable in respect of the financial commitment required.

4. What also became clear during the SRA’s tenure was the overly prescriptive nature of the franchises, with many franchisees complaining they are no more than management contracts with little room for flexibility, flair and innovation. Whether that will change now responsibility has formally moved to the DfT is not yet clear, although there are encouraging signs.

5. Despite this prescriptive nature, some extremely large players continue to bid aggressively for franchises, only to win, and then bemoan the fact they are on tight 4% margins! I should add this is absolutely not the case with all bidders, some of whom have made it publicly clear they will not bid against certain specifications.

6. Again, if this financial information is true, it would tend to support the “management contract” theory. However, supporting this tight prescription is a level of protection for franchises through “cap and collar”, in effect insulating a franchisee from failure of its own business plan.

7. This cap and collar protection ensures that should franchisees see revenue fall below a certain level, or increase above a certain level, then the DfT would effectively support the franchise through increased subsidy/reduced premiums, or take a share of increased profits. In exceptional circumstances, should a franchise be so poor it could be taken away from the franchisee.

8. Grand Central has also always been sceptical of franchisees claims on need for long franchises to protect investment, usually in rolling stock. What investment does the franchisee actually make?

9. As franchises are prescriptive, the rolling stock for example is part of the process. Whether a franchise is short or long, in each case stock procurement/leasing is underwritten by the Government (DfT). It is of absolutely no relevance whether it’s for three, seven or 20 years, as the actual investment is made not by the TOC, but by the ROSCO, in nearly every case underwritten by Government. If a franchise is re-let after say seven years, the DfT specification would almost certainly include “no new stock” so securing the initial investment.

10. Only with Open Access, where a real business decision needs to be made, by both TOC and ROSCO, does the market really play its part.

Is franchising compatible with open access operations?

11. The answer must clearly be “yes”. Franchises are specified by Government though DfT. By their very nature, these tend to be current services/specifications let to the operator agreeing to run it for the least subsidy/largest premium. In theory, there is nothing wrong in DfT seeking the best financial return, but this is looking at a very small piece of the overall picture, and so no focus is given to expansion beyond the core network.

12. If franchisees are tightly specified, all entrepreneurial flair is driven out, with the result that focus is “on what is”, not “what could be”. In this respect Grand Central has some sympathy with franchisees.
13. As the industry, and all open access operators know, many of the industry “models” for revenue growth are based upon incremental increases on an established service pattern. So the industry tools are pretty good, (it would appear) on increasing known markets. Where it is not so good is identifying new markets, as an incremental increase on nothing is still nothing!

14. As a result, all open access development nearly always requires a full “bottom up” business plan, with detailed discussions with stakeholders, the use of focus groups and then full evaluation of the available data. This time consuming and costly process will help determine whether indeed proposed new services will meet the stringent criteria laid down by the ORR in both the “Criteria and Procedures for the Approval of Passenger Track Access Contracts” and the “Moderation of Competition: Final Conclusions” documents. Both documents fully consulted on within the industry.

15. As Grand Central is only too aware, not all open access proposals meet this stringent criteria, and after 10 years of the private railway, only one new “open access” operator is running at present, the highly regarded Hull Trains.

16. This should give comfort that there is not a flotilla of open access operators waiting in the wings to challenge the status quo, but that those with the determination and vision must be allowed to put forward suitable opportunities for consideration.

17. Additionally, without holding out the opportunity for open access innovation, what improvements could the large populations of Wearside, Teesside and West Yorkshire expect to see?, and at other locations what price to pay for passengers with no direct competition?

18. In a nutshell, franchises deliver the railway the Government can afford to buy. What open access offers is the ability for the Government to get “more for less” as open access operators concentrate on important—but probably not core parts of the network—to develop new markets and offer limited competition as well. The risk is ours, no one else’s.

Should train, rolling stock and track operation be more closely integrated?

19. I believe it would be beneficial for a more structured approach to be taken to the “cascade” of quality rolling stock, something British Rail was extremely good at. I found it somewhat bizarre that the SRA did not use its influence to propose a suitable programme for this to happen during its tenure, particularly considering the undoubted influence it should have been able to exert in that market.

20. It may be that the system is now maturing, as 10 years is a relatively short time in railway terms, and our understanding is that DIT is developing a more structured approach to this issue.

21. With relation to track operation, I would echo the words of some of my freight colleagues here—“Why would a passenger operator with say a 10 year franchise think it could do it better than Network Rail”—this would in effect give it priority of information etc over all other operators, both passenger and freight, and no doubt lead to further, in this case, very necessary regulation.

22. Network Rail at least is independent of train operations, and that position should remain.

23. I hope the information provided proves useful, and please don’t hesitate to contact me should you require clarification or further information.

20 June 2006

Memorandum submitted by Renaissance Trains Limited

A request has been received from Annette Toft for a written submission from Renaissance Trains Limited to the inquiry into passenger rail franchises in the form of a description of open access passenger operations. Similar questions to those listed in the terms of reference have been used although some further information has been provided which it is hoped the Committee will find useful.

Renaissance Trains is a promoter of open access passenger services, forming Hull Trains in partnership with GB Railways (later First Group), which commenced operations in 2000. Renaissance is currently promoting the operation of new train services between Wrexham, Shrewsbury, Telford and London in partnership with Laing Rail—the owners of the Chiltern railways franchise.

Passenger open access operations have characteristics that offer a combination of better value for money in terms of operating the services and external economic value that can be higher than that achieved by the franchised operators.
The pattern of passenger train services continues to reflect operating strategies developed by British Rail, which focussed on high levels of resource utilisation rather than detailed product design to serve individual markets.

Thus the product offered for long distance express passenger services was standardised around fixed coaching stock formations that typically offered 500 seats. A high service frequency was also operated to maximise the use and productivity of the rolling stock and traincrew, with services often running at times of the day when there were few takers.

The result of running high capacity fixed formation trains and the belief that they should operate for as many service hours as practical meant that the rail product was deliberately concentrated on a relatively small number of point-to-point flows. At stations served large car parks were provided, and “rail-heading” as it is known (driving to the station) was the general shape of the product rather than relying on the use of local rail feeder services.

This strategy appealed to the higher value market (first class and full fare) as feeder trains were often run with poor quality rolling stock and even though operating over quite long distances (50 miles plus) often did not have first class accommodation or catering services. As local trains the availability of space for luggage was also a problem.

**Hull Trains**

Hull Trains is the first UK open access operator and it can be seen that the approach is quite different. Although Hull is a significant population centre it did not offer sufficient business to run regular 500 seater trains and so was discarded by BR as a core route to and from London. Passengers wishing to travel between Hull and London were encouraged to travel by road and “rail-heading” to Doncaster to catch the regular trains and so was discarded by BR as a core route to and from London. Passengers travelling from London faced the need to change trains and use unsuitable rolling stock.

It is worth saying here that many population centres were similarly treated with examples such as Sunderland (where a new open access operation is now proposed), Blackpool, Bradford, Grimsby/Cleethorpes/Lincoln, and Telford/Shrewsbury (also subject to a new open access service proposal). In Scotland there has in the past been a similar debate within rail planning circles about removing through trains between London, Aberdeen and Inverness although in this case stakeholder objection has been strong enough to head-off the idea.

Hull Trains operates without subsidy and is able to do for the following reasons:

- It runs 180 seater trains rather than 500 seater formations.
- Product quality matches that provided by other long distance express operators, and as a result encourages passengers to travel throughout by rail between London and Hull rather than “rail heading”. Indeed full catering with hot meals and buffet services are operated at weekends, which is not generally the case for other operators.
- *It only runs trains where there is demand and the six current daily services on weekdays have an average load factor of more than 80%.* There is very little wasted capacity. This is achieved by a very different approach to sales channels with passengers buying tickets over the Internet and by telephone. An internal travel agency is also provided to allow an account management relationship to be developed with large organisations based in Hull. Tickets are sold for specific seats on specific services.
- The company is locally based and approximately 75 staff are employed at Hull. All staff are encouraged to provide the highest level of individual customer service and help to vulnerable passengers such as the disabled. An emphasis is given to training and development and a number of staff have progressed from the junior role of providing catering and hospitality to qualified train driver. A high loyalty factor and low turnover has been achieved with resultant high motivation.
- A strong relationship has been built up with local stakeholders to increase awareness of the services and contribute to the local economy.
- Marketing expenditure is high relative to turnover and many bespoke value for money travel offers are available to specific market segments such as families who would not normally be able to afford the fare.
- High standards of performance and safety have been achieved. The company has leased new rolling stock and is operating the newest trains on the East Coast Main Line (class 222 type).
- Passengers can use services with inter available tickets on a turn up and go basis and all national railcards are accepted. This is particularly important for the student market.

*The purpose of an open access operator is to attract new rail customers who have previously regarded the service offered on a given route to be poor in product terms. This particularly applies where this involves a change of train where the feeder service is not of sufficient quality to reflect expectations for the overall journey.*
In business case terms the margin of expected revenue over costs must be sufficient to attract investment to cover start-up costs and initial trading account losses as volume is built up by marketing action.

In achieving this aim there are substantial external economic benefits that are of a great value in areas where local stakeholders are seeking to regenerate the population centres concerned.

Open access operators are not eligible for direct operational subsidy although they may qualify for European or regional funding in terms of job creation. As the services are new the jobs created are not at the expense of others in the railway industry and there is also the opportunity for wider job creation by using locally sourced suppliers in areas such as catering, uniform, train cleaning and maintenance, and office services.

The nature of the business risk is different from the franchises as independent companies are not able to rely on Government support if things go wrong, such as the severe effect on railway revenues after the Hatfield accident, and to a lesser extent after 7 July incident in London.

Open access operators also carry the risk of adverse change to the track access charging regime, whereas franchises are indemnified from this risk.

There is also less ability to influence policy that might affect operational costs and track access terms as the promoters of open access operations are outside many of the consultative processes.

How well does the process for gaining track access rights work?

Renaissance Trains has recent experience of the process as it is seeking to operate a new service between Wrexham, Shrewsbury, Telford and London Marylebone, which is being backed by Laing Rail—the owners of the Chiltern Railways.

It should be relatively straightforward to gain track access rights (provided all statutory licence conditions are met) under what is known as a “section 18” application. This works by proposing a timetable to Network Rail that fits with other services on the route without importing undue performance risk—although obviously any additional train services will mean there is some increase in this risk. Perfect performance would only be achieved if there were no trains.

Once the terms of the access contract are agreed this is submitted to the Office of Rail Regulation who advises stakeholders of the intention to operate the service and provides the opportunity for comment on any factors considered appropriate. The most usual comments are in relation to concerns about revenue abstraction and the perceived threat to performance.

The process is of course iterative and many meetings are held to satisfy the parties concerned.

There is limited experience of actual open access operation as this is confined to Hull Trains but in this case the increase in new traffic and subsequent external economic value has outweighed any revenue abstraction issues, as the rail market as a whole has been increased at stations served so there are benefits to the franchised operators as well, who earn commission on ticket sales at stations and benefit from higher awareness of rail services in general as a result of marketing action.

Where a timetable cannot be agreed with Network Rail the applicant has the option of making a “section 17” application to the Office of Rail Regulation. This is a more complex process, as the Regulator has to identify why Network Rail has refused the application, which may be due to competing claims for the available capacity. This is resolved by detailed analysis of the economic benefit of the various proposals.

Are track access contracts of the right length?

The length of the access agreement needed reflects the commitment to leasing rolling stock and the length of time taken to build up the market until it becomes profitable.

If rolling stock is new it is unlikely that a competitive lease can be secured for less than 10 years. If second hand rolling stock is used there are likely to be substantial refurbishment costs that need to be offset over a similar 10-year period, as otherwise undue costs will be faced in the early years of operation, which may well be unprofitable until the market builds up.

Business models with which I am familiar indicate that a break-even on the profit and loss account is achieved by year three, with losses in the early years recouped by year five. Again the business case would require a 10-year access agreement to allow investors to earn a return from years six to 10.

Competition and Vertical Integration

It is not the principal aim of the open access operator to compete with other passenger operators. Regulatory policy is to avoid undue revenue abstraction on existing flows and demonstrate that the new services generate additional travel from population centres that are poorly served by rail.

Despite this open access operators have the potential to influence the behaviour of what might be described as monopoly franchises by setting high standards of product deliver that provide a benchmark for others in terms of the price/service mix. This might be seen to influence those operators where services
are regarded as poor value for money which can be seen from the National Survey Statistics published by Passenger Focus to be directly related to fare levels and the standard of product and customer service provided.

Close contact must be maintained with Network Rail in optimising network performance and a number of industry-wide mechanisms are in place to deliver this.

The key issue for the open access operator is “fair” terms of access to the rail network, which is a crucial function of independent regulation.

14 July 2006

Witnesses: Mr Ian Yeowart, Managing Director, Grand Central and Mr Mike Jones, Director, Renaissance Trains, gave evidence.

Chairman: Good afternoon to you, gentlemen. We do have a little bit of housekeeping to transact before we begin. Members having an interest to declare.

Mr Martlew: Member of Transport and General Workers and General and Municipal Workers.

Graham Stringer: Member of Amicus.

Chairman: Gwyneth Dunwoody, member of ASLEF. Mrs Ellman.

Mrs Ellman: Member of the Transport and General Workers’ Union.

Clive Efford: Member of the Transport and General Workers’ Union.

Q328 Chairman: Thank you. I do have one important point. Before we start I want to remind you that when we hear evidence in public we are bound by the resolution of the House of Commons of 15 November 2001: no matter currently before a Court of Law should be debated. There is a case currently before the courts concerning open access on the railway network and I wish to make it clear that I will allow no reference whatsoever to this individual case in the forthcoming evidence session. Gentlemen, you may not know that the microphones in front of you record your voices but do not project your voices, so I am going to ask you to identify yourselves, and I may even from time to time ask you to speak up.

Mr Jones: Michael Jones, Director of Renaissance Trains Limited.

Mr Yeowart: I am Ian Yeowart, the Managing Director of Grand Central Rail Company.

Q329 Chairman: Thank you very much. Did either of you have anything that you wanted to say before we go on to questions, or may we proceed?

Mr Yeowart: I am happy for you to proceed.

Q330 Chairman: Mr Jones?

Mr Jones: Yes, thank you.

Q331 Chairman: Mr Jones, without mentioning the current judicial review could you summarise what your experience of open access operations has been to date?

Mr Jones: Madam Chairman, the first thing to say is that we would view the company as being very successful. We started on a small-scale basis and we have achieved continual growth of new customers—that is not customers that we have secured from other operators. The first two years of operation were not profitable and that was part of the effect of the Hatfield crash and the general difficulties in the industry at the time. From year three we moved into a small profit and gradually enhanced that to the point that at the end of year five we were able to pay for the losses that had been incurred in that initial period. So the company is now trading successfully in terms of earning a rate of return and that is quite an achievement when you think that we have bought new trains, the Class 222 125 miles per hour units. I think also so far as the city of Hull is concerned—and that remains our predominant market—that a great deal has been achieved there in contributing to the regeneration of the city. Hull is a very rundown part of the country and one of the poorest in terms of the socio-economic mix. We have provided access to people who would not otherwise have access to rail services and I think that although an independent private company we take very seriously the desire to bring a greater access of the railway to all sections of the community.

Q332 Chairman: One of the things that you have done in open access is worked as joint ventures with franchise companies. Has that made it easier for you to gain access?

Mr Jones: I think it may be wrong to use the word “franchise companies”; it has been done with owning groups in the sense that GB Railways and First Group own franchises but they tend to use resources in their headquarters’ organisations to provide the backing for an open access operator that they support. That was not, in fairness, the situation when we started with Hull Trains; there was very short notice available and basically we subcontracted the operation to Anglia Railways, who provided all the necessary things that were needed to get the railway started quickly.

Q333 Chairman: So has it been easy for you to find partners?

Mr Jones: I would say that if the business case is robust the answer to that is yes; they are basically providing venture capital.

Q334 Chairman: Mr Yeowart, do you also have established partners?

Mr Yeowart: We do, but they are not currently rail operators.

Q335 Chairman: So what should be the government’s objective in allowing open access to the railway? Let me ask you first, Mr Yeowart.
Mr Yeowart: The basic franchise, as we see it, is for the government to buy what it believes it can afford and what it believes it needs to deliver in relation to railway services. Open access was always designed to perhaps fill in some gaps or provide some new opportunities whereby franchises and indeed BR in its day would not perhaps have seen a business opportunity. One of the difficulties we found in creating a business case is that most of the railway development work is based on incremental traffic, so therefore if you have a level of service now you get a bigger level of service. The problem with that is if you have no traffic at all an increment of 1,000 times nothing is still nothing and therefore the models that are used do not actually work. So I am sure Mike had to do exactly the same as we had to do, which is to strip it right back to bare basics and in effect build a business case from scratch in the same way you would if you were looking to open a shop or put something else in the high street.

Q336 Chairman: If an open access is viable and profitable on a particular route, why would it not be better for the government to widen an existing franchise to include those paths?

Mr Jones: I think the answer against that is the lack of marketing focus. If you look at Hull it is very much seen as Hull’s railway. All the staff are employed there, we have 75 people or so who are based in Hull, and we probably spend more on marketing relative to our turnover than the franchised operator would do. I think the franchised operator is always going to be interested in its key eight or 10 flows—the flow from London to Bristol, London to Birmingham, London to York, etcetera; but when you have a flow like London to Hull, which is a small percentage of the overall revenue, the effort that has to be put in to growing that is probably a lot more than the effort needed to get a similar growth on the flow from, say, London to Leeds.

Q337 Chairman: Do you really think open access operations affect coordination of the integration of train services at a national and regional level?

Mr Jones: I do not think there is a problem with that because the timetable making process is something which involves all the other operators. We are members of ATOC, we offer all the usual national products—

Q338 Chairman: That is not quite the question I was asking you. Mr Yeowart, do you agree that it would make it difficult to coordinate and integrate?

Mr Yeowart: I think the problem with integration within a franchise is they are very tightly specified and if they are tightly specified and there is a pressure on spend, for example, then they will always look at the margins—BR always used to and I am sure that franchises will be the same. Open access has to survive by the fact that it delivers for its customers and in relation to what Mike was saying about the timetable, he is right that there is a responsibility on all of us, open access, freight and franchise passenger services to integrate our services. We are talking to Northern, for example, about connectional opportunities at some of the stations on the Durham coast where our trains serve and the local trains serve. So we are trying to make it so that perhaps they are five minutes before us rather than five minutes after us so that they can deliver people to Redcar, for example, to Eaglescliff as a connection onwards. So we do try to integrate but the railway is now, I think, a bit more mature than it was in most areas but it is an evolving process and will no doubt continue to evolve.

Chairman: Mrs Ellman.

Q339 Mrs Ellman: Mr Yeowart, you refer to franchises being very tight. Do you think that there is a case for PTEs and other regional operators to have more involvement in the drawing up of those franchises?

Mr Yeowart: I am an ex-BR man and I used to work in two PTE areas so I know quite well the level of specification that PTEs put forward. I always used to think that that worked very well under BR. Whether it can work well under a franchise position in the same way where people’s desire is profits for the shareholders then it might be a little bit different than where it was when we were BR managers working to a set budget, if you like. But if PTEs contribute then they should be allowed to specify, and even as an open access operator where we are we do interface with the PTE in Sunderland, Tyne & Weir, and for our proposed services from Bradford we spent a lot of time with West Yorkshire PTE and the PTA in trying to elicit some support—not financial support, but just support—and that has included talking to them about timetables and opportunities. So I think they should perhaps have a bit more of an involvement.

Q340 Chairman: You are quite a good example of what can be done within that set up. Mr Jones.

Mr Jones: What I wanted to say was that our experience of working with the passenger transport executives, I have had two approaches asking them if they could sponsor with Renaissance Trains open access services. The reason for that, I think, is a certain frustration with the ability to influence the timetable design process at the centre and the belief that the open access operator will probably be able to do it with either no subsidy or a lot less subsidy. It just gives me an opportunity to say that we have to run trains where money is made and whilst I do not want to equate open access to low cost airlines you can see many of the principles are quite the same. All our services run with an 80% seat occupancy and we achieve that through various marketing efforts and different methods, different outlets for selling tickets. I do not think any franchised operator could sit down and say that they sell 80% of their seats, even in comparable long distance express services. So it is very much a cultural thing about the market approach.

Q341 Mrs Ellman: What about vertical integration, how would that affect your businesses?
Mr Yeowart: I do not believe that vertical integration is an option unless you are going to re-nationalise the entire network and put BR back in place as it was. The problem with vertical integration with franchises is that various franchises operate across a route. Virgin cross-country, for example, go through half a dozen different routes, so who is responsible and why should Virgin not take responsibility? On the East Coast mainline why should only GNER be responsible for the upkeep of the infrastructure when indeed there are five or six operators across the route and franchises are transient—they are here one day and a few years later they might still be here, they might not be here. I think what we have seen certainly as a perspective open access operator is a development over 10 years or so—I have mentioned before—where the railway has slowly started to mature and settle down. Network Rail still has its faults but it is a far better animal than Railtrack was and slowly but surely as the industry settles down and people understand their roles and responsibilities within the industry it is starting to work, and I think the last thing it wants now is another wholesale change where everything is ripped apart and we go back to basics. So, for me, vertical integration means British Rail, otherwise do not do it.

Q342 Chairman: Do you disagree with that, Mr Jones?
Mr Jones: What I would say is that I think it should be recognised that the network is probably in the best condition it has ever been since nationalisation and I think Network Rail are go be congratulated for getting the engineering right. Also, operational integration is taking place—at most major centres now integrated traffic control rooms are being built where the staff of the train operating companies and the Network Rail controllers will sit together in one room.

Q343 Chairman: We understand that, Mr Jones, but do you think vertical integration is good?
Mr Jones: Could I just continue and finish with the thread of my argument? I think there would have to be arrangements for use by other operators, freight and open access, but in principle I do not necessarily see it as a problem because an independent regulator would have to ensure that the infrastructure was fairly allocated and used by people who did not control it, and I think of the BT telephone service here and the fact that they control the local delivery of services to your house. As I say, I think provided that there is independent regulation there to set fair terms of access to an integrated network then so far as the open access operator is concerned I would not have concerns.
Chairman: Mr Goodwill on this.

Q344 Mr Goodwill: On this particular point, we had the point made by Network Rail that train operators are opting for heavier and heavier trains and this is causing the track maintenance costs to spiral. Do you think that actually having a system of vertical integration where the non-franchise holder would pay for access to that network would actually reverse this trend and you would see maybe the costs of running trains on the track being taken into account by the operators?
Mr Jones: I think that is a very difficult one to answer because it is the freight operators who are running the bigger, heavier trains, and there would have to be some convention for the cost of their access to an integrated network run by, say, First Great Western of GNER.

Q345 Mr Goodwill: Do you think that if freight operators were paying a cost which took into account the wear and tear on the network that freight would become less prevalent on the railways or not?
Mr Jones: It is my understanding that the marginal charge that is levied on the freight operators takes account of all of their wear and tear.

Q346 Chairman: Mr Yeowart, do you have a view on that?
Mr Yeowart: I think the variable charge that is in place now which has developed over time does take account of the type of rolling stock, so the heavier or more wear and tear you are liable to bring to a network the more you pay and I think that is right. But there is also, as you have rightly pointed out, heavier passenger trains now appearing on the network to do with the air conditioning units, more crash worthiness in trains despite the fact that it can be built with different materials. A diesel multiple unit, for example, carries its own engine in every vehicle, whereas in the past they did not, so you have heavy vehicles at either end. In relation to whether vertical integration would make a difference there is still a cost and I do not think it would make a difference as such. I think it is really to do again with a mature industry and these things are coming out now, 10 years down the line since privatisation, and perhaps in another 10 years people will recognise it and realise it. I am sure it will come through with HST2 or its equivalent when it happens, that it will be taken into account. But I think it is really more about railway people being more involved now in the railway delivery than the accountants—Chairman: I do not want to go on too long on this. Mr Leech, on this.

Q347 Mr Leech: Mr Jones, at the beginning you said that you had created a lot of new extra rail users.
Mr Jones: Yes.

Q348 Mr Leech: If that is the case who are your main competitors? Is it the people using cars, the people using aeroplanes, or do you see any of the franchisees as competitors?
Mr Jones: I think firstly that the BR idea of a long distance passenger service with a 500 seater trainer that just operated on core routes—you build big car parks and people drive in 50 miles or so and catch the trains—that does not seem to me to be a very good railway policy. The alternative of changing trains was changing trains into poor quality rolling stock, which was not attractive to many users. So I think
that we have generated a lot of new users and there is a lot of anecdotal evidence to suggest that there are more students travelling to Hull, that businesses find it easier to relocate to Hull because the transport links are better, and also the people who perhaps did not think that they could afford to use the train are using the train, because we have some very attractive family offers. Just sitting here, and probably advertising, but there is a very attractive fare for a family of four to travel to London during the summer holidays, which would not previously have been available. So we are very minded towards the responsibility that goes with the right to run these services that we have to meet the needs of all the community in Hull.

Chairman: I did interrupt Mrs Ellman. I will come back to you in a minute.

Q349 Mrs Ellman: What would you say the obstacles are for new bidders wanting to seek franchises?

Mr Yeowart: The biggest problem for a company like ours—I do not know if it is the same with Mike—is that the requirement for capital in order to mount the bid alone would probably preclude a small operator from doing it, and of course our backers, is roughly a £40 million, £50 million turnover and we would not be regarded as big enough to consider an application for a rail franchise, and I would certainly be very surprised if we ever got short listed if we were interested. But for somebody like ourselves, who we like to think we are innovative, they are too prescriptive for us at the moment anyway; you are basically told what to run and how to run it and I do not think that is really what railway people like to do. You have to work within the parameters, we understand that, but certainly as a new operator we believe that the system at the moment offers small niche players the opportunity to fill up markets that perhaps the big players cannot or are not allowed to address, and I think that is quite important and it should not be lost.

Q350 Mr Leech: Just one follow-up question. Do you think that open access routes are more likely to be able to get modal shift into the trains than the franchise operation?

Mr Jones: Without a doubt because they are more focused on the local market, understand that local market and also have more consistently high product quality. I did submit a paper which provided some details of that.

Q351 Mr Leech: Would you agree with that, Mr Yeowart?

Mr Yeowart: Yes, I think so. We are looking at using the infrastructure that is already there. Sunderland, Hartlepool, Eaglescliffe, that is through Teesside, the railway lines are there. They are not the high speed lines, they are 70 miles an hour generally, but the railway lines are there, so we are not talking about running new services and spending millions on the infrastructure; what we are saying is that if the franchisers cannot see an opportunity the infrastructure is there, we will provide the rolling stock, and people therefore believe that these are services being provided for them. Hull Trains are slightly different because their name is synonymous with Hull and our name is more general, but the fact is that we are regarded, if you like, as the local operator and that is quite important, I think, for people’s perceptions about modal shift.

Chairman: On that general note can I thank you both very much?

Memorandum submitted by the Office of Rail Regulation

1. The Office of Rail Regulation is the independent regulator of the rail industry in Great Britain. As such, we are the economic regulator for the national railway, focusing particularly on Network Rail and its key industry relationships. Since 1 April 2006, we have also been the health and safety regulator for all railways in Great Britain. As regulator of the national railway, we are not a funder of the railway. We cannot impose requirements which are specified and paid for through franchises.

2. In the exercise of our functions and powers, we routinely work with DfT, Transport Scotland, and other funders of passenger services to facilitate the franchising process. We regulate Network Rail, both by monitoring its performance under its network licence, and by setting its revenue requirement over successive control periods against the background of what government wants from the railway and the franchise agreements which are in place. We do it in a way which encourages and requires Network Rail to work with franchisees to meet the needs of passengers and freight customers.

The Purpose of Passenger Rail Franchising

3. We believe that the main line railway should be a partnership of Network Rail, train operators, suppliers and funders, working together to meet the needs of passengers and freight customers, and deliver a safe, high-performing, efficient and developing railway. Within an overall specification set by government and funders, we believe it is important that decision-making is wherever possible decentralised, and taken closer to the customer. Private sector companies should be empowered to make decisions in accordance with market needs, within a framework of incentives and accountability that ensures they operate in the public interest.
4. Within this framework, the objective of franchising should be to facilitate improvements in safety, performance, efficiency and customer service in order to enable the railway to continue to grow and to meet the needs of government and users.

5. To enable this to happen, we consider that passenger rail franchising should:
   — enable the separation of the specification and procurement of publicly financed passenger rail services from the provision of those services;
   — ensure that the provision of services is aligned with the needs of passengers and efficient and safe service provision;
   — enable the risk attached to service provision, in particular revenue risk, to be allocated to those best placed to manage that risk; and
   — enable the injection of new ideas and new management, and where appropriate new investment into Great Britain's railway service provision and network.

6. Such improvements are more likely if we capitalise on the expertise of franchise operators and their ability to be innovative in service delivery.

7. To achieve this, there needs to be:
   — a clear specification by government of what it requires, a competitive procurement process, and enforcement of the specification;
   — flexibility and incentives for operators to deliver in the most effective way and to adjust their offer to meet the needs of passengers and respond to changes in the market; and
   — a partnership with Network Rail, to deliver this.

8. The franchising system should not only allocate risk in a way which acknowledges the ability of franchise operators to manage those risks, but also provide operators with sufficient freedom to do so. Where new investment is desirable, franchises must either be long enough to enable franchise operators to develop an attractive business case for private sector investment, or must provide alternative mechanisms to enable outgoing franchise operators to obtain a fair share of residual value for any investments made during the franchise.

THE FRANCHISE AWARD PROCESS

9. At present, we have very little input into the design of franchises. We are currently working with DfT and Network Rail to become more closely involved at an earlier stage in the franchising process. By doing this we hope to help funders and bidders obtain greater clarity on the availability and use of network capacity before franchise bids are made. However, if this approach is to be successful, Network Rail will need to ensure that its knowledge of, and ability to model, the capacity and performance implications of service and timetable changes is adequate.

10. We believe that the widest possible range of private sector operators should be encouraged to bid for passenger rail franchises. This requires a franchising process which makes available to potential bidders comprehensive and uniform sets of information about the franchise in question. If the government is to encourage the entry into the franchise operation market of new operators with fresh ideas and operating practices it should work to make it as easy as possible for such operators to bid for franchises.

THE NATURE OF FRANCHISE CONTRACTS

11. We consider that the length of the franchise agreement can have a material effect on the way in which the franchise operator regards it. In general, the longer the franchise contract, the more chance there is of a franchise operator being prepared to invest time and resource in making improvements to the services and facilities it operates. Equally the government must be concerned at the possibility that very long franchise contracts, without the possibility of termination in the event of poor performance, could leave it powerless to act against poorly performing franchises. Subject to those considerations, we note that many railway improvements are unlikely to achieve positive returns in less than 10 years. This means that, even at the beginning of a 10-year franchise period it may be difficult to justify such investment and, as the franchise moves on from its early stages, the case for any further investment is diminished.

12. The government may consider that different franchises have different qualities and therefore require different models in order to achieve what is required. For example, where a franchise is likely to require significant changes in service, or enhancements to infrastructure, a different approach, in terms of the length of the franchise, or the degree of risk transfer, may be needed to that required for a relatively steady state franchise. As part of this, we also consider that the Government should be encouraging innovation and responsiveness—franchise tendering exercises which focus on the level of premium or subsidy to the exclusion of other desirable qualities may not always achieve this.
Risk Apportionment

13. We consider that the government should place those commercial risks with franchised operators which the operators are best placed to manage. That would imply that operators should generally take revenue risk, or at least a significant element of it. This would also help to align their incentives with the needs of passengers. However, it would be difficult to expect them to do so unless they also had greater freedom over service specification and had the ability to make changes to services where this could impact on revenue. The need for this is likely to vary according to the involvement and requirements of the funder of the services. In some cases, particularly intercity services, we consider that too prescriptive an approach to service specification can prevent operators from responding by using their expertise to optimise services in a way which meets the needs of passengers better. Some franchise operators could see themselves as simple service providers, managing cost-plus contracts, rather than franchises where there is scope to improve earnings through the application of their management expertise, which we consider is likely to offer greater benefits to the passenger.

14. One area where the government assumes all risk is that of the effect of reviews of access charges on the costs borne by franchised train operators. At present, if we make changes which increase the charges made by Network Rail to franchised operators during the period of a franchise, the government is required by the terms of the franchise agreement to indemnify the operator against the additional cost. Similarly, if our decisions reduce charges, the operator is required to repay any gain to the government. The justification for this mechanism is that it makes it unnecessary for bidders to factor a risk premium for access charges into their bids for franchises and leaves that risk with government. In the past, the government has seen this as the best way to maximise value for money in bids.

15. We note that this approach can be relatively time-consuming in practice to administer for the industry. It also has the undesirable effect that changes, which we might make to the charging and incentive framework, cannot have any effect on franchise operators until the end of an existing franchise. Given the experience that now exists of the regulatory framework, and the work which we have done to improve the transparency and predictability of regulatory decisions relating to charges, it might now be worth considering whether there is a case for shifting the balance of at least some of this type of risk towards the franchise operator. If this were possible, it would ensure that franchised operators had a more direct experience of Network Rail’s costs, and it would help to achieve a closer alignment of the incentives facing Network Rail and train operators.

Service and Safety Improvement

16. The scope for improvements to be made through franchise agreements varies according to the quality of the existing service provision. Improvements are achieved either if they are specified as part of the franchise offer or if the franchise operator is given the incentive and the opportunity to identify and implement improvements during the course of its franchise. The former approach is the one largely adopted by the government and it carries the weakness that it is left to the government to identify those improvements which are desirable and affordable. Moreover, this is a static process which is carried out before the beginning of the franchise and which results in a specification which is then likely to remain in place through the life of the franchise (potentially 10 years). Passenger service provision should meet the needs of a constantly changing market. We consider that it should be made easier for franchise operators to identify potential improvements and to implement them, and that they should be incentivised through the franchise agreement to do so.

17. One area where we do, however, consider that there is scope for specifying improvements at the outset is that of safety—(purely by way of example, these could include matters such as improvements to stepping distances or passenger security). In this area we would like to see more discussion with the government on the potential for safety improvements which might be required with the introduction of new franchise agreements. These might not be improvements for which there is a commercial case, but ones where there are societal and other non-quantified benefits. It would make more sense to decide, at the outset, what was both desirable and affordable, so that bidders take account of such requirements when developing their bids.

Competition

18. In recent years, the trend has been for a smaller number of larger franchises, moving towards the principle of one operator per major London terminus. In general, this approach has reduced the amount of direct competition between franchised operators over routes—although this continues in a limited number of cases.

19. There are arguments for and against this: consolidation can reduce the overhead costs of operations, and might also have a positive effect on train performance on routes leading to busy termini. However, this is, as yet unproved—for example, performance on services into Liverpool Street Station has not improved materially since the introduction of the “one” franchise. The passenger benefits of simplifying the service offer might be offset by the reduced choice available to passengers and some benefits of market competition might be lost. In addition, in cases where urban, local and inter-city operations have been merged, there is the possibility that the operator will be less responsive to the different requirements of its passengers.
20. Competition between operators can lead to improvements in the service to passengers. This includes competition by “open access” operators (ie companies operating rail services without a franchise). Hull Trains, which has significantly improved services between Hull and East Yorkshire and London, is an example of this.

21. We have a statutory duty to exercise our functions in part 1 of the Railways Act 1993 (which include the allocation of access on the network) in a way which promotes competition in the provision of railway services for the benefit of users of railway services. This duty is balanced by a number of other statutory duties, including a requirement to have regard to the effect of our decisions on the funds available to the Secretary of State and the Scottish Ministers. Before approving open access operations, we consider all matters relevant to our statutory duties in order to achieve an appropriate balance. We also have to make sure that we act in accordance with relevant European legislation.

22. Whilst we do not approve open access services which are expected to be primarily abstractive of revenue, it is still normal for such services to abstract some revenue from franchised operations. Our experience to date is that open access services can generate significant additional revenue. We consider that new open access services have the potential to bring worthwhile benefits for passengers and for the locations which the new services connect together directly.

23. The competition provided by such services can also generate other benefits—by stimulating a competitive response in existing franchised operators. Such benefits can range from improved customer service and facilities, to improved train frequencies and reduced fares. However, such benefits can only be achieved if franchised operators are able to respond. Our perception is that it can be difficult for them to do so under the terms of most current franchise agreements.

INTEGRATION OF TRAIN AND NETWORK OPERATION

24. There is a requirement (under both European and domestic law) for train and network operation to be separated for accounting purposes. This is intended to ensure transparency and to help market entry, and there is no reason for that to prevent greater alignment of those two activities—indeed we support that approach, so long as the interests of third parties are properly protected.

25. Network Rail and train operators should regard themselves as in a partnership—the development of joint performance improvement plans, joint boards and shared control rooms are all examples of this positive trend. In addition, we would support initiatives such as the proposal to transfer responsibility for the Merseyrail network from Network Rail to Merseytravel—which already has responsibility for train service specification and procurement in that area. This would have represented a useful pilot, and would also have provided the opportunity for some more direct benchmarking of performance, costs and efficiency than has previously been possible. Even without full vertical integration as proposed by Merseytravel, we believe there is much more scope to develop partnership at local level between franchisees and Network Rail, so that the franchise can be seen as effectively a joint venture.

ROLLING STOCK

26. Rolling stock for passenger train operators is mostly leased from rolling stock companies. Franchised operators are very unlikely to be able to fund rolling stock themselves unless franchises are significantly longer than at present, or mechanisms are in place to accommodate the residual risk associated with such funding.

SUMMARY

27. We believe that franchising can and should deliver improvements for passengers and better value for money for funders. We believe that this requires government to set a clear specification of what it wants to buy. This should contain enough flexibility to enable decisions as to how it is to be delivered to be made closer to the customer. Franchisees should be able to use their considerable railway expertise to respond efficiently to the needs of customers, within a framework of incentives and accountability which ensures this happens. The franchise needs to be operated and developed in partnership with Network Rail. We are keen to work with all industry stakeholders to facilitate this approach.

20 June 2006

Memorandum submitted by the Competition Commission

I am glad to respond to your request for a note describing the involvement of the Competition Commission (“the CC”) in passenger rail franchising.

It would in principle be possible for the CC to be asked (by the Office of Fair Trading—“the OFT”—or by the ORR) to examine a number of aspects of the railways market, such as access arrangements. In practice, however, our only involvement to date has been as follows.
The Enterprise Act 2002 requires the OFT to examine all significant mergers between UK companies, and to refer to the CC any mergers which the OFT believes may result in a substantial lessening of competition—and so might lead to customers facing higher prices, and/or lower service quality etc. The OFT typically examine around 200 mergers a year (most of them in advance of completion) and refer around 15 or so to the CC. Some of these mergers are subsequently abandoned, for a wide range of reasons, and we typically allow more than half of the remainder to proceed.

Most, if not all, proposed awards of rail franchises fall within the definition of mergers for the purposes of the Enterprise Act, and are therefore always examined by the OFT, and sometimes, where OFT identify a competition problem, by ourselves. It is important to note that each separate bid for a franchise counts as a separate (potential) merger.

The following franchise bids have been referred to the CC since 2002. All the mergers were allowed to proceed without conditions, apart from the award of the Scotrail franchise—see further below.

(a) FirstGroup plc and the Scottish passenger rail franchise, referred 13 January 2004;
(b) National Express Group PLC/Greater Anglia Franchise, referred 27 May 2004;
(c) FirstGroup plc/InterCity East Coast Franchise, referred 21 December 2004 but cancelled when the franchise was awarded to another bidder;
(d) National Express Group PLC/Thameslink/Great Northern Rail Franchise, referred 3 August 2005 (although the CC did complete its report, the franchise was awarded to another bidder); and
(e) The three bids by FirstGroup plc, National Express Group PLC and Stagecoach Holdings plc for the Greater Western Passenger Rail Franchise, referred 30 September 2005, of which the last two were cancelled when the franchise was awarded to First Group.

It might be helpful to the Committee if I comment on two questions which seem to me to arise as a result of the interaction of the franchising and competition regimes.

First, it does at first seem odd that a Ministerial decision to award a franchise can be examined and in principle thwarted by the competition authorities. In practice, however, this is less of a problem that at first appears. For a start, we would expect the Department for Transport itself to have been alert to concerns about reductions in competition between rail companies, and to have designed the franchises so that such concerns were minimised. Whether or not this happens, the fact is that the CC has not yet identified a rail-only substantial lessening of competition. It should also be noted that, even if we did identify such a rail-only competition problem, in choosing and designing remedies we could take account of the benefits likely to flow from the award of the franchise. It might be possible for the operator (and the Department for Transport) to persuade us that no action should be taken that would jeopardise these benefits.

We do, however, frequently encounter concerns that a proposed franchisee will in effect monopolise public transportation in certain areas because they already run local bus and/or coach services. Such concerns clearly need to be investigated and, if necessary, remedied by, for instance, obtaining undertakings that fares will not be increased above certain levels, or service frequencies reduced etc It is clearly desirable that such investigations take place. But it is equally desirable that any regulatory intervention takes place only when absolutely necessary. Indeed, as noted above, all franchise awards since 2002 but one have proceeded without our imposing any conditions. The only exception followed the award of the Scotrail franchise to Firstgroup plc which the CC expected to result in a substantial lessening of competition, particularly in the Glasgow area. We accordingly imposed certain controls, including over fare increases, in the affected areas.

The second concern is that the rail companies have had to endure examination by the competition authorities even if they were not the successful bidders. They have thus incurred apparently unnecessary cost. We and the OFT have discussed this problem with the Department for Transport and the companies, and are implementing a number of changes which will help minimise the burden on potential franchisees. In particular, we have agreed that the Department will encourage operators to notify their acquisition of a franchise to the OFT only after they have been awarded the franchise. This will avoid situations in which operators undergo investigation only to find that they have not won the franchise. We have also agreed a standard set of information requests to go to the new franchisee, which avoids the need for the franchisee to prepare different submissions for the OFT and the CC. This new approach is being piloted in the current South West Trains franchise process.

30 June 2006
Witnesses: Mr Bill Emery, Chief Executive, Mr Michael Beswick, Director of Rail Policy, Mr Brian Kogan, Deputy Director, Rail Markets, Passengers and Freight, Office of Rail Regulation, and Mr Martin Stanley, Chief Executive, Mr John Banfield, Inquiry Director and Ms Catherine Abbott, Policy Coordinator, Competition Commission, gave evidence.

Q352 Chairman: Good afternoon to you, I am sorry to have kept you waiting. May I ask you first of all to identify yourselves for the record, starting with the only lady?
Ms Abbott: I am Catherine Abbott, I work at the Competition Commission.

Q353 Chairman: Gosh, you are a brave lady!
Mr Banfield: John Banfield; I also work for the Competition Commission.
Mr Stanley: Martin Stanley, the Chief Executive of the Competition Commission.
Mr Emery: Bill Emery, the Chief Executive of the Office of Rail Regulation.
Mr Beswick: Michael Beswick from the Office of Rail Regulation.
Mr Kogan: Brian Kogan from the Office of Rail Regulation.

Q354 Chairman: Thank you. I am sure you know the rules. Speak up and if you agree with one another please do not say so at inordinate length, and if you disagree please seek to catch the Chairman’s eye. Can we begin with the Office of Rail Regulation? You are working to become more involved in the franchising process in order to ensure that bidders are well informed about the network capacity. What do you want to add to that process above and beyond what Network Rail can bring to the table?
Mr Emery: As you are aware, our role in the franchising process is pretty minor. We do have a significant role in agreeing the access requirements to the rails and the stations and depots, and in a sense one of the issues around franchises is at what stage in the franchising process do the access arrangements get confirmed so that the franchise operators and potential bidders are aware of the position on access. So one of the areas where we do see that there is some scope for improvement is in the way we work with the Department on better information to franchise bidders. I think there are other areas where in our experience of talking to franchisees—because part of our role is to monitor the performance of the franchisees and Network Rail—we meet each franchise company every six months to discuss issues on performance and issues come out there. We do see some scope—and I picked up some of the evidence earlier—that slightly more flexibility on the specification would help the franchise companies respond to markets as well, and we think that that could be facilitated. We are ourselves going to be consulting in a few weeks’ time on improving the incentives for the whole railway industry as part of the 2008 periodic review, and one of those is to try and align the incentives between the franchise operators, and Network Rail, and if we get that right we do think that the industry should be able to deliver more for less and do it quicker than under the current arrangements.

Q355 Chairman: So are you suggesting that not enough is being done to encourage new entrants into the franchising market?
Mr Emery: I am not certain we are saying that there is not enough being encouraged. We have a longstanding policy on open access, and you have had discussions earlier from Hull Trains and Grand Central. At the present time the costs of franchising are such that the number of players are reducing. We have some worrying signs from some of the existing owners who find the whole process is becoming more difficult and they wonder whether they really want to bid. So in a sense there are issues which need to be looked at by the Department in how they are running the actual process. But my colleague, Michael Beswick, who has been around this industry for a long period of time and much closer to that may well be able to help.

Q356 Chairman: Come on, Mr Beswick!
Mr Beswick: I think the other point I would make is that we think that the franchisees can bring quite a lot in terms of innovation and customer and local focus to the railway.

Q357 Chairman: Would you like to give us a short rundown of one or two really innovative methods?
Mr Beswick: I think, for instance, Laing Rail taking the Chiltern franchise by the scruff of the neck and coming up with a scheme to improve it in terms of extra services and in terms of extra infrastructure and project managing that through in partnership with Network Rail is a classic piece of innovation. We have seen many more innovative ideas—

Q358 Chairman: Just a minute, I am not quite clear. Are you saying that they took hold of a failing company and turned it into an efficient company and that is innovative? No, you are not saying that?
Mr Beswick: I think what they did was built on what was quite a successful piece of railway already and moved it a long way ahead and I think that is a good example—

Q359 Chairman: So it is management and it is the ability for a company to do what it was paid to do.
Mr Beswick: I think the key thing there was that they had quite a lot of flexibility to do that and they did not have a very tight specification.

Chairman: I am trying to sort out what is innovative about running a good railway. I am missing something, obviously. Mr Scott.

Q360 Mr Scott: Do tight franchise specifications make companies risk-averse? That is for anyone.
Mr Emery: I am not saying there is an automatic link. What tight specifications do is to limit the options that are available to respond to the market and in a sense you create a lot of barriers to responding to the market place, and that is where some of the difficulties are. There is an issue about what the franchising process is about; it is about
selecting the right player and then it is about getting the right specification, and you could say that there is a little bit of a question mark in some of these things that they join up those two things and then they do not go on and look at a more flexible specification.

Q361 Mr Scott: A question for the ORR. You appear to indicate that the government is too preoccupied by the objective of minimising subsidy or maximising premiums. Could you explain the position more clearly, please?

Mr Emery: Certainly the government has a very legitimate role in seeking value from money from the railways, and in the sense of pursuing the best franchise bid for the services that it wishes to buy then it has done exactly what is right. What I think it does, it gets back to the point of saying that there is a tendency then to assume that the full benefit arises from just during the franchising process and not allowing the flexibility, it having got there, for the franchisee then to respond to the market, and barriers are put in that make it more difficult for the franchisees to respond to the market. The incentives in the system are such that the franchisee has little incentive, working very closely with Network Rail, to reduce Network Rail’s costs, because in fact the way the risk allocation plays out the majority of risks are carried by government and that again presents a marginally sub-optimal way of running it, although the testing regularly of what is the best franchise is a way of getting value for money at that time. The question is open. You are going out with a franchise bid and yet it is running for a period of seven years or longer, it is very difficult to be able to forecast what the market needs over that period of time. You lock that in too much and if you do not give the franchise companies full incentive to operate and cooperate with Network Rail then you are losing something. This is an area we want to explore with the railway industry as to better ways in which we can align incentive, as I said at the beginning.

Q362 Mrs Ellman: How can you get more entrants into the franchise markets, or do you think that is necessary?

Mr Beswick: In terms of impeding new entrants then clearly the cost of bidding is always a serious consideration, but there will be a cost in bidding. Clearly a part of that which I know we are all concerned about is that if they have to go through the procedure of competition clearance then that again is another cost, and I think we are working with the competition authorities and the Department to ease that.

Q364 Mrs Ellman: Are there any other observations on that? No. Would it be better to have a one-stop competition authority instead of having the OFT and the Competition Commission in respect of rail issues?

Mr Stanley: Would you like me to take that?

Q365 Chairman: Shall we get rid of you is what we are saying, in the nicest possible way!

Mr Stanley: The difference between the Office of Fair Trading and ourselves is that they take a first look at a wide range of issues, a wide range of mergers—they might look at 200 cases a year. There always, whether you have a separate authority or the same authority, has to be a second stage where the problem is identified and somebody has to do a really heavyweight job and a really proper deep economic analysis before you can stop a merger happening or permit it. In Europe, in the States it is done within the same authority within a two-stage process: here we happen to have two different authorities—an advantage or disadvantage I guess in different places. But it seems to work here. I think the cost of changing would be quite large.

Q366 Mrs Ellman: Can I ask the Competition Commission, what proportion of all bids is referred to you?

Mr Stanley: Franchise awards or mergers more generally?

Q367 Mrs Ellman: Both.

Mr Stanley: The Office of Fair Trading look at around about 200 maybe a bit more mergers per year, including the number of railway franchise awards.

Q368 Chairman: Sorry, is that 200?

Mr Stanley: 200 or slightly more, perhaps. Of those we normally get to look at around 15 mergers so we would look at the London Stock Exchange, Waterstone’s/Ottakars, those sort of famous cases. Rail awards, I reckon we get the majority but not all of them, by any means.

Q369 Chairman: It is an affirmative nod there. Mr Banfield?

Mr Banfield: We have had five references since 2002. There are obviously some franchise bids that have not come to us such as the integrated Kent franchise or Trans-Pennine, but we probably do the majority.

Q370 Mrs Ellman: Would you say that it is sensible to consider the awards of the franchise as being the equivalent of a merger?
Mr Stanley: Whether it is sensible or not, it is the law first of all so we cannot avoid it.

Q371 Mrs Ellman: Is it sensible now?
Mr Stanley: Yes, I think so because there are a lot of implications as a lot of these companies own local bus routes, local coach routes and somebody has to defend the consumer and look at that particular aspect of it. The Department for Transport has enough on its hands without employing a large number of lawyers and economists to carry out that sort of analysis. So I think it is quite wise to have a separate authority look at that aspect of an award.

Q372 Mrs Ellman: Do you think it justifies the expenditure? Is there not a simpler way of doing it?
Mr Stanley: These cases are quite complicated. It used to be five or six years ago that mergers were dealt with in a quicker and less expensive way, but these days with us taking our own decisions and companies wanting a fair hearing and wanting to argue they themselves have good lawyers and good economists and it all gets rather expensive. But at the end of the day the process is a very strong one and it is well respected, which I think is important.

Q373 Mrs Ellman: The train operating companies tell us that it costs around £1 million to go through your process. Is there any way of reducing that cost?
Mr Stanley: It is quite hard to given the depth to which we have to go into these things. Something like the Great Western Franchise that John Banfield looked at, involving a huge number of different flows covering the whole of the West Country, you have to do a lot of analysis of what would happen where in Bristol and on other routes in terms of passengers switching between bus and coach and rail if prices were to change, and it is a very deep process, but it is also a good one. Most people are happy if the end result is they get the permission, which they did in this case.

Q374 Mr Leech: Mr Stanley, you made the very interesting comment, you talked about buses, coaches and trains but you did not mention cars. I think one of the concerns raised by the rail companies is that their biggest competitor is the car and certainly I would strongly agree with that. Do you not take that view?
Mr Stanley: It is a perennial debate. John you are the expert on that.
Mr Banfield: This is an issue on which we regularly disagree with the companies. There is a lot of research on demand of the use of public transport and what is called the price elasticity of the demand and the extent to which you could put your prices up because if you put your prices up by 10%—

Q375 Chairman: A little louder I think, Mr Banfield. Have a heart because we are writing a record!
Mr Banfield: Broadly, if you put your prices up by 10% does your demand go down by 10%? Do you make any money or not? A vast amount of research does suggest that demand for public transport is inelastic and it is profitable to put your prices up, so the competition from the car is not an effective competitive constraint, at least in the short term.

Chairman: Mr Efford.

Q376 Clive Efford: The train operating companies have told us that going through the full Competition Commission process can cost £1 million. Why is it so expensive and is that in the public interest?
Mr Stanley: It is expensive because we do a very thorough job. We ourselves of course do not charge them anything, we employ our own economists and our own accountants. In order to combat the clever people like John Banfield on my right and all the other teams the industry chooses to employ very expensive consultants and very expensive lawyers and to do a lot of research and put in a lot of data and it costs them a lot of money. I cannot control that cost; we just do the best job we can and a fairly thorough job, and in response they choose to spend that money.

Q377 Clive Efford: So the charge that these costs are imposed by the strictures that are imposed on them to satisfy the procedure is not a fair one?
Mr Stanley: Obviously they feel it is a burden and indeed it is, but the choice of whether to spend half a million or three-quarters of a million or a million is very much their choice, depending on the depth into which they wish to go. If the end result is that they get allowed, as they usually do at the end of the day, having put forward very persuasive arguments, if at the end of the day they not only get the franchise but also get the competition clearance they probably on reflection think it is good value for money.

Q378 Chairman: That is actually quite an interesting point, but you have not blocked any awards and you have only imposed conditions in one case since 2002.
Mr Stanley: Indeed.

Q379 Chairman: But you looked at seven bids through five separate referrals all at very considerable cost, as we have heard.
Mr Stanley: Yes.

Q380 Chairman: Does that not indicate you that there is little need for all this costly process?
Mr Stanley: What happens is that the Office of Fair Trading get to look at the initial franchise and they will look at somewhere like Bristol, where they will see First Group also running the buses and they will say, “Initially the bus prices could indeed go up,” as we found they would have done in Glasgow and Edinburgh some years ago when the ScotRail franchise was handed out. The OFT have fairly limited resources and a fairly limited amount of time so quite rightly, I think, they ask us to take a deeper look. At the end of the day we do not set out to block these things and at the end of the day First Group in that case persuaded us that there was no problem. But it is hard to see a way round that situation other
than by giving the Office of Fair Trading more huge resources, which I do not would be a good idea. We are on tap to do a good job if we are asked to do it.

Q381 Clive Efford: This is a question to both sets of witnesses. It has been argued that in reality risk has not been transferred from the public to the private sector through rail franchising because the rail network is crucial to the economy. Do you agree with that?

Mr Emery: Certainly in terms of the franchising the government has insulated the franchisee from some changes in Network Rail’s costs and in a sense that has detached the franchisee from some of the pressures on that, but I would not say that the franchisee is risk-free in that sense. We think that there is a good case for looking quite carefully at whether the allocation of risk is the right one and whether or not in time they should move more of the risk to the actual people who are in a position to manage and influence the risks and the implication of costs and also the benefits arising from those things. So I think that this is a fruitful area to look at quite carefully as to whether or not by moving or exposing franchisees more to the costs incurred to Network Rail or exposing Network Rail more to the costs and benefits of changes in revenue associated with their actions may well lead to a better outcome. So it is a rather longwinded way of saying that there are risks around: the present allocation does allocate quite a lot of the risks in the franchise process back to government but leaves quite a lot with the franchisees. With Network Rail clearly the government underwrites through the financial indemnity the costs of Network Rail going completely wrong, and that is an area which needs looking at and again we are looking at as part and parcel of our incentive consultation. So there is quite a fruitful area for debate whether what we have at the present time is really fit for purpose as we roll this out past 2010 into 2015 and 2020.

Q382 Clive Efford: Is Modern Railways right to argue that the concentration of multiple franchisees in the hands of a few franchise train operating companies actually weakens the government’s position under the cross default process?

Mr Beswick: I think ultimately it can do. That is really an issue for government to take a view on it and government is in a better position to take a view on cross default.

Q383 Clive Efford: I am asking your view because the argument is that taking away the Connex franchise because it was just the one franchise was relatively simple, but to do it to a company that has a multiple number of franchises actually puts the government in a very weak position. Is that your assessment of the situation?

Mr Beswick: I think it gets more difficult as more franchises are under the same owner. I am not sure that it is a particularly big problem at the moment, but it could get worse if there was more concentration.

Q384 Clive Efford: Competition Commission, presumably you have a view on that?

Mr Stanley: It is outside our field, I am afraid.

Q385 Clive Efford: Office of the Rail Regulator, you argue that the current distribution of risks between the government and the train operating companies should be adjusted. Can you explain exactly what you mean by that?

Mr Emery: I think it goes back to what I was saying earlier, that we think that the government actually insulates Network Rail and insulates the train operating companies a little bit too much and that it would be better if more risk was passed down to the train operating companies so that they can take the risk of increasing Network Rail costs but also take some of the benefits if, through working closely and innovating with Network Rail, they can reduce Network Rail’s costs. So there can be a means by which they can have a commercial incentive to work closely in partnership with Network Rail to reduce the cost of the rail industry which, as you look at the railway industry, is one of the biggest challenges—the costs are too high and they do need to come down to make it an affordable railway and to provide the funds to grow the railway to meet the growing needs of passengers and freight customers. So there is a need to work on how you can reduce the costs and one of the ways is looking at the risks, allocating a little bit more out to both Network Rail and the franchisees as a means by which you can engage them both in means by which they can look to find better ways of doing things together as partners rather than just staying in their own paths and possibly not looking at these kind of options.

Q386 Clive Efford: Is vertical integration a means of bringing costs down?

Mr Emery: We could have a long debate about vertical integration or whatever it is—

Q387 Chairman: No, no, we cannot!

Mr Emery: But we do not want that! I am not certain that it is a matter for the regulator, it is a matter for Parliament at the end of the day and ministers on these things. We think that there is plenty of scope to build on the success of the railway industry to date to find ways of achieving a lower cost railway that is meeting the needs of passengers.

Q388 Clive Efford: I am sorry to press you a little bit, but you are somebody who is very experienced in the rail network and therefore someone the government will have to take note of when coming to decisions about issues, for instance, around vertical integration, so presumably you do have a view that you would like to share with us?

Mr Emery: We were somewhat disappointed when the initiative in Mersey Rail was not given a chance to prove the case, but that led on of course to Network Rail offering a much closer partnership between themselves and Mersey Rail, so in a sense we may well start to see whether closer working will deliver some of the benefits that were identified by...
Mersey Rail as to what they could achieve. I think what you look at is creating a huge entity—and I know what the previous witness was talking about, whether that would be a problem—and it is really recognising that the railway is lots of little railways, different railways serving different markets, and attacking that may well be a way of looking at it. There may be areas, whether it be Mersey or Scotland, where you could try and see whether vertical integration could work, but it is a matter for ministers and government and then Parliament.

Q389 Chairman: Except you have expressed an opinion. Is it correct that European legislation advises us to have a system of open access?
Mr Emery: I think it does actually.

Q390 Chairman: Why have there been so relatively few open access permissions granted during the decade since privatisation?
Mr Kogan: I think it is fair to say that European legislation requires two things which relate to open access. One is that it does require accounting separation between infrastructure managers and train operators, first of all; but secondly, and more importantly, it requires a process to be put in place which allows people who want to gain marginal access to the network to get that access on a fair basis.

Q391 Chairman: So why have there been so few?
Mr Kogan: We cannot force people to make applications for open access.

Q392 Chairman: So it is a lack of imagination on the part of the operator?
Mr Kogan: There may be a lack of opportunities. It may well be that the franchised passenger services cover most of the likely opportunities.

Q393 Chairman: So do you think open access is a good way of providing rail connections for cities that are poorly served?
Mr Kogan: I think we think that there are a certain number of limited opportunities which are not currently being exploited by the franchised services.

Q394 Chairman: It is difficult. Forgive me, Mr Kogan, but you cannot say on the one hand, “The thing is the franchise is already covering all the bits that make money” and then in the next breath say, “Except there may be some cities that are not being covered and therefore we ought to be looking at them.” Which is it? Are the franchises so all-embracing that there is no room for open access or is it that you sincerely feel that there are all sorts of commercial opportunities being missed?
Mr Kogan: Franchise services do occupy the majority of capacity on passenger networks.

Q395 Chairman: The majority?
Mr Kogan: That is undoubtedly true. We believe that there is a limited group of flows which may be commercially worthwhile for open access operators.

Q396 Chairman: So what magnitude, what order of magnitude is that, typically?
Mr Kogan: I think it would be very difficult for us to venture an opinion on that.

Q397 Chairman: Forgive me. I thought you were here to venture an opinion. It is something upon which, as an office, I would have thought you would have an opinion, since you are suggesting that there is a real opening here. Mr Emery, will you take your life in your hands and say something?
Mr Emery: I am not going to take my life in my hands, but we have Grand Central and Hull Trains. I do not see open access being a substantial player in the rail for a long time. I think what you will see is the franchise operators beginning to compete more strongly on the areas which are outside the specification. But I do think that open access does provide a real challenge and a real opportunity to connect cities that have poor linkages, to offer local services—and you have heard some very good examples this afternoon of how a small local entity can respond quickly to local needs—

Q398 Chairman: So I ask you again, Mr Emery, with your detailed knowledge of franchises what is the order of magnitude we are talking about? Are we talking about two, are we talking about 22, are we talking about 202?
Mr Emery: I would say that we talking about staying under ten, I should think, in the grand scheme of things.
Chairman: Under ten, thank you very much. Mr Martlew.

Q399 Mr Martlew: Just on that point, one that I can see is quite badly served, and it is badly served by Virgin, is the London to Blackpool situation, but on the West Coast mainline and everywhere else there are capacity problems and they are going to be more acute next year and worse the year after. So are the opportunities for open access going to recede as the capacity problems become more acute?
Mr Emery: Certainly the capacity of the system coupled with the definition of the specification for the franchise operators by the Department and a growing market as well do leave little scope. Let us look quite clearly as an industry, regulator and Department as to what should be the investment in the railways to meet growth and meet demand. That is part and parcel of one of the big issues that face the industry as part of the period review coming up, and that is something that needs to be resolved.

Q400 Mr Leech: On the same point, you are saying to us that you are aware of some limited commercial opportunities, so if you are aware I am sure all the rail companies are aware and I am sure that the Department for Transport is aware, so what is it that is stopping those commercial opportunities from becoming realities?
Mr Emery: I think there are uncertainties around in other places that need to be resolved on these matters. I think there is a need for Network Rail to
have a much better handle and publish a much better handle on the capacity of routes, and the route utilisation strategies they are going through at the moment will provide a basis for that. I think that people should be encourage, and it is a matter that we will, as a regulator, as part of our job when we are doing access, look on and use our procedures that we set down fairly and openly to judge any open access operation. What this means is that we are not seeking open access to be primarily extracted from existing franchisees; it is not a cherry picking exercise, this is where there are real new markets that can offer an additional service and that is the primary need.

Q401 Chairman: So we can take it from your evidence that this is not going to be a large number?
Mr Emery: I do not think it will be a large number.

Q402 Chairman: Mr Stanley, finally, I am sorry to come back to this vexed question of costs again, but supposing we said to you, “Cut the costs of applying down to a tenth of what they are at the moment,” could you do that?
Mr Stanley: You could say that the companies should spend one-tenth and they would be absolutely furious because they would not be able to use the clever economists and clever lawyers that currently are very successful. What we can do and what we have done is work with the OFT so that we do not ask different questions of them. We have joint information requests and so on, so we have had a number of meetings with the OFT, ORR, Department of Transport, to smooth the whole system. So I am sure we could do more but we have done a lot already to cut the costs because we are aware of it. But basically, any serious competition inquiry into a very big, long-term franchise has to be done well and it is going to be quite expensive.

Q403 Chairman: So when the companies say there is no case law and each time they apply they have to start from scratch, that is wrong, is it?
Mr Stanley: There is a certain amount of precedent but, of course, they are very anxious to try and get away from precedent when it does not suit them. In very simple terms, we could have turned round to First Group and said, “Look, Bristol looks to us very much like Glasgow and Edinburgh. You know what happened there. We imposed price controls to save people complaining about the bus fares and coach fares coming up. Can we do a deal?” They would not have accepted that. They said, “No, we want to argue about it” and we were persuaded in the end that, for various reasons, the railway density was different, car use was different, Bristol was not like Glasgow and Edinburgh, so each case really has to be looked at on its merits.

Q404 Chairman: So what you are saying really is that the costs are very much in the hands of individual companies, and when they tell us that it is all your fault, they are not being 100% accurate?
Mr Stanley: I do not think they ever say it is our fault.

Q405 Chairman: Oh, Mr Stanley, you should be sitting where I am sitting!
Mr Stanley: They said the system is very expensive and they wish it was not, but they have not come to us . . . They have suggested a number of ways in which we could make the system slicker, a little quicker, a little better, and we have done all that. They have not suggested any way in which we could significantly cut the costs without disadvantaging your constituents. We are protecting the customer at the end of the day. We are protecting people who travel on buses and coaches.
Chairman: We have total faith in you, Mr Stanley. Gentlemen, thank you very much indeed. Do come back again, please, Ms Abbott. We will ask you the awkward questions next time.

Memorandum submitted by the Department for Transport

INTRODUCTION
The purpose of this memorandum is to provide the Committee with a summary of the Department’s position on passenger rail franchising. The sections below set out the Department’s views under the following headings:

I. Opening statement.
II. Purpose of passenger rail franchising.
III. Process for awarding franchises.
IV. Contractual arrangements.
V. Competition and Industry Structure.
VI. Summary and conclusions.

I. OPENING STATEMENT
The Department for Transport (DfT) undertook a wide ranging review of rail policy issues in 2004 that led to the publication of The Future of Rail White Paper (WP) in July 2004.
The overarching aim was to tackle the problems that emerged following the privatisation of the railways by putting in place a more effective industry structure in which:

- Government sets the overall framework with the Secretary of State setting strategy/rail budget and DfT letting franchises;
- Network Rail delivers an efficient network and takes a lead on performance;
- Train Operating Companies (TOCs) deliver services for their customers; and
- Office of Rail Regulation takes responsibility for economic and safety regulation.

There were a number of WP commitments made in relation to passenger rail franchising—some proposed change whereas others endorsed maintaining the status quo. Since this time, DfT has been driving forward improvements to the franchising process, in collaboration with industry partners, through new working practices and changes to contractual relationships. In parallel, we have been successful in maintaining “business as usual” with a new franchise map formally announced in October 2005, three franchise competitions completed either on-time or ahead of schedule in late 2005, continued delivery to key milestones on four current competitions, and ongoing engagement with key stakeholders that recognises the changing roles of devolved bodies.

In March 2006, DfT published “A Guide to the railway franchise procurement process”, which provides interested parties with an overview of the policies and procedures employed, including the distinction between the roles carried out by Ministers and those delegated to rail officials. It also reinforces the WP objectives of placing greater emphasis on past performance during the pre-qualification process and awarding franchise contracts on the basis of price and a commitment to reliability. There is also the DfT’s Franchise Replacement Process Manual (June 2006)—primarily an internal guidance document—which outlines the templated processes followed, including DfT’s commitment to continuous review through compliance with Office of Government Commerce (OGC) best practice. We are also due to issue formally the guidance notes we have been developing for Passenger Transport Executives (PTEs), which summarises their rights and roles in the revised franchising process.

II. PURPOSE OF PASSENGER RAIL FRANCHISING

What should be the purpose of passenger rail franchising?

Is the current system achieving that purpose?

The WP highlighted how privatisation of the rail industry was introduced in the early 1990s on the premise that “private sector innovation and discipline would drive down the railway’s public funding requirement and drive up quality of service, against a backdrop of falling demand” (WP 1.2.1).

Although it was acknowledged that franchises were successful in some areas (eg through helping to grow the rail market), there were constraints (eg difficulty in sustaining revenue growth once network capacity became more constrained), including the original franchise contract having little capacity to deal with significant change. There were also costly renegotiations when TOCs found themselves unable to deliver the commitments outlined in their original bids. More generally, there were problems with the overall industry structure, as the attempt to create a commercial relationship between the infrastructure and service providers failed and there was a misalignment of incentives between the rail parties, particularly with respect to operational performance.

Through the Rail Review, publication of the WP, and subsequent implementation, Government has sought to remedy these issues and redefine what the purpose of franchising should be.

The Franchising process is designed to harness private sector commercial judgment and innovation to reduce the net cost and increase the value for money (VfM) achieved from the Government’s overall support for passenger rail services.

By setting the base specification for each franchise, the Government is seeking to achieve a number of high level objectives:

- to set out the level of train service provision required (through a review of historic provision and forecast of future demand) where, otherwise, market forces would not normally deliver;
- to protect the passenger from monopolistic actions in specific markets (eg through regulation of London commuter fares);
- to protect the benefits of a national rail network in the UK mainland;
- to provide a “level playing field” for a competition to successfully award the franchise within the terms of procurement legislation and general best practice; and
- to allow the specification to be varied over time to reflect emerging market needs through innovation and commercial judgment.

This approach seeks to achieve an appropriate balance between sufficient specification to deliver Government objectives and enabling the benefits of private sector innovation and commercial judgment to be applied during the procurement and subsequent franchise term.
It is also designed to secure:

— a continuing improvement in rail services’ operational performance, in line with the Public Service Agreement (PSA) targets;

— sufficient capacity to accommodate passenger demand—generally within existing infrastructure constraints; and

— continued delivery of WP aims, including the new franchise map and allowing Local Decision Makers (LDMs) to exercise their right to buy/propose savings.

It should be noted that, since 1994, the outcome of this industry structure has helped to deliver growing passenger volumes in the UK mainland. In parallel, there have been overall improvements in safety standards.

### III. Process for Awarding Franchises

**How well does the process for awarding franchises work?**

DfT’s approach to franchising builds on the processes developed in recent years at the Strategic Rail Authority (SRA) whilst also implementing significant improvements.

The Franchise Replacement Process Manual outlines the staged and gated processes followed by the DfT in which individual projects are initiated about two years before a franchise is due to expire. A simplification of the key stages followed is summarised below:

— **Specification** of what Government wishes to buy (with reference to VfM and affordability) in consultation with key stakeholders;

— **Procurement** competition to elicit the most competitive bid from prospective TOCs;

— **Mobilisation** period between announcement of award to Selected Bidder and commencement of new franchise;

— **Operation/Service Delivery** by TOC for a defined franchise length, which involves Government monitoring relevant commitments to ensure benefits are realised and assessing operational and financial risks; and

— **Franchise close** during the “Last 12 Months” when the Government exerts stronger contractual control.

Simplified overviews of the DfT’s Franchise Replacement Process and forward plan of activities are respectively provided in Attachments 1 and 2.

**What input do operators, passengers and other interested parties have into the design of franchised services?**

In developing the specification for individual franchising projects, we employ an objective-led, evidence-based approach that takes into account available information on demand, growth and development from relevant Route Utilisation Strategies and other studies. We also seek to understand the operational and financial interdependencies between franchise propositions and continuously engage with industry partners and other key stakeholders for their input—in particular, Network Rail who provides timetabling assistance to the DfT during the development of the service specification.

The formal means through which passengers and other interested parties (eg Passenger Focus, London Travelwatch, and local authorities) input to the design of franchised services is through our consultation process. We also work with LDMs, like Transport for London (TfL) and PTEs, during this period to enable them to exercise their right to buy additional services (“increments”) or propose savings (“decrements”).

These inputs are developed into a specification that captures these requirements whilst allowing appropriate scope for private sector innovation and commercial judgment to further develop the specification over the franchise period. For instance, in previous competitions, bidders have proposed additional services and minor investment schemes that have been contractualised on the basis of being cost neutral overall.

**What criteria and processes are used to evaluate franchise bids?**

“A Guide to the railway franchise procurement process” demonstrates our commitment to a consistent and transparent process. It also highlights how the revised franchise replacement process has been one of the starting points for enacting change.

Our recently augmented pre-qualification phase gives greater weighting to track record (70%) with another 25% on bidders’ plans for mobilising and operating the franchise and 5% on their approach to bidding. A proven track record of customer delivery and financial management is the best guarantee of ensuring that we shortlist a field of bidders we are confident could run a franchise were they to submit the winning bid in the next procurement stage (Invitation to Tender). Our new approach would also make it difficult to entertain any bids (for at least several years) from any TOC who, as a result of its own business
decisions, gets into serious financial difficulties so that it defaults on the franchise. In addition to attracting the right bidders, we also seek to ensure we get the right price by maintaining competitive tension through the subsequent stages of evaluation by only announcing the Selected Bidder once the contract award has been firmly agreed.

Through our procurement strategy, we seek to elicit the most competitive bid for the specification. The franchise specification itself is critical to ensuring there is a “level playing field” in which all bids are compared to a common output requirement. The evaluation of bids is underpinned by analysis of the reliability of operational deliverability and the achievability of the bid revenue, so that the bid offering the best overall deal for the taxpayer is selected.

**Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?**

DfT successfully awarded the three franchise competitions (Integrated Kent, Thameslink/Great Northern, and Greater Western) inherited from the SRA either on-time or ahead of schedule and we have continued to achieve on-time delivery to key milestones on the ongoing competitions. We issued the Invitation to Tender for the South Western franchise at the end of March with bids expected to be returned at the end of June. During October 2005, we published a new franchise map, which will see a reduction in the number of franchises in the Midlands from four to three (following the expiry of existing franchises) and a better alignment with Network Rail’s regional structure. Prior Information Notices for the three new franchises—New Cross Country, East Midlands, and West Midlands—were published in February 2006 with advertisements seeking Expressions of Interest being published at the start of this month. The formal consultation period for these three commenced on schedule in early June and the Invitations to Tender will follow at the end of October 2006.

In parallel, we have enacted the policy changes discussed herein (eg revised bidding process and less prescriptive approach to franchise specification). The Department is committed to a process of continuous review and improvement for the franchising process with the aim of securing best VfM bids on behalf of rail passengers and taxpayers.

**IV. Franchise Contracts**

**Are franchise contracts the right size, type and length?**

*What criteria and processes are used to determine the nature and length of franchises?*

The WP proposed a reduction in the number of UK franchises and alignment as far as possible with Network Rail regions and routes in order to encourage joint working between track and train to deliver an improved service to customers. This has had consequential impacts on the general scope of franchise areas with the Government formally announcing, in October 2004, a reduction in the number of franchises from 25 to 19 with the detailed plans of the new franchise map being revealed in October 2005.

In terms of the contractual arrangements, the DfT has proposed a number of improvements in consultation with key industry partners. For instance, we have sought to simplify franchise contracts by separating the general requirements that apply to all new franchises—the National Rail Franchise Terms—from franchise specific terms, resulting in streamlined negotiating activity. We have also reduced the number of Key Performance Indicators to lessen the management burden on franchises and avoid micro-management by the Department. This, again, reflects improving the balance between a centrally imposed specification and facilitating train operators’ commercial skills and innovation.

The overall aim of both initiatives has been to incentivise operators to focus on the key outputs sought. Likewise, contractual obligations are limited to areas where franchise operators have demonstrated the most success (ie delivering services and other minor enhancements, including third party funded initiatives, to their passenger). Capital enhancements are no longer included in the base case, which helps to mitigate a number of risks surrounding costs and deliverability. Instead, Network Rail will deliver all capital enhancements in response to the Government’s High Level Output Specification.

The Government has decided to let contracts of varying lengths. Current policy is that franchises will generally be let for periods of eight to 10 years, as experience has shown that there are challenges in forecasting cost/revenue any further ahead than that with any confidence. Also, Government takes the view that this is long enough to present an attractive business opportunity—thus encouraging a robust field of bidders—whilst allowing the taxpayer and passenger to benefit from the innovation and efficiencies associated with competitions taking place at regular intervals.

There might be a good case to let longer contracts in specific circumstances, for instance when a franchise will cover a period of operational instability or there is an identified need to allow a longer period for a return on an operator investment. However, these would need to be balanced against the risks of TOCs seeking financial support in the later years of their franchise life for items deemed to be out of their control.
Likewise, in some instances, it is appropriate to include “break clauses” to deal with the implications of major infrastructure projects (e.g., Thameslink Route Modernisation). There may also be justification for aligning contiguous franchises’ terms to enable a more holistic review of future service provision. Again, such exceptions would need to be carefully considered during the development of the procurement strategy and with reference to EU Directives.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

Franchise specifications are developed in accordance with strict VfM guidelines, based on appraisal principles set out in the Treasury Green Book and the DfT Transport Analysis Guide. As previously highlighted, DfT also ensures that key outputs are contractualised at franchise award.

During the life of the franchise, we ensure that benefits are realised through the review of contractual obligations. These include monitoring TOCs’ financial and operational performance on a monthly basis and taking a quarterly review of the financial health of their owning groups. Review of these operational and financial obligations provides an early warning system for the DfT. In addition, on the newer franchises, there is a forward planning requirement to submit an annual Business Plan. TOCs are also incentivised to continuously improve operational performance, as the achievement of specified performance targets allows them to retain the right to continue operating the franchise in its later years.

We have also committed to conducting Post Project Evaluation reviews to confirm whether the original business case justification, as agreed by the DfT, was realistic and seek independent confirmation that the franchise obligations are being (and will continue to be) delivered in line with original contract terms.

There are also cross-industry PSA targets, where joint success has been achieved by exceeding operational performance of 85% of trains running on-time, as measured by the industry standard Public Performance Measure (PPM), by March 2006. This was achieved six months early. Passenger Focus also performs a valuable role for the industry through reviewing customer satisfaction via the National Passenger Survey and London Travelwatch provides a similar challenge function (where appropriate).

Are risks suitably apportioned between the Government and franchise holders?

DfT has attempted to incorporate an appropriate balance of risk between the public and private sectors in the new franchise contracts through provisions such as:

- a variation mechanism to cope with changes during the life of the franchise;
- revenue share/support arrangements so TOCs are not held accountable for major revenue risks beyond their control (e.g., GDP dips or Government action) whilst simultaneously ensuring that any windfall revenue gains are shared with Government;
- pass through mechanisms so TOCs are not held accountable for certain cost risks beyond their control (e.g., Track Access Charge changes); and
- force majeure provisions to cope with certain extraneous events beyond the TOCs’ operational control (e.g., natural disasters or terrorism).

However, we have also made clear that we expect contractual commitments to be delivered. For instance, new franchises are expected to ensure the financial viability of the business through a requirement for their Management Accounts to include compliance with specific financial ratios. Failure to deliver such obligations leads to graduated penalties, ultimately resulting in them being liable to lose their franchise. If necessary, we are prepared to use our Operator of Last Resort powers (as shown when Connex South Eastern was failing as a franchise) and consequently have robust plans in place to ensure the continued provision of train services to the public.

What is the scope for improving services through franchise agreements?

We previously highlighted the contractual mechanisms in place to incentivise continuous improvement in operational performance throughout the life of the franchise.

More generally, in re-letting franchises, the DfT reviews the scope of the proposed franchise services, including future market requirements, which gives us an initial view of the minimum service levels required. One of the key aspects of the procurement process is that there is flexibility for bidders to be innovative through proposing additional services—provided there are no adverse effects on operational performance and there is no abstraction of revenue from other operators. There is also the opportunity for bidders to propose additional investment, for instance to rolling stock or minor station enhancements (e.g., Passenger Information Systems and CCTV). This helps to secure improvements before the franchise contract is let through the sound commercial judgment of the private sector.
It is likewise accepted that services should not remain static and we are committed to working with TOCs as changes arise during the franchise life—employing the variation mechanism where needed—in line with principles previously described to harness the innovation, commercial judgement, knowledge and skills that the private sector brings.

V. Competition and Industry Structure

Do we need more competition and vertical integration?

The foremost competition for the passenger rail industry is with other modes of transport, so we work to ensure that the rail offer is competitive, for example, with air travel between London and Manchester, and with the M4 alternative between London and Bristol and South Wales.

Competition within the rail industry is achieved by the holding of vigorous competitions for new and replacement passenger franchises. The aggressive bidding that has characterised recent franchise replacement contests has ensured a good deal for the taxpayer, and there is no sign that the forthcoming round of franchise letting will be any less competitive.

The main competition within the rail industry, therefore, is the competition “for the ground” rather than “on the ground”. The actions of TOCs since privatisation have shown that competition for lucrative passenger flows on congested routes results in a poor use of track capacity, because the incentive is for operators to concentrate more on maximising their returns through the revenue allocation system than on the provision of a coherent service pattern.

Is franchising compatible with open access operations?

The DfT maintain the position “that operators should continue to be free to apply to run passenger services under open access rights” as “the possibility of purely commercial services supplementing those provided under franchise remains a valuable one” (WP 4.4.9) but we think “access rights should not be granted for services which just poach passengers from other services and do not increase the overall market” (WP 4.4.10).

Should train, rolling stock and track operation be more closely integrated?

The main reasons for not combining track and train are (a) EU restrictions and (b) the fact that the revised franchise model between infrastructure owner and train service operators has been working well, especially since Network Rail sharpened its focus on network performance. The wheel/rail interface issues are controlled effectively by industry working groups involving both Network Rail and the TOCs.

One of the successes of rail policy since the demise of Railtrack and publication of the WP has been the evidence of much closer alignment of incentives between Network Rail and the TOCs. This has led to more co-ordinated working at the ground level, as evidenced by the setting up of new integrated control centres at Waterloo and Swindon. Similarly, the development of the High Speed Train replacement project at national level is benefiting from a close working relationship between DfT and Network Rail. The DfT continues to believe that such alignment of incentives and collaborative working is the optimal solution for the rail industry, as there are a number of drawbacks to combining ownership of track and train.

Vertical integration of infrastructure and train operation, on any geographical area of the rail network, would lead to difficulty in securing sufficient competition without additional regulation, as monopolies could be created through merging track and train operations. In addition, it would require measures to ensure the effective operation of any “inter-regional” and freight trains that might be required to operate over the infrastructure, as the “owning” operator would naturally be inclined to favour its own trains. In general, there would be a loss of synergy and associated economies of scale from moving away from a body that is able to manage network issues at a national level.

There are similar issues with integrating rolling stock, although ORR has been taking account of different types of rolling stock in setting access charges with a view to incentivising behaviour towards minimising total long-terms costs. Overall, DfT continues to maintain that rolling stock risk is generally best left to the market to take. The asset life of rolling stock tends to be 30 to 40 years, whereas the franchise terms are considerably shorter, so there is an incentive on the Rolling Stock Leasing companies to develop and improve their trains to make them commercially attractive for new franchisees.

VI. Summary and Conclusions

The Rail Review and subsequent WP implementation sought to address cross industry rail issues, including a number relating to passenger rail franchising. This memorandum has sought to address all of the questions posed by the Transport Select Committee through providing the relevant background leading up to the DfT’s current policy.
DfT has sought to learn from historical industry experience and enact a franchising policy that achieves an appropriate balance of risk, reward and involvement between the public and private sectors. Good progress has been achieved since taking over direct responsibility for the franchise replacement process which is reflected by the on-time and ahead of schedule delivery of key milestones on both completed and ongoing competitions.

DfT will continue to review and monitor progress through Post Project Evaluation and continued compliance with OGC best practice with the ongoing aim of delivering the best deal for both the passenger and taxpayer.

21 June 2006
Franchise Replacement Process

Initiate

Outline

Define Outline Base Proposition/Options
Outline Business Case
Prepare Proc’t Strategy
Prepare advert and pre-qualification pack

Detailed

Detailed Base Proposition/Options
Detailed Business Case
Consultation (Base and LDM Increment/Decrement)
Prepare ITT
Evaluate responses to accreditation questions and shortlist for ITT

Procure

Maintain / finalise Base Service Specification/Options
Confirm LDM Increment/Decrement
Prepare Mobilisation Stage Plan
Evaluate bids, Negotiate, and Contractualise

Implement

Lead Mobilisation, Transition/Migration
Prepare overview of options and review of relevant RUS inputs
Develop detailed timetable & performance modelling of base proposition and assessment of increments and TAA
Provide advice to bidders, report on bids, sign off final DfT specification and agree handling of increments.

Network Rail

Implement timetable through industry processes and finalise TAA
Manage franchise

Deliver

Sponsor major changes to franchise

Transport Committee: Evidence Ev 149

Franchise Specification Procurement Service Delivery

Network Rail

Sponsor major changes to franchise

0 months
6 months
12 months
24 months
C.7-10 years

= Franchise Specification
= Rail Procurement
= Service Delivery
= Network Rail
Rail procurement activity

<table>
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Key
- Strategy and Finance
- Procurement
- Durations and Franchises
Witnesses: Derek Twigg, a Member of the House, Parliamentary Under Secretary of State, Mr Mark Lambirth, Director of Rail Strategy and Finance Directorate, and Mr Roger Jones, Divisional Manager of Rail Franchise Specification, Department for Transport, gave evidence.

Q406 Chairman: Good afternoon to you, Minister. May I begin by saying that I am very delighted to see you and your colleagues here this afternoon, but you will be aware that the Treasury were asked to send a Minister to accompany you because one development that has been very clear in the railway industry in the last few years is that the Treasury has a very real role to play and is taking a very active role both in policy making and in policy control. I would like to put on record that it has been extremely unhelpful that that letter was sent to the Treasury a considerable time ago, and it was only yesterday that I received a final letter explaining that a Treasury Minister was not available. I am, frankly, unimpressed with that and I think the Committee will want to return to it, possibly in this report. However, I am sure that you will have all the answers because I am assured by the Treasury that you are speaking for the whole of Her Majesty’s Government. I hope you are aware of this responsibility and will respond to it in your normal manner. So you can tell me what are the Government’s overarching strategic objectives in the franchising process?

Derek Twigg: I wonder if I could introduce my colleagues first.

Q407 Chairman: I am so sorry. Yes, please do tell us the names of your colleagues.

Mr Lambirth: Mark Lambirth, Director, Rail Strategy and Finance in the Department.

Mr Jones: Roger Jones, Head of Franchise Specification in the Department.

Q408 Chairman: You are most warmly welcome, gentlemen. Now, you have had at least two minutes to think. What are the Government’s overarching strategic objectives, Mr Twigg?

Derek Twigg: Thank you, Mrs Dunwoody. Basically, obviously, it is to achieve the best value for money for the taxpayer and for the passenger; also, obviously, to improve and extend passenger services. I think you have to look at the context of this as a whole in terms of the success of the railway, in terms of the record number of passengers, and of course, the improved reliability—many TOCs now are actually hitting around 90%—and of course, the investment in terms of rolling stock, big projects like the Channel Tunnel Rail Link and West Coast main line and of course the improvements in passenger services in terms of information for passengers, et cetera, and also some very good ideas in terms of pricing and ticketing aimed at cheaper tickets and attracting more passengers on to the railway.

Q409 Chairman: You may think that it is quite clear and that you have brilliant ideas, but your passengers and the industry do not seem to be of that opinion. How do you think you can make it clearer?

Derek Twigg: Let me make it clear that I do not accept that everything is rosy in the garden and there cannot be further improvements both in franchising and we have to learn lessons and are learning lessons in the new franchise we have just done in the South West, which Mr Lambirth will go into in some detail later when you ask the point, in terms of making sure that they do bring about better value for money and deliver better services for the passenger. I accept that, of course, there are improvements that need to be made, but if you look at passenger satisfaction, overall satisfaction with the rail journey is about 80%, either satisfied or better. Now, again, of course, we want to improve that but I think that is a figure that is worth quoting.

Q410 Chairman: How do you balance your desire to drive down the public funding requirement and driving up the quality of service?

Derek Twigg: What is important to look at here in terms of what we want really to look at first is deliverability in terms of the service we want to specify for a particular franchise or part of the network, and of course, then we examine that in detail in terms of how we can look at it in terms of value for money, in terms of what it does for the passengers, looking at passenger research, in terms of passenger numbers and growth and so forth, and look at whether that would need a certain amount of subsidy or whether we could possibly call in a premium for it. It is a multiplicity of things we need to look at.

Q411 Chairman: Yes, and when you have looked at them all, how do you reconcile trying to drive down what it costs with trying to provide better quality?

Derek Twigg: I do not think there is actually a conflict.

Q412 Chairman: So it is quite possible to drive down costs and give people a much better standard?

Derek Twigg: If you just look at what is happening in the railway currently . . .

Q413 Chairman: I think that is what we are doing, Minister.

Derek Twigg: If you just look at it now, you will see that passenger satisfaction is around 80%, which is the highest it has been in terms of the overall journey. We have increased punctuality and reliability of trains, and of course, a much younger rolling stock than we have had for many years. Of course, within that there is an increase in the number of passenger kilometre/miles being travelled. So I think there are lots of good things that are improving. I think also passenger services, information on trains and stations has improved. I also think in terms of the ticketing I mentioned before there are lots of good deals around.

Q414 Chairman: We are delighted with all the good things. How do you reconcile these very clear problems of the whole service costing less and standards being improved?

Derek Twigg: I think standards are being improved and I think we look to get . . .
Q415 Chairman: But you have not so far driven down the costs.
Derek Twigg: I think there are some interesting figures which maybe I could quote to you. There has been an increase, obviously, in the number of passenger journeys which you are aware of in terms of the over the billion mark. That is a 42% increase in 10 years. We have also seen the number of passenger train kilometres operated, again in 10 years, increase by 23%, and costs have risen by 27%. So I think that is a reasonable figure to give you in terms of seeing the improvements in both passenger kilometres that have been travelled, the increase in passenger journeys and of course increase in fare box revenue is 47% as well.
Chairman: We are delighted you are carrying many more people.

Q416 Mrs Ellman: The number of people using rail has grown largely over the past few years. Do you attribute that to the Government’s success in improving the economy?
Derek Twigg: I certainly do attribute a large part of that to the Government’s success in the improvement and success of the economy. I think also that you would have to say it would not be that alone. I know there was a study done by Professor Nash1 in about 1998–99 which looked at London South East Railways, which suggested nearly 20% of the improvement was down to privatisation and franchising. That is a few years ago, so it is difficult to be definitive about what actual percentage it has put on as part of the franchising process, but it is clear that the railway has become more attractive, it has become more reliable, and while there are lots of factors in that in terms of, obviously, the maintenance and renewals but also the passenger service, the investment in trains, the investment in staff on trains, information, make it a more attractive journey. So I think there are lots of reasons, but I do accept your main proposition that much of it is down to the improvement in the economy.

Q417 Mrs Ellman: Would you be concerned if increased rail fares then stopped people using the trains as much, if there were not sufficient regulation of fares?
Derek Twigg: As you know, our current regulation is RPI plus one, and they have fallen in real terms in the last 10 years by about 3% but obviously the other fares are a matter for the train operating companies within a basket of fares. All I can repeat, as I did at a previous hearing, is that it is not in the interests of train operating companies to price people off the railway.

Q418 Chairman: Are you quite sure that that is their attitude, Mr Twigg? Are you not convinced that some of them, really as almost a conscious policy, are pushing to price large numbers off because they do not feel they have the capacity?
Derek Twigg: I think there are issues around demand management, Mrs Dunwoody, but there is also certainly—and I accept the point, one of the criticisms you made at previous hearings, in terms of transparency and information regarding the current ticketing system, but there are many excellent fare deals out there which range from, obviously, South West Trains megatrain fare . . .

Q419 Chairman: I am sure there are excellent fare deals. That was not actually what we were asking you. You are saying it is not in the interests of train companies, I quote, “to price people off the railways”. We are saying to you are you sure they are not using that as a way of dealing with the lack of capacity?
Derek Twigg: It is clear from the variety of deals that they are offering to attract people on to the railway, particularly at off-peak times, that that is not their aim and should not be their aim. They want to grow their revenue, they want to get more people—and so do we—using the railway, and that has been borne out by the massive rise in passengers on the railway over the last 10 years or so.

Q420 Mrs Ellman: Do you think more could be done on linking up franchise specification, pushing to increase usage of the railway, with infrastructure planning? Are you satisfied with the way that operates now?
Derek Twigg: I think the current structure works well. Again, I am not suggesting it is perfect and cannot be improved, but I think the partnership working with Network Rail and the train operating companies works quite well, the integrated control centres are in place in a number of areas of the network. Obviously, the investment has gone in in terms of the renewals and maintenance of signalling and so forth, which has helped improve reliability. With the involvement of train operating companies with Network Rail, we are actually putting pressure on them, obviously, to make sure that things work correctly on the railway and put problems right quickly. Also in terms of Network Rail, they have a challenge now because they have responsibility for performance, and they need to rise to that challenge, and I think they are doing so.

Q421 Mrs Ellman: Do you think there is enough linkage between, for example, the Route Utilisation Strategy, Regional Planning Assessment and the High Level Output Statements? Are all these things working together?
Derek Twigg: The High Level Output Specification will need to take account of what is going on in the Route Utilisation Strategies and obviously the Regional Planning Assessments as well, which are very important in looking at the short to medium term. Obviously, going into the High Level Output Specification in terms of the longer term, and

1 The study was produced for the ECMT Workshop on Competitive Tendering of Rail Passenger Services: Experience to Date by Chris Nash and Andrew Smith (ITS, University of Leeds) entitled, “Passenger Rail Franchising—British Experience” (Paris, 12 January 2006). In this paper, Nash and Smith look at the “Impact of External Variables on 1990–98 Rail Demand Growth” [Source: Wardman (2005)] and note “A distinct change in trend post 1995 is found, accounting for some 20% of the growth for London and South East”.

19 July 2006 Derek Twigg, Mr Mark Lambirth and Mr Roger Jones
obviously the longer-term strategy, we are also looking at 20–25 years. So I think for the first time in a number of years we have seen some long-term planning thinking taking place in the industry about how it can be taken forward, so they do all work into each other and certainly the High Level Output Specification will take account of them.

Q422 Mrs Ellman: You are confident that is going to happen soon then?

Derek Twigg: The High Level Output Specification work has started now, obviously to be completed next year, and that will be all part of that.

Q423 Mrs Ellman: Franchises were reduced from 25 to 19. What was your thinking behind that?

Derek Twigg: The franchise policy we are looking at currently is in terms of how we align them better with the Network Rail routes or regions, in terms of improving the sort of partnership and challenge that you were talking about a few moments ago in your earlier question. We think that would work better and we have been looking at the franchises in terms of how they sit in a particular part of the country, which is important as well, but I think specifically to fit in with the Network Rail structures is going to be a very important part of our thinking on that.

Q424 Mrs Ellman: Routes out of London termini have been consolidated into one franchise but that is not happening anywhere else, is it?

Derek Twigg: I am not quite sure, Mrs Ellman. Services outside London will obviously be covered by a range of franchises. That will continue to be our policy.

Q425 Mrs Ellman: Are they not being consolidated into one franchise for the individual termini?

Derek Twigg: You mean, for instance, West Coast going into Euston?

Q426 Chairman: The services will be under one franchise. Is that not correct?

Derek Twigg: No. If you want to clarify that later on, I am happy to write back to the Committee.

Mr Lambirth: If you look at what we did in relation to the Midlands franchises, what we were trying to do there was to create an East Midlands franchise which broadly aligns with the Network Rail route which runs up the Midlands main line, a West Midlands franchise which aligns with the services around Birmingham and the West Coast main line and a cross-country route because there are always going to be routes which you cannot map on to the Network Rail route map. That is how we approach that. I do not think we have any plans to try and align services with termini in major provincial towns.

Q427 Chairman: Yet, of course, there is a problem, is there not, for many of these major towns? They have exactly the same problems with commuters as they do in London.

Derek Twigg: In terms of?

Q428 Chairman: In terms of people using the system, lots of people getting on lots of trains and finding it difficult to get lots of seats.

Derek Twigg: For a number of reasons. In terms of, say, the West Midlands franchise, clearly the impact of travelling to Birmingham is a very important part of that. We are actually increasing the services in all three franchises by some 3–5%. I think there are going to be 40 extra train services in terms of the West Midlands. It is the impact, of course, not just on local services we have to take account of but the longer services, InterCity services, and therefore the whole service we provide in a particular franchise area is very important in that respect.

Q429 Chairman: So why are you not using the same systems in relation to them?

Derek Twigg: For a number of reasons. In terms of, say, the West Midlands franchise, clearly the impact of travelling to Birmingham is a very important part of that. We are actually increasing the services in all three franchises by some 3–5%. I think there are going to be 40 extra train services in terms of the West Midlands. It is the impact, of course, not just on local services we have to take account of but the longer services, InterCity services, and therefore the whole service we provide in a particular franchise area is very important in that respect.

Q430 Chairman: Mr Lambirth, why did you not do it when you were reorganising West and East Midlands?

Mr Lambirth: As I say, the 2004 White Paper announced a policy reducing franchises from about 25 to about 17 with the aim of trying to improve the alignment with the Network Rail routes, and the reason for that is to address one of the downsides of the vertical segregation of the railway—it has advantages as well—in which you have a separate infrastructure operator responsible for one set of decisions, a train operating company responsible for another set of decisions and they need to work very closely together. So the intention was, and this is being followed through, to align the two management structures. That is largely what drives the reduction.

Q431 Mr Goodwill: If I could pick up something you said, Minister, in your very first comment, which was that you wanted to extend passenger services, we have heard from a number of witnesses already that the current franchise system is seen by some as being too prescriptive and mitigating against innovation and flexibility. We have heard this afternoon that the open access arrangements are only a handful at the moment and likely to be less than 10 in the future. Do you not think that the current system in effect freezes our railway network into a time warp and that we should think of ways to maybe break that current log jam?

Derek Twigg: No, I do not accept that. As I have said previously, there has been a 42% increase in passenger journeys since the mid Nineties, over a billion passengers last year. The new franchises, East Midlands, the Cross Country and the West Midlands will see services grow by about 3–5%. So we are actually growing services. If you look at the West Coast main line, significant growth in service and further growth in service is expected from 2008–09, with three trains an hour going to Manchester, to Birmingham, and faster services both to Glasgow and Liverpool, more services
possibly to Liverpool during the peak time, increased services on the West Coast line from Birmingham onwards, stopping off at more stations. So I do not accept that. The specifications where we do franchise, I think there is a lot of scope for innovation, for thinking about additional services. It is all also subject in terms of capacity and obviously how that works, but the facts are that there is a significant improvement and growth in the railway.

Q432 Mr Goodwill: Would you say those comments would apply to Northern Rail, for example? When we took evidence last week the Dutch owners of the company basically said, “We operate the railway as we are told under these fairly tight, prescriptive parameters set out in the franchise” and they almost said, “We don’t really see our job as coming up with suggestions as to how this can be made better or different. We just operate it as we are told.” Do you think maybe there is an area that we could look at in the future to try and introduce a bit more innovation and flexibility into a big network like Northern?

Derek Twigg: We do not specify what the times of the trains would be. We say what the minimum number of trains may be that should be run per hour or whatever. So there is quite a lot of scope. OK, it is subject to the availability and track capacity and obviously whether it impinges on other franchises. All these types of issues have to be taken account of, but there is significant leeway if they wished to and obviously can justify doing that. If you take the Northern franchise, what was interesting there was that people were expecting cuts in the service. I looked at it with the Secretary of State and felt that actually, given the savings that were deliverable, it just did not stack up anyway. Secondly, Northern Rail felt they could grow the service within the Northern franchise. I am not saying it could ever be anything like some of the franchises where they have been paying premiums, because they obviously receive a heavy subsidy.

Q433 Mr Goodwill: An 80% subsidy at the moment. Derek Twigg: But if you talk to Northern Rail, if you talk to the Managing Director, Heidi Mottram, she is very confident she can grow the services. They are also doing quite interesting things there in terms of involving passengers, in terms of involving local authorities, working together to see how they can improve that.

Q434 Mr Goodwill: You mentioned that you are trying to align the franchises with the Network Rail regions. Would that make it easier to move to a more vertically integrated type of rail system?

Derek Twigg: I do not really see that there is a strong argument. We have just had a rail review. We have obviously gone from nationalisation to privatisation, from Railtrack and obviously what happened at Hatfield, and I do not see why we would want to put the rail industry through another lot of upheaval again and a whole load of change, when actually, the current system is delivering significant results, both in passenger numbers and in terms of improvement in service. Further improvement is obviously possible and will happen, but also, Network Rail are working well with the train operating companies. I am not saying every relationship is perfect, but if I give you an example of Midland Mainline and how following changes that were made there in terms of how it was managed, both Network Rail and Midland Mainline, massive improvements in reliability and performance, and that is seen as significant in large parts of the country. So I think the relationship works well. I think it can continue to improve. There are still a lot of lessons to learn. I also think in terms of the track renewals and maintenance, it is very important that they work closely with the train operating companies.

Q435 Mr Goodwill: Do you think maybe that important lessons could be learned from possibly a pilot project with, say, Merseyrail, who seem keen to get involved in more integration? Would that maybe allow us to take a better view as to other areas where we could roll out this type of policy?

Derek Twigg: We discussed this in the White Paper, and the reactions on that and the Act. Clearly, there is an argument for it because it is pretty self-contained. I use it myself on a regular basis. It is a pretty self-contained area. But Network Rail obviously did not feel that was the best way to go, and they decided they did not want to do that.

Q436 Mr Goodwill: Did they want to keep their empire in one piece?

Derek Twigg: No. If you look at it, I think Merseyrail’s current punctuality PPM performance is about 92–93%. I think it had been up to 94, even 95. They are one of the top performing train operating companies in the country. That is partly obviously because of the way they run it but a lot of it is also to do with Network Rail and the way they work and support them in terms of the maintenance of that particular part of the network. So they are already into high numbers in terms of punctuality, and they want to improve further. I think what has got to happen is to make sure that Network Rail and Merseytravel build on that relationship to improve it further.

Q437 Graham Stringer: Is there not one figure that dominates all the thinking, whether it is you or the absent Treasury Minister’s thinking, the £5 billion you put into the railway when it was expected pre-Hatfield that it would be about zero at the moment? When do you expect this figure to come down, and what will it come down to?

Derek Twigg: We are going through the process now, as you know, in terms of the HLOS and of course the Spending Review, and I do not want to pre-empt any of them, but we are spending for this control period, that is the five-year period up to 2008, about £23 billion in terms of the railway. A lot of the increased expenditure has been down to, obviously, major renewals and maintenance work that has been undertaken by Network Rail because of the decades of under-investment and now the investment by Network Rail. Obviously, you would
not need to have that amount of money in terms of the future but, having said that, we then have to look at what we need to do in terms of capacity as part of the HLOS process and also maintain the maintenance renewals and also the safety aspects of the railway as well. So at this stage I think the White Paper in 2000 said it is going up to round about £3.5 billion, but clearly, while the process is in train in terms of HLOS and the spending review, I do not want to pre-empt that at the moment.

**Q438 Graham Stringer:** That is an interesting answer, Minister. Do you envisage—I do not know what they are; maybe you could tell us—that there will be investment in the 20-odd pinch points in the rail system that were identified in a previous White Paper? Can we expect improvement in the capacity of the railways over the next five years?

**Derek Twigg:** I think you can expect improvements in capacity as part of the issue around HLOS and the next control period, which is part of the discussions, and of course, you will be aware that Network Rail produced their base case only a couple of weeks ago and raised a number of issues in terms of the pinch points you refer to and the investment in that. Reading is a typical example that I can quote there. Clearly, this is all part of the consideration we have been giving obviously with the regulator as part of the next control period investment. Clearly, there are a number of infrastructure improvements that can be made which will improve capacity.

**Q439 Graham Stringer:** You are considering that. Can you be more specific about whether there will be any of them dealt with, or will it be five, 10, 15, 20 of these pinch points? The previous evidence we have heard from some expert witnesses said that there really are not any major investment decisions that have been taken for the future. We know the West Coast main line has improved and the fast link to the Channel Tunnel is under way but what major projects can we look forward to in the future?

**Derek Twigg:** If you take, say, Reading, for example, clearly, in terms of the signalling, that has got to be replaced by about 2012, 2013, 2014, and clearly there are issues there about platform capacity, and obviously something needs to be done there. But clearly, we have to look at the whole picture in terms of how we deal with that and how all that is funded. There are, as you know, in terms of Birmingham New Street issues there in terms of the platform capacity and moving passengers around there. It is an interesting point you make in terms of the big projects. What I think passengers want most of all is a reliable, good-quality train service, and I want to see that continue. Whether that can be brought about by just basically putting extra trains on or extending the length of trains or platforms is one way of looking at it, but in terms of whether we can bring about infrastructure improvements, we can help that as well. It has got to be based on what is affordable and on what is determined as being a priority. I think what passengers want most of all is to ensure reliability, performance, and of course the cost of travel. They are the things that are important to them.

**Q440 Graham Stringer:** The capacity in the system is directly related to the fares, though, is it not? If you are operating at full capacity, unregulated fares are likely to go up, so that is one of the issues. When you have pinch points, as you say, like Birmingham, Reading, platform 13 and 14 in Manchester Piccadilly, then you are going to affect both reliability and price. I ask you again. Your answer was ambiguous. Are we going to see the investment that was promised previously in those 20–27 pinch points?

**Derek Twigg:** I cannot guarantee that 20–27 pinch points will be included. We have to look at the priority in terms of what is affordable and what investment they want to put in place, but clearly there will be improvements that take place. In a sense, Mr Stringer, I have to be clear: we are currently going through the HLOS process and obviously consulting and looking at a longer term rail strategy. We are also doing a range of Regional Planning Assessments, the Route Utilisation Strategy that Mrs Ellman quoted, and all this needs to be taken into account when we move through the HLOS process before we come to a decision about what is needed and what is affordable.

**Q441 Graham Stringer:** Can I go back to the questions Mr Goodwill asked about the specification of franchises? Why are you increasingly putting very detailed specifications out? Does that not curtail the ability of the franchisee to make innovations? I have heard that you are going as far as specifying the level of catering on board trains. You can deny it, but there has been some evidence to that effect. Why are you getting so detailed in the specification?

**Derek Twigg:** I do not accept that we are getting detailed. As I said before, we might say there should be X number of trains as a minimum per hour but we are not saying they should be timed at a certain point. There might be a last and first train issue. At the end of the day, if we are buying the service and specifying the service, we need to say exactly what we want to buy and what we want to specify. That is important, I think, because we now obviously, at the Department of Transport, have the strategic direction and responsibility for the railway and, as I said before, the train operating companies, over and above the minimum that we specify, and what is possible within the capacity and other restrictions that they can run extra trains, that is something that can be done. So I do not accept that we are in any way putting constraints on them about what they can and cannot do. I have not heard anyone yet pick up with me or the Department from passengers saying that we have over-specified.

**Q442 Graham Stringer:** We have heard that. You also mentioned vertical integration. Can you tell us which EU Directive makes vertical integration difficult?
Mr Jones: It is EU Directive 91/440, as amended by Directive 2001/12.

Q443 Graham Stringer: We have had contradictory evidence. One witness today told us that that was just an accounting issue, that you had to keep your accounts separate for Railtrack from the operating companies. Another witness told us that there had to be different ownership. Could you clarify what the Department believes on this Directive?

Mr Lambirth: The view we took when we looked at all this in the context of the 2004 rail review is that there is no insuperable obstacle in EU law to the creation of vertically integrated franchises. As you say, it is primarily the EU legislation directed at transparency establishing that the costs properly attributed to the infrastructure are so attributed and the costs properly attributed to the passenger operation, so that anyone else who wants to enter the market can see that they are being charged a fair price compared with an incumbent. That is the essence. We have never said in the White Paper or elsewhere that the rationale for rejecting vertical integration as a model is rigid compliance with the EU legislation.

Q444 Graham Stringer: So it is completely departmental government policy that you are not in favour of vertical integration? It is not for the reason of EU Directives?

Mr Lambirth: No.

Derek Twigg: Clearly, there are issues in terms of setting up different organisations and financial reporting systems and so forth as part of that but we think the current system is working well.

Q445 Graham Stringer: The rolling stock companies have been referred to the competition authorities, Minister. I do not want to pre-empt, obviously, what they are going to do, but can you tell us why you thought that that market, which is unregulated, was operating so badly that they needed to be referred to the competition authorities?

Derek Twigg: If you take the new rolling stock, you get a better value deal in terms of that. That is working reasonably well, but if you look at the older rolling stock, we do not think we are getting best value for the taxpayer for that, and that is why, after a lot of negotiations and a lot of time spent talking to them, we decided to refer.

Q446 Graham Stringer: What is the benchmark you are using for deciding whether or not you are getting best value out of the older rolling stock?

Mr Lambirth: We have to tread a bit carefully here because of the commercial confidentiality of the information we provided to the competition authorities, but I think there are two issues we focused on. The first is the evidence we have on the rate of return that the rolling stock leasing companies earn on existing stock versus new stock, and the second was just looking at the structure of the market, and this is a market investigation reference for that reason. When train operating companies are looking to buy new rolling stock for a franchise, there is pretty intense competition between rolling stock manufacturers and rolling stock leasing companies. When the obviously right solution for a new franchise is to buy the existing rolling stock, there is a de facto monopoly in those circumstances. So it is the combination of those two that drove the case. It is difficult to go beyond that. Yes, we had heard that basically, short franchises—and I accept that perhaps eight to 10 years is not really too short—actually have an effect on the amount of investment, not through the TOCs but that Network Rail will put in to allow, for example, for the electrification of the Great Western line. There is a short franchise there. There is a feeling that has been expressed to us that if it were a much longer franchise, that certainty would mean that it would be electrified.

Derek Twigg: That is an interesting suggestion. I do not think it is for the TOCs actually in terms of putting that investment in. I think the electrification, say, of the Great Western, which I think has been mentioned, is a very large area, and secondly, it has

Q447 Chairman: Do not short-term franchises create a captive market for ROSCOs?

Derek Twigg: I do not necessarily accept that. In terms of the franchise system, if you look at the rolling stock replacement in recent times, over 40% has been replaced. TPE just took on new rolling stock, have started to take on new rolling stock. We have just agreed a few months ago to have 17 four-car trains for South West. So again, it is about making sure in terms of the way TOCs manage the system, in terms of them looking for the best deals. They have obviously got to continue to operate in the market.

Q448 Clive Efford: To continue that theme, I have been struggling with the ideal length of a franchise. We have been questioning TOCs and they do not seem to have an idea, but I also get the impression that the Department does not have an idea, that there is no clear thinking behind the policy on the length of franchises. Am I right or wrong on that?

Derek Twigg: Our figure is we think it is about 8–10 years in terms of the length. There are a number of reasons for that, but we think that is probably the right time to revisit the market and it keeps train operating companies on their toes in terms of obviously knowing over a shorter period of time they have to bid again and we see improved competition, but also, in terms of the longer term franchises, I can see there obviously are advantages to doing that. Mrs Dunwoody mentioned rolling stock and there are issues there in terms of investment and innovation, but in terms that we think it is best to revisit the market before that but also they could become stale towards the end and it could actually peter out in terms of the sort of performance they give over that period of time. Also, it is difficult to forecast over that length of time, for anybody, I think, in terms of the passenger numbers, the sort of market that would be there then.

Q449 Clive Efford: We have heard that basically, short franchises—and I accept that perhaps eight to 10 years is not really too short—actually have an effect on the amount of investment, not through the TOCs but that Network Rail will put in to allow, for example, for the electrification of the Great Western line. There is a short franchise there. There is a feeling that has been expressed to us that if it were a much longer franchise, that certainty would mean that it would be electrified.
implications not just for the TOCs; there are also issues around the environment, in terms of the scale of investment that would need to take place, is that best for the way we want to look at the railway in the future? For instance, the high speed train, the mark 2 we are currently looking at, in terms of the development of that. That is a very innovative and interesting project. All these things. I think that is probably not best with the TOCs actually. I think that is best for Network Rail to actually look at in terms of one, the affordability. Is it necessarily going to bring about the best benefit? How does it affect things like the environmental issues and so forth?

Q450 Clive Efford: So you reject the proposition that the length of the franchise has anything to do with the amount of infrastructure investment you will put in on that line?
Derek Twigg: Yes, but I feel it would be disingenuous to the Committee to say there is an absolute right way of doing this, that it is almost certainly the right thing to do. We just took on obviously the role now of franchising in the Department from the SRA, Mrs Dunwoody, and of course, we need to obviously assess how that goes as well. I cannot rule out that we would not ever change that, but I think currently it appears about the best period for us in terms of . . .

Q451 Chairman: The point has been made to us, Mr Twigg, which I think is a very valid one, that 30 years ago British Rail had plans to expand the railway, to electrify Crewe to Holyhead, the Great Western line, things which are not even discussed either by the present Government or by the people involved in the industry, and if you use the franchising system to in effect freeze the railways into their existing situation, how will that change? Are you telling us that in the future that will be the responsibility of Network Rail, and they would expect to have commensurate compensation? Is that what you are telling us?
Derek Twigg: No. First of all, you would have to say what is important for the railway, what you decide are its priorities in terms of meeting the capacity challenges, growth and of course what is affordable. You mentioned British Rail. They, of course, used to rely on a source of yearly annual budget from the government.

Q452 Chairman: Mr Twigg, forgive me. Let us not get into too many cliché-ridden paths. I am asking you a very straightforward question. Thirty years ago British Rail had a consistent programme of modernisation which looked forward to electrification, expansion of the system and extra capacity. We are being told that the existing franchise system freezes the railways in the size they are, and you have also told us today that there is no prioritisation and no indication in relation to capacity pinch points. We have had that from the answers you have already given. I am asking you very simply do you think that is correct, and if you do not think it is correct, where are all these modernisations and innovations to come from? Is it going to be Network Rail?

Derek Twigg: My answer is this, Mrs Dunwoody. You have to take account that most or quite a large part of the investment in recent years, the last control period, has gone into renewals and maintenance because of decades of under-investment.

Q453 Chairman: So where is the next lot of innovation going to come from?
Derek Twigg: Not least around £8 billion on the West Coast main line and also in terms of the improvement in the Channel Tunnel rail link. So there has been significant investment and that is why I was trying to say before to Mr Stringer, in terms of the High Level Output Specification process, obviously, the Eddington report is looking at things in terms of the economic benefit and of course our longer term...

Q454 Chairman: We have agreed you are the person paying the money, so you have the right to specify.
Derek Twigg: That process in terms of what infrastructure projects and how we want to spend money will take place as part of that process, and we have not completed that yet.

Q455 Chairman: So we do not have a policy? That is something that is going to be part of the assessment of these different systems?
Derek Twigg: The point I am trying to get across, Mrs Dunwoody, and obviously I am failing to do so, but let me try again. What I am trying to say to you is that a High Level Output Specification process in terms of what we want to buy, what is affordable for the railway for the next control period, 2009–14, obviously we are looking at things like infrastructure improvements and other ways we can actually improve capacity on the railway, such as longer trains and longer platforms, but then also we are looking in tandem with that at a longer term rail strategy.

Q456 Chairman: Yes, but forgive me, Minister. You were asked some very specific things on pinch points, and you have been asked by other members on other aspects. We would like something from your Department.
Derek Twigg: I am saying that is part of the process.

Q457 Mr Martlew: When are we likely to find out the results of these investigations?
Derek Twigg: The HLOS will be published next year and the long-term rail strategy, I think, will be at the same time.

Q458 Chairman: When?
Derek Twigg: Alongside it, next year.
Mr Lambirth: June or July 2007.

Q459 Clive Efford: Is it not true that risk has not been transferred from the public to the private sector through the rail franchising system because the rail network is so essential to the economy that the Government could never allow it to fail?
Mr Lambirth: The rail infrastructure is obviously essential to the economy. The position of the train operating companies is, I think, very different and I think you saw when you took evidence from the train operating companies they feel exposed to risk and they take very seriously our stern injunctions that we would not charge to their rescue. If you delve into the risks that they bear, essentially, under the new franchise regime, they bear the cost risk, they bear revenue risk for the first four years and then revenue risk starts to be shared with the Department from year five onwards, and there are force majeure provisions in there. But they bear the cost risk and they bear a significant part of the revenue risk over the life of the franchise. If they fail to deliver, the Secretary of State has made it perfectly clear that we would not come to their rescue.

Q460 Clive Efford: Let us go through a scenario. If there were a downturn in the economy, and the profitability of the rail franchises is very much reflected in employment and the performance of the economy, and a rail franchisee came back to the Department and said, “Look, we just can’t make ends meet,” would you renegotiate?

Mr Lambirth: We would have two types of TOC in those circumstances coming back to us. There is the one that has a new style contract with revenue risk sharing mechanism in place, and we would say, “No, we’re sticking to the letter of the contract.” The whole purpose of writing revenue risk sharing into the contract was to address precisely that scenario. What we have said in the guidance on rail franchising that we placed on our website is that if in that sort of circumstance a train operator who was operating under an old-style franchise came to us, we would entertain the claim. You have to understand we have a negotiating position that we would not come to their rescue.

Derek Twigg: In terms of the point that Mr Lambirth has just made, if they are in breach of the franchise, then that is a different matter. Then obviously we could take that off them and re-franchise.

Q463 Clive Efford: There are two points here. There is one about the reaction to the position of a train operating company in a downturn in the economy. The other is, does the Department actually feel in any way intimidated by a large corporation that has a multiple number of franchises?

Derek Twigg: No. We are very clear. We set up a franchise, it is clear what they have got to deliver, and we expect them to stick to that.

Q464 Clive Efford: What about the costs of the industry? Why have train operators failed to control their costs in recent years, resulting in increases of 47%?

Derek Twigg: Again, it is an interesting figure but none of us can actually determine where it comes from or how it is backed up with anything in particular. I think I mentioned in my opening remarks, Mrs Dunwoody, and it is probably worth reiterating in answer to Mr Efford, that if you look currently, the TOC fare box revenue is 47%, and of course, the passenger journeys have increased by 42% and passenger train kilometres operated is up by 23%. We are looking at costs of around 27%. So I do not think that is excessive in terms of what is happening on the railway. It is not in the interests of train operating companies to increase their costs. What is in their interests is to drive down costs but to provide a good-quality passenger service, which then attracts more passengers and therefore more income.

Q465 Clive Efford: We have had evidence from Professor Nash that the figure we had for four years directly post Hatfield are that, having stripped out track access charges and payments to the ROSCOs, train operating costs appear to have gone up by 47% in real terms. You do not recognise those figures?

Derek Twigg: We do not recognise them.

Q466 Clive Efford: I was going to say “spiralling costs” but costs are going up and you have accepted they are going up. How do you intend to bring those costs down in future?

Mr Lambirth: We are in danger of using “costs” in two rather different contexts here. When we are letting a franchise, we are not actually interested in what the costs of the franchisee are, although we are very interested in whether their cost reduction plans are realistic or in what their revenue is, though we are very interested in whether their revenue increase plans are realistic, because the price that they are bidding to us is the difference between the two. So if a train operating company looks at an opportunity and says, “Look, if I spend an extra £1 million on improving catering or recruiting extra revenue protection staff, that will generate £2 million of revenue” then they will do it and that must be in both their interests and ours. So we have no separate aim
of controlling their cost line. We are very concerned about the gap between revenue and costs, which is what they bid to us.

Q467 Clive Efford: The train operating companies have said to us that part of the reason that their costs are escalating is that Network Rail’s costs are a significant contributor. Are we passing on Network Rail’s costs to train operating companies and is it passing the buck?

Derek Twigg: Network Rail have a clear target that they have to reduce their costs by 31%, and they are now on track to doing that, and I think they are getting better in terms of reducing the costs and being more efficient. You have to obviously take account of what happened in terms of the miles of rail track and what they had to pick up. Clearly, they need to continue to improve and, as I say, the target is a 31% efficiency saving and they are on target for that.

Q468 Chairman: Do you not think it is odd that in the bus industry tendering has meant there have been very big reductions in operating costs, but in the rail industry franchising has coincided with great increases? Does that not suggest franchises have failed to deliver value for money?

Mr Lambirth: Over time, our subsidy bill to the train operating companies is down, over a period when . . .

Q469 Chairman: Was that not the original intention, Mr Lambirth?

Mr Lambirth: Yes.

Q470 Chairman: So you are not doing anything that you are not expecting to do. You are just telling us that you are doing what you decided to do in the first place?

Mr Lambirth: Not me personally, but yes, the aim of privatisation was . . .

Q471 Chairman: I do not hold you entirely responsible for the whole system.

Mr Lambirth: Thank you. What we have seen is an increase in passenger numbers and a reduction in the subsidy bill. The bus market looks very different but, as I keep on saying, I think it would be very wrong for us to set out and have an objective of trying to drive down train operating companies’ costs, to say we think that rolling stock leasing costs should be driven down by this amount, pay bill by that amount, or energy prices by that amount, because the whole purpose of franchising is to put a private sector company in a position where they are incentivised to maximise the difference between the revenue and the costs.

Q472 Chairman: Yet we are eternally being told that one of the problems with the franchise decisions is that, when it comes down to it, cost is one of the things that is more important to you than the quality of service.

Mr Lambirth: No. Price, not cost.

Derek Twigg: Deliverability and price.

Mr Lambirth: If you want to talk about the assessment of companies’ bids, we are looking at two things: their proposition to us on price, ie the gap between revenue and cost, and their proposition on reliability, how much they would reduce delay when it is within their control; and then we also ask the question which Mr Twigg poses: are we confident that this is a deliverable proposition on both price and reliability?

Q473 Chairman: Do you look at how other nations within the European Union handle their franchise system, for example, the Dutch?

Mr Lambirth: We have talked to Anton Valk, who gave evidence about the Dutch system, but it is hugely different, as he will have explained to you. You have the provincial franchises, which are very small, and you have a single very large national franchise, which is the franchise that he operates out there. So yes, we have discussed it, but the regimes are so very different from those in the UK.

Q474 Chairman: Yes and no, Mr Lambirth. It is not the greatest land area in the world, even if we take account of both the franchises that relate to the regional input and those that relate to the national input. The whole geographical area is not so large that one would have thought one could differentiate too strongly.

Mr Lambirth: I think the point I am making is, if we had a single franchise which covered 80% of the railway network in Great Britain, then inevitably your approach to that operator would be different from the one which we pursue.

Q475 Chairman: Do you think it is constructive to use different franchise models for franchises that can pay a premium and those that require subsidy?

Mr Lambirth: I do not think we are convinced that there is a huge difference between franchises which pay premia and franchises which receive subsidy. In both cases we are setting the minimum level of service which we expect the franchisee to deliver, and I do not think that in either case it would be safe to allow the franchisee to determine what the service level should be, in other words, to have a reduction below the minimum which Ministers specified. The reason for that is that although a franchise may be paying a premium, that is not the same thing as saying that all of the services along that franchise are commercially viable. So in effect, we are asking the franchisee to provide services on there which are not commercially viable but which are judged by Ministers to be necessary.

Q476 Chairman: Would you accept that innovative proposals that are contained in a bid could be disqualified from being part of the bid if they are not fully and formally compliant with all aspects of the technical specifications?

Derek Twigg: That is part of the bidding process in terms of costed options, in terms of if a bid has come forward with innovative ideas for improvement in
services ... A classic example, I suppose, is that we looked at the sleeper service to the West Country, which obviously we talked about at one stage stopping, but the franchisee, the winner, felt they could continue with that and improve the service. So if they have an innovative idea or suggestion which obviously stacks up and we believe is value for money, then clearly it is something we will look at. I come back to the point, Mrs Dunwoody, that this minimum service level is what it is: a minimum. They are free within certain constraints, which I have explained, to come forward with additional proposals if they wish in terms of extra services.

Q477 Chairman: Why is it that both the industry and the companies seem to be still confused about how straightforward and accountable, consistent, you are in setting and adhering to award criteria? Derek Twigg: I think that we have just taken over responsibility, as I said before, and the first franchise that we started basically from start to finish will be the South Western franchise, and I think you will see a number of improvements being made in terms of how we work with the industry, consulted on that franchise, and I think there is much more clarity in that.

Q478 Chairman: How are you held publicly accountable for your choice and application of criteria for franchise winners? The Department, not you entirely. Derek Twigg: I am not quite clear in terms of what you mean, Mrs Dunwoody.

Q479 Chairman: It is said that we have very little you mean, Mrs Dunwoody. How are you held publicly accountable for your choice and application of criteria for franchise winners? The Department, not you entirely. Derek Twigg: I am not quite clear in terms of what you mean, Mrs Dunwoody.

Mr Lambirth: If I could supplement that, what Mr Twigg has said, we have placed on the website both the seven-page summary guide to precisely how we set about running the pre-qualification exercise, what are the criteria we apply there, and what are the criteria that we apply at award, and we supplemented that by putting on to the website our internal procurement manual. I think it is as transparent a process as we can possibly manage.

Q482 Chairman: Do you ever change the franchise specifications during negotiations? Mr Lambirth: We cannot change a specification during a negotiation. You can accept an offer from a franchisee to provide additional services. “Negotiation” is an odd word to use there, but you can accept proposals to provide additional services.

Q483 Chairman: Additional services? So it is not correct that First Group was able to negotiate advantageous changes to the cap and collar regime in return for reinstituting Cornish branch line services? That is not true? Derek Twigg: There is commercial confidentiality in terms of the way the bid is dealt with.

Q484 Chairman: All you have to tell us is whether it is true or not. We are not being anti-social about it, nor do we really want to know how much it cost. Did you do it or did you not do it? Forgive me. I rather think that you have said to us one set of circumstances is operating here, and then you have said “except when we want to do something else”. I understand that. That is the idea which I have always operated in politics, but I did not think it was common. Mr Lambirth: Whether or not there was a negotiation on cap and collar—and I am sorry if I am treading very carefully here—what I was saying is we would not accept a negotiation which resulted in a reduction in the level of service provided to the travelling public below what was in the franchise specification. Derek Twigg: There clearly have been extensive discussions with First in terms of . . .

Q485 Chairman: I asked did you change the franchise specifications, and is it possible for people to renegotiate the deal? All we are trying to work out is whether that is the case or not. You have told us no. Derek Twigg: We certainly have had discussions and negotiations. There had been an increased number of services or stops as part of the agreement and negotiation took place on that. I cannot go into the details because of commercial confidentiality, Mrs Dunwoody.

Q486 Chairman: Is over-zealous bidding where the bidder accepts less subsidy or greater premia than are realistic a serious problem? Mr Lambirth: We see it as a potentially serious risk, and the system we have described in the guidance that we placed on the website is one in which firstly we ask the train operating companies who are...
bidding, starting with the South Western franchise, to provide us with their three principal delivery plans: how they would set about increasing revenue, how they would set about reducing costs and how they would set about improving reliability. Then the assessment work that is done internally on that is aimed at establishing what risks are there associated with those bids, and we are trying to draw a distinction there, a fairly hard-nosed distinction, between the risk of a purely financial failure, ie the TOC merely cannot deliver on price and we go back to where we were earlier; it may wish to surrender the franchise and so forth, versus a much more serious risk, which is that it does something which has a direct adverse impact on the travelling public, on the value of the franchise. So that is the risk assessment that we are making going forward, starting with South West, which, as I say, is explained in our guidance note on the website.

Q487 Chairman: Are you aware of any incident of over-zealous bidding? (No reply) Do you have a difficulty with over-ambitious bids?

Derek Twigg: In a sense, in terms of the bidding process, a judgement has to be made in terms of what is deliverable. That is the key thing in terms of us as Ministers, on price as well, but deliverability is the key thing. I cannot say that I have come across any particular problems in recent franchises.

Q488 Chairman: Do you think it is right that firms use low-ball tactics, under-bidding for contracts, knowing they can be renegotiated at a later stage? We have established over-bidding; now we are on to under-bidding.

Mr Lambirth: I think this goes back to the point that we have said already in terms of that.

Mr Jones: In truth, I do not know the exact number either.

Q493 Chairman: But you are going to tell me, are you not, in a little note, which would be very helpful?

Mr Jones: Yes.

Mr Lambirth: It definitely happened if you go back to OPRAF. There were definite rescues.

Chairman: Let us by all means go back to OPRAF and you will give it to me in writing.

Q494 Clive Efford: On a separate issue, we have seen large profits for ROSCOs and I wonder if the Department has a view on that and whether they have actually shouldered enough risk in providing rolling stock for the train network.

Derek Twigg: We obviously have concerns about whether the taxpayer is getting best value for money and that is why we have now referred them to the ORR because that is now being looked at by them. I would not want to say too much more than what we have said already in terms of that.

Q495 Clive Efford: Earlier on Mr Martlew raised the issue of the length of contracts. Just how much is the length of a contract affected by the provision of rolling stock, given that the rolling stock is not owned by the train operating company but by the ROSCO, therefore should they not be shouldering the risk? How does that impact on the length of the contract?

Mr Jones: It does not impact on the length of the contract. The contract length for the franchise is patently set at the point at which we issue the ITT. The bidders then go and talk to the rolling stock companies for rolling stock leases to cover that period, so it does not in any way reflect on the provision of rolling stock.

Q496 Clive Efford: When we have asked this question before, particularly of the train operating companies, about the length of contracts, we have been told it is about rolling stock.

Mr Jones: I am not sure that we accept that, because the rolling stock is owned by the rolling stock lease companies and the bidders negotiate in their bid preparation with the rolling stock companies for the provision of that rolling stock, and the successful bidder then signs those agreements for the length of the franchise.

Derek Twigg: There might also be an argument that some operators might want to have a longer contract anyway. It might be a nice argument to say this is why we should have it, but if you look currently TransPennine Express have new stock going in, as I said before, South West Trains 17 four-car trains, and I know at least one other train operating company is considering how they might invest and get new rolling stock. I do not think there is any evidence to suggest that that is the case. It may be that some TOCs would like longer franchises, but I do not think it is actually the case that rolling stock cannot be improved as a result of the current franchise policy. I do not see any evidence for that.
Q497 Chairman: Through 2005–06 and 2006–07 government support for franchises is forecast to increase by over 40% in cash terms. Does that not suggest franchising is failing to deliver value for money?

Mr Lambirth: I think that figure must include track access charges, and it relates to the cost of the infrastructure which we talked about earlier. When he conducted his periodic review in 2003 the then rail regulator said that this would be the financial year in which the track access charge went up.

Q498 Chairman: So it is as simple as that. Nevertheless, the fact that it is so, is it still delivering value for money? Is the whole system of franchising working?

Derek Twigg: I think it absolutely is, Mrs Dunwoody, as I tried to explain before, in terms of the actual increase in passengers, the fare box revenue, the increased kilometres travelled, the investment that has taken place, the improvement in many areas in customer service in terms of passenger information, in terms of configuration of trains, in terms of refreshment of carriages. Take, for instance, Great Western’s plans now to invest over £200 million, of which a lot will go to improving, refreshing, carriages, and of course trains and of course new engines. So I think significant value for money. We must not forget, of course, the West Coast main line that has been massively invested in, and of course the Channel Tunnel rail link. There are significant benefits to passengers. I accept that much of the increase is down to the improvement of the economy but I think a lot of it is also down to the increase of the value added by train operating companies and the investment that has taken place.

Q499 Chairman: You are committed not to renegotiate franchise contracts if the train operating companies come cap in hand. What are you going to do if there is a multiple franchise failure during an economic downturn?

Derek Twigg: In terms of what may or may not happen, it is interesting speculation, but clearly, in terms of meeting the franchise obligations, if they are in breach of that, clearly we would have to re-franchise, but in terms of a significant drop in the economy, it does not necessarily mean that would happen. This would actually be an interesting point in terms of what added value train operating companies have put on in terms of attracting additional passengers to the railway as well.

Q500 Chairman: I did not get that last bit.

Derek Twigg: It is also interesting in terms of the added value, the improvement that train operating companies have brought about to the train network over and above the economic return which has brought about the increase in passengers so far.

Q501 Graham Stringer: You have said, Minister, that it is both the economy and the franchising system of the railway, but what percentages would you put on the increase in passengers due to the economic upturn and because of the way the railways are operated now?

Mr Lambirth: The only piece of analytical work I have seen on this is the one that was done by Chris Nash2 in his ECMT paper. His assessment was that approximately 50% was attributable to GDP growth, approximately 30% to fares and to congestion on the roads, which is quite an important issue, and 20% to the effects of privatisation. There are two limitations on that: firstly, it was looking at the period 1995 to 1999, so the early days of privatisation, and maybe they expected a bigger impact there; and, secondly, it was looking only at London and the South East which is not the area of the country in which TOCs can do most to increase demand.

Chairman: Minister, I hoped to allow you to escape before the vote, but I am going to ask you to come back.

The Committee was suspended from 4.56 pm to 5.06 pm for a division in the House.

Q502 Graham Stringer: Thank you for that answer, which was about one-fifth, I think. In our last evidence session, I think it was, Mr Ford said that he agreed with Professor Nash that all the growth was exogenous, which I take to mean externally stimulated, not stimulated by the actions of people within the railway system. I would like to ask the question in two parts: firstly, do you have any comment on that as it is in direct contradiction to the previous answer; and, secondly, if you do not agree with it, do you think it is worth doing further research to find out what is stimulated and what is from the economy?

Derek Twigg: No, I do not accept it. I think if you look at the facts of the massive increase in the use of the railway, the improved reliability, the improved rolling stock and customer service in many parts of the railway network is focused on how we can attract more people on to the railway, and I am not saying everyone agrees, but a significant number of people are saying that it has improved and it is more attractive to use. I do think it would be difficult to say that there has been no impact of that on attracting more people on to the railway and that it is all down to the fact that the economy is doing so well, so I do not accept that. You are right in terms of what percentage it may or not be, and we are going to do some research on that.

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1 Answers 410 and 501: For clarity, Derek Twigg and Mark Lambirth are both referring to the same study that was produced for the ECMT Workshop on Competitive Tendering of Rail Passenger Services: Experience to Date by Chris Nash and Andrew Smith (ITS, University of Leeds) entitled, “Passenger Rail Franchising—British Experience” (Paris, 12 January 2006). In this paper, Nash and Smith look at the “Impact of External Variables on 1990–98 Rail Demand Growth” [Source: Wardman (2005)] and note “A distinct change in trend post 1995 is found, accounting for some 20% of the growth for London and South East”.

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2 This refers to Chris Nash’s work in his ECMT paper. The statement is presented in the context of a debate on the effectiveness of the franchise system in the UK rail industry.
Q503 Chairman: How do you justify the escalating costs of a franchise bidding process when it is estimated to cost each bidder £3 million to £5 million and with further significant costs incurred by the Department?

Derek Twigg: Well, in terms of what the bidders want to put into it, that is a matter for them. In terms of what they submit and how they wish to address it, what research they do, the surveys, it is a matter for them in terms of how much they want to put into the bid. I think, as part of our new franchise process for South West Trains, which is the first one which I mentioned before, we have streamlined that. I do not know what the costs are made up of actually, but I think it is a matter for them how much they spend on it.

Q504 Chairman: Well, we have got a written answer from the Department which said that between 2001 and 2004 the SRA “had incurred costs totalling £40.7 million”.

Derek Twigg: Sorry, are you talking about the whole costs or the train operating bidders’ costs?

Q505 Chairman: Well, the SRA is technically part of what you now are, is it not?

Derek Twigg: I am sorry, I thought you were referring to the bidders’ costs.

Q506 Chairman: Well, it is, but, as I pointed out, it is not just the bidders. The bidders are saying £3 million to £5 million for them, but also you are incurring considerable costs. It said that, “Between April 2004 and November 2005, £14.4 million had been spent”.

Derek Twigg: I will ask Mr Lambirth to talk about this, but I think it is important to get this in perspective as well. These are obviously large contracts for a significant part of the transport network. It is important that the deliverability is right and it is important that we get the improved service and the investment that we want in this, so I think it is right that we do spend money, though not waste money and not do it unnecessarily, but to make sure—

Q507 Chairman: Well, in that case, can you tell me how much the refranchising process has cost the Department in the last five years?

Mr Lambirth: You have some SRA numbers. Refranchising cost us £8.4 million in the last financial year, but that is only nine months of the year because we took over the SRA three months in. That is £8.4 million last year, so call it £11 million on an annualised basis.

Q508 Chairman: So that is 2005–06, but only nine months?

Mr Lambirth: Yes, and I would expect a broadly comparable level of expenditure, ie about £11 million, on an annualised basis for 2006–07, the current financial year. The aim is to get it down by reducing the use of consultants, but that is not a quick or easy process.

Q509 Chairman: Have you got an estimate of the total cost of each round?

Mr Lambirth: To us?

Q510 Chairman: Or you can give me both. I would not say no to both.

Mr Lambirth: A rough estimate to us is probably of the order of £2.5 million per franchise.

Q511 Chairman: Is that good value?

Mr Lambirth: It is letting contracts which, on average, are generating perhaps £200 million per annum of revenue, so they are quite big franchises. As I say, the aim is to get it down, but that is by bringing things in house and becoming less dependent on consultants, not, I think, by doing less work.

Q512 Chairman: Are you content with the system of referral to the Competition Commission?

Derek Twigg: That is a matter for the Competition Commission in terms of the regulator. It is a matter for them, another body, in terms of determining that, but it is an issue that they must decide. It is not for us to decide.

Q513 Chairman: So you do not even have a view on whether the system is working correctly or not? That is of no importance to you?

Derek Twigg: Well—

Q514 Chairman: Mr Jones, is the system working or is the system not working and, if it is not working, how is it not working?

Mr Jones: Technically, the replacement of a franchise with a new franchise is classified as a merger legally and, therefore, the OFT and the Competition Commission take a view on that merger and whether they wish to investigate it. There has been quite a lot of dialogue over the years between the former SRA, the Competition Commission and the OFT and we have now got in place, I think, an agreement whereby rather than every single bidder being referred to that process, only the successful bidder is then reviewed by the OFT and the Competition Commission where they decide whether there is an issue they need to resolve.

Derek Twigg: Certainly they can take an overview in terms of the wider issues.

Q515 Chairman: I understand that they must have a view on their own powers, I do understand that, but you do understand that we need to know whether franchising is good value for money and if all of the bidders are being referred, then we need to know that this is a sensible use of their money and ours.

Derek Twigg: I understand that.

Q516 Chairman: You did not get the PTEs involved in the franchising process through the Railways Act, did you? Is there a reason for that?

Derek Twigg: Not got them involved? They are involved in terms of the consultation.
Chairman: Well, they were pretty marginalised, were they not?

Twigg: No. As you know, from your examination and discussions you will have had on the Act, we took the view in terms of the DIT taking the strategic direction and setting what we need in terms of the railway, but that is not marginalising them because they were involved and consulted at various stages during the franchising process and of course they can still suggest decrements and increments as part of that process.

Graham Stringer: But, because they are not signatories to the contract, the private sector is bound to see them as less important. What the 2005 Act did was effectively remove their right to sign the contracts, did it not, so it was reducing the rights of the PTEs? Why was that so important?

Twigg: Well, we felt, as I say, because we wanted to take the strategic direction we have and take responsibility for obviously setting the bids and the minimum service, that we should do that. Obviously as co-signatories they worked with the SRA of course and certain things happened in being co-signatories. Now, that might not obviously have been in the best interests of the railway overall and it might have been a particular issue in your area, so I think we had to look at that as well, but I would sort of reject the point that they are not involved and that somehow they have been marginalised. They are still very much an important partner and very much an important part of the delivery and consultation for the franchise.

Stringer: But they are not involved on a statutory basis?

Twigg: No, they are not. That is the view we took, as you know.

Stringer: Yes, I was on the Standing Committee and I made the point.

Twigg: Yes, but they still can suggest decrements and increments of course and they would have to find the resources for that and we would still look at that in terms of how the franchise bid is put together.

Chairman: But you do have sort of slightly different criteria for Transport for London and the rest of the country, do you not, Minister? Transport for London says it wants to make service specifications, set the fares, and certainly the Mayor has expressed a very clear view that he wants to extend his role way beyond the areas where people can vote for him. Now, are you going to go that far because you seem to have been given a whole lot of extra powers when no one was looking or perhaps some people were?

Mr Lambirth: I think as far as the 2004 Rail White Paper was concerned, the clear policy intent was to place Transport for London and the passenger transport executives on a level footing. Neither of them is a co-signatory to our franchises. Both of them can come along to us with a very clear right to say that they want to buy more services or buy fewer services, so they have exactly the same legal standing and they have the same financial responsibility. In other words, if they want to buy something extra, in both cases it is down to them to fund it, so the 2004 Rail White Paper has created a level playing field. Clearly the PTEs would like to get co-signatory status back and clearly the Mayor has said what he would like to have, but as far as the 2004 White Paper and, therefore, the 2005 Act are concerned, the legal position was then placed on a level footing.

Chairman: Well, Transport for London said to us that “the Mayor is seeking further specification responsibilities over rail, including possibly fare-setting responsibilities, because there is confusion on where the risks lie and the relationship of franchise outputs with other service modes”; and he also had very strong views on other things. You are telling us that that is a wish-list from his point of view and not something the Department—

Twigg: It is what he is seeking, yes.

Chairman: Therefore, the fact that in recent days he has been given extra powers does not indicate he is going to be given extra powers over the railway system?

Twigg: I am not aware at this stage that we have agreed anything of the sort.

Chairman: Well, we could fill a whole afternoon on that, but we will not. Do you think Network Rail ought to be encouraged to get involved in the provision of rolling stock and train services?

Twigg: No, I do not. I think what is very important for Network Rail to do is concentrate on maintaining and renewing the railway structure, focusing on performance and the delivery of core safety as well. I think that is what their role is and that is the role they have been constantly improving on.

Clive Efford: It has been suggested to us that, in commissioning rolling stock, not enough attention is paid to the impact of that on the infrastructure, for instance, damaging rail. Has the Government got a view on that and is there something you think we need to tighten up on in the future?

Twigg: I think there is an issue in terms of how heavy the rolling stock is and its impact on the rail. If you think of the Pendolinos, and I am sure you will probably know them as well as me, in terms of the way they were designed and the impact they had and—

Chairman: That was just the loos on them!

Twigg: There was an argument about whether the loos actually put extra weight on, and I think Mr Stringer asked a question in the previous session about that.

Chairman: I think it is definitely the weight they put on, but we will not go into that!
**Derek Twigg:** One of the things we are looking at is obviously the replacement of the HST2, the high-speed train, and one of areas which is obviously given some considerable consideration to is the weight of it and how we would balance that in terms of reducing the weight on the new train in terms of the safety and environmental impact as well, so that is something which is clearly very much in our minds and something we are looking at as part of that process and we are consulting widely in the industry about that as well.

**Mr Lambirth:** If I can just add to that, I chair the group which draws on Network Rail, the train operating companies, representatives of manufacturers and, above all, passengers who are involved in jointly trying to frame an output specification for that new train and a key issue is what we can do to bring the weight down, and I am pleased to say I think quite a lot can be done to bring the weight down.

**Q528 Chairman:** Is not a key issue how many British jobs you are going to create with this new employment in rolling stock?

**Mr Lambirth:** I think the Secretary of State will issue an invitation to tender which goes widely.

**Q529 Graham Stringer:** Can I just follow up that question because it is an interesting answer which I suspect this Committee is concerned about as well as yourself, but what I did not understand before you gave that answer was that you would have an easy handle on specifying the weight of trains because I would have thought it would have been a matter between the train operating company and the ROSCO. I would be grateful if you could expand on just how you envisage this.

**Mr Lambirth:** It has traditionally, as you say, been a matter between the train operating company and the ROSCO. What we have managed to do is build up a very strong industry consensus that actually you should design some parameters of the train, like its weight, because Network Rail then needs to design the infrastructure to go with the weight on a very joined-up-industry basis. If you have a lighter train, then Network Rail will have to maintain the infrastructure to a higher standard in order to improve safety and if you go for a longer train, Network Rail will have to make adjustments to gauge and platforms, so everyone welcomes the proposition that we should do this as a joint project led by the DfT with full industry involvement. That should not cramp the style at all of the train operating company in terms of the sort of things that it wishes to do inside the carriage for passengers.

**Q530 Graham Stringer:** So effectively you use your good offices rather than direct control you had?

**Mr Lambirth:** We are not using direct control, but, as a matter of fact, there has to be a customer and the customer who issues the invitation to tender for the design of the new train will be the Secretary of State.

**Q531 Chairman:** That is rather interesting. Are there enough of you, Mr Lambirth, to monitor the performance of all these franchise-holders?

**Mr Lambirth:** There are 256 staff in the Rail Group and perhaps 300 staff dealing with rail across the whole of the Department. That is significantly lower than the 530 that the DfT and the SRA sort of had combined before the merger. I think we have had very little reduction in the number of staff engaged in specifying and very little reduction in the number of staff engaged in procuring franchises. What we have done as a deliberate choice, reflecting the new relationship we want with train operators, is to reduce more significantly the number of staff in the area that manage the passenger franchises and interface with the train operating companies there.

**Q532 Chairman:** In what way? How do you do that?

**Mr Lambirth:** My fellow director who has four divisional managers, each dealing with groups of train operating companies, monitoring their financial performance, monitoring the improvement in reliability they are delivering, their compliance with contracts and so forth, that is one of the areas where the new Rail Group is significantly slimmer, we think, than the old SRA.

**Q533 Chairman:** Slimmer?

**Mr Lambirth:** Yes, fewer people.

**Q534 Chairman:** Cleverer, but nevertheless sufficient?

**Mr Lambirth:** Sufficient.

**Derek Twigg:** And cleverer.

**Mr Lambirth:** I am not allowed to say anything!

**Q535 Chairman:** Have any key decisions been delayed as a result of the changeover from the Strategic Rail Authority to you?

**Derek Twigg:** All the franchises have gone out on time.

**Q536 Chairman:** I am asking about significant decisions. We have been talking about developing the system and expanding capacity, so we are not just talking about awarding franchises, are we? Have we missed anything that we ought to know about and ask you about?

**Derek Twigg:** Not that I can recall. If I go back to the HLOS programme and the long-term rail strategy, then they are obviously developing on time, so no, I cannot recall—

**Q537 Chairman:** So things like the domestic services and the procurement of rolling stock for the Channel Tunnel Rail Link, they have gone ahead?

**Derek Twigg:** You are talking of the (?) contract?

**Q538 Chairman:** Yes.

**Derek Twigg:** I am not aware of any delay.

**Q539 Chairman:** And you are quite happy that that is the situation?

**Derek Twigg:** That we are keeping on track and on time?
Q540 Chairman: Yes.  
Derek Twigg: Yes.

Q541 Mr Goodwill: When gauging customer satisfaction, do you think you possibly rely too much on some self-appointed groups who are purporting to represent passengers and do you feel you should be doing more actually to plug into what people are saying on the platform?  
Derek Twigg: It is an interesting question. We have set up now Passenger Focus which is now the body which represents and they are independent in terms of how they go about their work. I think what is interesting about what they have done is that they developed through the Chairman a better and more focused approach in terms of a research-based approach to the issues and developing that, so I think they are quite good and I think their passenger link managers, which they have set up as well, they are working okay. I think if you talk to Colin Fox, the Chairman, he would say there was more work to be done, but I think they are doing a pretty good job in terms of taking over the passenger survey, some of the results of which we have been discussing today. We do go through the consultation process as well in terms of franchises and clearly that is with local authorities, the regional bodies, the PTES, et cetera, but again there is a way for people actually to feed into that. Certain rail groups have certain issues and certain problems, but I do talk quite a lot of rail groups and, whilst I may not always agree with them, they always have some very valuable things to say, so I think there are lots of opportunities for people to actually get their views across.

Q542 Chairman: Well, Minister, I hope you have enjoyed speaking for the whole of the British Government—  
Derek Twigg: Can I just say because I forgot to mention this before, but the point you made about the train operating companies and others who are a bit confused about the franchising process and especially about specification, we did actually hold, our officials held a trade day about a month or two ago where they were all invited in. Quite a large proportion of them came in and they had quite a long session going through the processes and what we do and what we do not do as part of that franchising specification process. As far as I am aware, there were no major issues that were brought up that they were so confused in understanding, so we did go out of our way to actually explain the system to them, invite them all in and discuss the process with them.

Q543 Chairman: Let me ask you this one simple question: why does Her Majesty’s Government feel it necessary to compensate train operating companies when there is, for any reason, industrial action against them?  
Derek Twigg: Well, the reason basically is to ensure that any unplanned and excessive financial pressures are taken account of in terms of any strike action which may take place.

Q544 Chairman: I beg your pardon! Do private companies not normally face all sorts of exigencies and it may even be that people do take action against them and that they may actually include industrial relations? What is so special about the train companies that they need to be treated differently? I thought we were treating all these people as if they were independent, sovereign companies.  
Derek Twigg: Well, we have got to be clear that any action, industrial action does not jeopardise the viability of any train service. That is obviously very important.

Q545 Chairman: So we are not treating them in the same way that we treat normal companies in the independent sector, but we are treating them on the assumption that we must not allow them to go bankrupt in case they cannot continue to provide a service?  
Derek Twigg: Well, they are not necessarily susceptible because it is also pressures in terms of things they may or may not agree to and how that affects their viability, so in terms of pressures in terms of what they may do and what they may agree to, it may affect the viability of the service, of the franchise, so we had to look at that. Yes, we are aware of this point, so we have looked at it and, as you are probably aware, we decided to take it forward. We have not used it.

Q546 Chairman: Well, why? What is different? I am confused, and it is very easy to confuse me, I accept that, but given that these are supposed to be independent train operating companies, and that is how they call themselves, why should they be compensated if somebody takes industrial action?  
Derek Twigg: As I say, if it threatens the viability of the train service.

Q547 Chairman: I see, so although they are independent train operating companies, they are not so independent that we will not underwrite them if there is a problem?  
Derek Twigg: They would have to justify to officials in the Department that they have actually gone through every possible way of trying to resolve disputes in a fair way.

Q548 Chairman: So what is the problem? Why have the officials been unable to unhook themselves from this situation in which you find yourselves? Presumably because the SRA agreed it. Is that what you are saying?  
Derek Twigg: The reason, as I have explained to you, is to continue with that policy. We have not used it since the DfT Rail Group was put in place.

Q549 Chairman: Well, no, because has there been any great industrial action against any of the train operating companies—  
Derek Twigg: It is not something that would be used lightly, Mrs Dunwoody. As I say, it is really an issue around the viability of the train service.
Q550 Clive Efford: So the circumstances where you would use it are those where the Department would deem the trade unions to be acting unreasonably?

Derek Twigg: To put it another way, we would have to be satisfied that the train operating company had acted in the best possible way and tried all they could to try and resolve the dispute in a fair way.

Q551 Chairman: So when we got some evidence from Mr Franks, the Chief Executive of National Express Group who quite inadvertently, I am sure, misled us by saying he had not any money, he wrote and said, “I responded, stating that no such payments had been received by the National Express Group. Since then, I have been made aware that a payment was received principally in relation to the ScotRail franchise. This related to driver and role of the guard dispute”. What was the reason for that?

Derek Twigg: I could not comment on that particular dispute. That was done during the SRA time as well, I think.

Q552 Chairman: Well, it may have indeed been during the SRA time, it might not, but it is actually State money, it is taxpayers’ money.

Derek Twigg: As I say, there are a variety of issues that need to be considered in terms of what the company has done and what reasonable steps it has taken, et cetera.

Q553 Graham Stringer: It is possible to ask this question in two ways. Why should the Government be involved in trying to smash the trade union, is the aggressive way to ask the question, but asking it in a less aggressive way, when you have got a huge group like FirstGroup, why should the taxpayer pay for the loss to a subsidiary company during a strike rather than FirstGroup?

Derek Twigg: I cannot really add much more to what I have said. Mr Stringer, in terms of again it is about the issue about unplanned and excessive pressures in terms of the viability of the train service. Now, I could not say in what circumstances it would be that we might decide to do it, but it could be that a strike could cost quite a lot of money, but it is difficult to say and we have to judge each case on its merits.

Q554 Graham Stringer: I understand that any sensible minister says that he has to judge every case on its merits—

Derek Twigg: I should say our officials.

Q555 Graham Stringer: And officials, that is completely reasonable, but this is a principal question about why taxpayers’ money should go into a particular private sector company, even if it is going to go to the wall. Why should taxpayers pay? Why should the company not go to the wall if its industrial relations are so bad that its staff go out on strike for a period of time? Why should you stand behind them?

Derek Twigg: Because, as I say, it affects the viability of the train service.

Q556 Graham Stringer: Let me put it another way. You told us earlier on in this session that these companies could go to the wall and that you would not be bailing them out unless, we find out now, they have very bad industrial relations. Why is that sensible?

Derek Twigg: I think it has not been a secret that the SRA and the Department have actually had this policy. I do not want to repeat myself, but that is the reason, that our judgment is based on the viability of the train operating company to provide passenger services because clearly it would depend on the circumstances. I agree that it is difficult to get into what might happen and what might not happen in terms of if and when we took such a decision.

Q557 Graham Stringer: You are repeating yourself, Minister. What is the difference between the viability of a company affected by bad industrial relations which has a strike and the viability of a company that gets its sums wrong and it cannot reframe, so it goes to the wall? Why does the Government make the distinction to stand behind the company and put millions of taxpayers’ money in in one case and not in the other case?

Mr Lambirth: I think the risk, as I understand it, that is being guarded against here is not the risk of the train operating company going bankrupt, and we have set out our position on that very clearly. The risk that concerns people, and I think it is an issue that you picked up in relation to particularly the last years of a franchise, is that if you have a company which is operating a business that is going to continue in perpetuity, its approach to an industrial relations dispute will be different from that of a franchisee who has only one or two years to go in the life of the franchise. Therefore, I think that the risk that is being guarded against is almost the other way round, that the train operating company will make a concession to avoid a strike which makes financial sense to it looking over a two- or three-year time horizon which would not have made the same sort of sense to an employer or a business that was a permanent business.

Q558 Chairman: So it is really an insurance against irresponsible behaviour on the part of the franchisee? You are saying that companies cannot be relied upon in the last years of their franchise to behave in a responsible way and they are very likely, if they think they are going to lose the franchise, to agree to something which might cause considerable difficulties? Is that what you are saying?

Mr Lambirth: I am not sure what is irresponsible about that. If the franchisee has only two years left of a franchise to look at, whether it is looking at an investment or an industrial dispute or anything else, its perspective must be different from that of a company which has 10 years to run. It is one of the sort of very few very powerful arguments that there are for longer franchises. That is, I think, what I am saying.
Q559 Chairman: Well, £12.65 million to National Express in respect of revenue lost by ScotRail is not a small amount of money. That is some insurance for the company, is it not? How many hours of overtime would they have to agree to before £12.6 million was actually good value on the part of the taxpayer?

Derek Twigg: I am sure we are not going to agree on this, Mrs Dunwoody, but I can only repeat what I have said in terms of a concession to passenger services in terms of viability of the service. At the end of the day part of it is as Mr Lambirth has said, but it is also that they have got to provide absolute evidence that they took all reasonable steps and that they have done everything possible.

Q560 Chairman: When you took over from the Strategic Rail Authority, tell me something simple, did you seek to change this clause or did you say, “Payments of £12.65 million, £3 million, £6.8 million, £143,000, £701,000 are good value for the taxpayer”?

Derek Twigg: Ministers, in taking over when the DfT Rail Group was set up and obviously the SRA was done away with, we looked at the policy and we decided that the arguments for it were still ones that we would support and, therefore, we kept the policy.

Q561 Graham Stringer: Is this kind of government decision replicated anywhere else in the whole of government and all of the government contracts that they have?

Derek Twigg: I am not aware of that, Mr Stinger. I can only speak in terms of—

Q562 Chairman: But what about the ones you have got yourselves in relation to things like ports or the Underground? Do you give these kinds of undertakings anywhere else? Do shipowners get this type of compensation?

Derek Twigg: I am not aware that they do.

Q563 Chairman: So the train operating companies are the only people the you cannot trust not to come to some agreement which would be so expensive it would add up to more than all these sums of money that you have already paid out to one company?

Derek Twigg: The case is based on the viability of the passenger services and we have to look at that.

Q564 Clive Efford: But the logic of the argument has got to be that these costs are outside the control of the train operating company, but that is the same if the economy was to turn down and the viability of the franchise was undermined.

Derek Twigg: Yes, but if they took reasonable steps to try and bring about a perfectly fair resolution and satisfy us of that case and the viability of that train service is at risk, then I think it is reasonable for us to consider using this policy.

Q565 Clive Efford: But on the logic of that argument, if we accept it, surely it must follow that if a train operating company has taken all reasonable steps, and I use the same argument again, in an economic downturn, you would take the same sympathetic view surely?

Derek Twigg: No, it is a specific issue around the fact that if it was affected by an industrial relations dispute where, in terms of the point Mr Lambirth made in terms of the end of the franchise or whatever, if we feel that everything reasonable had been done in terms of that particular dispute and the viability of the train service is under threat, then on that basis we would look at it. It is a policy, I think, which has worked well for the railway and—

Q566 Chairman: It has worked well for certain rail companies, has it not, Minister? You have only got to look at the amounts which have been paid out so far.

Derek Twigg: I think I have made it clear that it is not something which would be used lightly and, as I say, as of today the Department for Transport has not used it.

Q567 Graham Stringer: In determining whether or not the company behaved reasonably or not, would you talk independently to the trade union that was involved to ascertain whether they were reasonable? Also, as a matter of fact, do you know, and if you do not, can you let us know, whether the SRA, when they agreed to these payments, did take independent evidence from the trade union?

Derek Twigg: I have not got the answer to that question today, but I can write to you.

Q568 Graham Stringer: One was historical, and you can write to us, and one was about the way you would approach it as the Minister responsible.

Derek Twigg: I am sure that we were quite clear as to what the trade union views were in terms of the issues.

Q569 Graham Stringer: Would you take independent evidence from them directly?

Derek Twigg: We have not actually come across such a dispute yet, so, as I say, we will treat each case depending on its merits and circumstances, so clearly we would want to make sure that we had the absolute picture.

Q570 Clive Efford: Would you consider whether it would be reasonable to do so?

Derek Twigg: We would want to get the whole picture, so clearly we would do everything, and we would have to justify reasonableness as well in terms of how we applied the policy.

Q571 Chairman: Do you think that the payment by the Strategic Rail Authority of £15.6 million in 2003 and £7.6 million in 2004 under its discretionary power, in other words, it did not have to do it, was reasonable?

Derek Twigg: I do not know the circumstances of those particular industrial action disputes, so I could not answer.
Q572 Chairman: These are parliamentary questions, Minister, column 2226, written, 24 November 2005. Presumably that information came from your Department.

Derek Twigg: Well, they would have had to take all reasonable steps before deciding to make that payment. As I have said, they would have to assure themselves that the TOC had taken all reasonable steps to settle the dispute and come to a conclusion on it and they would have had to have behaved reasonably to have done that.

Chairman: Well, we have been very interested in your answers, Minister, and doubtless it will just be an accident that we will have to now pose our questions to the Treasury, but thank you for coming and thank you for bringing your supporters with you.

APPENDIX 1

Memorandum submitted by the South Hampshire Rail Users’ Group

What should be the purpose of passenger rail franchising?

In a DETR leaflet of January 1995, the Conservative Secretary of State Dr Brian Mawhinney justified privatisation in these terms: “We want responsiveness to passengers’ wishes. We want, in the railways, all the characteristics of the best of British industry. The Sainsburys of this world respond rather well to their customers’ changing demands without any help from the state, thank you very much. We want that responsiveness for the railway too”.

The purported principle of rail franchising therefore was that private expertise should improve on State provision, give passengers the product they wanted, adjust that product to reflect changing demand, and aim for financial self-sufficiency. This vision was fine but unrealistic. The success of the supermarkets was based on strong competition, aggressive expansion and economies of scale. Rail franchising brought very limited opportunity for competition or expansion, but substantial extra costs from fragmentation.

Although the franchised railway can cite success stories, overall it is doubtful whether it has delivered improvements which British Rail would not have delivered more cheaply. Operating costs have generally expanded in line with, or even ahead of, the additional resources which Government has made available. The development and introduction costs of a wider than necessary range of rolling stock are an obvious example of waste.

The evidence suggests that franchising has resulted in widely varying standards of leadership and ethos. BR had the advantage of some inspired leaders and a deeply-ingrained public service ethos. It was never likely that some two dozen train operating companies would simultaneously match BR’s best. In our Group’s response to the Committee’s 2001–02 Inquiry, we therefore contended that the railways needed a supremo to drive up standards in all areas of activity.

The Strategic Rail Authority brought the opportunity of a supremo which we envisaged, but failed to grasp the nettle. Handouts to the worst performing private operators soared. Stagecoach was given an extra grant of £29 million for a few enhancements on South West Trains such as additional evening services. Evening cancellations then became routine because the company failed to provide sufficient trains or crews for a robust service.

Responsiveness to passengers’ wishes has been patchy. Among the successes, GNER gained a formidable reputation for its customer service standards, with Chiltern and Anglia also widely acclaimed. To highlight its readers’ aspirations, the Yorkshire Post newspaper ran a campaign for Sea Containers to keep the GNER franchise when the original term expired. Passengers got what they wanted.

By way of contrast, Stagecoach’s South West Trains franchise was controversial from the outset, as recorded in Christian Wolmar’s book, “Stagecoach”. The company’s profiteering soon led to the cancellation of dozens of trains on a daily basis, followed by a reduced timetable. Stagecoach director Brian Cox referred to critics as “Fully paid up members of the Hindsight Club”. Chairman Brian Souter attributed hundreds of letters of complaint to commuters being bored with having nothing to do in their offices. There was a stark lack of public service ethos.

The outcry when Stagecoach got a second term was predictable. It can be summed up by the words of the BBC’s transport correspondent, Paul Clifton, when he wrote in the May 2001 edition of Rail Professional magazine, “Here’s the opinion of one regular SWT commuter, sent to me by e-mail: ‘The award to Stagecoach is the cruellest betrayal of passengers departing from Southampton since the unsinkable Titanic set sail’”. 
How well does the process for awarding franchises work?

Under the SRA, the franchising process was opaque, but there was compelling circumstantial evidence of an uneven playing field, which raised ethical questions. Stagecoach Chairman Brian Souter had once told the Scotland on Sunday newspaper that “Ethics are not irrelevant, but some are incompatible with what we have to do because capitalism is based on greed. We call it a dichotomy, not hypocrisy”. As recently as February 2005, South West Trains’ e-motion magazine referred to him as “the tough Scots bruiser who came to dominate the UK’s bus services by ruthlessly driving rivals off the road”, despite the Monopolies and Mergers Commission having in August 1995 condemned this activity as “deplorable, predatory and against the public interest”.

Persistent research by Private Eye established that the father of the SRA’s chairman and chief executive Richard Bowker was a Stagecoach director and that Mr Bowker once worked with Graham Eccles, who became head of Stagecoach’s rail division. In the circumstances, Mr Bowker might have been expected to be particularly careful to demonstrate neutrality towards Stagecoach. However, Private Eye further established that he once attended Brian Souter’s church (a round journey of 1,000 miles from the SRA’s London base), and helped Stagecoach enter bidding for the Integrated Kent Franchise a second time. Mr Bowker also reportedly stated before your Committee that a £106 million grant to Virgin Trains had been to stabilise both Virgin and Stagecoach (which has a 49% interest in the company).

Against this background, the switch of franchising responsibilities from the SRA to the Department for Transport is welcome, and it has brought a more obvious willingness to take account of passengers’ interests. The Department’s franchise consultation and Network Rail’s Route Utilisation Strategy consultation for the South Western Rail franchise provided an opportunity for rail users to comment on what they needed for the future. Some major changes to the original proposals, particularly in respect of service patterns in South Hampshire, have resulted from the consultation.

Turning to the bidders for the new South Western franchise, members of our Group have attended very constructive meetings with Arriva, First Group, MTR/GNER and National Express. We gained the impression that these companies were genuinely interested in passengers’ views. We were not contacted by Stagecoach.

It is disappointing that passengers and other interested parties are not asked their views on how existing operators have performed. The patchy picture of achievement across the national network suggests that past performance is highly relevant to getting best value for money in the future. Official statistics play a role, but regular commuters are in the best position to comment on the facts behind the figures. As far back as August 2000, the Guardian reported that the National Audit Office was calling on the Shadow Strategic Rail Authority to get passengers to “snoop” on poor performing train operators.

Some aspects of the rail franchising process remain opaque. We had no idea how franchise bidders were chosen at the pre-qualifying stage until “Rail” magazine recently reported that 80% of the available score is awarded for “demonstrating a proven track record of service delivery and sound financial management”.

On this basis, it is remarkable that Stagecoach has pre-qualified to bid for the South Western Franchise. Recent reports indicate that over the past decade the franchise has received £499 million from public funds whilst building up the highest performance penalty for any franchise, of £54 million. In 2002, confirmation of the second SWT franchise period was delayed when Stagecoach shares dipped to 10p and SWT’s performance continued to deteriorate.

The fact that users are not consulted in more detail about their experiences of existing franchises creates vulnerability in the franchising process. It is difficult to imagine Department for Transport Ministers or officials developing the working relationship which apparently existed between Richard Bowker and Stagecoach. However, Secretaries of State come and go, and the Strategic Rail Authority was short-lived. What if an ethically-limited operator seeks advantage from re-writing history?

The kind of lines Stagecoach is taking in public in support of its bid are exemplified by SWT’s tenth anniversary press release. This states, for example, that “When we took over in 1996 the first few years were by far the hardest, but we put our heart and soul into delivering a railway to be proud of”. In fact, the company immediately sought to maximise profits by disposing of train crews and cutting services. Transport Minister Steven Norris commented, “We in the Conservative Party were very happy at the way rail privatisation was going—new investment, new ideas, new services . . . SWT instantly unwound all that”.

SWT claimed in the same press release that “Safety and security is our number one priority”. Commuters have watched with disbelief as SWT has carried off successive “secure station” awards at stations where the barriers are left open in late evening when there are fewer fares to protect but passengers are more vulnerable to attack. The Evening Standard campaigned on the broader issue of station security, and bidders for the South Western franchise have been warned that they will be required to step up station security.

The Department for Transport’s franchise consultation document highlights the issue of capacity. Yet it contains a glaring error in using Stagecoach’s standard line that: “SWT have recently completed the single largest order placed for new stock since privatisation (worth £1 billion)”. Under the original order SWT was to hire 785 new coaches, worth £644 million. Only the addition of the long-term maintenance contract brought this figure to £1 billion. Euston and Northampton services then received 120 of the coaches. This reduced the pro-rata value of the 665 coaches which SWT has actually
accepted to about £540 million, a little over half the value suggested in the government document. The term “single largest order” appears deliberately phrased to be misleading because Go Ahead ordered and accepted 742 coaches for their Southern franchise.

SWT’s improved performance isn’t a great triumph either. From its December 2004 timetable, it slowed services even further, a phenomenon which has not happened with operators of comparable services. By way of example, in 1990 Brighton–Victoria fast trains required 52 minutes and Southampton–Waterloo fast trains 66 minutes, each with one intermediate stop. This represented average speeds of about 60 mph and 70 mph respectively. Currently, the times are Brighton–Victoria 51–52 minutes with two intermediate stops and Southampton–Waterloo 79 minutes with three intermediate stops, with an average speed of about 60 mph in both cases.

Despite the introduction of such a slow timetable, train doors close before departure time, and stops are omitted and trains curtailed short of destination on a daily basis. This helps disguise late running but makes services very unsuitable for vulnerable passengers like frail and disabled people. Provision for disabled people is at times farcical. For example, the down platform at Totton station is not wheelchair accessible but has a wheelchair loading ramp.

It sometimes seems that Stagecoach is paranoid about its record on SWT. It has resorted to advertisements exhorting passengers to talk to the company rather than to each other. In addition, it has largely conducted consultation through “Meet the Managers” sessions on trains and at stations. This means that passengers have not learned one another’s views as they have at meetings arranged by rival bidders.

Since MPs are likely to recall constituents’ complaints against SWT, the company apparently doesn’t want commuters talking to them either. SWT’s e’motion passenger magazines contain what are purported to be the views of its “Passengers Panel”. The Panel is attributed with this suggestion that MPs who claim to support their constituents’ aspirations are as trustworthy as petty thieves: “Counting the spoons: As the voice of train passengers on SWT, it’s vital that we understand the issues that really matter to you so that we can protect your interests and ensure your views are strongly represented. The politician faced with a rail problem and little idea of how to deal with it cries ‘We have to put our passengers first’. If they have no idea at all, ‘have’ becomes ‘determined’ and they shout even more. Isn’t there a saying ‘the louder they shout their innocence, the faster we count the spoons?’”

E’motion appears essentially to be a vehicle for manipulating public opinion. The number of published letters attributed to individual members of the public is limited. Instead, the Passengers Panel puts forward the “most frequently asked questions”, like: “I think that South West Trains has done a pretty good job recently and deserves a new franchise, and I’m not alone in this. Before all of you at the Panel groan and consign my letter to the waste-paper basket as just a note from another sycophant, let me hasten to add that there are a number of my fellow passengers who would not agree, which is exactly why I am writing. What can the ordinary passenger do to make his or her views heard by whoever awards the new franchises?”

What passengers don’t hear is comments like that of Stagecoach director Rufus Boyd, as recorded on CD at the February 2005 meeting of the Hampshire Economic Forum. He opined that performance across the rail network was fine and the only problem was poor press coverage due to long-distance commuters who made the “ultimate distress purchase” in buying a home remote from their workplace.

The overall impression therefore is of a company hell-bent on profiteering and still without public service ethos. Even with the projection of a false façade of achievement on SWT, official customer satisfaction statistics have struggled from 64% to 84% over four years—with 162 million passenger journeys a year, this equates to an improvement from some 135,000 dissatisfied passengers a day to 70,000.

Are franchise contracts the right size, type and length?

In practice, the Government seems to have decided that franchise periods of around six to seven years, which can be extended to 10 years if performance is satisfactory, will in future be the norm. This seems ample, given that operators are no longer expected to undertake major enhancements.

With a booming economy, increased mobility and climate change, it is hard to imagine that franchise bidders have hitherto worried much about risk, especially while SRA handouts have been generous. Now that the Government is requiring operators to move from subsidy to premium, competition is likely to be restrained even in the context of bidding. For example, in the current South Western franchise exercise, Go Ahead, National Express and GNER have withdrawn their bids in order to concentrate on other, recently awarded, franchises. There is already speculation in the press that Stagecoach may retain the franchise, effectively by default. If that happens, it is difficult to see how the process will have achieved a good outcome for passengers.

Do we need more competition and vertical integration?

Competition was supposed to drive up standards and offer variety. With a few exceptions, as for example between London and Birmingham, there is little scope for competition on the network, so the question of whether we need more is probably academic. The award of franchises appears to ignore service competition...
with even the two busy commuter routes between London and Southend now operated by the same parent company. The underlying problem, however, is lack of capacity. In theory it is fine that an open access operator should be bidding to run direct services between Sunderland and London, but it makes little sense that this would use capacity which has been promised to GNER for extra London-Leeds trains.

The Integrated Kent Franchise will bring a new element of competition. However, it is open to question whether Kent commuters will want to pay premium fares for fast services to St Pancras, and probably Tube or bus fares on top, when normal fares are already about the highest in Europe. The existing slower services direct to the City and West End may well retain most of the custom. London commuters typically like trains which take them to work without onward journeys by bus or Tube. This is apparent for example in the well-recognised aspirations for more SWT trains to stop at Clapham Junction for Victoria connections.

On the Cross Country routes, Virgin now runs an improved service, but with trains often too short to cope with demand. If competition is desired, the Cross Country franchise should logically run fewer and longer trains, and give up some of the track capacity to other potential operators. It may be that the Route Utilisation Strategies which are now in vogue should be complemented by a national utilisation strategy to identify where longer trains or dual portion trains could help meet demand and extend rail markets into areas which have traditionally been excluded from good rail services.

Vertical integration would be just another step in the fragmentation of the rail industry. Network Rail has taken maintenance in-house because problems with sub-contractors led, literally, to disaster. The normally good safety record of rail travel relies to a considerable extent on proper standards of infrastructure maintenance, and this is an area where best practice is essential.

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**Summary**

— The original vision for the franchised railway was unrealistic. Despite pockets of success, the rail network is more costly and no better overall than British Rail.

— There is little scope for service competition, because of lack of capacity and infrastructure. In future the premiums required of operators are likely to restrict competition in the bidding process also.

— The process for awarding franchises is tending to become more transparent since responsibilities were transferred from the SRA, but the Department for Transport does not consult regular users on operator issues. This will tend to impede any goal of getting best value for passengers and other taxpayers.

— There are issues around the integrity of the franchising process. The evidence suggests that Stagecoach was unfairly favoured by the SRA in the first South West Trains re-franchising exercise and is seeking advantage in the current exercise by re-writing history and manipulating public perceptions.

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**Conclusions**

— The case for franchising is not made, but we assume that franchising will remain. A tightly regulated railway therefore offers the best route to good value, for example through economies from having fewer types of new rolling stock.

— There is little capacity for competing services, but better value might be extracted from the network by adopting a national utilisation strategy to identify demand for longer trains and promote inclusivity through dual-portion trains.

— There should be consultation on operator issues in the course of franchising exercises, so that Government knows the facts behind the figures from regular users who are best equipped to provide informed opinions. This would help remove the risk of an ethically-limited incumbent operator bolstering a bid by re-writing history.

— If the franchised railway is to be more joined up, but there remains little scope for more competition and the pool of potential operators stays small, it is difficult to see the sense of having individual operators’ franchises scattered around the country. It would seem preferable to merge adjacent franchises (such as ONE and C2C). This could create a structure like the old BR regions.

— Vertical integration shouldn’t be considered because of the potential risks to safety in the event of deviation from best infrastructure maintenance practice.
APPENDIX 2

Memorandum submitted by London TravelWatch

London TravelWatch is the official watchdog organisation representing the interests of transport users in and around the capital. Our response to the questions which the Committee wishes to address is as follows:

What should be the purpose of passenger rail franchising?

1. We expect the franchising system to deliver a safe, reliable, frequent, affordable rail service, which provides a clean, comfortable travel experience.

Is the current system achieving that purpose?

2. The broad picture is very patchy. Some routes achieve quite good standards, others have significant shortcomings. This inconsistency contrasts with the high standards on Docklands Light Railway and generally, with some reservations, on London Underground.

3. The wide variability of standards arises from TOCs having different franchise agreements and differing ideas on what is commercially worthwhile. This is unhelpful in the quest to achieve a seamless integrated public transport system in London and the multiplicity of parties now involved in railway decision making makes for a very slow and convoluted process for obtaining improvements.

4. Details of our vision and our assessment of current achievements are as follows.

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<th>London TravelWatch vision</th>
<th>Current achievements</th>
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<tr>
<td><strong>services which run frequently and reliably, at all reasonable times of the day and the week</strong></td>
<td>Within the London fare zones we look for turn-up-and-go frequencies from about 0600 (0730 Sundays) until after 2400, seven days per week. Only the “one” Liverpool St–Shenfield metro service achieves this. Most other routes are poor in the evenings and on Sundays, and some which are reasonable during daytime off-peak become poor in the contra-flow direction during the peaks—despite increasing numbers of passengers commuting outwards from or through central and inner London. Chiltern is notable for making no serious attempt to provide adequate services within London. Under the terms of its franchise it is under no obligation to do so.</td>
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<td><strong>networks which provide good access to all areas, have adequate capacity, and offer easy interchange between different types of transport</strong></td>
<td>We recognise that rail cannot provide access to all areas of London, so easy interchange between modes is vital. Many interchanges between rail and underground (for example Finsbury Park and Ealing Broadway) are poor in both capacity and convenience. Despite almost 10 years of franchising, few have been improved as a result of any initiatives by the franchised operators. Rail/bus interchange is haphazard, with improvements almost totally reliant on TfL. The issues of capacity and overcrowding on services to and within London are well known. Whilst some TOCs have been quite ingenious in fine-tuning timetables to concentrate capacity at the times it is most needed, only SWT has taken a co-ordinated approach to crowding by re-drafting its timetable and investing in re-design of its metro rolling stock. Introduction of additional capacity elsewhere has been dependent on funding outside the franchising system, such as SRA/DfT West Coast modernisation for Silverlink County, and TfL sponsoring “PIXC buster” trains on Silverlink Metro. Where overcrowding is caused by lack of track capacity, the responsibility for investing in track or network improvements lies with government and Network Rail, not the franchisee. However, government funding is often delayed or not made available until the problem reaches a stage where it can no longer be ignored.</td>
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<td><strong>London TravelWatch vision</strong></td>
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<td><strong>vehicles</strong> which are</td>
<td>Trains in London are reasonably comfortable, and as most are electric comfortable, clean, easily accessible, readily identifiable, quiet, non-polluting, and convenient for those travelling with luggage, shopping or small children</td>
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<td>Cleanliness is variable. External cleaning has improved considerably during the last 10 years, but many trains have been allowed to become scruffy and dilapidated internally—notably but not exclusively on Thameslink and Silverlink Metro.</td>
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<td>Accessibility and convenience for those with small children, shopping and disabilities etc has barely improved. No attempt has been made to provide level transfer between train and platform. So far as internal layout of metro trains is concerned, only a few new (SET) and refurbished (SWT and Southern) trains provide well-designed flexible spaces for wheelchairs, luggage, buggies etc.</td>
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<td><strong>staff</strong> who are alert, helpful, highly-motivated, well-informed and committed to providing a high quality of service</td>
<td>Most franchises have increased their passenger-facing staff levels, and have recruited and trained them to be more effective in meeting passenger needs for help and information—assisted by new and relatively cheap technology. However these improvements have been very much concentrated on the busier stations and times of day. Many stations remain unstaffed from mid-afternoon or early evenings onwards, and with OPO trains almost universal within London this means that many passengers can complete their entire journey without ever seeing any customer-facing staff.</td>
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<td>The availability of staff on stations is a topic on which passengers have expressed low satisfaction in the latest National Passenger Survey.</td>
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<tr>
<td><strong>journeys</strong> which are safe and free from crime or the fear of crime</td>
<td>Safety in terms of the risk of accident or injury caused by the industry is extremely high—so much so that passengers take it for granted and barely mention it when asked what they expect from the railway. However, personal security has a low satisfaction rating from the latest National Passenger Survey. Statistics indicate that crime on the railways is low, and certainly no worse than in other public places. However passenger (and non-passenger) perception and fear of crime is significant, perhaps because the physical constraints of being on a train or station make it more difficult to retreat to a place of safety if one feels threatened. Substantial work has been done to address this issue by means of CCTV and associated monitoring centres—albeit largely funded by TfL rather than through the franchising system. Also some TOCs have introduced security staff (eg, travel safe officers) in the evenings. However these are inevitably thinly spread so most passengers rarely see them, so it must be questionable to what extent they can reduce the fear of crime.</td>
</tr>
<tr>
<td><strong>information</strong> which is intelligible, relevant, accurate, and readily available in appropriate formats both before and during travel</td>
<td>With the development of NRES into an efficient source of information, coupled with imaginative use of new technology such as web sites, e-mails and text messaging, pre-journey information has improved beyond recognition over the last 10 years. However many Londoners are much less aware of the rail network and the services it offers than is the case with the Underground. This an issue where fragmentation of Network South-East into individual TOCs has not helped, as there is now no network marketing and no common branding of London area services. Information during the journey has also improved. However as dissemination and explanation of this depends much more on individual staff taking the initiative to identify and help people in need, standards vary widely between different locations and times of day.</td>
</tr>
<tr>
<td><strong>fares</strong> which are affordable, represent good value for money, and are structured in ways which encourage frequent use</td>
<td>Generally fares in London are reasonably affordable for most people, but public perception of value for money is poor and wide variations in fares compare badly with the simplicity of TfL/LUL fares. The latest National Passenger Survey shows that across London and the south-east only 35% of passengers are satisfied with value for money—a 5% drop since autumn 2005 despite overall satisfaction with services remaining the same.</td>
</tr>
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Transport Committee: Evidence  Ev 175

London TravelWatch vision | Current achievements
--- | ---
Frequent use would be greatly encouraged by the acceptance of Oyster pay as you go on national rail in London. The long delay getting the principle of this accepted is a major indictment of the difficulty of getting system-wide changes in the face of multiple operators and in the mid-term of franchise contracts.

An issue now emerging which causes London TravelWatch considerable concern is the effect of high franchise premium payments to government on fares and on the diversion of funds from rail investment into government coffers. The banning by First Capital Connect of many cheap day return tickets and travelcards from evening peak trains from London—although publicised purely as a crowding reduction measure—is effectively a hidden increase on unregulated fares and one which they surely recognise will be of considerable value to them in meeting the very onerous financial terms of their franchise. This sets a dangerous precedent for the government to milk the busy London and south east TOCs and is tantamount to a tax on tickets.

ticket systems which are user-friendly, flexible, and appropriately integrated between different operators and types of transport

All London area TOCs participate in the TFL travelcard scheme—not necessarily because they want to but because (fortunately) this was made compulsory in the original privatisation scheme. At times this has been used as an excuse for not improving metro area services, as TOCs falsely claimed that they would not receive the increased revenue from the extra traffic thus generated. However this is an argument which has been deployed less frequently of late.

The next stage of flexible integrated ticket systems is Oyster pay as you go. As mentioned above, this has been a very difficult issue, with about two years being wasted whilst individual TOCs and ATOC collectively deployed all manner of, in our view mainly false, arguments for not participating. The impasse has only now been broken by the Mayor offering a major financial inducement to the operators and it will still be at least two more years before passengers will obtain the benefits. Even this lengthy timescale depends on hitherto antipathetic TOCs negotiating the details willingly and quickly with TFL.

stations which are well designed, properly maintained and fully accessible, offering a civilised waiting environment

This is an area where progress over the last 10 years has been disappointing. Apart from some of the main termini, the inheritance from BR was largely a mixture of dilapidated Victorian structures and 1970s minimalist stations, many also in poor condition.

Railtrack’s programme of station renovation in the early years of privatisation substantially addressed the maintenance backlog—albeit outside the franchising structure—but little has been done beyond this and few London suburban stations really offer a civilised 21st century waiting environment, let alone full accessibility.

transport providers who are communicative, take complaints seriously, and have proper redress mechanisms when things go wrong.

Some TOCs have good management systems which enable complaints to be used to address shortcomings in performance.

However many appeals which come to London TravelWatch show a greater concern to process correspondence to meet targets than to fully understand and respond appropriately to passengers’ concerns.

How well does the process for awarding franchises work?

What input do operators, passengers and other interested parties have into the design of franchised services?

5. London TravelWatch is consulted by DfT and bidders on the broad principles of new franchises, sometimes including detailed train service specifications, and all parties are very willing to meet us to discuss issues.

6. However DfT willingness to change the franchise specification is generally limited to peripheral issues and they are not interested in higher standards if these would raise costs. Important examples of this are their failure to agree to specify—or even engage in serious discussion of—full turn-up-and-go metro services for the Greater Western and the Thameslink/Great Northern franchises.

7. Bidder’s hear what we say, but won’t consult about their own ideas because of commercial confidentiality and DfT instructions not to do so.
8. London TravelWatch’s influence is therefore much more by way of general discussions with the industry feeding ideas into the “conventional wisdom” than by direct input into specific franchise negotiations.

Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

9. So far as London TravelWatch is concerned, yes.

Are franchise contracts the right size, type and length?

10. London TravelWatch is not privy to these criteria and processes.

11. The original franchises were not determined by a master plan, but simply took over the sector structure which existed at the time of privatisation. Thus south of the Thames they were largely area based, whereas north and west of London they were defined by service type, ie commuter, inter-city, regional.

12. Recent policy has been to switch to area based franchises, with the exception of the long distance East and West Coast and Cross-Country routes. These area based franchises have made it easier to achieve integrated timetables and operations.

13. The length of franchises has been an issue where several different policies have been tried. The original franchises let by ORPRAF ranged from seven to 15 years, with many of the longer ones later collapsing under the weight of unrealistic financial projections. The SRA initially pursued even longer term franchises, but only Chiltern’s 20 year contract ever saw the light of day. The latest position is that franchises are let for six to 10 years, often with automatic extensions for a few extra years if certain performance targets are met. In the London area this means that there will be a continuous churn of franchises, and if these continue to be ones which allow the operators considerable commercial freedom then it will always be difficult to secure consistent network-wide standards.

14. A specific problem with franchises as short as seven years is that, after the very early years, it becomes increasingly difficult for the operator to justify investment in new facilities. A case in point is the replacement of worn out and user unfriendly old BR self-service ticket machines, which operators within two to three years of the end of their franchise are unwilling to replace because they say they cannot obtain the pay-back within the remaining term. There is a mechanism within the legislation to cater for this situation, by the DfT designating investments as “franchise assets” for which the operator would be re-imbursed if they fail to win a renewal, but there appears to be a reluctance to use this facility. As this will always be a problem in the London area with one or more franchises nearing the end of term, London TravelWatch believes this is a matter which the DfT should address.

What criteria and processes are used to evaluate franchise bids?

15. London TravelWatch is not privy to these criteria and processes. However it appears that current criteria lean very heavily to the lowest subsidy/highest premium bid winning. Given the many market and other forces which can derail an operator’s financial projections, this is not good news for those who aspire to higher standards, because the history of franchising to date shows that the best quality commuter operators—as reflected by high levels of passenger satisfaction—tend to be those which are relatively generously funded (eg Chiltern and SWT). Those which run into financial difficulty or have to fund premium payments tend to be the ones which become scruffy and second rate (eg Connex, Thameslink, Thames Trains and the original Prism TOCs) and which cannot afford to spend money on some of the “soft” issues which can make an important difference to passengers’ perception of the service.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

16. The original London area franchises varied widely in performance and therefore in value for money to passengers. Examples include Connex—a disaster, Great Eastern—pretty good as a clean and tidy efficient operator, SWT—a series of ups and downs but most recently largely up, and Silverlink & WAGN moving from poor to quite good operationally but still poor in terms of stations.

17. Chiltern has probably been best for consistency of delivery and overall quality, but with its focus shifting from an outer-suburban to a longer distance main line operation it’s overall contribution to London has been weak.

18. The more recent franchises are too new to pass judgement.
Are risks suitably apportioned between the Government and franchise holders?

19. This is not really a matter for London TravelWatch. However the current attitude of DfT seems to be to withdraw from the SRA practice of financially supporting struggling operators. The consequence is that TOCs committed to large traffic increases to fund premium or low subsidy franchise contracts but which then run into trouble may only be able to rescue themselves by cost cutting—and as pretty well the only costs controlled by TOCs are staff costs, this can only mean lower standards of service for passengers.

20. This is not to say that we support the concept of bailing out unsuccessful private companies. The Connex affair showed that rapid transfer of a franchise to a public agency, with a reasonable funding base, can achieve good results—and can do so much more quickly than if a new contract had to be tendered or negotiated with a private operator.

What is the scope for improving services through franchise agreements?

21. Given that TOCs do not control the infrastructure on which they operate, nor the fabric of the stations they serve, their scope for improving services on their own is very limited.

22. Whilst they can be held to deliver on whatever they have signed up to in their franchise agreement, major changes within a franchise term are very difficult to secure. The franchise system therefore tends to sterilise services for the duration, even if circumstances change. Given the speed with which economic and social change can nowadays take place, this is not helpful. If franchising is to continue, a mid-term review might be a useful way to re-set priorities and adjust costs or premium payments to allow for changing investment and operational needs.

23. An important example of how of the present system fails to improve things for passenger relates to the proposed transfer of Class 319 units from Southern to relieve overcrowding on the Thameslink section of First Capital Connect. The need for this has been known since long before the draft specification for the new franchise was issued in June 2005, and the latter made it clear that additional stock would be needed to operate the planned new timetable from December 2006. It was also known, at least to anyone such as SRA/DfT who should have been aware of Southern’s affairs and their rolling stock plans, that the latter could not release the units without substantially adding to their own overcrowding problems. The obvious solution was to transfer Class 458 units becoming spare on SWT to Southern, so that the latter could release its 319s. Now, a year later (mid June 2006), no result has been achieved and First Capital Connect have introduced complex, unfair and difficult to enforce restrictions on the use of cheap tickets in order—they claim—to reduce overcrowding. This effectively means that some passengers’ fares will increase by over 100% because of poor planning at franchise bidding/award stage.

Do we need more competition and vertical integration?

Is franchising compatible with open access operations?

24. This is only an issue which has arisen with long-distance services—no open access operator has expressed any interest in running local services in the London area. However it is a matter of concern for rail industry finances as a whole if an open access operator can run on the network without paying a contribution to the fixed overhead costs of the system, and can thus undercut a franchised operator whose fares have to allow for the latter (and also perhaps a premium to government). This effectively means that public funds are transferred to a private company without the need for the latter to take on any public service obligation. This situation is only worsened if the open access operator is also allowed to use the ORCATS system to take a share of the franchised operator’s revenue regardless of the number of passengers actually carried. London TravelWatch does not consider that this can be called fair competition.

25. Competition can of course occur between franchised operators, either where two operators share a route or where adjacent routes serve the same towns. In the London area this competition has been largely limited to TOC specific fares to get round the ORCATS rules. This has resulted in complex fare scales and rules which passengers—and sometimes staff as well—find difficult to understand. The most notorious examples have been on the London—Gatwick—Brighton corridor between Connex/Southern, Thameslink and Gatwick Express, and they have been a contributory factor to the knot the industry has created for itself over the Brighton line RUS and the inefficient use of the capacity of the Gatwick Express trains.

26. It has long been said that the real competition issue for railways is not competition between operators, nor even with other public transport modes, but competition between rail and the private car.
Should train, rolling stock and track operation be more closely integrated?

27. This topic came to the fore post-Hatfield, when the virtual collapse of the railway in terms of both operating and engineering led to the fragmentation of the British method of privatisation being questioned.

28. Action since then to establish more co-operative working within the industry has largely solved these problems, particularly with the establishment of joint control centres between TOCs and Network Rail in which one party (normally Network Rail) is allowed to take tactical operational decisions in the interests of users as a whole.

29. Also, the establishment of Network Rail enables it to take a long-term view of infrastructure requirements, and provides continuity for improvement work even though the franchise holder may change during the course of a major project.

30. However a big problem remains in terms of how to secure progressive improvements in service in a world where responsibilities within the industry are fragmented. An inordinate amount of time is spent trying to persuade multiple parties, none of whom has sole responsibility, and each of whom can if it suits them profess agreement with an objective but blame someone else for inability to deliver. This contrasts with how decisions could previously be taken under a system with an element of centralised command and control. Some form of vertical integration (including consideration of the issues around rolling stock ownership) might resolve this problem, but it is clearly a major issue which would need wide debate.

31. One form of integration which has been publicly suggested is that part of the network where there is one dominant TOC might be vertically integrated by transferring Network Rail’s responsibility to the former. However this would transfer responsibility for the maintenance of and investment in ultra-long life assets to organisations whose role in the industry is not guaranteed for the long term. This is not an idea which London TravelWatch would favour.

32. However, the proposed arrangement for the forthcoming North London Railway concession to be funded and administered by Transport for London will adopt the very successful model used by TfL for the Docklands Light Railway. The operator will run a service, specified in detail by TfL, who will set the fares, look after publicity, take the revenue risk and take responsibility for dealing with Network Rail on infrastructure matters. London TravelWatch hopes that this arrangement will be a success, and that its eventual extension across the whole of London will provide the means—at long last of—of securing an integrated and consistent public transport system for the capital.

Franchise names

33. A small but important issue is the matter of franchise names. The original names inherited from the previous sector organisation had a geographical basis from which people could fairly easily infer their areas of operation. It is extremely unhelpful that franchises have been allowed to adopt meaningless brand names such as Silverlink, “one” and c2c, and even worse that new operators are allowed to change the names at whim. This does nothing to help people understand the network and the services it provides.

34. The worst case is the replacement of the name Thameslink by First Capital Connect, on the grounds that it has a bad image. The Thameslink name, in less than 20 years, has established a strong identity as the only cross-London rail line, and is used in a similar way by passengers to the Underground lines. It is highly confusing for passengers—and potential passengers—to have that name disappear. Franchises are let for a short time and it is not desirable to keep changing well-known and well-understood names. London TravelWatch considers that DfT should exert much greater control over franchise names and only permit them to be changed in exceptional circumstances.

19 June 2006

APPENDIX 3

Memorandum submitted by RMT

INTRODUCTION

1. The National Union of Rail, Maritime and Transport Workers (RMT) welcomes the opportunity to provide written evidence to the House of Commons Transport Committee inquiry into “Passenger Rail Franchising”.

2. The RMT organises over 73,000 members in all sectors of the transport industry and with over 45,000 members employed in the rail industry, the RMT is the largest of the rail unions.
SUMMARY

3. RMT’s support for public ownership of the rail network is well documented. We are firmly of the view that the current franchising regime is fragmented, financially opaque, poor value for money and provides the train operators with no incentive to commit long-term investment in station upgrades, improvements and enhancements. In short the current arrangements have failed the travelling public. RMT believes that passenger franchises should be returned to the public sector as expire.

4. There should be greater transparency in the franchising process. Specifically we believe that Invitation to Tender documents should be made publicly available and that rail trades unions should be included in the list of organisations that can access bids once they are lodged.

5. Financial risk should be held by the private sector. Recent “cap-and-collar” franchise awards continue to expose the public purse to inappropriate levels of risk. The policy of indemnifying train operators from losses incurred as a result of industrial action should be scrapped.

6. RMT supports vertical integration of the rail network in the public sector but is opposed to private sector horizontal fragmentation of Network Rail’s safety and operational powers and responsibilities over the national railway infrastructure.

7. The dispute over open access on the East Coast Main Line demonstrates a lack of strategic leadership in the provision of passenger services. The Government should resolve the structural flaws which have led to the dispute in the 2007 Rail White Paper.

What should be the purpose of passenger rail franchising?

8. Franchises should provide punctual, accessible and reasonably priced services to the travelling public. However, a series of reports have supported RMT’s view that the current franchising arrangements are fragmented, heavily subsidised by the public purse, poor value for money, with fare and ticketing structures that are too expensive and unnecessarily complex.

9. The Transport Select Committee’s April 2003 report: The Future of the Railway found “The network is now being run by a patchwork of companies, which operate in a variety of ways, with a variety of incentives. It is not for us to judge whether more efficient companies could have performed more creditably; however, the number of franchises in difficulties suggests something is fundamentally wrong with the structure of the industry”.

10. The July 2005 National Audit Office report: Maintaining and improving Britain’s railway stations points out that there is no overarching strategy or single organisation leading on the modernisation of Britain’s stations. In February 2006 the House of Commons Public Accounts Committee (PAC) confirmed that “the number of bodies involved in maintaining and improving stations has led to a fragmented approach, lacking overall leadership and strategic focus”. RMT believes that the current franchising arrangements act as a disincentive for operators to invest in station improvements and enhancements, particularly when the franchise is in the last few years of life.

11. The September 2005 Catalyst working paper: the performance of the privatised train operators explains that initial post-privatisation Government estimates of the level of public subsidies required to fund the franchisees had proved to be “hopelessly optimistic”. The report concluded “These companies (the ToCs) are totally dependent on subsidy for their financial survival. They could not cover their operating costs, let alone provide a return to the providers of finance, without generous public subsidies”.

12. The May 2006 Transport Select Committee report: How fair are the fares? Train fares and ticketing confirmed the RMT’s longstanding view that, 10 years after the break-up of passenger services, the franchises operate a fare and ticketing regime that has been an “abject failure” which is “not fit for purpose”.

13. RMT believes that over the past decade the franchises have failed to deliver what they are designed to do. That is to provide passengers with a quality service. We are strongly of the view that Government should return franchises to the public sector as they fall due.

How well does the process for awarding franchises work?

14. RMT believes that the time and energy expended by management teams drawing up bids to retain franchises is an unnecessary distraction from the task of providing a good service to the travelling public. In an interview with the Times on 20 April 2004 Michael Holden, the then managing director of South Eastern Trains, made the point that “bidding for franchises takes management time and time is the most precious commodity we have. We have been able to declutter the agenda and focus everyone on running the railway better”.
15. In addition the franchising and re-franchising process has proved to be expensive; two parliamentary questions indicating that over £60 million has been spent franchising passenger services.

\[\text{John McDonnell: To ask the Secretary of State for Transport what total costs have been incurred by the Government and Government agencies in the franchising and tendering of passenger rail services since 1997. (176270)}\]

\[\text{Mr McNulty: Between April 2001 and April 2004 the Strategic Rail Authority (SRA) has spent £40.7 million on franchise replacements and extensions. This includes the full costs of tendering and implementation. Prior to the SRA’s inception in 2001 total spend, in the period between 1998 and April 2001, on franchising was £6.095 million. (7 June 2004)}\]

\[\text{John McDonnell: To ask the Secretary of State for Transport what total costs have been incurred by the Government and Government agencies in the franchising and tendering of passenger rail services since April 2004. (29262)}\]

\[\text{Derek Twigg: Costs incurred in the specification and tendering of passenger franchise services since April 2004 are £14.4 million. (22 November 2005)}\]

16. Furthermore, the process for awarding franchises is insufficiently transparent. In February 2005 RMT requested a copy of the Integrated Kent Franchise (IKF), Invitation to Tender document. The request was rejected on the grounds that disclosure would, or would be likely to prejudice the commercial interests of the SRA or of others. The SRA concluded that it would not be in the public interest to make the ITT’s available and told RMT that the Stakeholder Briefing Document which had previously been made publicly available, “sets out in some detail what the SRA is asking of bidders”.

17. The Invitation to Tender documents were finally released to the RMT after the franchise had been awarded to Govia. There were some important differences between the ITT and the Stakeholder Briefing Document. Bidders were asked to consider changes to ticket retailing policies and procedures. As the Committee will be aware, South Eastern Trains had already brought forward proposed Schedule 17 changes to booking office opening times and staff numbers, which had led to industrial action ballots being called by RMT and, our sister rail union, TSSA.

18. Bidders were also told not assume any limit on the extension of Driver Only Operation (DOO), except on the CTRL west of Ebbsfleet where an additional person per unit will be required for emergency evacuation in the event of an incident in the long tunnels on this section of the route. The ITT goes on to say “should bidders propose to extend DOO, then their bid must clearly show the cost of any infrastructure or rolling stock enhancement and their industrial relations handling plan”. (Emphasis added). RMT contends that these differences between the ITT and the SBD represented a key reason for the refusal of the SRA to make documents publicly available. Huge sums of public money, in the form of Government subsidies, are available to successful bidders. RMT therefore believes that Invitation to Tender documents should be made publicly available in order that stakeholders can scrutinise the assumptions and criteria that bidders are being asked to make.

19. The ITT also deals with disclosure of information contained in the bids. It lists a series of bodies and organisations that, once a bid is submitted, can access the information in the bids, excluding commercially sensitive information. The organisations in question include DfT, Treasury, HSE, TIL, LCR, Network Rail, ORR, RPC, Regional Planning Bodies, affected Local Authorities and the Disabled Persons Transport Advisory Committee. However, trades unions are excluded from the list. As representatives of the railway workforce affected by re-franchising exercises RMT believes that the trades unions should be added to the list of organisations that can access information contained in bids.

\[\text{Mr McNulty: Between April 2001 and April 2004 the Strategic Rail Authority (SRA) has spent £40.7 million on franchise replacements and extensions. This includes the full costs of tendering and implementation. Prior to the SRA’s inception in 2001 total spend, in the period between 1998 and April 2001, on franchising was £6.095 million. (7 June 2004)}\]

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\[\text{Derek Twigg: Costs incurred in the specification and tendering of passenger franchise services since April 2004 are £14.4 million. (22 November 2005)}\]

20. The 2003 Transport Select Committee report: The Future of the Railways maintained “The new generation of franchises must be structured in a way which prevents franchisees returning for ever more public money, and ensures that costs are properly anticipated and controlled. Revenue risk should be assumed by the private sector wherever possible”.

21. RMT has on a number of occasions expressed the view that on both the privatised rail network and in relation to the Public Private Partnership on London Underground, risk is not appropriately transferred to the private sector. The Virgin West Coast and Virgin Cross Country “cost-plus” contracts are but two examples of where services are provided for a guaranteed rate of return to the franchise holder.

22. We are concerned that recent franchise awards continue the process of the public sector retaining revenue risk. On the face of it the £1.1billion premium payments that First Group has agreed to pay the Department for Transport over the length of the franchises appears to be a very good deal for the taxpayer. However the “cap-and-collar” arrangements associated with the repayment regime transfers risk from private to public if First’s revenue projections are not met.

23. In relation to Greater Western, Christian Wolmar explained the “cap-and-collar” arrangements in the 18 January 2006 issue of Rail Magazine. “This works in such a way that broadly, 80% of any large shortfall—or excess profits—will be borne by government. The formula is that First takes the whole risk of
the first 2% shortfall, then half the risk of the next 4%, but only 20% of the rest. So it loses little if there is a really big shortfall”. RMT is extremely disappointed that Government is continuing the practice of awarding franchises that do not transfer financial risk to the private sector.

24. Finally, franchise holders also benefit from the Government decision to indemnify train operators for losses incurred as a result of industrial action. To date over £23 million has been spent by Government in compensation payments. The financial incentive for franchise holders to dig in their heels in the hope that they will be indemnified should industrial action result, does not encourage good industrial relations and should therefore be scrapped.

Do we need more vertical integration?

25. The 1 April 2003 Transport Select Committee report: The Future of the Railways called for a public sector Railway Agency to combine the strategic functions of the SRA and control of the railway infrastructure. RMT also supports the vertical integration of “wheel and steel” in the public sector.

26. We are however, completely opposed to horizontal fragmentation, which would see the franchise holders controlling the tracks over which their services operate. RMT remains convinced that a single infrastructure controller, currently Network Rail, is the most appropriate way to set and monitor national operational and safety standards on the rail infrastructure. Recent improvements to Moving Annual Average train punctuality figures, now approaching figures achieved pre-privatisation in the early 1990s, have been aided by Network Rail returning maintenance functions in-house. Network Rail has reported delays caused by infrastructure falling by 17% and 8.7% in 2005 and 2006 respectively. In all, delays caused by Network Rail have fallen 28% since the company took control. RMT would not want to see these continuing improvements threatened by an unnecessary and potentially expensive fragmentation of the railway infrastructure.

27. RMT believes that some train operators would simply “sweat the assets” on the railway infrastructure, particularly in circumstances where their franchises were coming to end and the existing operators were either not bidding for or were not short-listed for the replacement franchise. RMT has serious concerns that horizontal fragmentation would repeat the Railtrack experience where the company systematically underinvested in order to maximise returns to shareholders. The result was a catastrophic degradation of the railway infrastructure.

28. In relation to the proposed vertical integration of Merseyrail RMT agrees with Network Rail which argued that proposals to split the national infrastructure would prove to be more expensive given that separate contracts would have to be drawn up for supplies and for track maintenance and renewals equipment.

29. The Committee will be aware of concerns that the RMT has raised in the past in relation to the rolling stock manufacturing and maintenance sector. Since privatisation rolling stock orders have been placed worth more than £4.5 billion. The Rolling Stock Leasing Companies, the only remaining wholly unregulated part of the rail industry, have at the same time made excess profits.

30. Regrettably the past period has also seen significant job losses and plant closures at sites including Derby, Washwood Heath and Eastleigh. This is an unacceptable state of affairs which Government should take steps to address. As a priority Government must breathe life into the railway workshop sector, protect the highly skilled workforce and encourage domestic production of new rolling stock. As franchises fall due and are returned to public ownership Government should develop a publicly owned rail manufacturing and maintenance division.

Is franchising compatible with open access operations?

31. The current dispute between GNER, the Office of Rail Regulation (ORR), Grand Central and the DIT is indicative of deep-rooted problems in the franchising regime.

32. For the Strategic Rail Authority to award the East Coast Mainline (ECML) franchise to GNER, promising extra half-hourly London-Leeds services and then see the ORR award Grand Central open access paths on the ECML and refuse the GNER London-Leeds services demonstrates a lack of strategic leadership in the organisation and delivery of passenger services. This absence of leadership reflects the structural flaws inherent in the current privatised network. The 2007 Rail White Paper provides Government with the opportunity to address these structural flaws and take overall responsibility for all passenger services on the network.
CONCLUSION

33. RMT believes that the current franchising arrangements have failed to provide value for money for the tax-payer and the fare-payer. Franchise awards are shrouded in commercial confidentiality and the franchising process has cost the public purse over £60 million since 1998.

34. In addition risk is not borne appropriately by the train operators, who according to the May 2006 issue of Modern Railways made operating profits of £306 million in 2004–05.

35. The current dispute in relation to open access routes on the East Coast Mainline demonstrates the lack of strategic leadership and serious structural flaws inherent in the privatised rail industry. The 2007 Rail White Paper provides the Government with the opportunity to take the necessary steps to resolve these issues.

36. RMT supports the vertical integration of the rail network in the public sector and is firmly of the view that at the heart of the 2007 Rail White Paper should be a commitment to return franchises to the public sector as they expire. We stand completely against the horizontal fragmentation of the network. Recent improvements to network performance have been delivered thanks in no small part to Network Rail bringing maintenance in-house, leading to reduced delays caused by infrastructure failure. Controlling the whole network has enabled the company to plan strategically across the national railway infrastructure.

20 June 2006

APPENDIX 4

Memorandum submitted by the Shrewsbury-Aberystwyth Rail Passengers’ Association

SUMMARY

— The UK scheme of rail franchising is unique in railway history. Independent operators before 1948 were based on a different model. When railways were in private hands previously, there was a body known as the Railway Clearing House (RCH) which oversaw their commercial and technical compatibility. (Section 2)

— There is no such body today, despite a clear need. The Strategic Rail Authority did not fulfill this role despite privatisation having fragmented the railway. Historically, the RCH provided a link and authority between diverse companies. (Section 3)

— Franchises have been awarded for very short periods. They do not compare well with the investment lifetime of the railway itself. (Section 4)

— Franchising on the UK model has delivered poor value for money for all concerned. The quality of service is poor when compared with other developed countries. Whilst the franchise bids are subject to a measure of competitive tender, this does not apply to anything else on the railway. Hiring trains is not good for the taxpayer but a great way to generate profits for banks, who own the rolling stock companies. (Section 5)

— The main competition for the railway is from the car and the aeroplane. Increasing rationalisation since Beeching has affected the ability of the railway to cope, both with competitors and out of course events, like breakdowns or busy periods. (Section 6)

— There should be more incentives for innovative, enterprising operators. (Section 7)

— Vertical integration makes for a more successful railway. It enables co-operation between the various departments of one organisation, rather than through the lawyers and accountants of separate companies. British Rail achieved a great deal on a limited budget and was respected throughout the world. Much indigenous engineering expertise has been discarded since privatisation. The lack of integration has meant increases in costs and engineering folly, such as trains that cannot couple together. Meanwhile, managers are relearning that integration is in fact necessary. (Section 8)

— Since privatisation, costs have escalated, to the tune of £15 billion. There is a danger that the treasury may take fright and lines could close. Instead of a world class railway we might only have world class profits for private firms. The heritage sector might provide some cost indications for secondary and rural lines. (Section 9)

— Conclusions are in Section 10.

1. PREAMBLE: SARPA—WHO WE ARE . . .

1.1 The Shrewsbury Aberystwyth Rail Passengers Association (SARPA) is the rail users group for the railway which runs through Mid Wales to the university town of Aberystwyth. For more information about us and the Shrewsbury Aberystwyth railway, please see our website: http://sarpa.info
2. Franchising: Historical Background

2.1 At the time of its inception in 1995, the scheme of passenger rail franchising was unique in railway history. The idea of a separate authority controlling the fixed railway infrastructure whilst allowing independent operators access to the system was mooted by the Stockton and Darlington Railway in the 1820s; it was rejected because it was felt that to do otherwise could bring operational chaos. So the railway ran its own trains and this formed the norm for the industry in the intervening 170 years. A change after all this period to allow separate operators to run over a centrally controlled network, was brave in the extreme.

2.2 In having to re-invent itself so dramatically, it is not surprising that many mistakes have been made and in many instances, the railway industry is starting again from scratch. Indeed, in recent years there have been accidents which have led to the loss of life from causes that one might have expected to have been banished years ago. (Hatfield: Broken rail. Tebay: Runaway wagon)

2.3 It would not be true to say that there were no independent train operators before 1995, though these tended to be in the minority. In fact they go back to the earlier part of the 20th century. The method was that they sourced the business themselves and then contracted the railway to operate the trains for them. The franchising system we have today is a completely new development.

2.4 It was not unusual before rail nationalisation in 1948 for trains of different companies to run over the same stretch of track under a system of “running powers”, whereby the trains of one operator were permitted to use the tracks of another. When this took place extensively in some parts of the country, the railway was administered jointly. Fair play was overseen by an organisation known as the “Railway Clearing House” (RCH), which also dealt with revenue apportioning between the various operators and set standards for types of brake and couplings, buffer heights and other engineering matters. This latter was to ensure that the engines of one company could pull the carriages and wagons of another without problems.

3. Worthy Successors to the Railway Clearing House?

3.1 Now that the railway is privately operated by many players once again, there is a clear need for a renewed body that will take up the functions performed by the old Railway Clearing House. The Strategic Rail Authority may have been intended to fulfill this role but it is now no longer with us. Whether it was effective is open to debate. Some high profile fiascos have resulted from this regulatory vacuum, such as the fleet of new trains for the South East that could not be run because to do so would have overloaded the electricity supply. The problem has since been solved, naturally at great expense.

3.2 With the best will in the world, the transfer of such responsibilities to the Department for Transport (DfT) has potential for difficulty. Civil servants may indeed be highly motivated, professional people but it is probably fair to say that they don’t have specialist railway knowledge or engineering expertise. That will of course, come in time via what we presume would be a very steep learning curve. Meanwhile the trains will not stand still while everybody waits for that to happen.

3.3 Privatisation fragmented the railway industry in the UK in a way not seen for many years. There is considerable lack of co-ordination with regard to many things, from station cleaning to types of coupling. For instance, the Class 175 type of diesel unit, used by Arriva Trains cannot couple to any other type of train used in Wales. Conversely, since the disasters at Hatfield and Westbourne Park, safety measures have been implemented if anything too rigidly across the board with consequent increases in costs. Here on our line, the “Train Protection Warning System” (TPWS) was installed at great expense a few years ago, despite the last passenger fatality on the Cambrian being in 1921. The system may have to be removed again when a new signalling system is installed before 2010.

4. Franchising Size and Period

4.1 Now that Wales has a modicum of self government, it is natural that the railways in Wales are under the control of Cardiff, so a nationwide railway operator makes sense. A similar situation persists in Scotland. In both cases, the railway is still divided because the fixed infrastructure is still owned by Network Rail. We are astonished at the number of franchises in England, presumably to provide some notion of competition. That being said, size is not necessarily an indication of competence levels.

4.2 It is sometimes understandably difficult for many people to grasp the timescale involved in railway operation. Typically, the lifespan of rolling stock is planned for around 25 years. The same goes for infrastructure projects, which are planned for a lifespan of over 30 years. The railways are therefore a long term business. Also, mistakes made now in planning and construction have to be lived with for a long time.

4.3 It is therefore somewhat astonishing to us that franchises are awarded for relatively short periods. Admittedly, there has to be the prospect that a poor operator can be removed but provision has been made for this. The railway system as a whole performs much better when its employees and managers are able simply to get on with the business of running it, rather than being in a state of continual flux and reorganisation. Continuity is very important to a thriving railway business and we would point to the success
of other franchises such as GNER and Chiltern Railways where long term duration has been a contributory factor. Conversely, our railway has had three franchisees in 10 years. Arriva Trains Wales are on their third Managing Director since 2003!

4.4 It seems desirable to separate train types into operating sectors, whatever style of rail management and operation is used. British Rail discovered this when it “sectorised” its operations in the 1980s. Regional railways have very different requirements to inter city links.

5. DO FRANCHISE HOLDERS DELIVER VALUE FOR MONEY TO PASSENGERS AND THE GOVERNMENT THROUGHOUT THE DURATION OF THEIR CONTRACTS? HOW WELL DOES THE PROCESS FOR AWARDING FRANCHISES WORK?

5.1 In order to attract private businesses into the rail industry, the 1993 Railways Act produced the convoluted structure for the railways we have today. The idea appears to have been to guarantee profits which would not necessarily accrue just from collecting fares and running trains: a false market was created.

5.2 We understand the bidding process to be very arcane and franchisees are locked into certain obligations. One of the most disadvantageous of these from the point of view of the passenger and also the taxpayer is that the operator is required to lease trains of a given type from a given rolling stock company (ROSCO). There is no opportunity allowed to go and obtain the best price, or to buy trains or rolling stock outright. Indeed, this is a kind of command economy for capitalists. The real loser here is the taxpayer, who paid for many of the trains in the first place when they were built by British Rail and now has to pay for them all over again to be leased back to franchisees.

5.3 In Wales, the total cost of hiring trains which were built by BR was reckoned to be around £15 million in 2005, which could have been spent improving trackwork and stations, or providing new trains. We would stress that this was not the full cost of Welsh train hire. About another £15 million was contributed by the Welsh taxpayer to the profits of Arriva Trains Wales. This means that there is a gap of more than £30 million between the Direct Operating Costs (DOCs) and what was actually paid out for the running of the railway. It would make much more sense if the trains were owned outright by those that operate them and the scam that is the ROSCO consigned to the dustbin of railway history.

5.4 The whole bid process seems shrouded in mystery and confidentiality, though bids are at least nominally subject to competitive tender. From what we have been told, beyond this there is no requirement for ANY other activity on the railway AT ALL to be subject to such scrutiny, which is truly astonishing. The 1993 Railways Act was sold to the people with the promise it would bring better services and value for money. Given that in reality, the act has failed to deliver we are left wondering what is the point of franchising other than to make large profits for the franchisee and the ROSCO.

5.5 However, we note the exception, where Chiltern Railways have achieved a tremendous success with their revival of the route between London and Birmingham Snow Hill, although this might have been done more cheaply but equally effectively by a unified and integrated railway.

5.6 We note that in the past, some franchise bidders have been successfully awarded a contract on the basis of their low bid, which in the event proved not to have been costed accurately for the operating conditions. These companies have then asked and been granted more subsidy to run the trains. One of our members was involved in a franchise bid which was outbid by a lower tender. He told us that the company which won had missed items out of their quotations by mistake and had to go and ask for more money.

6. DO WE NEED MORE COMPETITION?

6.1 Do we need more cars? Do we need more transport aircraft? These are the real competitors for the railway industry today. However, it is clear that the promoters of the original 1993 Transport Act missed the point and thought that competition between rail operators was paramount. In order for the railway to be successful, it must have an attractive and usable product to sell. The problem is that the railway has been carrying more passengers than for many years without corresponding improvements in infrastructure. This means cramming too many trains along a rail network that was heavily rationalised from 1963 (Beeching) and remodelled in the period to 1980. Indeed, during the 1960s forecasts expected passenger numbers to fall but traffic overall to grow by around 4% per annum. In reality even the Cambrian section has seen passenger growth of 7% pa every year since 1995. The quality of the product is therefore likely to fall and service standards are increasingly unsatisfactory.

6.2 The problem has been exacerbated here in Mid Wales by the progressive removal of important operational elements in the track and signalling since 1963. Quality of service is now unacceptable and the railway loses its attractiveness as a transport “product”. Competitiveness of the railway in the transport market therefore relies on having sufficient infrastructure to cope with out of course events. This problem of operational flexibility being compromised by rationalisation is not unique to Mid Wales. There are numerous instances whereby this has happened throughout the UK. As an example, the Wolverhampton–Birmingham section is becoming a very serious bottleneck.
6.3 One of the features of the Beeching programme was the elimination where possible of duplicated routes, so now only a few of these remain where one franchisee can take traffic from another. Train companies can try to compete against each other where they run over the same piece of track. On busy sections of railway they are keen to do this because under s system known as “ORCATS” they are all given a proportion of the revenue for that piece of the railway. However, in reality the prospect of them just getting in each other’s way should not be discounted. Meanwhile “ORCATS” does not apportion revenue to the same degree of accuracy as the old Railway Clearing House, which made an actual tally of the collected tickets from travellers.

6.4 One aspect arising from shortage of track space is that open access has been something of a non-starter thus far. In the main it has been limited to special trains and steam charters. These operators have been frustrated in many respects by the vagaries of Network Rail, who may on occasions give permission to run only at the last minute. In practice, franchising of the core network has meant few free paths available for true open access.

7. INCENTIVES

7.1 There does not appear to be much incentive for a franchisee to do other than fulfill the public service requirement (PSR). A glance out into the road in even quite rural locations which are served also by the railway would indicate that demand for travel and transport is quite healthy. There appears to be a dearth of operators who, casting an enterprise glance at our busy roads would like to grab as much traffic from them as they could.

7.2 There is little incentive for a franchisee to provide more than the bare minimum of rolling stock given the high costs of leasing, especially where its use would be intermittent, such as for strengthening trains at busy periods. Recently this has been a serious problem, here in Mid Wales. There are also indications that the operator here has sought to save on maintenance with dire consequences for the timetable in the hot weather. Trains have frequently been up to an hour late.

8. DO WE NEED MORE VERTICAL INTEGRATION?—SHOULD TRAIN, ROLLING STOCK AND TRACK OPERATION BE MORE CLOSELY INTEGRATED?

8.1 More vertical integration of the railway industry is essential. Train and track operation should be integrated too. Rolling stock should be owned by the operators. On today's fragmented railway there are too many instances of the right hand not knowing what the left is doing.

8.2 Historically, British Rail (BR) was respected throughout the rail industry worldwide because it achieved a great deal on a budget of very little. This was partly because of the rather unfortunate financial restraints placed upon it. BR was not allowed to borrow money from independent financial providers, even where it had a clear cut business case for investment; it had to seek all its funding from the Treasury, which if that were not forthcoming, spelled an end to the project. This being said, there were many ingenious solutions to railway problems that were devised by British Rail engineers who were working on a very tight budget to equip and run the railway. The original High Speed Train (HST) fell into this category, as did the radio signalling system currently in use on the Cambrian. The non-radio based replacement of the latter is anticipated to cost £60 million, provided by an outside company, assuming it can actually be made to work.

8.3 British Rail was a fully integrated railway. Until the advent of the Thatcher government it could also offer shipping services and hotel accommodation. These profitable sidelines were sold off in the 1980s, part of an asset stripping process that began in the years just prior to Beeching and is still going on today. Indeed, the asset stripping of the railways has been one of the scandals of our time, where the taxpayer has been short changed outrageously.

8.4 When looking for integration in the railway industry it is not enough just to look at the track and signals on the one hand, with the train operators on the other. That is too simplistic a view. Across the board, fragmentation of the industry has proved a disaster. This country still holds an eminent position in the field of railway engineering before privatisation but that has been thrown away. The mechanical engineering side of the business was sold off too. Recently, several workshops have closed with large job losses. Having so many short lived companies running many different types of rolling stock means that they do not have the interest or incentive to maintain a research team or workshops capable of constructing new trains. Even the valued test track at Old Dalby has been threatened with closure. The nationwide integrated railway with its own engineering departments had the benefits of scale on its side, making it worthwhile to have such facilities.

8.5 It would bring huge benefits to revive the vertically integrated railway. The benefits of scale and of people working together instead of trying to compete all seem so obvious. The question now is how to do it? On the passenger side, franchises could simply be taken back in house when they fall due for renewal and the whole combined with track and infrastructure operation. This would cost the government nothing and would probably be appreciated by the electorate. The problems start with freight operation, which is not franchised. A solution could be found in the “block train” concept which was used on British Rail. Private
companies owned the freight wagons and also contracted BR to run a stipulated number of trains, for which the railway provided the motive power and the spaces in the timetable. Means must also be found to grow the freight business.

8.6 Lack of integration causes problems and expense whilst making the railway less effective. It prevents people from running the railway. At the extremes, the lack of co-ordination and integration merely degenerates into a lack of common sense and an escalation of costs.

8.7 There is a degree of “feral integration” taking place. When questioned about control centres, an Arriva Trains manager told us that train controllers from Network Rail and Arriva now “sit in the same room” GNER have moved in this direction too. This is a step forward but there is still duplication of workforce. On an integrated railway, you only need one set of controllers (or one set of lawyers, accountants, engineers etc). However, it indicates that rail managers themselves are relearning that integration is desirable, even essential for the effective running of the railway.

9. Escalation of Costs

9.1 It would not be reasonable to write anything about the state of railways in the UK without adding something on costs, which have risen astronomically. The difference between what the privatised, franchised railway has received from government and the subsidy for BR, assuming it received the same amount as it did in the early 1990s has been calculated at c £15 billion; which is £15 billion which sadly has not been used to improve the railway. Franchising seems to be horribly expensive.

9.2 To its credit, the Labour government has made available a generous financial package for investment in rail. The danger is that if this money is not spent wisely and costs are not controlled, instead of a world class railway, we will just have world class profits for private companies. Lines could even be closed too. The provisions of the 2005 Railways Act made this an easier possibility.

9.3 A relatively unexplored area of financial control can be found in the heritage sector, which because they have much lower costs might be useful as a model for secondary lines. Whilst these operators use volunteers to drive the trains and pull the signals, so that element can be discounted. The major players have their own in house teams of paid professionals for things like track maintenance. Major civil engineering work like bridge repairs and building construction is handed to outside contractors on a tender basis. Whilst restricted to 25 mph for public passenger operations, the track is maintained to a much higher standard, capable of taking the heaviest steam locomotives. These are much more damaging to the track than the lightweight diesel trains used on secondary routes. These railways are also used for film location work and testing of main line rolling stock at speeds above the restriction for public operations. That they can control costs effectively we think is no coincidence because they are integrated railways, albeit on a small scale.

10. Conclusions

10.1 The railway must be returned to an integrated state so that the ownership of land, trackwork and signalling are vested in the same authority which operates the trains. This can be done in the main by bringing franchises back in house as they expire. The cost of this would be minimal.

10.2 Ownership of rolling stock which is hired to the train operators has meant a poor deal for the taxpayer and must cease as soon as may be effected. The railway operator must own the passenger rolling stock and locomotives.

10.3 Franchising in the UK has meant fragmentation and is in any case, not a true franchise. The franchisee has been hostage to fortune in so many fields that the system has been unworkable.

10.4 This does not mean that we think all franchising is a bad thing: it could have been a useful tool in the 1960s to have saved some lines which closed and have since been seen as worthy of retention. The reopening of one such railway has been the subject of a bill in Parliament (Central Railway). It is, of course much more expensive to put back a railway when it has been dismantled than to keep it open in the first place so a mechanism should be devised to allow a franchisee to take over a whole railway if the national operator has no further interest in it.

10.5 We would suggest that the national operator is independent of government or the DfT. A charter, in a similar vein to that of the BBC, to allow it to get on with the business of railway operating, might be a useful model.

10.6 We had expected the 2005 Railways Act to tackle the anomalies of franchising and were disappointed. There must be a clear remit to develop the railway and the railway’s business. We note this was absent from the 2005 Railways Act. We are not sure that the DfT or the government have a vision for the railways at all.

10.7 There must be a clear remit to help develop the freight business and work sympathetically with freight operators, who are not franchised but still do not have ownership of the fixed infrastructure. Open access should be encouraged as it could bring valuable revenue into the railways.
10.8 A regulatory body similar to the Railway Clearing House for engineering standards, operating
standards and other matters should be established to help the interests of independent operators and prevent
fragmentation. That being said, it should not be so bureaucratic or expensive to maintain that it would stifle
membership or industry growth. Moreover, as franchises will remain for some years, they will need some
connectivity.

10.9 A basic knowledge of railway history and practical operating procedures could have saved many
costly errors and mistakes.

16 June 2006

APPENDIX 5

Memorandum submitted by West Coast Rail 250 Campaign

BACKGROUND TO WCR 250

Since 1992 West Coast Rail 250 has campaigned for the upgrading of the West Coast Main Line, the key
rail route in Great Britain, linking London with four of the largest city regions of the United Kingdom.
Through the work of the campaign, supported by almost all of the principal local authorities within the area
served by the West Coast network, and of the supporting work by MPs and peers in the All-Party Group,
we have brought our influence to bear on major investment decisions taken over the last 10 years. As a result
we have now achieved the improvement of much of the route to carry faster and more frequent trains.

As the current project continues towards completion over the next few years, it is essential now to
commence planning for regular investment in the maintenance of the line so as to offer a service to its
customers, both passengers and freight, which is appropriate to the 21st century.

TIMING OF THE SELECT COMMITTEE INQUIRY

We recognise that franchising arrangements are of concern to the Select Committee but we feel that the
timing of this inquiry is overdue bearing in mind that new franchises have been awarded over the last year
and consultations are well underway in respect of the new Cross-country, East and West Midlands
franchises. As a result the West Coast 250 Campaign is only able to comment on a few broad points of
principle. Our priority must be to respond to the current franchise consultations, which are of enormous
importance to our members.

PROCESS FOR AWARDING FRANCHISES

We welcome the initial preparatory work undertaken by officials in the DfT Rail Division and the contacts
they have made at regional level. This process can only be really productive if DfT officials are able to be
forthcoming and honest in their dealings with local authorities, PTEs and other relevant bodies. We would
urge Ministers to encourage their officials to be more transparent in future consultations. West Coast 250
believes that there are real benefits to be obtained by the DfT from tapping in to local knowledge and to the
considerable knowledge that goes into the formulation of LTPs.

OBJECTIVES OF PASSENGER RAIL FRANCHISING

WCR 250 was instrumental during 1994–95 in persuading the then Government and OPRAF to use the
initial West Coast franchise as a good opportunity to invite bids for upgraded services and new rolling stock.
As a result the new Pendolino tilting trains, along with a comprehensive and lengthy maintenance contract,
are a key factor in attracting new customers as the substantial infrastructure investment on the West Coast
Main Line delivers high levels of reliability.

WCR 250 is also campaigning to secure major new investment in the fabric of our stations along with car
parking and ancillary facilities. These hardly featured in the original franchises, which is why we would urge
that all new franchises must place a greater emphasis on improving stations and car parks.

The DfT therefore should use the franchising process to clearly set out in detail what minimum service
levels it feels are appropriate for routes, stations and rolling stock.

ENVIRONMENTAL CONCERNS

Given the recent increases in fuel prices we would urge the Select Committee to investigate whether
passenger services, such as Cross Country which operates entirely “under the wires”, should be required to
operate by electric traction.
ACCOMMODATING GROWTH

We believe that it is crucial future franchises must be able to respond to demographic and economic changes. We know that, for example, the Milton Keynes area is designated for considerable growth in population and that significant economic growth is forecast for the West Midlands and North West of England metropolitan areas. Therefore it will be essential that the railways are able to play their part in providing environmentally sustainable transport and are able in particular to meet significant future increases in demand. Future franchises must facilitate such expansion in rail travel and must not in any way be an obstacle to modal shift and new investment.

19 June 2006

APPENDIX 6

Memorandum submitted by Hornagold & Hill

INTRODUCTION

This paper sets out Hornagold & Hills’ views on the issues surrounding UK passenger rail franchising, how it has evolved and the way forward. It considers some of the challenges facing the industry and proposes some items for the consideration of the DfT.

What should be the purpose of passenger rail franchising?

The primary objective of rail franchising is to lease the operation of a section of railway for a set period. The train operating company (TOC) will provide as a minimum a level of service specified by the DfT and will assume all “farebox” risk. The franchise should be a vehicle for obtaining the most value for money for any given subsidy whilst providing the appropriate level of service to the customers and harnessing the best entrepreneurial flair of the private sector.

How well does the process for awarding franchises work?

There does appear to be extensive public consultation on the franchises in the year preceding issue of tenders, although we would challenge how much of this is a tick in the box exercise instead of real debate. For example it might focus on stopping patterns at a particular station—of real concern to the passengers affected, but not of strategic importance.

The transition from the SRA to DfT has gone relatively smoothly and included transferring numbers of staff involved in the franchising process. As long as the knowledge acquired from previous bidding is fully utilised, we believe that this will provide a sound basis and knowledge repository that can be called upon to improve the bidding process. This should ensure that previously encountered issues are avoided during the franchising process.

Are franchise contracts the right size, type and length?

Our view is that shorter franchises at the time of bidding cannot achieve the longer term business case benefits that longer franchises could deliver. An example of this is where the payback of an investment cannot be realised in NPV terms in the short franchise—in that case it is unlikely to be included in a bidders base case.

We consider that where investments are agreed in the latter years and perhaps even in the franchise extension period these do not generate the same benefits for the DfT as if they were included at the time of initial bidding.

There is considerable scope for improving the process of franchise bidding still further. Items that the DfT should consider:

- Avoid issuing more bids concurrently—consideration for franchise bidding team workload optimisation and limited technical expertise nationally (e.g., timetabling, modeling).
- Ensure that datarooms are fully populated at the start of bidding to ensure a balance between the incumbent and the new players bidding.
- Ensure that the process for bid evaluation is sufficiently and comprehensively presented to bidders at the outset. Issuing changes during the three month bidding is a major and distracting challenge for bidders that must be avoided to allow bidders to focus on their deliverables.
— Ensure that an efficient and industry leading Q&A system is in place that does not disadvantage those bidding.

— Ensure that more accessibility to the incumbent TOCs facilities is possible at the optimum time to suit bidders. Restricting for instance site visits only leads to unknown risks and assumptions.

The recent move for bid evaluation being based on performance/cost/revenue with a focus on deliverability should be an improvement over 2005 bids. If it works it will give more certainty that the winner is capable of delivering and we support this.

DfT bidders feedback to unsuccessful bidders is constructive and essential and will result in improved bids.

It is accepted that the new franchise is an opportune time to incorporate major changes eg revenue protection through gating or demand management through smart card technology. We would suggest that where a clearer requirement is necessary that this is more explicit in bid documents to ensure comparable bids during evaluation and in delivering what the railway actually requires rather then a bidders interpretation. This is one area where risk ownership may not necessarily be in the ideal location.

There is a need for an industry wide forum for sharing of best practice and lessons learnt amongst operators. There is scope for the DfT to specify some minimal industry wide standards for TOCs to adhere to present a consistent industry face to the customer (yellow banding of first class, use of route indicators, etc).

Do we need more competition and vertical integration?

There are increased risks with open access operations being introduced during a franchise period without consideration of the existing franchise operator. If the existing operator incurs financial loss as a direct result of the open access, it may send out a negative signal to future franchise bidders who would need to take it into account at the time of bidding. Open access agreement within the terms of the franchise agreement should not present a problem and can be a solution to improve the offer for passengers although one might question the long term benefits.

Recent technical journals have written about cascade planning for rolling stock. This demonstrates that there is perhaps inadequate integration between train, rolling stock and track operation. Recent moves away from sourcing rolling stock from ROSCO’s to achieve better returns is an interesting development as TOC’s seek better commercial terms and packages.

Closer integration is essential to balance the longer term investment and solutions necessary for the railway vs the short term opportunities that the TOC alone can facilitate or drive. The industry leading South West Trains class 455 refurbishment could not for instance have been achieved without the TOC, ROSCO and DfT (SRA at the time) agreement to consider benefits beyond the existing franchise period into account—this was achieved with a section agreement.

There have been instances where station ownership has been taken on board by a county during the Railtrack and Network Rail transfer. In that instance this could not have been achieved without the TOC and DfT working together and establishing an alternative necessary owner.

One area where franchise agreements are already used to facilitate national changes in standards is safety. It appears obvious to incorporate essential changes in safety technology eg GSMR providing the DfT can accept the time delay of mobilisation and precise timing of franchise start dates.

Any move towards vertical integration will need to address the potential conflict that may exist between the short-term commercial interests of the train operator and the longer-term investment needs of the infrastructure. The organisation given responsibility for maintaining and renewing the railway infrastructure will need to be free of the current short term commercial pressures of the existing franchise system.

CONCLUSION

— The purpose of passenger rail franchising needs to be examined and questioned as to whether it is the most effective way of structuring rail operations.

— Lessons must be learned from previous franchise bids when awarding future franchises.

— Shorter franchises cannot achieve the longer term business case benefits that longer franchises could deliver.

— Any move towards vertical integration will need to address the potential conflict that may exist between the short-term commercial interests of the train operator and the longer-term investment needs of the infrastructure.

11 June 2006
APPENDIX 7

Memorandum submitted by North Staffordshire Passenger Transport Users’ Forum

What should be the purpose of Passenger Rail Franchising?

Passenger Rail Franchises should be designed to meet the needs of Communities, the railway serves, within the English regions. Which are non-inter city services, and are UK wide.

The Department needs to and must commission a service that meets the need of the travelling public, taking into account the needs of travel to work areas, health services, education and higher education, leisure and good quality food shopping. To ensure the cohesion and social inclusion of Communities.

The franchise must dovetail with regional spatial and economic strategies. And take into account the needs of areas which are designated as new city regions such as: Leeds, Greater Manchester, Greater Bristol, Greater Nottingham, Stoke on Trent, Coventry, Wolverhampton, Birmingham, Greater Plymouth (including parts of Cornwall) Portsmouth and Southampton.

Since the loss of the Regional Rail Passenger Committee’s there has been left a gap in the network for passenger representation. Although, good effective regional transport fora have been established in the South West, West Midlands and North West. Thought should, and must be given funding to ensure that good meaningful dialogue takes place between all parties, particularly on issues such as franchise etc DfT rail group needs to understand the needs of Communities; Examples of failure have been the loss of Stoke on Trent local services, to locations such as the County Town of Stafford, Wedgwood, Barlaston, Stone and loss of both service and station at Etruria. The recent decision to withdraw peak hour services from Longton & Longport leaving commuters without a train services, and no alternative provision. (See attached media report) This occurs when there is no local knowledge and dialogue-taking place, between transport authorities and passenger groups. After, the entire railway was built to convey passengers or freight, yet they appear to have the least say in any planning and provision of services.

Cornish branch lines have lost their Sunday services, again with no alternative bus provision provided by DfT, as has happened at Etruria, Cornwall is a vast area for tourism and this again affects many families who may only have this one opportunity for a holiday, and for anyone to ”cart” luggage and pushchairs etc around is very difficult. To ensure that DfT rail commission the appropriate local rail services to meet the social and economic need of the areas.

In cases of Rail Service withdrawals, DfT unlike the Beeching era and with the exception of Stoke on Trent–Stafford and Bristol Severn Beach have failed to provide any rail replacement bus services leaving some communities without public transport services. It is recommended that a complete revue of the consultation procedures with DfT rail Government Offices within the English Regions take place.

There is an urgent need to set up other Regional public transport user fora to replace the RPC, and to ensure that the whole of the UK is covered to ensure good dialogue between users and providers of services. This also applies to Scotland and Wales

Are Franchise contracts the right size and length?

The awarding of franchise does not take into account the needs of the communities which the railways are supposed to serve and the Government economic policies within the English regions, spatial plans and regional economic strategies. It would be better if the franchises were co signed by Regional Development Agencies, Regional Assemblies, Passenger Transport Executives (PTE’s) or Regional Transport boards (Transport boards need to be created in the English Regions) Which will understand the role of Public Transport provision in the City regions. They should also be able to specify bus and ferry services also those of light rail to ensure a seamless journey. (This is the situation in Western Europe, which is taken for granted)

The franchise agreements are too short and do not allow for investment levels to go beyond the basic management contract of refurbishing and managing train services, Painting, basic maintenance and improvement to rail stations, The Government in England outside of London needs to decide if it should have a 20 year franchise period where the private sector is able to invest new rolling stock and general facility improvements, jointly with local and regional Government. If a pure management contract is the order of the day, which cleans the stock, operates the service and provides the catering contracts, in return for a capitation fee where the risk remains with the treasury to provide the capital funding and resourcing to the level of public service the community requires. When franchise agreements are made, it should be ensured that on board catering facilities are in built, to ensure the travelling public can obtain refreshments. Public sector organisations should be able to operate franchises.
Do We Need more competition and Vertical Integration?

All services should be specified by Regional and National Government, taking account of Government policies on Transport, Global Warming, Social Inclusion, Regional planning, Regeneration of major Cities. With the Government paying 88 million per week and six billion per year in subsidies, to Network rail. The idea of non-specified, private entrepreneurial railway operation which does not make a contribution to infrastructure cost, or social need should not be allowed.

The franchise should not be a way of generating income out of vital public services. The money clearly needs to be re invested into meeting the needs of the Communities to provide revenue support to local regional and suburban and metro services.

We would support Vertical integration of integrated franchises based on the eight large regional companies in England, Scotland and Wales, with access rights and running powers across the whole rail network. The Government as Network rail should remain the owner with local networks going to such as Merseytravel etc and self contained transport authorities/boards. The following regional and national railway companies such as Scottish railways, Welsh railways ie First Great Western and Arriva trains could be vertically integrated through a joint company with Network rail providing separate welsh franchising authority, similarly South West trains with a similar company but separate specification with London.

Community railways could be vertically integrated companies and in places like the rest of Europe be integrated with the local regional authority to provide local bus, rail, ferry and tram services.

Security and catering must be specified in the franchise. The British Transport Police should remain as a separate authority and should not have its offices and resources built into the franchise arrangements. It should be the authority that specifies the travel safe officers, community support officers, rail enforcement officers and security officers these too should be integrated across bus, rail ferry and trains.

Specification to franchise should also include links to ferries such as Isles of Man, Wight, Scilly’s Scottish Highlands and Islands and the Channel Islands. Bus/Rail integration including tickets, service specification, interchanges and rolling stock.

Stations should remain under the control of network rail and should not be constantly painted in corporate liveries eg regional colours and should reflect government ownership and branding and not the operating company colours eg In Wales should have Welsh Assembly gvt colours and a statement saying operated by Arriva Trains Wales. Have a look at how the PTE’s maintained and take ownership of infrastructure.

21 June 2006

APPENDIX 8

Memorandum submitted by Transport 2000

SUMMARY

Transport 2000 campaigns, broadly, for a railway in this country that is modern and efficient, integrated, accessible to all, high quality, accountable, safe, affordable and comprehensive. Our current rail campaign calls for a rail network that is capable of handling, in terms of capacity and quality, the travel demands of twenty-first century Britain. We believe that the railways should be expanded, not contracted, and that a growing railway is critical to meeting economic, environmental and social objectives, as well as creating sustainable communities, tackling climate change and solving road congestion. Passenger rail franchising should be part of a strategy to expand capacity rather than manage demand. The primary purpose should be to provide and develop railway services, within a framework set by the Government, so as to serve the needs of passengers and to secure wider public benefit in terms of social, economic and environmental objectives.

What should be the purpose of passenger rail franchising? Is the current system achieving that purpose?

The use of the railways has grown significantly in the last 10 years, and there are real capacity problems on parts of the network. Franchising should be part of a strategy to expand capacity rather than manage demand. The primary purpose should be to provide and develop railway services, within a framework set by the Government, so as to serve the needs of passengers and to secure wider public benefit in terms of social, economic and environmental objectives. Passenger rail franchising should not lose sight of the passenger and passengers’ needs. Sadly the current policy seems to combine maximum revenue with detailed central control, neither of which is necessarily in the passenger interest. Franchising, as currently practiced, does not give enough emphasis to the railways as a national network or to the needs of local communities. We are also concerned that too little emphasis is placed on integration of the railways with other modes of
transport, particularly buses and cycling. In general, the Department for Transport seems to intervene over detail, but does not get involved in developing network benefits, which is much more its role as the specifier of rail services. For example, it has been left up to the train operators themselves to develop integrated ticketing with bus services, through the “plus bus” scheme. It is a tribute to those involved that the scheme is as widespread as it is but benefits like this should be delivered nationwide rather than left up to operators. Similarly on fares policy, the SRA and the Department for Transport stood by while operators reduced the value of the network card, and as the Committee’s previous report has shown, have failed to require operators to come up with an easily comprehensible fares structure.

How well does the process for awarding franchises work? What input do operators, passengers and other interested parties have into the design of franchised services? Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

Unfortunately, passengers and other interested parties do not have any statutory means of inputting into the design of franchised services. Consultation is far too restrictive, and has sometimes failed to take on board concerns expressed by user and environmental groups and local authorities. There is also a danger that franchising fails to take on board wider policy concerns, for example, links with spatial strategies and proposed new developments.

Transport 2000’s local groups and representatives are in many cases very involved in the franchising processes, and while they have seen some improvements, they have found it difficult to get cost effective improvements in local rail services considered and in some, cases cuts have been made in these services, for example in stopping services on main lines, to make way for longer distance services. Examples include the reductions in local services and stopping trains in the South Eastern Trains Franchise and the elimination of stations in and around Stoke-on-Trent. Some of these have gone directly against other government policies, for example reductions in trains to Hastings, which is designated as a regeneration area, and the failure to consider alternative options in Stoke-on-Trent which could have tied the railways more closely into development and regeneration in the area.

Perhaps the biggest complaints have arisen from the Greater Western Franchise. Our local groups believe that this led to serious errors which have needed rectifying, and which could and should have been avoided. The franchise specification seemed to be driven by attempts to save rolling stock and the leasing costs, and this has driven the timetable and cuts in services. This is at a time when rail demand has been at its highest since 1959, when housing growth is imminent and when cities and towns across the South West region are suffering tremendously from the impacts of road congestion. The impression of our local groups has been that the Government has been more concerned with short-term savings than with dealing with these problems.

For example, the Department removed stopping trains at Westbury which is a key junction where people travelling from London change to travel to Southampton, Poole, or Weymouth for example. Consequently, this service had to be reinstated.

The Greater Bristol Strategic Transport Study showed that people wanted better rail services, and so too the Local Transport Plan highlighted the need for better rail. The Bristol, Bath to South Coast Study recommended that the hourly service between Cardiff and Southampton, be promoted to a half hourly service. However, the new timetable under the Greater Western Franchise cut the existing hourly service to a two-hourly one.

It is unclear how the Regional Planning Assessments (RPAs) fit into the rail franchising process. In theory, the RPAs are supposed to link planning processes to rail policy. In practice, however, many RPAs are not yet published. Those that are, take a very cautious view of the railways’ potential and of future demand (for example, the East of England RPA did not allow for the railways capturing significant freight traffic to ports or new passenger traffic as a result of housing development). This matters because rail franchising should reflect wider development plans. In the case of the Greater Western Franchise, the first version did not appear to take into account but seemed to even contradict two key statutory regional strategies—the Regional Economic Strategy (RES) and the Regional Spatial Strategy (RSS). The RES has very recently been submitted to Ministers for approval. Government Departments, including the Department for Transport, have all been supportive of the revised RES. Both strategies clearly set out policies for maximising the sustainable development outcomes of significant growth and change in the region. The RSS and RES are consistent with the DCLG’s objectives for creating more sustainable communities. The RSS and RES support the priorities for continued growth in urban areas, with better access to jobs and services for people and businesses in smaller towns. However, the proposed timetable appears to work against these agreed national and regional priorities.

For franchising to succeed, there needs to be greater involvement of local and regional authorities, and other bodies so that they have a key role in the franchise awarding process.
Transport Committee: Evidence

Are franchise contracts the right size, type and length? What criteria and processes are used to determine the nature and length of franchises? What criteria and processes are used to evaluate franchise bids? Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts? Are risks suitably apportioned between the Government and franchise holders? What is the scope for improving services through franchise agreements?

The length of franchise contracts is an important factor in delivering a thriving railway. The length of franchise contracts is currently too short and this discourages the kind of investment essential to a thriving railway and constrains franchisees as businesses. The longer franchises seem to be about seven or eight years on average, compared to the Swiss whose average is 20 years. To make a profitable system out of the railways, companies need to know that their investment will be useful not just in the short term but in the mid and long term, with the proviso that companies are monitored at checkpoints during the franchise to ensure they are performing well and to enable action if they are not. Longer franchises would also provide the incentive to buying rather than the more expensive option of leasing trains.

Chiltern railways provides an excellent example of how a longer franchise, in this case 20 years, has produced excellent results: significant investment in stock and track, and satisfied customers, together with a profitable company.

CONCLUSION

Clearly, a system where use has grown so much cannot be wholly wrong. However, we are concerned that the current franchising system is too concerned with maximising revenue/minimising subsidy, and with too detailed intervention. It does not take enough notice of passengers, user and environmental groups, local and regional authorities and other bodies and this has led to the downgrading of local services and local needs, to make way for longer distance services. The Department for Transport, while intervening at a detailed level, has failed to make proper links between franchising and wider policy, and to use its role in franchising to develop network benefits.

22 June 2006

APPENDIX 9

Memorandum submitted by Transport 2000—South West Network and T2000 Wales

What should be the purpose of Passenger Rail Franchising?

Passenger Rail Franchises should be designed to meet the needs of the communities, which the railway serves, within the English regions.

The Department needs and must commission a public service that meets the need of the travelling public, for example to serve travel to work areas, access to health services, education and higher education, leisure and good quality food shopping. The service must be of sufficiently high quality to provide an alternative to those travelling by car in view of policies for modal shift, reduction of congestion on the roads, and sustainable travel.

The franchise must and should fit within the Regional Spatial and Economic strategies. Account should also be taken of areas which are designated City Regions such as: Leeds, Greater Manchester, Greater Bristol, Greater Nottingham, Stoke on Trent, Coventry, Wolverhampton, Birmingham, Greater Plymouth (including parts of Cornwall) Portsmouth And Southampton.

How well does the process for awarding franchising work?

The process is complex, and much of it appears to go on without openness to the public gaze. In the many English regions, many stakeholders got the impression that much was taking place behind closed doors and the intention to make fairly drastic cuts in local and inter-urban services was not made explicit until it was almost too late. Certainly in the South West it was unclear what briefing was delivered to the DfT regarding the desirability of cuts to services and reduction in the length of trains or changes to stopping patterns. It would have been useful if GOSW could have had discussions with stakeholders much earlier on in the process so that they could have communicated current government policy and spending on rail to such groups and organisations, and discussed where the constraints and where problems might lie. This would have enabled early feedback to the DfT regarding the true need for services and their future value.

As it was, the process of awarding the Greater Western Franchise for example, franchise suffered from a real lack of meaningful input into the decision making process on timetable specification, service quality awarding and service provision.
We feel that the Department for Transport failed to do their homework when it came to the future demands of the South West Regional Spatial Strategy, the expansion of Bristol, Plymouth and Exeter, and the wider needs of communities, passengers, local authorities and the SW RDA within the contract specification. Much of the liaison work was therefore left to groups such as Transport 2000 and the South West Passenger Transport Users’ Forum (SWPTUF) who had to put in a great deal of extra work as a result.

One of the more curious decisions was the reduction of services and the length of trains between Portsmouth—Southampton—Salisbury—Westbury—Bath—Bristol—Newport and Cardiff. These cuts fly directly in the face of the Bristol-Bath to South Coast Study which actually recommended in 2003 that trains were made longer and much more frequent. The decision to withdraw three car units and then to replace these by two car units resulting in 1,000 less seats at peak times into Greater Bristol is extraordinary in its own right. But to impose cuts on the whole corridor from Bristol to Southampton and Portsmouth when this is one of the fastest growing parts of the UK is surely nothing short of foolhardy. With trains already bursting at the seams and passengers often left stranded on the platform at Bath unable to board, how were the DfT briefed that it was reasonable to cut back rail services?

The loss of services on the Exeter—Plymouth corridor, serving the towns of Totnes and Ivy Bridge is also unexpected. This service is going from 12 trains per day down to only three in each direction, even though it serves Plymouth, which again is an area of economic and housing growth. Other examples of cuts in the new franchise appear in Cornwall, Wiltshire, and so on. We feel that there was little meaningful discussion as to the rationale behind decisions.

Outside of the South West, we regret very much the loss of Stoke on Trent local services, to locations such as the County Town of Stafford, Wedgwood, Barlaston, Stone and loss of both service and station at Etruria. The recent decision by DfT rail to withdraw peak services from Longton & Longport, leaving commuters without a train services, and no alternative provision owing to lack of local knowledge and input by local transport authorities and passenger groups.

We regret very much the loss of the Regional Rail Passenger Committees as there is now a large gap in the network for passenger representation.

Rolling stock has been an issue in the South West, and the lack of it has constrained services quite unreasonably. Contrast to Wales, where the Welsh Assembly Government, to which the franchise has devolved to Transport for Wales and operated by Arriva trains Wales, has a well-focused approach involving the Transport Minister, Andrew Davies with intervention directly by Welsh Assembly Transport Civil Servants in managing Arriva trains Wales. This has resulted in the recent change of Managing director and leading to a more focused approach on capacity to meet the needs of the Welsh Valley line services. This has lead to the hiring of additional rolling stock to meet needs.

In summary then, we feel that the awarding of franchises do not take into account the needs of the communities which the railways are supposed to serve and the Government economic policies within the English regions, spatial plans and regional economic strategies. It would be better if the franchises were co signed by Regional Development Agencies, Regional Assemblies, Passenger Transport Executives (PTE’s) or Regional Transport boards (Transport boards need to be created in the English Regions) Which will understand the role of Public Transport provision in the City regions. They should also be able to specify bus and ferry services also those of light rail to ensure a seamless journey. (This is the situation in Western Europe, which is taken for granted)

Are franchise contracts the right size, type and length?

We feel that the franchise agreements are too short and this does not allow for investment levels to go beyond the basic management contract of refurbishing and managing train services, painting, basic maintenance and improvement to rail stations. A 20-year franchise period would at least allow the private sector to invest new rolling stock and general facility improvements jointly with local and regional Government. On the other hand, it may instead be that a pure management contract is the order of the day, which involves cleaning the stock, operating the service and providing the catering contracts, in return for a capitation fee where the risk remains with the treasury to provide the capital funding and resourcing to the level of public service the community requires.

Do we need more competition and vertical Integration?

All services should be specified by Regional and National Government, taking account of government policies on transport, global warming, social inclusion, regional planning, regeneration of major cities and so on.

The idea of non specified private entrepreneurial railway operations which do not make a contribution to infrastructure costs or social need should not be allowed. Exceptions to the rule could be the Hull Trains situation providing economic development between Hull and London, and the proposed Wrexham to London service where support and direction is coming from the Welsh Assembly Government. We would
not support a pure open access operation which undermines the viability of existing inter city operations. We have major concerns regarding the Grand central operation between Sunderland and London and would prefer all services to be clearly specified and procured by Government.

The franchise should not be a way of generating income out of vital public services. The money clearly needs to be reinvested into meeting the needs of the communities to provide revenue support to local regional and suburban and metro services. For example, Great Western should have provided local services between Exeter, Bristol and Plymouth, Swindon, Sothampton and Portsmouth–Cardi

routes. The maintaining of the Swansea–Penzance service should likewise mean that Virgin Stagecoach should provide the necessary services in the Stoke area.

We would support vertical integration of integrated franchises based on the eight large regional companies in England, Scotland and Wales, with access rights and running powers across the whole rail network. The Government as Network rail should remain the owner with local networks going self contained transport authorities or boards.

Community railways could be vertically integrated companies and in places like the rest of Europe be integrated with the local regional authority to provide local bus, rail, ferry and tram services.

Security and catering must be specified in the franchise. The British Transport Police should remain as a separate authority and should not have its offices and resources built into the franchise arrangements. It should be the authority that specifies the travel safe officers, community support officers, rail enforcement officers and security officers these too should be integrated across bus, rail ferry and trains.

Specification to franchise should also include links to ferries such as Isles of Man, Wight, Scilly Isles Scottish Highlands & Islands and the Channel Islands, and also bus/rail integration including tickets, service specification, interchanges.

Station should remain under the control of network rail and should not be constantly painted in corporate liveries.

22 June 2006

APPENDIX 10

Memorandum submitted by Mr Jim Steer

INTRODUCTION

1. This submission has been prepared in response to a request to do so as a practising consultant in the field. I have appeared before the Committee before, to answer questions on matters related to franchising, on behalf of the Strategic Rail Authority.

2. As a founder and Director of Steer Davies Gleave, I have been engaged as an adviser to the British Railways Board and its constituent business prior to privatisation and subsequently to various parts of the privatised railway “family”. My own experience covers franchise bid advice to management buy-out and corporate investor teams, and ongoing support of operational franchises. I was seconded to the SRA for a period of three years and three months from 2002 to 2005, as Managing Director, Strategic Planning. I took a pre-agreed three month break before returning to Steer Davies Gleave in October 2005. I am also a Director of Greengauge 21, a not-for-profit organisation that seeks to advance the debate around high-speed rail for Britain.

3. I have participated therefore in various aspects of the privatised railway with the benefit of having also been involved in a number of important developments in the BR era. I set out some views on these matters at conferences and in journals.9 In 1992, I wrote a report for Transport 2000 entitled “Costs of Rail Privatisation”. This foretold increases in the overall costs of rail provision, in part because of the increased costs of transactions between the various industry players. This indeed turned out to be the case, although I believe that there are a number of benefits that can and should be set alongside the additional costs of rail provision today compared with 13 years ago, most of which are unrelated to the structural changes in the industry in my view.

4. I shall restrict myself to the specific questions in which the Committee has expressed an interest. The opinions here are my own, and they may not be those of my employer Steer Davies Gleave.

THE PURPOSE OF RAIL FRANCHISING

5. The rather fundamental first question posed by the Committee is: “what is the purpose of passenger rail franchising?” and then, “is the current system achieving that purpose?”

6. The purpose of passenger rail franchising is, in my view five-fold, as it has turned out:
   — To create entities and management that can be closely focussed on meeting customer needs in an operationally complex system (the railway) where technical, operational and engineering considerations have a natural tendency to dominate.
   — To introduce a managed level of competition into train service provision, avoiding the uncertainties and therefore costs associated with an on-track open access type of competitive environment, yet still deriving the benefits of competitive pressure as a means of delivering value for money to the public purse.
   — To introduce fresh ideas and a diversity of ideas on how best to deliver quality and value for money, removing any dependence on a single centrally determined prescription, and offering the prospect of a learning-from-rivals culture to achieve best practice.
   — To create an ability to measure and incentivise performance and performance improvement and provide the means to benchmark.
   — To achieve an objective of successive Treasuries, which is to contain public sector spending, and in this case, specifically to keep the capital elements of passenger train service provision costs off the public sector accounts. In relation to rolling stock, this is generally achieved through franchisees’ use of ROSCOs for the supply of trains on a leasing contract.

7. I am not suggesting that these were necessarily the objectives at the outset, in the minds of the authors of the rail privatisation model. But these are identifiable purposes that franchising has brought, that would potentially be lost without it.

8. The proposition of a separate entity focussed on customers was a feature of the thinking behind the “sectorisation” of BR brought about under Sir Robert Reid in the early 1980s. Indeed, the contractual structure of franchising, in theory, ought to deliver what I recall senior BR managers at the time were hoping to achieve: a commercial approach, customer-led, and able to determine the standards to which the critical and expensive technical and engineering components should be supplied. That would have been in the public sector and under a single management structure of course. But my point is to distinguish the first of the three objectives—an alignment with customers’ interests—from the wider debate about the merits of privatisation per se, with which I suspect it is frequently confused.

9. As to whether these purposes are being met, I would answer as follows. As to the first purpose, I would argue to a very significant extent that this is being achieved, day-in day-out, remembering that the alternative is an un-franchised structure under some kind of command and control management system. Comparisons across the decades are hard to make empirically in this field, but it is certainly the case that the level of attention to customers on today’s railways by the franchisees is immeasurably much greater than it was in the latter days of British Rail. That isn’t to say that performance in this area couldn’t yet be made very much better still: surely it could be. But the growth in rail passenger use would not be continuing were rail not offering a better travel solution than its competitors.

10. With regard to the second purpose, I would also suggest a significant level of achievement. This can be empirically tested up to a point. Certainly, the market for rail passenger franchises is well established, with major UK listed companies regularly contesting the market, and a number of off-shore companies involved too. DfT and the SRA before it have had no apparent difficulty in attracting bidders. It is a competitive environment, with bids offering the prospect of significant savings to the public purse. The problem is that in some cases, these remain just that—prospects, although in general it is the case that franchisees are continuing to deliver against agreed declining levels of subsidy, albeit that the overall levels of subsidy are higher than in BR days.

11. The fact is, however, that there are good reasons why costs (as well as revenues) are higher than in the BR era. These are (1) the railway is a lot busier, carrying many more passengers (2) it is operating at a higher level of passenger safety and this comes at a price (although quantifying this price is extremely difficult) (3) there has been inflation over the period since the demise of BR, including in specific areas such as pension costs (4) the railway has been going through a period of catch-up on renewals. The last-mentioned in particular applies to Network Rail, and this is reflected in a significant increase in track costs, with, for example, franchisees using the West Coast Main Line which has been the subject of a major renewals programme passing on very much higher track costs to DfT than they started with. In these circumstances, in an industry where there is a mix of premia and subsidies for franchises that sum to a net cost (subsidy) as far as the exchequer is concerned, it is not surprising that cost increases exceed revenue growth. A worsening over time of “franchise” economics may mean several things: it doesn’t necessarily mean that franchising is offering poor value for money compared with the alternatives.

12. Value for money is at the heart of this second purpose. I am not aware of any research designed explicitly to prove the point either way on the role of franchising in this context. To do so would require definition of what economists would call the “counter-factual”, in other words, what is assumed to exist in the absence of franchising? This cannot sensibly be “just turn the clock back”. Rather a contemporary
arrangement would have to be defined. It would seem rather likely that such an arrangement would have a significant degree of decentralisation (after all, the initial franchise definitions followed BR’s “sub-sector” boundaries), ie key components would be contracted out. This could probably only be done under law by a competitive tender. So the distinction would presumably be about ownership and whether the relationships are contractualised, rather than on the scale and nature of the business entities (leaving aside the rather separate question of the virtues or otherwise of so-called vertical integration). There was a good argument to be had at the time of privatisation that a preferable solution would lie in the retention of a central contracting entity (BRB), with separate businesses hived off. The passenger rail service companies would have looked remarkably similar to today’s model. The difference would lie in the nature of the contracting authority and its ability to direct coherent behaviours. The notion of track access “rights” which franchisees regard as a principal asset would not arise. But, as noted, no such study has to my knowledge been carried out and there would be little purpose served in doing so unless there was a clear consensus around an alternative model or models.

13. A further factor in the value for money equation would be the question of whether or not the private sector businesses that have acquired franchises have brought in skills previously lacking in the rail sector. While it would be judgemental to argue the relative virtues of the management skill-set between the public and private sectors as a generality, it is certainly the case that the new owners have challenged many assumptions that previously would have been taken as fixed. I would argue that they need to go further and in particular to establish a means of engaging in industry-wide developments more effectively than has been possible so far under the aegis of ATOC.

14. The third and fourth purposes are straight-forward, secondary but of significance. Franchisees have tackled challenges differently and broken various “moulds” of behaviour. I would cite the fresh approach to contracting for the supply of rolling stock, with some franchisees opting to procure the provision of rolling stock, their maintenance and the supply of new depots through a single integrated contract with associated tariffs and performance incentives as an example. It is far easier to test out new ideas dependably if they are attempted locally with a committed management effort (rather than as a nationwide programme) if the overall outputs are tightly specified in a franchise agreement. There has been a welcome diversity of ideas brought to the railway, much of it not particularly visible to commentators, because the innovations tend to be at the routine or management level.

15. When franchising commenced, the only data made available for public consumption on a regular basis was a set of monthly performance statistics, franchise by franchise. Newspaper editors then had the pleasure of publishing league tables, with nobody bothering to explain that some franchises were very much easier to run reliably than others. Nevertheless, these statistics proved ultimately to be a significant influence over the owners and managers of the rail franchises. Performance reliability became a driving policy for the industry, with the very public exposure of data against the names of major plcs I suspect an important factor.

16. The fifth purpose is about the public sector accounting treatment of capital expenditure on passenger rail service provision. It is intimately tied up with the issue of risk transfer. A move away from franchising that left government able to “interfere” in day to day management, including in capital expenditure would, I suspect, trigger ONS interest. The current arrangement has the characteristics of PFI, with the ability to have private sector management and financing of investments by franchisees, although usually not on the scale that has sometimes been hoped for.

17. Overall, while the value for money question cannot be fully answered on the basis of the evidence available, there is sufficient here to suggest that the purposes of franchising, as I have identified them above, are, to at least a reasonable degree, being fulfilled.

THE PROCESS OF AWARDED FRANCHISES AND THEIR DESIGN

18. I believe that the processes for awarding franchises have been exemplary. I am not in a position to comment on the smoothness of the transition from SRA to DfT, but I understand that similar approaches are being followed—and many of the specialist personnel transferred across.

19. There is a full consultation on the proposed “design” of the franchises with stakeholders and passenger group representatives. When I was at the SRA, I was responsible for the creation of an industry planning framework into which franchise specifications were intended to be embedded. This process provided the key links, with appropriate feedback/up-dating along these steps:

   Strategic plan → Regional Planning Assessment → Route Utilisation Strategy → Franchise Specification.

20. Thus the franchises are not set in isolation, but by reference to wider industry plans that are designed to reconcile inter alia conflicting demands on a constrained network. This sequential process has yet to become established, although each of the constituent parts has been continued under the revised industry arrangements following the demise of the SRA and should become so in due course. The Strategic Plan was intended to be an annual document; the high level output statement (HLOS) process with associated statements may serve as its successor.
21. An important feature of the franchise award process has been the existence of two dimensions along which the franchise bids can be placed and valued. One of these is price; the other in effect reflects critical quality and delivery capabilities. The existence of the two is essential, in my view. Clearly, it is easier to measure a bid along the price axis. If departmental budgets are under pressure (and they always are) then there might be pressure to focus unduly on this most measurable output. I have no evidence that this has happened, but it is a risk and perhaps a greater one with responsibility for the process of franchising having been transferred from an agency into the Department.

22. The tighter specifications for franchises originated by the SRA and continued by DfT, are important here. Without this clarity, fair comparison of bidder responses other than on price is much harder, and can take the focus off the important area of delivery. It also reduces bidder costs, but means there is less innovation.

FRANCHISE SIZE, TYPE AND LENGTH; RISK ALLOCATION AND CONTRACTUALISING IMPROVEMENTS

23. The Committee asked questions here about the criteria and processes for determining these key franchise parameters, for the rather separate question about how franchise bids are evaluated (which I have addressed in answering the previous question-set), and the related question of whether franchise holders deliver value for money throughout the duration of the franchises.

24. The original arrangements on franchise length are well-known. The norm of seven and a half years was an attempt to strike a balance between, on the one hand, longevity so that the consequences of actions would bear on the incumbent and, on the other, frequent re-tendering from which the advantage of competitive pressure would flow (but which impose higher transaction costs on the industry). Exceptions were contrived for some franchises where there were significant investment programmes.

25. In the early years of the shadow and full SRA, an attempt was made to let longer franchises, but this was in the Hatfield era. The extension of journey times and appalling levels of punctuality meant that no bidder could be confident on revenues, and the longer ahead they were asked to contemplate, the greater the level of commercial commitment and risk involved. Given the state of Railtrack’s finances, it was very difficult as well to commit the investments which it is frequently supposed might have helped justify longer franchises.

26. It was therefore necessary to adopt short term franchises for a period, since to do other than extend them until such time as an open competition could be held in a more propitious market-place, would not represent best value for money. Other franchises where a lengthy franchise term had been contemplated were the subject of shifts in bidder positions that rendered them poor value for money, so franchise length was curtailed.

27. It has often been said that long franchises are necessary to encourage investment. In practice, it is not the franchisee’s finance that is of relevance here so much as their contractualised commitment and capability to deliver not just a continuing service but also a proven enhancement. The problem isn’t having sufficient franchise duration to earn a return on capital (there are mechanisms available to cover off the miss-match between pay-back periods and franchise length) the issue is about having sufficient time to plan and undertake what often are complex programmes of work associated with making improvements in rail service provision. For example, Chiltern Trains was widely commended for making investments in its original formulation as a “short” (7 year) franchise. Indeed its competency in investment management was probably a factor in the award of a lengthier second term franchise. Chiltern happens also to be a franchise that has provided some finance as well as management of investment. Franchise length is not as critical to making investments as some people seem to imagine. The evidence for this is that “investments” of over £100 million are being made under “short” franchises. Major investments in infrastructure and new trains are not financed directly by franchisees, as a rule.

28. Franchise length is also a matter of EU law.

29. The question of franchise size has been driven by four things:
   — Commercial and operational coherence, defined by the market served (intercity, regional or commuter) and the physical configuration of the network.
   — The benefit of continuity (including onwards from BR’s devolved management structures).
   — The economics of the franchising process which do not help the case for small franchises.
   — The desire to reduce complexity on the railway, including the number of contractualised operational interfaces. This led the SRA to develop a means to reduce the number of franchises, a process that is still in hand.

30. The Committee raises an interesting question about the latter period of franchises, and one with which I believe there has only been moderate success in a policy sense. It is difficult to plan as confidently and therefore to contractualise actions in the latter stages of franchises compared with the early years. There is a tendency therefore to see less initiative being taken further into a franchise term. However, it is also the case that perceptions matter, and in the lengthy run-in to the award of successor franchises, it can obviously be in the interests of the franchise owners to put on a “good show” if at all possible. While this may drive up the bench-mark standards that the tendering agency is likely then to set for the successor, these standards
apply to all bidders: they make it harder to perform the successor franchise obligations but they do not harm incumbent bidder prospects. The introduction of major reviews into franchises also helps address the problem.

31. On the question of risk allocation, there has been an interesting change with the introduction of floor and ceiling thresholds after the first few years of the franchise. These are designed to address the risks that lie totally beyond the control of the franchisees, and yet could blow a franchise off course. The value of this policy shift should be experienced in the acceptability of tighter profit margins.

32. Improvement through the life of a franchise is the subject of various contractual levers. Usually, performance reliability measured by PPM will be set on an upward slope. Investments, even of a major nature have been deployed in franchise agreements. The unique experience of the West Coast project does not prove that these cannot work. Indeed, the contractual obligation on Virgin Rail Group is arguably the reason why a solution to that project’s problems had to be found rather than allow the industry to simply “give up”.

**COMPETITION, OPEN ACCESS AND VERTICAL INTEGRATION**

33. The industry track access arrangements are designed to facilitate a mix of open access and franchised operations. Most open access operations are freight. The problem to which the Committee refers concerns open access passenger operations and is the subject of legal action between a franchisee and the Office of Rail Regulation. I do not propose to comment on any matter related to this case.

34. What I would say is that the process described in §19 above is of some relevance. It entails the production of Strategies, and these Strategies the ORR was obliged to take into account in its consideration of track access applications, including from open access operators. Following the demise of the SRA, this is no longer the case and the ORR no longer has any such obligation.

35. This is most unfortunate, since the “light touch” coherence to industry plans that the §19 processes were intended to bring relied on this regulatory connection to ensure that the coherence achieved was given expression through the difficult decisions that the ORR faced on track access matters. While the Route Utilisation Strategies being taken forward by Network Rail are widely regarded as being very worthwhile, it cannot be for Network Rail (which has a duty not to discriminate between customers) to come to a view on how to handle the choice between open access and franchised passenger operations.

36. The Route Utilisation Strategies need to have an input from those responsible and accountable for rail industry funding, which is now the Department for Transport, that extends beyond any over-arching statement of policy to make explicit, in the circumstances of each route, how it wishes to see the particular issues of open access passenger services handled. Moreover, the Office of Rail Regulation needs to be able to have sight of the Route Utilisation Process (which it has) to ensure that this government input has been properly reflected and discharged by Network Rail so that it is in a position to align its subsequent individual track access determinations with the agreed route strategies. I would argue that ORR should be obliged to reflect these strategies in its decisions, and that such a position cannot be said to undermine its independence. If this is the counter-argument, however, then based on what I judge will deliver the best service to the public for a given level of public sector £ support, I would sacrifice some of the independence of the Regulator in exchange for greater coherence in the way that passenger rail services are planned.

37. This does not mean that there can be no open access operations, merely that they need proper thought and planning just as is the case with franchised services. The concept of planning does not fit easily, without this wider apparatus I have just described, into the essentially reactive processes that the ORR undertakes. It requires the contrivances I mention to ensure a sensibly joined-up outcome with predictable financial consequences.

**SUMMARY AND CONCLUSION**

38. The franchising model, as it turns out, has a number of virtues in an environment where there is continued public subsidy of the network and therefore the need to influence the service level and quality to be procured. It is gradually being adopted across the EU, although certain member states are very resistant to a break-up of the state-owned monopoly service provider. Whether it represents best value for money of the options open to us is a matter of conjecture, requiring the considered formulation of a coherent alternative. It would seem unlikely to me that such a development, even if properly assessed, would be a priority for improving passenger rail services, especially given the huge costs associated with all restructurings. But there are a number of improvements that need to be made, not least as described in the paper, to avoid losing the benefits of the joined-up planning processes that the SRA devised.

*26 June 2006*
APPENDIX 11

Memorandum submitted by Stagecoach Group: Rail Division

EXECUTIVE SUMMARY

1. Stagecoach Group is the current operator of South West Trains and Island Line on the Isle of Wight. We are currently involved in the process of bidding for the South Western franchise, which will cover both South West Trains and Island Line.

2. In this submission we address particularly two of the Committee's principal questions: how well does the process for awarding franchises work; and are franchise contracts the right size, type and length.

3. On the first point, introduction of the franchise structure was intended to free the railway from an annual round of budget-setting. But the corollary is that there is a need to determine budgets and plans for the duration of the franchise during the bidding process. This can of course be complicated, and so time-consuming and resource-intensive, and has led to some comment about bid costs. There is a particular issue with "over-heating" in the specialist consultancy sector to support these bids.

4. The cost issue is compounded by the fact that the Department for Transport has not had a procurement model settled from one franchise to the next.

5. The resulting high cost of bidding in the end impacts on the cost of the franchise. Any proposal that would streamline the process, even to a limited extent, would be welcomed by all train operators, including Stagecoach Group, and would also benefit taxpayers and the travelling public.

6. On the second point, the main issues are the length of each franchise and how prescriptive are its terms. Operators are resourceful, and will adapt to the circumstances presented to them. But longer franchises allow for improved planning, and the possibility of greater and more imaginative investment on the part of train operators.

7. The degree to which the franchise is prescriptive also has a bearing on how imaginative investment plans will be. In particular operators are resistant to over-regulation on the revenue and timetable sides, since that limits their freedom for manoeuvre and to deliver the management of capacity.

8. We accept the current structure of franchising, but believe that there are changes that can be made that will ultimately benefit the travelling public and taxpayers. The Committee's inquiry is timely, and we welcome it. We look forward to its conclusions, and to learning from its report.

INTRODUCTION

9. Stagecoach Group is one of the world's leading transport operators with train, bus, tram and express coach operations in the UK and North America. Our rail division includes being franchise holder for South West Trains and for Island Line on the Isle of Wight, as well as a 49% holding in Virgin Rail Group, which runs the West Coast and CrossCountry franchises.

10. We are proud of the way in which we have managed the South West Trains and Island Line franchises. Earlier this year we were awarded HSBC Rail Business of the Year, and we were named the Passenger Operator of the Year at the National Rail Awards in September 2005.

11. Stagecoach Group is currently bidding to retain the South Western franchise, which incorporates the existing South West Trains and Island Line. As the Committee will understand, this has placed considerable demands on our resources, and we have not been able to prepare written evidence as fully as we would have liked. Nevertheless, we trust that this memorandum is of use to the Committee.

How well does the process for awarding franchises work?

12. Stagecoach Group has recently been involved in the process of bidding for the Inter City East Coast, Greater Western, Thameslink, Great Northern, and Integrated Kent and South Western franchises. Stagecoach has operated the South West Trains franchise from 1995, receiving a four-year extension to the franchise in 2002. Our comments below derive from our experience as an operator and as a bidder.

13. Prior to the introduction of the franchise structure the railway was subject to an annual round of budget-setting by the Department of Transport. It was argued that this inhibited long-term planning and constrained investment. The franchise system was intended to move the railway away from short-termism, and it has generally been successful in doing so.

14. However, the consequence is that budgets for each franchise must be set prior to its award, and they must be valid for the duration of each franchise. Thus the plans and documentation tend to be long and the process of compiling them is time-consuming for all bidders, and is therefore costly.
15. Current invitations to tender for franchises also require respondents to prepare a large number of very detailed documents. Indeed, just to get on a tender shortlist and receive a prequalification document requires the submission of two or more substantial folders of evidence.

16. In addition, some aspects of the franchise bid require the input of very specialist consultants. Their numbers are necessarily limited, and with typically five companies short-listed for each tender they are in high demand. This can lead to “over-heating” in the consultancy sector, further inflating costs for the whole rail sector. If consultancies are guaranteed a stable base of franchise work then costs will come down over time. If there is least and famine then we expect the average cost of consultancy to rise. This is particularly the case if a high level of detail is asked for in the Invitation to Tender.

17. Another factor driving up costs is the fact that the Department for Transport (DfT) has not made use of a settled procurement model for different franchises. Indeed, all bidders have experienced that the evaluation model can evolve through “clarification” during a bid process, leading to frustration and abortive cost. Greater uniformity in the technical specification of each tender, and in the methodology of bid assessment, would help to reduce the cost of bidding and thus the cost to passengers and taxpayers.

18. The DfT has been open to change and has—for example—held trade days where bidding groups can feedback on DfT’s processes. Whilst this supports continuous improvement in principle it can create continuous change from franchise competition to competition in practice. This has increased costs.

19. This memorandum is not a criticism of the franchising process per se. As we have said, we do understand the need for robust budget-setting and planning before franchises are awarded. However, judging from train operating company owning groups’ reports and accounts, it is the case that the cost of bidding is high. In the end costs incurred in bidding are reflected in the cost of the franchise, and thus impact on DfT finances.

20. Therefore, streamlining and simplifying the bidding process, even to a limited extent, would be of direct benefit to taxpayers. Our initial proposal is that DfT establish a settled procurement model which is used for different franchises. We look forward to the other recommendations of the Committee.

Are franchise contracts the right size, type and length?

21. Our concerns in respect of this second question are the duration of franchises, and the degree to which their terms are prescriptive. Although train operating companies are resourceful and adaptable, there are clear benefits for taxpayers and the travelling public if franchise lengths and conditions are optimised.

22. It is self-evident that train operating companies will only plan for investments that will deliver improvements during the term of the franchise. Franchises of shorter durations inevitably discourage investments for radical change. Instead train operating companies focus on incremental, relatively small-scale improvements. It is equally evident that longer franchises allow companies to plan greater and more imaginative investment, particularly in relation to managing for capacity.

23. For example, the 20-year Chiltern Railways franchise is often rightly cited as including plans for investment which were far more wide-ranging than were contained in shorter franchises elsewhere. Clear benefits for passengers and indeed for taxpayers, in terms of the rail service delivered and particularly in station and capacity improvements, have resulted.

24. It was originally mooted that the new South West Trains franchise to run from 2002 would be for 20 years. Stagecoach Group’s proposals for the franchise included plans for investment which would have led to a step-change in the service provided. This was particularly the case in relation to capacity, where we planned for platform extensions at many stations to permit a 10-car railway. It is not surprising that the one year franchise extension plus three year new franchise that was eventually agreed did not include such measures.

25. To develop the point, Stagecoach Group also supports the idea of vertical integration within franchises, bringing together those responsible for the operation of trains, and those responsible for the track. That was the proposal for the 20 year South West Trains franchise proposed in 2002. Such integration would, in particular, help in the co-ordination of the investment required for capacity improvements, since it would allow consideration of platform extensions alongside the need for longer trains and more rolling stock.

26. There is also a case—which the Government has to an extent taken up—for fewer and bigger franchises. The travelling public, and the taxpayer, want a joined-up railway in which services complement one another, and in which operators are best placed to respond flexibly to demand, delivering additional capacity where it is required. Bringing together smaller franchises, such as is the case with the Greater Western franchise, helps to provide that flexibility.

27. Another issue to be considered is the degree to which franchises are prescriptive. If operators are unduly trammelled by franchise conditions that will also affect how imaginative their plans will be.
28. Particular concerns relate to the regulation of fares and the specification of timetables. Having freedom, to a degree, to set fares allows operators to manage demand. There is of course a good case for controlling peak fares, but outside the peak it is important that fares can be increased or decreased to respond to demand, and to maximise usage. Having this freedom has, for example, allowed Stagecoach Group to institute its megatrain service on South West Trains, and now on Virgin Trains services.

29. Similarly, over-prescription in relation to the timetable constrains operators in the services they can deliver. It is clearly the case that on some lines, particularly close to London, variations in the timetable are not possible due to a lack of capacity. But it is important to allow operators to be responsive to passengers. Setting the timetable in stone at the beginning of the franchise may mean that such responsiveness is impossible. We also firmly believe that Train Operators are best placed to optimise timetables.

30. In short we believe that franchises should balance the need for Departmental oversight and management with being of sufficient length, structure and flexibility to allow operators to plan for investments that will deliver significant change. They must also give operators room for manoeuvre.

CONCLUSION

31. Stagecoach Group accepts the current structure of franchising, but believes there are areas in which improvements might be made that would improve both the structure and the process. We have described some of those areas in this memorandum; other stakeholders will doubtless have other proposals.

32. There are lessons that can be learned from the on-going round of recent and forthcoming franchise awards. Therefore the Committee's inquiry is timely. We look forward to its conclusions, and to learning from its report.

29 June 2006

APPENDIX 12

Memorandum submitted by CTC

The CTC has since 1878 provided a voice for cyclists in shaping transport policy and provision, and today represents some 70,000 members and affiliates mostly based in the UK. The use of the bicycle as transport, and its value as a complementary mode to public transport are key areas in which CTC and its members press for recognition and implementation of policy and projects.

What should be the purpose of passenger rail franchising?

The experience of the recently tendered franchises is that they are very negative in their position with regard to growing and developing rail services, and focus in many cases in retrenchment and minimum price options. This often hits our members as the awarded franchises tend to move away from flexibility and versatility which rail offers and the desirability of a system which can handle both commuter, business and leisure travel.

How well does the process for awarding franchises work?

The experience here, in theory has been one of improving prospects.

What input do operators, passengers and other interested parties have into the design of franchised services?

With established franchises there is a huge variation in management style. CTC has found the ability to talk to franchises like SW Trains (Stagecoach) has provided a valuable input to design of refurbished trains, and development of cycle policy. GNER, Northern Rail, Scotrail and Merseyrail have all been good at delivering, and reacting to our concerns. Notable for their diktat style and reputation for not wanting to talk or listen are the Govia companies, Southern, and South Eastern (and formerly Thameslink).

Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

Both smooth and if anything an improved presentation and handling of the invitation to comment.
Are franchise contracts the right size, type and length?

No, the long franchise for Chiltern shows just what stability can do, but the option for break-points in a long franchise has not been fully exploited. We believe that a long franchise with significant review of progress and the opportunity to have the incumbent in a preferred position to submit a bid to run-on for five or 10 year segments, rather than have the hiatus of a complete shut down and restart, which effectively stops all projects and investment in the run-up to the franchising. The incumbent would submit their prospectus, and DfT their aspirations for the next period say 18 months ahead of the end of the current agreement, and if this delivers appropriately, the franchise would be extended, if not, bids would be invited to take-over the franchise, and the incumbent invited to sharpen their pencils.

Do franchise holders deliver value for money to passengers and the Government throughout the duration of their contracts?

No, most notably from the reports of cyclists refused travel on almost empty trains when Southern management went for a rigorous curfew on cycles on the London-Brighton line for six hours per day. CTC and affiliated groups were astounded that Southern were driving away regular commuters (in some cases making it almost impossible to carry on working and commuting by rail) with an average annual payment of £2,300 per cyclist, all when the company received over £71 million to run the services (ie government subsidy used to run empty trains whilst potential users were being refused access).

Are risks suitably apportioned between the Government and franchise holders?

We cannot comment in detail, but the arguments by franchisees against investment to deliver effective cycle-rail integration suggests that the long term investment and related risks are not being addressed effectively by the current arrangements.

What is the scope for improving services through franchise agreements?

This is the way to improve services, as effectively it is the agreement the Government has with the franchisees to deliver the rail service. However, the ability of a franchisee to exploit a new market or work outside the basic service specified by the franchise seems to be too severely constrained.

Do we need more competition and vertical integration?

The SRA Rolling Stock Consultation allowed us to suggest that there could be no reason that the three Rolling Stock Companies have the exclusive rights to supply the operators with trains, and operators should be able to buy trains, plus mini RoSCos and leasing from EU-based companies should be possible, so that specialist vehicles can be provided, and a genuinely competitive supply sourced should be able to exist with the ability to provide specialist trains for special traffic.

Is franchising compatible with open access operations?

It would be very useful to have choice, and the ability to run a special service for a special event or traffic is seriously limited by the control which the regulator and principal operator can exercise—examples could include running a special service to get cyclists away home from Brighton after the annual BHF cycle ride, where the principal operator dictates no bikes on any trains (even if other operators can offer this).

The extreme in the other direction is to guard against predatory operations, and the bus industry has the position of not registering services which directly compete. In this way an operator who does not deliver to a market, by shortening trains and pricing out or otherwise driving away custom, may find another operator able to move in and offer a better service for that specific market.

Should train, rolling stock and track operation be more closely integrated?

There is certainly a need for this. The limitation on a train operator modifying the layout of trains to suit the actual needs of their customers is constrained by the need to hand the trains back in a specified condition, and the near cartel conditions relating to the leasing of rolling stock.

Some services are curtailed or otherwise dictated (ie short trains to save on access charges) by the way the market is organised at present. Additional vehicles/space for carrying bikes and luggage on a train carries a greater penalty than the small cost of hauling an extra coach making the decisions on running trains with greater flexibility in the ability to carry a variety of traffic and widely varying numbers on commuter lines (especially in SE England) a per train charge might be more appropriate. It is pointed out that by vehicle count (64 per night of which 32 do not call to set down passengers) Scotrail incur charges similar to the local train operator at Preston Station, as the latter only use one and two-coach DMU’s.

8 July 2006
APPENDIX 13

Memorandum submitted by the Office of Fair Trading

We would wish to make the following points:

1. Public transport is obviously an issue critical to consumer welfare and the markets affected by rail franchises represent a significant proportion of the economy. Competition analysis should therefore be brought to bear to make these markets work well for consumers—here, the passengers. The OFT equally recognises the importance of balancing other public policy considerations, outside its direct remit, in this sector.

2. As outlined below, the competition authorities, together with other public sector bodies, have worked to improve the existing regime of competition scrutiny of rail franchise awards, and its smoothest possible interaction with the other aspects of the overall franchise process.

3. Notwithstanding these efforts, we are not convinced that the current system is fully effective. We therefore welcome the Committee’s inquiry into whether the current regime works well from various perspectives, including from the standpoint of competition and consumer welfare. The OFT seeks to maximise the use of its resources to the benefit of the consumer, while minimising taxpayer and private sector costs.

4. In particular, the current regime does not easily permit competition considerations to be accounted for at the point of franchise design; the merger control process is initiated only at the award stage. And yet, in our view, consumer welfare considerations should also be given proper weight at the inception of the process: at the design (including franchise remapping) stage.

5. The actual award of a franchise raises public policy issues of which competition considerations are a critical, though not the only issue, and where there may be short- and long-run trade-offs. The current regime applies competition scrutiny by treating franchise awards as if they were private merger activity: the Railways Act 2005 specifies that franchises awards are mergers for the purposes of the general merger regime of the Enterprise Act 2002 (EA02). As the rail franchising process has peculiarities not shared by private merger activity, this approach means that competition factors may conflict with other public policy considerations in the rail transport sector. There is no formal integrated mechanism for resolving such tensions, so that efforts to adopt a “joined up” approach across government are complicated. And, at the same time, the system generates very substantial public and private costs.

6. Part of the OFT’s concern relates to the timeliness of competition scrutiny and the impact this has on remedial action. Effective competition scrutiny must contemplate the ultimate possibility of enforcement. By involving the mechanisms of EA02 merger control late in the process, remediating adverse effects becomes difficult, particularly where restoring inter-modal competition (bus or coach vs rail) may be concerned. In such cases, the cornerstone of merger remedy policy—structural remedies such as partial divestment or prohibition—may be unattractive or indeed impossible in practice to implement. Other tools of intervention open to the competition authorities for example price and service regulation of commercially viable bus or coach passenger services to restore lost inter-modal competition in the franchise area incurs significant regulatory costs.

7. In our view, substituting competition with regulation in an unregulated sector is neither effective nor desirable. This is especially so when regulation must be crafted within the tight deadlines of merger control. It is, of course, settled government policy that the majority of UK markets should be subject to open competition, and only a minority subject to price regulation. The OFT’s own experience of the unintended adverse consequences of price regulation is apparent in the remedy it recommended when National Express Group (NEG) acquired Prism Rail plc, and thus the Stansted Express line: it appears to have had the unintended effect of depriving consumers of cheaper coach tickets between Central London and Heathrow airport.

8. All relevant public sector parties have actively sought to resolve the difficult issues of timely competition scrutiny and cost mitigation in the rail franchise process:

   — in the early period of implementation of the EA02, notification of franchise awards was voluntary, and investigations were conducted ex post, in some cases from complaints. This approach culminated in the reference to the Competition Commission (CC) of the award to NEG of the Greater Anglia franchise, which NEG had already begun to operate. Concerns were raised that the competition authorities were potentially frustrating government policy to award a franchise to a given bidder.

   — subsequently in order to accommodate provision of first- and secondphase merger review before the operation of a franchise by a successful bidder, the OFT agreed with the SRA that it would conduct competition review of all pre-qualified bidders, and the SRA made it compulsory to seek merger clearance from the OFT. This led to review of three to five bids for each franchise award, all but one of which would be losing bids and thus “hypothetical”: the public and private costs of OFT review were incurred for each bid (all but one unsuccessful), as were the costs of (partial) CC review in those cases. This regime applied from late 2004 to 2005, covering the InterCity East Coast,
Integrated Kent, Thameslink/Great Northern and Greater Western franchise awards. The concerns as to regulatory burden, shared by all, led to a concerted effort by OFT, CC, ORR and the Department for Transport to reduce the unnecessary costs of this revised approach.

— Accordingly, for the pending South West Trains franchise, we have agreed to revert to a variant of the initial systems to that the OFT only examines the franchise award once it has been made, albeit with undertakings to prevent operation of the franchise and/or changes to road transport services until OFT (and where applicable CC) review is complete.

The OFT believes that its own experience raises important questions about the costs and benefits of the current system. It would be happy to explore these issues further with the Committee and other stakeholders as may be appropriate.

14 July 2006

Memorandum by North West Group of Labour MPs

The North West Group of Labour MPs would like to make a submission to your important inquiry into Passenger Rail Franchises. The Group are concerned that the new rail franchises configuration will have an adverse effect on the North West region.

I have attached a letter from Brian Simpson, Campaign Director of the North West Rail Campaign which sets out their concerns. These concerns are also shared by the Group.

I am sure that you will give this submission serious consideration.

RE: CONSULTATIONS ON NEW RAIL FRANCHISES

I write on behalf of the North West Rail Campaign (NWRC) in regard to the consultation process for the three new rail franchises for Cross Country, East Midlands and West Midlands.

In general the NWRC welcomes the creation of the East and West Midlands franchises, and the majority of the proposals concerning Cross Country. However, we would like to make the following points for your consideration.

We recognise that the three franchises concerned are an attempt by the Government to improve both the quality and frequency of services presently in operation, and that in the main it is the Cross Country and East Midlands franchises that affect the North West of England most.

However, we must make the point forcibly that, in our opinion, the lack of infrastructure capacity in and around Manchester not only brings into question the ability of the railway industry to deliver better services, but it is also having a detrimental effect on the region’s economy. Increasingly we are trying to get “a quart into a pint pot”, particularly at peak times.

With passenger numbers having increased more than 10% in the Greater Manchester area, our peak services are at capacity and beyond, causing overcrowding and delays getting in and out of Manchester.

Therefore, whilst it is not necessarily an issue in regard to these three franchises, we feel that the point has to be made that infrastructure enhancement in the Manchester Hub along with longer trains and extra rolling stock in the wider North West region are urgently required if we are to deliver a better railway.

It also has to be said that the constraints at Birmingham New Street also present a problem that needs to be addressed particularly as it would appear that the Government are increasing services between these two very congested hubs.

However, we are happy that the Government appears now to recognise that other major cities outside of London have commuters, and that there is an urgent need to separate commuters from long distance travellers.

Here in the North West, our long distance trains are often overcrowded because of commuter usage. This is a particular problem on the Preston-Bolton-Manchester corridor. What is required here is more rolling stock for the Northern Rail franchise which is why the NWRC opposes the removal of units, particularly 158s, away from our region unless there is a quid pro quo replacement programme of other rolling stock of similar or increased capacity.

The proposals outlined for the three new franchises cannot be judged in isolation. There has to be a serious look at the role of other franchises, the services they offer, the rolling stock that they have to work with, and how the railway infrastructure copes or fails to cope with the number of services it has to accommodate.

If the Government is serious about separating commuters from long distance travellers then here in the North West, they will have to give serious thought to allowing Northern Rail to acquire rolling stock that can increase capacity on their services, thus easing problems for the longer distance TOCs.
CROSS COUNTRY

The NWRC has some concerns in regard to the proposals not to have cross Country services north of Crewe on the WCML. Whilst we appreciate that it is intended to bring these services within an extended TPE franchise, we would question whether this would lead to an improvement in service for those areas affected.

It is our belief that for towns between Crewe and Glasgow, the removal of Cross Country services will, at best, cause inconvenience for passengers and, at worst, will cause extra congestion on Virgin West Coast services as passengers for the South West try to get to Crewe or Birmingham by the quickest possible service. Added to this is the fact that more passengers will be changing trains at an already overcrowded Birmingham New Street, or a run-down Crewe station.

However, if the Government is determined to incorporate Cross Country north of Crewe into TPE, then there are a few points we would like to make:

Finally, we appreciate the need to ensure that these franchises are placed in context with the various regional Rail Utilisation Strategies. The NWRC reminds the Government that we are still awaiting the North West RUS and the Regional Planning Assessment, as well as a final agreement on the West Coast franchise. We are told that, like Christmas, they are coming: but which Christmas?

Memorandum by Department for Transport

Thank you for your letter of 18 October about rail passenger operations and the circumstances in which the Government might be prepared to renegotiate a franchise agreement.

Changes to franchises at the detailed level are common. Franchises often last for 10 years or more and changes will inevitably be needed from time to time to take account of changing circumstances. The Department, franchise holders and others may well seek alterations, for example, to stopping patterns for individual trains or a complete service. Because franchise agreements typically specify services to this level of detail, an amendment to the contract will generally be needed to allow changes of this sort to happen. I expect routine changes of this sort to continue. You may also know that we are seeking to replace our existing year-by-year agreement with Virgin West Coast with a conventional franchise. This, though, will depend on achieving a deal which represents good value for money. We are in any case looking at this with a view to moving to a proper franchise comparable to others around the network rather than as a response to any approach from the operator.

We have, on the other hand, made it very clear more generally that we are not prepared to renegotiate the main terms on which a franchise was awarded in the first place other than in circumstances where doing so would clearly benefit the public purse. That remains the case. It is difficult to say that there will never be any circumstances in which we would set that policy aside. What I can say is that I cannot currently foresee a situation in which we would be prepared to do so.

Memorandum submitted by Mr A Crowhurst

PASSENGER RAIL FRANCHISING

SUMMARY

It would not be possible for a passenger with no involvement in the rail industry to address all of the concerns and questions to be addressed by the Committee but it might be worthwhile to make points in that limited capacity. These are therefore submitted in the order that they have been raised in the invitation and cover franchise management, lengths and other related matters as well as Government involvement in management.

1. The purpose of Rail Franchising

Should the ultimate aim be to provide passengers with ever improving services of an increasing number of routes in comfortable vehicles. This should be achieved with the minimum of Government involvement after it has set the initial criteria for each franchise. There should then be no further Government involvement in matters involving the running of trains over and above the initial franchise conditions, the choice of equipment used or the investment by the franchisee in additional equipment. It would of course be necessary for the Government to ensure that franchise conditions are met but that should be all.
The current system clearly does not meet those conditions since continuing changes to franchises must make improvements more difficult. Rail equipment is very expensive and any franchise must be of sufficient length for costs to be met, say 10–15 years minimum with options for a further similar period. There is too much Government involvement with day to day management ie which type of train should be used, which stations may be served etc.

I can make no comment on the franchise process as my knowledge comes only from the media who reported on franchise extensions, delays in making awards, referrals to the Competition Commission, etc. There appears to be, when viewed from outside the process, great difficulty in reaching decisions for whatever reasons.

2. Franchise process

I do not know what input passengers have especially after the removal of the regional passenger committees and their centralisation into one body based in London. I am not aware of any input by passengers into the design of franchised services other than in making pleas for changes.

3. Transfer from SRA to DfT

Yet another of the continuous process of change that must make those within the industry wonder what is going to happen next. I am not convinced that franchising should be handled directly by a ministry rather than a more independent body.

4. Franchise size and length

Some aspects of franchise size concern me, eg the limitation of services into a station to those run by a specific franchisee. This has resulted, for example, in the loss of a valued rail service from the Marches into London Waterloo.

I have quoted above my views on franchise length—I am amazed that any company would consider five year terms or that the Government could consider terms so short as to limit development and improvement.

Not being a commuter I have had very positive experiences of some franchises. Others have been less good but possibly not always because of their managements. For example if a franchisee is obliged to use a particular type of rolling stock and has only a year or two to complete the franchise he will not consider replacement with more modern equipment which might meet the same operating conditions with which he has to comply.

I cannot make observations on risk management as only the parties concerned can do this. With the detailed involvement of Government in the management of franchises I consider that the scope for improving services is severely limited.

5. Competition and integration

Since it is very difficult to introduce any new service let alone one providing competition, I would consider that under the current systems there is very little scope for any significant development under current arrangements.

As far as vertical integration is concerned would this now be possible under relevant EC rules? Whilst there should be closer co-operation between TOCs and Network rail I cannot see how systems could be combined save for exceptional circumstances eg the Isle of Wight.

There is one aspect in which closer co-operation is required and that involves the design of rail vehicle operating systems. In 2006 should not it be possible for all new types of vehicle to be able to connect up and run with all others, ie some kind of standardisation. Should not the industry also be working to ensure that as many vehicles as possible can access as much as possible of the rail network with the eventual aim of universal accessibility.

CONCLUSION

Whilst I feel that the overall franchising concept is worthwhile and has provided many benefits that might not otherwise have been provided, the current piecemeal system of relatively short franchises, very short extensions and the detailed management by Government needs a thorough review. After so doing the Government of the day should only act to police compliance with franchise terms and not be involved in rail management per se. Franchises should be for realistic terms such that much more investment can be justified.
Memorandum submitted by Lord Bradshaw

**Passenger Rail Franchising**

*What should be the purpose of passenger rail franchising?*

To give operators incentives to carry more passengers by investing more. It is very ineffective in that it tends to force fares upwards. Franchises are too short to encourage significant investment.

*How well does the process for awarding franchises work?*

Operators and prospective bidders for franchises are fixated on offering terms which will win the franchise. This means making the highest bid which involves maximising fares and providing the least costly service and lowest investment that will meet that aim. Past performance and objectives such as expanding carrying are not taken into account. The objectives of the Treasury to minimise expenditure are given paramount importance and the process is now increasingly focussed to this end with less room for initiative on the part of bidders.

*Are franchise contracts the right size, type and length?*

NO. The best franchises are long (eg Chiltern) and lead to long term investment. They give too little weight to past performance. They deliver the short term financial results desired by government. Passengers have only a very marginal input despite a lot of “consultation” which is largely ignored by governments.

The franchise holder bears most of the risk. There is little scope for improving services through franchise agreements unless franchises are made longer with measurable success criteria which are taken into account on re-bedding. If the railway is to carry more people at peak times then franchises should state this.

*Do we need more competition and vertical integration?*

Neither is necessary unless genuine new markets are opened up (like Shrewsbury). It would be valuable to benchmark both Network Rail (through allowing vertical integration in a long franchise eg Merseyrail) and the ROSCO’s by means of either government or The Mayor of London entering a long lease of some rolling stock directly with a manufacturer.

The franchising process is far too bureaucratic (ask how large the bid documents are?) and expensive. The process is designed to protect officials from the possibility of judicial review. Any value judgements are replaced with expensive success criteria devised expensively by management consultants.

I would be glad to expand on this brief statement having long experience of the franchising process.

Memorandum submitted by Mr Simon Norton

1. **Introduction:** The primary question before this Inquiry is whether the passenger rail franchise system is working satisfactorily. My view is that it has been a disaster and should be drastically overhauled or abolished as soon as possible. I will be explaining my reasons for this conclusion below, and will follow with a list of recommendations.

2. **The first question we are invited to address is what the purpose of franchising should be.** Personally, I am at a loss to find any worthwhile purpose whose achievement can be seen as remotely plausible. But if pressed I could come up with three possible purposes:

   (a) To secure private finance to improve the rail system.

   (b) To dissociate the government from political pressures associated with the running of the rail system.

   (c) To protect the road lobby against environmental pressures by entangling the rail system in such a network of bureaucracy that large scale improvements become impossible.

   The first, if achieved, would be a benefit to the public; the second, to the Government; and the third, to the road lobby.

3. **The next question is whether the current system is achieving these aims.**

   For (a), the answer is an undoubted “no”. To the best of my knowledge, only one significant improvement to the national rail network has been secured through private investment—the doubling of the track between Princes Risborough and Aynho Junction on the former Great Western route between London and
Birmingham now used by Chiltern Railways. Any consequent savings to the public sector will have been offset many times over by cost escalations in publicly financed rail projects which can be at least partly blamed on the fragmentation caused by privatisation and franchising.

At various times, there have been suggestions that other urgently needed rail links could be financed privately: Tunbridge Wells-Lewes via Uckfield, Derby-Manchester via Matlock and Buxton, the Woodhead route between Manchester and Sheffield via Hadfield and Penistone. None of these have come anywhere near fruition.

There’s also the Central Railway project, mainly oriented towards freight but with potential to provide worthwhile passenger improvements (including the reopening of the Woodhead route referred to above), where the Government actively spurned the offer of private capital for a project which, if it worked properly, could remove a high proportion of lorries from some of our most congested motorways.

There is another way in which private money can finance rail development, and it is one that has been neglected by the Government: planning conditions. For example, agreement to Heathrow Terminal 5 could have been made conditional on BAA’s financing integrated transport—both road and rail—for a wide area round Heathrow, including contributions to projects such as Central Railway and Crossrail, and the opening up of its Heathrow Express/Connect services to the non expense account public which would alleviate overcrowding on the Piccadilly Line which affects both budget airport travellers and local residents. As another example, the vast development planned for the Oxford-Cambridge arc could easily finance the restoration of the rail link between these cities.

For (b), the answer is again “no”. This was apparent even before mismanagement by Railtrack induced the Government to effectively renationalise it: there was always bound to be a need to take public interest criteria into account when regulating the industry. Now the Government is involved not only in regulation but also in assigning both capital and revenue finance to maintain and develop the system, and this is bound to lead to political arguments.

However, for (c), if indeed this was one of the intentions which led to privatisation and franchising, the answer is “yes”. The Blair Government came to power with the famous promise by Mr Prescott that if traffic levels hadn’t started to fall by the end of the Government’s first term of office, he would have failed. Well, he did fail.

Why did this happen? A contributory reason is surely that the burden of fragmentation has made it impossible for the rail industry to take much of the traffic that could theoretically be transferred from the roads—both passenger and freight. Some possible contributory reasons for this:

(a) The need for multilateral legal agreements between all the parties involved in the fragmented industry has pushed up project costs.

(b) The lack of a unified project developer analogous to the Highways Agency has drastically weakened the bargaining position of those seeking to pursue major rail development proposals.

(c) The need to compensate train operators for the engineering possessions required to implement improvement projects is another factor that has pushed costs up.

(d) For those projects that are publicly financed, the financial assessment is considerably weakened because the revenue from the increased patronage which can be expected on the completion of a major improvement scheme goes to the train operator rather than the public sector.

(e) The disablement of the rail network following the Hatfield crash—which killed fewer people than die on the roads in an average day—fundamentally undermined the credibility of rail as a provider of a reliable service.

This will lead to the following recommendations:

(a) Reintegrate the industry.

(b) Set up a rail analogue of the Highways Agency, with its own funds which can be used to pursue major development projects. Alternatively, expand the remit of the Highways Agency to cover rail development—and change its name and orientation so that it is no longer either in name or in fact a road development organisation.

(c) Prioritise schemes for reopening old lines or building new ones. As they don’t impinge on existing track (except for the short period required to join the new line up to the existing network) there will be far less need for track possessions.

(d) Fares revenue should accrue to a public sector organisation. If the task of running services is delegated to the private sector then they should do so on an agency basis. (This would bring other advantages that we will come to later.)

(e) Expand the safety responsibilities of the rail industry to include the reduction of road danger by capturing traffic that would otherwise go by road.

4. I now skip to the question of whether risks are suitably apportioned between the Government and franchise holders, which will raise some points relevant to (d) above.
I believe that almost all the financial risk of a franchise should accrue to the public sector. Franchisees should get a bonus if they perform well, but that’s all. This would bring the following advantages:

(a) Franchisees would no longer have to be compensated—ultimately at public expense—for track possessions etc.

(b) The financial assessment of rail development projects paid for by the public sector would improve. (This is the point made in (d) above.) In theory, a partnership agreement could be used to capture the benefit to a train operator from measures that would increase patronage, and this is in fact one of the proposals I made in my response to this Committee’s fares inquiry, but this is a cumbersome way of doing things.

(c) The financial assessment of road development projects which might take existing or prospective traffic off the railways would become less attractive. In other words, there would be less call for schemes which degrade our local and global environment by putting more of our countryside under concrete and increasing traffic and greenhouse gas emissions there from.

(d) It would be easier to design a fares system that could be seen as fair, without the distortion resulting from differing policies between train operators. Some of the anomalies can be seen in Barry Doe’s evidence to the fares inquiry referred to above.

5. Let me now go through those other questions for which I feel I have something to say.

What input do operators, passengers and other interested parties have into the design of franchised services? As far as passengers are concerned, not enough. There is also the problem that with franchise agreements “set in stone” it may be hard for passenger groups to campaign for the improvements they want while a franchise is in progress. This is of particular concern when there is a “window of opportunity” for a certain improvement, eg a new station to serve a particular development proposal, especially if it is to be enshrined in a planning condition imposed on the developer.

Are franchise contracts the right size, type and length? No, as suggested above they should be agency agreement with the fare revenue accruing to the public sector. As for their length, longer contracts may have their advantage in facilitating investment, but they also exacerbate the “set in stone” factor referred to above. If operators are to assume the financial risks from investment, there should be some way in which benefits that continue beyond their franchise term can be credited to them.

What criteria and processes and used to evaluate franchise bids? At one time we hoped that the prospect of development projects would be taken into account. The loss of the Southern contract by Connex, even though they had promised if the contract was re-awarded to reopen the line between Uckfield and Lewes, put paid to that hope.

Do we need more competition and vertical integration? I’m not sure of the relevance of competition, but vertical integration is harder to achieve than might be thought, because track is shared between different franchises. At one stage the idea went round that there should be a single franchise for each London terminus (as has been implemented at Liverpool Street and Paddington), but this leads to the question of why London? If every station, or even every principal station, was to have a single franchisee covering all services, (as has been implemented at Liverpool Street and Paddington), but this leads to the question of why London? If every station, or even every principal station, was to have a single franchisee covering all services, we wouldn’t be far off having a single franchisee covering the whole rail network.

Is franchising compatible with open access operations? I don’t see why not. The regulatory authority must retain discretion to reject an open access bid that sabotages the franchised network.

Should train, rolling stock and track operation be more closely integrated? I don’t know, but the oligopoly situation of rolling stock companies is a severe brake on the ability of rail to increase its capacity. As I recommended in my response to the fares inquiry, what we need is an integrated system where train operators are provided with extra coaches which they use to increase their modal share; they reduce their fares to ensure that the extra capacity is used; and this replaces road widening as a mechanism for dealing with road congestion.

6. The effects of fragmentation on passengers. This doesn’t seem to have been covered in the list of questions, but I think it is important, and wish to outline some of my personal experiences to illustrate why.

A: On one occasion I did a day trip from Cambridge to the Peak District, leaving my home before 06.00. On the return leg, I used the Central Trains Nottingham-Norwich train which is scheduled to arrive Ely at 22.08, and there I would connect into a WAGN train originating in Kings Lynn and due to leave Ely at 22.20, to reach Cambridge.

Unfortunately the Central train was running late. By the time it was en route to Ely it was about 11 minutes late. Just before Ely North Junction it was stopped by signals, presumably to let through the WAGN train which was due at that time. We did in fact reach Ely before 22.21, but the station management refused to hold the connection. As a result I (and several other passengers) had to wait nearly an hour for the next train. I missed the last bus from Cambridge station to my home, and had to walk two miles, while in a desperately tired state as a result of my early start.
Whom should I complain to? Central Trains, who ran the late running train; WAGN, who ran the train that wouldn’t wait even a minute to connect; or One, who manage the station where the connection should have taken place? The fact that all three were subsidiaries of the National Express Group doesn’t make them accountable for one another. I put the blame squarely on One. They told me they had a strict policy of letting connections go. Who was responsible for designing such a lunatic policy? I was unable to find out. They did say that holding connections might have knock on effects further along the system, but I can testify that there was neither train nor bus leaving Cambridge at around the time my connection would have arrived whose connection off that train could possibly have been jeopardised.

B: I make occasional visits to Shropshire. One of the routes I used most frequently was the X5 bus from Cambridge to Milton Keynes where I bought a good value “Central/Silverlink” Saver (or even day return) ticket. At one stage, however, the Birmingham-Shrewsbury service was split between Central Trains and Wales and Borders, both of which continued to be National Express Group subsidiaries. After a period of frustration from having to wait at Birmingham or elsewhere for a train run by the right operator, I asked why Wales & Borders was excluded from the system. This complaint dingdonged between the three operators and the Rail Passengers Committee for over a year, after which I eventually was told that the anomaly had been overlooked when Wales and Borders was hived off, but that due to the impending takeover of this franchise by Arriva (as Arriva Trains Wales) no action would be taken. Shortly afterwards, the fare was withdrawn anyway, and the journey made more difficult by imposing an extra change at Northampton and reducing the service between there and Birmingham.

C: A few years ago Central Trains introduced a special ticket called a Shirerider. This is an add on to any rail ticket which allows unlimited bus travel on a Sunday on a widespread network of bus routes in an area including most of Worcestershire, Herefordshire and Shropshire.

The problem was, and probably is, that nobody seems to know how to issue Shireriders. On one occasion I turned up at Paddington for the 08.03 train to Worcester run by Thames Trains. Their own ticket office was closed so I went to that of First Great Western, who as I said didn’t know how to issue a Shirerider. So I had to keep all by bus tickets for that day and send them off for a refund. Now whom should I send them to—First, who ran the ticket office, Thames, who ran the trains I used, or Central who sponsored the offer? Again, my complaint dingdonged between the three operators and RPC. This time I did eventually get a refund from First.

7. Summary of recommendations. (Note: most but not all of these are covered in the foregoing.)

(i) Action should be taken as soon as possible to return the financial risk and rewards from passenger train revenue to the public sector. This could be done by changing the basis of franchises when they expire, by agreement with existing franchisees, or by buying them out. A public debate should take place into what sort of fare system would bring the greatest benefit to rail and road travellers. Assessment of rail and road projects should reflect the benefit or disbenefit to the public if they attract or abstract passengers to/from rail.

(ii) An inquiry should be launched into the reasons behind the cost escalation of projects involving the rail industry. Depending on the conclusions, appropriate action should be taken.

(iii) Priority should be given to projects whose implementation would minimise the disruption to existing train services, such as line reopenings.

(iv) If franchisees are expected to invest, provision should be made to credit them with at least a share in the benefits from such investment after the expiry of their term.

(v) Either a rail equivalent of the Highways Agency should be set up, and provided with finance to develop major projects; or the remit of the Highways Agency should be extended to include rail development, again with funding provided. In the latter case, its name should be changed to reflect its new multi-modal role, and steps should be taken to ensure that it doesn’t continue to pursue road development as its main aim. In either case, there should be freedom to transfer money from a road solution to a rail solution if the latter is found to be more appropriate to a given corridor.

(vi) Performance measures for train operators should include the holding of connections.

(vii) There should be provision to impose a change in the terms of a franchise on the operator where this is required to meet needs that have newly emerged (or newly been recognised).

(viii) If the above steps fail to regenerate the rail industry, then it should be renationalised, and the cost involved written off as a one-off expense required to reverse a very costly blunder.
Memorandum submitted by Dr Roger Sexton

RAIL PASSENGER FRANCHISING

I can be relatively brief. I wish to address a question which you do not expressly mention in the terms of reference for your enquiry:

Who should grant rail passenger franchises?

A. Local and Regional Services

The franchising should be in the hands of regional PTEs. I take the liberty of repeating a section from my memorandum to your 2003 enquiry on The Future of the Railway. There I said (Evidence page 194, section 12).

“In my submission to the Committee regarding bus services, I advocated that the London system of bus franchising should be extended to the rest of the country. The franchising would be done by regional PTEs. I stick by this proposal, but with a crucial addition. The regional PTEs would also take over the franchising of local railway services in their respective areas. The regional PTEs would have their own budgets, but I would expect them to ensure that bus and train services were integrated with each other, not competing with each other.

The regional PTEs would also take over the franchising of local railway services in their respective areas. The regional PTEs would have their own budgets, but I would expect them to ensure that bus and train services were integrated with each other, not competing with each other.

The model for this proposal comes from Sweden, where all local bus, train and boat services are franchised by regional PTEs called ‘Lanstrafiken’. All transport timetables are integrated with each other. All services within a particular Lanstrafik area have the same fares system. I would suggest that the committee pays a study visit to the Väst region based in Gothenburg, to see how things should be done.”

B. Long-Distance Services

The franchising should be done by a national body (with regional representation) supported by the national Department of Transport. Again borrowing from Sweden, I will call that body British Rijkstrafiken—“BRT”.

It would be a major function of BRT to ensure the co-ordination of long distance services with local services—both ticketing and timetables. The current Route Utilization Surveys started by the Strategic Rail Authority and being continued by the Department of Transport would come under BRT’s auspices. On busy sections of line (eg St Pancras-Luton) and at congested stations (eg Birmingham New Street), BRT will have to make tough choices.

C. Why this Franchising Structure?

My franchising structure is intended to give Britain the properly integrated system of public transport enjoyed by the Swiss and by some of our EU partners. As things currently stand, the legal regimes now governing British public transport (bus deregulation and over-centralised rail franchising) make such integration impossible.

13 June 2006

Memorandum submitted by Mr Tony Bolden and Mr Reg Harman

INTRODUCTION

The country faces a number of very severe challenges: global warming, the possibly imminent peaking of world oil supplies, the poor quality of life in some urban areas and the need to maintain a stable economic direction. With nearly 60 million people on a relatively compact island land mass, it is vital that these challenges are tackled in a firm and cohesive fashion. This means that strategic plans and their implementation for the various fields of national policy should be coordinated: in other words they should draw their rationale from each other and from an overall view of where we are going.

The development of the national rail passenger system should fit within this, as passenger rail services form an important tool for addressing the various challenges. The passenger railway offers a significant, efficient and environmentally friendly means of travel for both commuting and for inter-urban travel. At a time when the national economy has become more based on the services sector—finance, administration, research, commercial activities—it requires people to interact in many locations in large numbers. The global environmental challenges will need a serious reduction in movement by oil-powered transport systems, and would benefit from more compact and environmentally benign urban forms with a
consequential uplifting in the quality of urban life. In all of these, rail-based passenger transport forms a crucial tool, enabling people to move within and between the main urban areas with comfort and speed, while for the most part not relying on oil fuels.

Under the current regime, development of the passenger rail system is through the franchising regime, largely as established by the 1993 Railways Act. This is not, however, proving to be an effective and enduring mechanism. This submission focuses on the purpose of franchising in this light. It looks in turn at the current regime, especially its approach to producing a railway strategy; the key factors in administration of railways elsewhere in Europe; and what changes might be needed for rail franchising to be an effective tool in a national development strategy.

Is there a purpose to the system?

The current structure of railway franchising was established to bring in private operation for Britain’s railway system. It did not appear to foresee substantial change to the network over time, although implicitly it was expected that public financial support for it would decline. Several factors have subsequently arisen:

— Passenger numbers have grown very substantially, especially for medium distance travel and for commuting;
— Management and financial problems with Railtrack as the infrastructure provider led to its demise, and its successor Network Rail faces financial constraints in expanding capacity to meet current pressures;
— Total public funding for the various train operators has risen rather than declined;
— The creation and subsequent abolition of a Strategic Rail Authority designed to bring a strategic direction to the railway’s development has meant that the responsibility for overall strategic guidance is once more with the Department for Transport;
— A series of Route Utilization Strategies is being developed, aided by Regional Planning Assessments, but these focus on making the best use of existing lines rather than informing on where major development of the network should be expected.

After the first round of franchises, in the mid-1990s, the structure of franchises has gone through several reviews. At one point it was considered that the franchises would be very long (20 years), with the aim that the franchisee would be responsible for investing in expansion of the infrastructure. Subsequently the approach has reverted to what amounts to management contracts within relatively short-term franchises. The geographical and business content of franchises has also changed. Originally the franchises were based on a division between inter-city, commuting and regional type services. Now there are now more likely to be based on one franchise operating exclusively as far as possible into one London terminus, regardless of the nature of the business to be serviced. Examples of this occur on services operating into Liverpool Street and Paddington. The latest change will see new franchises for both the West and East Midlands—again mixing up the nature of service operations.

All franchises are now determined by the Department for Transport, and appear to be awarded on a basis that is almost entirely geared to financial objectives. However, there also appears to be some confusion over the role of open access operators as allowed by the Office of Rail Regulation (ORR) when they potentially compete with existing franchisees. This confusion has been highlighted recently by the award of an open access arrangement on the East Coast main line that appears to conflict with the aspirations and cost projections of a newly awarded franchise (largely because insufficient track capacity is available). There thus seems to be no proper and consistent understanding of what franchises should be and how they should operate, which in turn does not allow for proper planning and development of the railway system.

Particular concern has also been raised by the failure of the system to match up with the needs of communities at regional and local level, as particularly expressed in the regional and local planning frameworks and their implementation. This crucial problem has been well documented in both the professional and general press over time. Three particular issues may be quoted, as examples of the problem.

— The Government’s Sustainable Communities Strategy, dating from 2002, recognises the pressure for population growth in the South East of England around London, where the financial and administrative businesses form the backbone of the UK economy. But no attempt has been made to support the major housing growth envisaged across and beyond the Home Counties with infrastructure, notably enhanced railway lines. The two major projects of Crossrail and Thameslink continue to stutter through planning processes, thirty years after their initial conception, without any apparent recognition of their real significance.
— This in turn constrains the pattern and scale of the passenger rail services in the region. The franchising conditions for these continue to focus on medium term financial priorities, with no regard to the effects on lifestyles, economic impacts on the region or possible regeneration of socially disadvantaged areas. For example, there is now pressure for franchisees to “price off” excessive numbers at peak periods, in order to avoid any investment in extra capacity, with no assessment being made of the effect on London commercial and financial activities. (A specific
example concerns First Capital Connect, the new franchisee of the Thameslink and Great Northern suburban lines, which has brought in severe restraints on the evening use of off-peak tickets, with no consultation.

Elsewhere in Great Britain the Department for Transport has exercised a similarly tight direction over service patterns for new franchisees. For example, in setting the operating guidelines for the new Great Western franchise, the Department required significant cuts in services for the various West Country branch lines, leading to proposals by the franchisee for reductions that amounted to no effective service for many small stations. This saved a limited amount of running time, but at the expense of cutting rail links from rural catchments to the main cities, to which many people look for part-time jobs, education, shopping, leisure and health. The potential effect was that many people’s lifestyles would be seriously undermined or that they would make more use of cars for regular trips. The initial proposals have now been withdrawn; but there are no proposals to increase the level or quality of services or to integrate them with other local transport.

The Department for Transport is now well into the process for preparing the High Level Output Specification (HLOS), which will set the direction for railway policy and implementation into the next decade, and has recently issued a guidance note. The HLOS is not itself the long-term strategy; but the actions which it leads to will set the direction for the long term, as the Department’s note itself recognises. Therefore it is very alarming that the approach indicated by the guidance note perpetuates the status quo: it implies that the present railway system is generally fine, subject to a few tweaks, and that these tweaks can be achieved for significantly lower investment than today’s levels, through efficiencies in Network Rail. No attempt is made to consider what the purpose of the railways might be or whether this should require any real changes in the present structure. This forms a dangerously narrow approach.

Development of railways elsewhere in Europe

Almost all of Europe’s railways have been restructured within the last decade, largely following the principles set out in European Union Directive 91/440. The ways in which railways are now developing across western, central and northern Europe varies between countries, but a number of common features may be identified. These differ from the British approach, in some respects fundamentally. They are worth reviewing, as they offer some guidance over the way in which changes might be brought to the British regime, especially the franchising of passenger services.

The features broadly common to Britain’s European neighbours are briefly summarised in the following table and compared to the current British structure:

<table>
<thead>
<tr>
<th>Common features for mainland Europe</th>
<th>British approach</th>
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<tbody>
<tr>
<td>The national rail infrastructure is owned and managed by a public agency (constituted on very similar lines to the national trunk roads agency).</td>
<td>The infrastructure is owned and managed by a nominally separate “not for divided” company.</td>
</tr>
<tr>
<td>Railway infrastructure is developed by a consistent programme of investment, drawn from defined national and regional infrastructure funds.</td>
<td>Infrastructure investment is funded by Network Rail from funds obtained mostly through funds for system use paid by Train Operating Companies (TOCs).</td>
</tr>
<tr>
<td>TOCs pay a marginal cost for use of an infrastructure which is under consistent development.</td>
<td>TOCs pay a cost for use of infrastructure aimed at recovering most system costs, including investment, this amounts overall to about half their total costs while not offering any gains in capacity.</td>
</tr>
<tr>
<td>Steady upgrading of inter-urban and cross-country rail corridors continues, to balance out economic opportunities across the nation, with high speed rail links between the major cities as a key component in many countries.</td>
<td>The South East remains economically buoyant, whilst other regions in the North and West are still economically weak by European standards, yet no real investment in inter-urban rail is planned to help spread economic growth.</td>
</tr>
<tr>
<td>Upgrading of suburban rail capacity around main cities continues apace, especially through links across the national and regional capitals, to support access to their range of jobs and services (eg Paris now has five RER lines and Berlin has just opened its new Cross-city line).</td>
<td>There is still no commitment to serious capacity increases around London, let alone any commitment to Thameslink or Crossrail.</td>
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<tr>
<td>Electrification covering about two-thirds of the network on average and still extending, to reduce reliance on petroleum oil.</td>
<td>One third of the British system operates on electric power, with no extensions in hand.</td>
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<tr>
<td>The national main line passenger network is run by one national company (usually the former State company).</td>
<td>The whole network is run by a number of different TOCs, with different policies applying even for the main national routes.</td>
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</tbody>
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**Common features for mainland Europe**

Franchising of regional and local networks has mostly been transferred to regional and city bodies, who can ensure integration of timetables, ticketing and development with other modes.

**British approach**

All decisions on railway services are taken centrally by the Department of Transport—there is very little scope for integration at regional and local level with other transport modes.

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**Passenger service franchising and development in Japan**

Japanese railways are known to be safe, reliable and profitable. Their nationalised system was privatised and split up in 1987, but unlike ours it remained as an integrated railway system. Six geographically defined passenger companies were formed but they remained as vertically integrated companies responsible for all aspects of operations. The Japanese companies carry four times the number of UK passengers. Their tenure of operations is not limited by a determined time period governing the length of franchise.

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**Possible changes to the current regime**

Great Britain’s position in face of the major world challenges is no different to its European neighbours. In consequence it cannot afford to make less effective use of its railway system for the movement of people. The potential for achieving effectiveness is held back by the present administrative regime, which seems likely to be perpetuated by the present approach to the HLOS. Overnight change is not feasible, but it is vital that the rail franchising system is better able to produce a passenger rail system which can play a key role in national development.

To this end we suggest that the following changes should be considered:

— The purpose of franchising passenger rail services should be made clearer and be more consistently applied over time. It should not be just about meeting financial objectives but should relate to wider developmental issues as well. It should allow revenue risk to be taken by what are privately run companies in ways which do not conflict with supporting sustainable development. The role too of open access operators should be clarified in relation to existing and potential new franchise operators;

— The charging regime for use of Network Rail’s infrastructure should be changed. Charges to TOCs should become more marginal in nature, not aimed at recovering both fixed and variable charges. Funding for Network Rail’s management of the system should be given directly, on the same basis as for the Highways Agency. This would result in lower overall costs for TOCs and more of their costs would be within their control. It would also mean that public funding of the railway system would be more under control, as it would be used fully by Network Rail, not pass through the TOCs’ finance systems.

— Responsibility for franchising of services other than the main inter-city trunk routes and the London and South East commuter network (the old Network South East in essence) should be transferred to public bodies at regional and city level. This would probably be local authorities, either singly or in groups. The PTEs would play a major role in the main conurbations, perhaps as part of the strengthened “city regions”, while elsewhere similar frameworks might be developed. Following the Lyons review of local government. In this way local rail services could be developed to operate more efficiently in relation to real local needs and opportunities, reflecting the knowledge and expertise of local politicians, managers in TOCs, local transport officers, and other stakeholders. Of course, while many services may be developed along existing lines, there would be flexibility to change their operation (eg to light rail or tram-train) or in some cases to withdraw them if this provided more effectively for local transport. An appropriate level of funding for this should be made available to public authorities. Community rail partnerships should be encouraged and developed so that rail services are more integrated into local needs and lifestyles: this is particularly important for rural lines.

— A consistent programme of public funding for railway infrastructure should be developed. Of course it is recognised that public funds are not unlimited, it would be possible to proceed in a positive fashion through building up programmes of medium size schemes that will address the immediate problems faced by the industry while also leading into more consistent investment. Proposals for this have been set out by the writers recently in Public Money & Management.

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**Conclusions**

The current passenger rail franchising regime does not make for easy or consistent progress. There is, despite substantial growth in passengers travelling by rail, little prospect of expansion in capacity. Projects to increase capacity, both large and small, have no funding commitments attached to them. Railway services are run by TOCs whose activities are heavily controlled by the Department of Transport, mostly against

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financial objectives. Private innovation on changing or expanding services is stifled. There is virtually no scope for regional bodies or local authorities to influence railway services and their development, despite their responsibilities for spatial planning and other local transport. This is damaging to the effective use of passenger railways.

The UK faces major challenges in terms of the environment, the economy and society, and development of passenger railways forms a most important part of the toolkit needed to address these. Changes to the railways development and franchising network are needed in this respect, and valuable directions are offered by the commonalities of approach found in other European countries and elsewhere.

**Memorandum submitted by Coastliners**

**INTRODUCTORY SUMMARY**

Our Rail User Group cannot answer all the questions and sub-questions that this Committee has posed, simply because few if any outside Department of Transport circles—even aspiring franchise-holders, in some instances—have access to the criteria used at present to allot rail franchises. This does not stop us from expressing our very strong views on those matters to which we do wish to contribute answers, and that is what I do, on behalf of “Coastliners”, now.

**What should be the purpose of passenger rail franchising?**

— Is the current system achieving that purpose?

Any student of elementary logic will have seen that the rider cannot be posed until the basic question has been answered, so why pose it? Existing systems cannot be measured against what would apply in an ideal world, sadly. But, as a starting point to answering the main question, may we suggest that such an ideal world would be one in which rail operators at all levels of the railway hierarchy were able to provide the extent and the quality of rail services that their customers, actual and potential, known and unknown, would wish for, at a reasonable price. We see no reason why such provision should have to be restricted to franchise holders as such—for instance, the Government, or its Transport department, need not by definition be excluded from running train services, which is what seems to apply now—except that, in southern England, at least one section of rail passenger operation is supervised directly by Government as a result of the franchise-holder proving consistently unable to do what was expected of it. Why not, with suitable safeguards, encourage more such sections?

**How well does the process for awarding franchises work?**

— What input do operators, passengers and other interested parties have into the design of franchised services?

— Has there been a smooth transition of franchising arrangements from the Strategic Rail Authority to the Department for Transport?

If we as “Coastliners” compare what we have submitted as what we would like from our next franchise-holder with what has actually been provided, the gap is of an intolerably-glaring size. Often this is because of short-sighted (in our view) Government curbs on overall spending; the recent Northern Franchise Review illustrates this very well, even if, for now, few if any cuts in service-levels are pending. Another source of discrepancy is, in our region, Tyne and Wear’s passenger transport operator, NEXUS. “Heavy” rail services between Newcastle and Sunderland have been halved simply to help NEXUS balance its finances; the needs of the users affected and/or displaced have scarcely come into it, and the implications of this radical reduction of train availability on levels of car-use in south Tyneside seem to have been ignored completely. To the best of our information, nobody who was asked about the nature and scale of future rail-service in the North-East would have dreamed of advocating a drastic cut on this scale: so why is NEXUS allowed to get away with it?

Every week or more, we are reminded of the increasing and dangerous threats posed by CO₂ emissions, of which there are fewer attributable to rail than to just about every alternative on offer. Where does the Department for Transport stand on this? Should it not be demanding ever-increasing funds from the Treasury to add more electrified lines local and national, to Britain’s undoubtedly below-average total (even with the Southern network taken into account)? We as a group have urged such additions in our contribution to a Passenger Focus questionnaire about the impending Cross-Country franchise; as we see no hope for a healthy 20-year development of existing cross-country services unless the stretch from York to Birmingham (at least), if not Bristol and beyond to Plymouth, is programmed for state-of-the-art
electricity well within the lifetime of a renewed Cross-Country franchise. Similar considerations would have prompted us to lobby similarly for Bristol-Paddington to go under the wires, had we been in a position to comment even briefly on the now-completed Great Western re-franchising process.

So our answer to the first “rider” here has to be “hardly at all”; to the second “rider”, that we cannot possibly know; and to the main question “demonstrably badly, with no sign of imminent improvement”.

Are Franchise-contracts the right size, type and length?

(a) What criteria and processes are used to determine the nature and length of franchises?
(b) What criteria and processes are used to evaluate franchise bids?
(c) Do franchise-holders deliver value for money to passengers and the Government throughout the duration of their contracts?
(d) Are risks suitably apportioned between the Government and franchise-holders?
(e) What is the scope for improving services through franchise agreements?

Main Question “Right” for whom? The operators or the rail users? Or the Government Treasury? A feature of the first tenure by GNER of the East Coast Main Line was that, almost from Day One, spokesmen publicly lobbied for the then seven-year franchise, to be renewed—the only way in which they could be expected to plan service-improvements sensibly. It is to the greater credit of some other franchisees, eg of Arriva North-East (hurried successor to MTL Holdings), that they strove to maintain and improve their service and quality standards even after they knew that they had not won a renewal of their Northern Franchise.

We as users are grimly used to the long delays between a rail operator deciding to renew rolling-stock, gaining an acceptable quotation from a manufacturer, its application for finance if need be, Government approval for the investment concerned, the testing of the desired new trains, the hurried repair-work and vital modifications, and—eventually, years later—full acceptance and operation of the trains concerned. By this time the “state of the art” has usually moved well on. Anything that can speed up this process is more than welcome, and does not directly affect the desirability or otherwise of lengthy franchises; but it does raise the increasing spectre of high leasing-charges, the only other method of stock-change that we have come across. We are by no means alone in bemoaning the (apparent) high rents that rail operators must pay, even for 20 year old diesel units in Classes 142, 143, 144, 150, 153 and 156. The shaky basic economics of many a local rail service are skewed even more unfavourably by such standing charges than they are by apparently limited passenger-use; and (though it is not, strictly, part of the same answer here) the Track Access régime makes such fragile balance-sheets even worse. Yet if we had a franchise system that, effectively, allotted lines and/or service-groups to one operator ad infinitum, subject only to review every five years and the right to remove a franchise for unsatisfactory performance (and such a right demonstrably exists, as the fate of Connex proves conclusively), we would certainly see far better results for one and all, not least the passengers. Encouraging a long-term programme of steady improvement in service, and hence in numbers of Riders (a) and (b) If only we knew what these were! Without them, we cannot comment.

Riders (c) and (d) We are fairly confident that the franchise holders deliver as best they can, but, for reasons stated above in the main answer, we deplore the undoubted financial handicaps with which they all have to work. If, for instance, the full costs incurred by Network Rail in maintaining and improving track and signalling nationwide became chargeable fully to the Treasury, as happens with the nation’s road network, we are convinced that the financial picture presented by all rail operators, local and long-distance alike, would look infinitely more attractive. (Track Access charges would become a thing of the past, for instance.)

There is another point on this arising from the Government’s expectation that GNER and now First Great Western will not just operate the services laid down but also contribute several million pounds of profit annually to national funds as part of their franchise obligations. This, implying as it does that both these operators are compelled to charge their passengers significantly more than the fares-rates needed to balance their books, smacks of an unfair handicap against rail users and operators, especially when perceived costs of travelling by car seem, if anything, to be falling gradually. (Compare also our remarks above on increasing CO₂ emissions, page 1.)

Rider (e) In our experience, very small, when it should be far larger. See earlier remarks answering the second Main Question (How well does the process . . . work?). As long as an excessively-hands-on financial scrutiny is applied to rail operators, to the detriment of their regular and occasional users, especially those who know what specific extra train-services could immediately benefit their local line, franchise agreements will double as straitjackets at a time when global warming increasingly calls for flexibility at all levels of rail operation. One example from our own Coast Line will serve here—we have been unsuccessfully
campaigning since 1997, when we were first formed, for a later last train south from Newcastle (at 21.00, believe it or not!) to serve known demand from Sunderland University students who commute daily to and from Teesside. How much longer do we have to wait?

Do we need more competition and vertical integration?

(f) Is franchising compatible with Open Access operations?

(g) Should train, rolling-stock and track operation be more closely-integrated?

The main question, in its posed form, is inappropriate. It is combining two quite distinct features.

More Competition? It depends on how this is defined. Between rail operators along the same route, it would depend on the perceived purpose and responsibilities of each operator; as it is, there is a controversial system by which revenue from an entire line is allocated among all operators [ORCATS], and apparently not every operator is happy with how the revenue is split—cf GNER’s current apoplexy in the face of Grand Central trains, despite their clearly separate basic passenger markets, intended service-frequency, and overall standard of passenger facilities on board.

We would in any case argue that there is quite enough competition in the world of transport already, thanks to parallel attractions of road (bus, private car, etc) and, less often, air transport. All rail operators have long faced, and will continue to face, competition of this sort.

Vertical Integration? This term puzzles us. If it refers to the reduction of conflict of interests among operators, track authorities and so on, yes; the current improvements should continue indefinitely, to the advantage of everyone using and running train services. See also “Rider (g)”, below.

Rider (f) We see nothing, endemically, to prevent it. Anyway, European competition law seems to insist, rightly or wrongly, that provision for Open Access (however defined) must be made on all lines in all countries belonging to the European Union. That includes our own. And, indeed, with a strong minded Office of Rail Regulation, such as we seem to have now, led by a firm Regulator with an expect command of current legal checks and balances, ditto, we have confidence that all applications for Open Access services, from operators new or existing, will be treated firmly but dispassionately. However, we do note the danger of a Department for Transport, now or in future, trying to lean on the Rail Regulator to vary a judgement from operators new or existing, will be treated firmly but dispassionately. However, we do note the danger of a Department for Transport, now or in future, trying to lean on the Rail Regulator to vary a judgement between operators, either “minded” or finalised, just to fit in with an agenda, hidden or otherwise, to save money (ostensibly), instead of developing fresh rail services.

We also urge that somebody, somewhere, takes greater pro-active responsibility for advocating new rail services in parts of the country without them, for whatever reason. Examples from this area could be the desired introduction of faster direct Tees-Tyne passenger services along the now freight-only Stillington route (Norton South-Ferryhill); and an extension of existing Middlesbrough-Whitby rail services along the former trackbed (with tracks restored, of course) to Robin Hood’s Bay, at the edge of the North Yorkshire National Park, in the interests of reducing road traffic congestion in and around Whitby. Neither innovation would necessarily look financially good in their early years, largely thanks to vast sums needed to improve or restore adequate track facilities, but both would benefit their communities and the surrounding areas enormously, when viewed over, say, a 20-year perspective. Both look to us to be schemes best financed entirely from public funds in the first instance, just as most if not all road improvement schemes are now (cf. our earlier remarks about funding Network Rail as a national asset instead of a drain on the finances of rail operators and rail users).

Rider (g) Again, it is not clear what the hidden agenda may be behind this question, but our view on this should be fairly clear from remarks foregoing. The fewer obstacles there are between the several vital elements in the provision of a successful rail service for passengers and for goods traffic, the better.

Conclusion

On the face of it, a response to an Inquiry that spends much time criticising the Committee for asking questions that often seem either illogical, or irrelevant, or both, is not one that is likely to gain much notice. But, as pointed out in our introductory remarks, we as a group do feel very strongly about a number of aspects of current rail operation, and to that extent we are very glad that this Inquiry is taking place. Our conclusion, however, is that this discussion is trying to adjust rail-users’ deckchairs on the privatised deck of a railway Titanic. Climate-change, energy-conservation, increasing road-congestion and the innate inability of extra road-building to reduce it, all persuade us that Rail facilities must be improved and extended, almost regardless of expense, as a long-term investment for the health—and indeed the physical survival—of everybody in the UK, if not the whole world.

Sorry to be alarmist, but we see no alternative. However, as a tail-piece, may we point out that the only part of these islands in which rail passenger lines are being re-opened is Scotland, where public funds are more readily available—and where most lines are under one franchisee, viz Scotrail. Does this not suggest lessons for the rail system in England and Wales?
Memorandum submitted by Mr Ian Murray

PASSenger RAIL Franchising

What should be the purpose of Passenger Rail Franchising?

Passenger Rail Franchises should be designed to meet the needs of the local communities, which the railway serves, within the English regions—which are the non-inter City services that are UK wide. The Department needs and must commission a service that meets the need of the travelling public, for example covering local “travel to work areas”, access to Health services, education and higher education centres, leisure opportunities and good quality food shopping. Rail services should help to promote Social Inclusion and diversity of local communities.

The franchise must and should fit within the Regional Spatial and Economic strategies. Account should also be taken of areas which are designated City Regions such as: Leeds, Greater Manchester, Greater Bristol, Greater Nottingham, Stoke on Trent, Coventry, Wolverhampton, Birmingham, Greater Plymouth (including parts of Cornwall) Portsmouth and Southampton.

In the English Regions there appears to be no meaningful input into the decision making process on timetable specification, service quality awarding and service provision. Since the loss of the Regional Rail Passenger Committee’s this has left a gap in the network for passenger representation. The DfT and Government officers are failing to ensure DfT Rail Group understands the needs of local communities, passengers, Local Authorities and Regional Development Agencies within the contract specification, leaving commuters with inappropriate train services and no alternative provision by not using local knowledge and input from local transport authorities and passenger groups when planning services.

Other examples have been the Great Western Franchise between Portsmouth—Southampton—Salisbury—Westbury—Bath and the Bristol—Newport and Cardiff where the DfT appears to be withdrawing three car units to be replaced by two car units resulting in 1,000 less seats at peak times into Greater Bristol; this area is one of the fastest growing economic belts in the UK.

Other examples of DfT failure is the withdrawal of the Southampton—Swindon via Melksham service, going from a train every two hours to one every 14 hours and the loss of services on the Exeter—Plymouth corridor, serving the towns of Totnes and Ivy Bridge. This service is going from 12 trains per day down to only three in each direction, again serving Plymouth, which again is an area of economic growth. Cuts have also occurred on the Saltash—Plymouth service, which has removed late night and evening economy trains from around Exeter. Services have equally been removed from the Bristol—Gloucester corridor and have socially excluded the area of Dilton Marsh, a large council estate on the edge of Westbury. There are few bus services and the cuts have resulted in 14 trains per day to six. Also loss of catering services on Cross Country and First Great Western routes is not of benefit to customers using these routes.

Cornish branch lines have lost their Sunday services, again with no alternative bus provision provided by DfT, in many cases the local Government officers have watched conflicts between LA’s, DfT Rail and Regional Development Agencies develop with no intervention. There is a need to ensure that DfT Rail commission appropriate local rail services to meet the social and economic need of all areas.

Within the Welsh Assembly Government, to which the franchise has devolved to Transport for Wales and operated by Arriva Trains Wales, there appears to be a well-focused approach by Transport Minister, Andrew Davies with intervention directly by Welsh Assembly Transport Civil Servants in managing Arriva Trains Wales. This has resulted in the recent change of Managing Director and leading to a more focused approach on capacity to meet the needs of the Welsh Valley line services. This has lead to the hiring of additional rolling stock to meet the needs of peak hour travel for commuters, school children and students. There are still issues around the cleanliness and quality of the franchise, which Welsh Assembly Government needs to address, for example, cleaning of train interiors and the integration of the TRAWS—Cambrian coach network alongside the rail network to provide an integrated network, and connectivity with the ferries to Ireland. The problems with the franchising in Wales are the cross border wide services. Before devolved railways there were through services from West Wales and Cardiff to London Waterloo. Bristol—Manchester via the Welsh borders, Swansea to Penzance via Bristol, Taunton, Exeter & Plymouth and Cardiff—Liverpool; these links are being lost owing to the focus of the Assembly on services in Wales and the borders, with no thought of connections to Bristol, Birmingham and Liverpool. The recent decision by WAGG to run through services to Cardiff airport and Portsmouth Harbour is welcomed. Whilst we welcome new services, these should not be lost from main line economic corridors between South Wales and the South Coast.

There is a lack of consultation with LA’s Regional Government, Passengers and User Groups. DfT civil servants within the Government Offices and the Railway Directorate are failing to attend public consultation meetings organised by the Travel Watch Network, Passenger Focus & Bus Users UK and other groups to facilitate stakeholder input into the franchise process.

In cases of Rail Service withdrawals DfT, unlike the Beeching era and with the exception of Stoke on Trent,—Stafford and Bristol Severn Beach have failed to provide any rail replacement bus services leaving communities without public transport services. Some of the worst locations in the South West where they
have left no public transport procurement are places such as Ivy Bridge, Melksham, Ditton Marsh and Keynsham. Similarly decisions taken to remove South West Train services from Exeter have left communities such as Dawlish, Teignmouth, Totnes, Ivy Bridge and Plymouth with reduced local services. In growing city regions, eg Exeter, Torbay, & Plymouth, these decisions were made by civil servants in London, Plymouth & Bristol with no meaningful public consultation. We recommend a complete review of the consultation procedures with DfT Rail Government Officers within the English and in Wales there needs to be an urgency the setting up of public transport user forums to replace the RPC; this also applies to Scotland.

Are franchise contracts the right size and length?

The awarding of franchises do not take into account the needs of the local communities which the railways are supposed to serve and the Government economic policies within the English regions, spatial plans and regional economic strategies. It would be better if the franchises were co signed by Regional Development Agencies, Regional Assemblies, Passenger Transport Executives (PTE’s) or Regional Transport Boards (Transport Boards need to be created in the English Regions); they will understand the role of Public Transport provision in the City regions. They should also be able to specify bus & ferry services and those of light rail to ensure a seamless journey. This is the situation in Western Europe, where is taken for granted!

The franchise agreements are too short and do not allow for investment levels to go beyond the basic management contract of refurbishing and managing train services, painting, basic maintenance and improvement to rail stations, The Government in England, outside of London, needs to decide if it should have a 20 year franchise period where the private sector can invest new rolling stock and general facility improvements jointly with local and regional Government, or if a pure management contract is the order of the day, which cleans just the stock, operates the service and provides the catering contracts, in return for a capitation fee where the risk remains with the treasury to provide the capital funding and re-sourcing to the level of public service the local communities require.

Public sector organisations should be able to operate franchises not just all be in the private sector provided the public sector company is well rewarded for providing the services especially where there is risk in purchasing buses, trains or trams.

Do we need more competition and vertical integration?

All services should be specified by Regional and National Government. ie; Scotland and Wales and take into account Government policies on Transport, Global Warming, Social Inclusion, Regional Planning and regeneration of major Cities, as the Government is paying 88 million per week and six billion per year in subsidies to Network rail. Non-specified private entrepreneurial railway operations which do not make a contribution to infrastructure costs or social need should simply not be allowed. Exceptions to the rule could be the Hull Trains situation providing economic development between Hull and London and the proposed Wrexham to London service where support and direction is coming from the Welsh Assembly Government. We would not support a pure open access operation which undermines the viability of existing inter city operations. We have major concerns regarding the Grand central operation between Sunderland and London and would prefer all services to be clearly specified and procured by Government.

The franchise should not be a way of generating income out of vital public services. The money clearly needs to be re invested into meeting the needs of the local communities to provide revenue support to local regional and suburban and metro services. eg; Great Western should have provided in local services between Exeter, Bristol and Plymouth, Swindon, Southampton and Portsmouth—Cardiff routes and the maintaining of the Swansea—Penzance service. We would support vertical integration of integrated franchises based on the eight large regional companies in England, Scotland and Wales, with access rights and running powers across the whole rail network.

The Government, as Network Rail should remain the owner with local networks going to such as Merseytravel, etc and self contained transport authorities/boards. The following regional and national railway companies such as Scottish railways, Welsh railways ie First Great Western and Arriva Trains, could be vertically integrated through a joint company with Network Rail providing a separate Welsh franchising authority, similarly South West trains with a similar company but separate specification with London.

Community railways could be vertically integrated companies and in places, like the rest of Europe, be integrated with the local regional authority to provide local bus, rail, ferry and tram services.

Security and catering must be specified in the franchise. The British Transport Police should remain as a separate authority and should not have its offices and resources built into the franchise arrangements. It should be the authority that specifies the travel safe officers, community support officers, rail enforcement officers and security officers these too should be integrated across bus, rail ferry and trains.

Specification to franchise should also include links to ferries such as Isles of Man, Wight, Scilly’s Scottish Highlands and Islands and the Channel Islands. Bus/Rail integration including tickets, service specification, interchanges and rolling stock eg Bridgend, Porthcawl, Exeter, Okehampton, Bude Taunton and Minehead.
Station should remain under the control of Network Rail and should not be constantly painted in corporate liveries and should reflect government ownership and branding and not the operating company colours—Wales should have Welsh Assembly Government colours and a statement saying operated by Arriva Trains Wales.

Memorandum submitted by Mr George Huxley

NOTES FOR INQUIRY INTO PASSENGER RAIL FRANCHISING

This is an attempt to answer some of the questions posed in the document of invitation. However, one vital question is missing: is there a need to continue passenger rail franchising?

Franchising was an outcome of the Robson-Wilson (-Foster) scheme of privatisation forced upon the system by the Treasury’s insistence upon vertical disintegration of operations from infrastructure. The insistence resulted from a deliberate misunderstanding of European legislation: there was no need to have separate ownership of track and signalling from operations and rolling stock. The legislation—over-interpreted in the cause of rapid sell-offs of public assets—is embodied in European Community Directive No 440 of 1991; it does not require separate ownership, but it does require separate accountability of infrastructure and operations. That is why one can see locomotives in, for example, permanent way depots of the SNCF clearly marked SNCF Infrastructure.

Separation has led to failures of communication between track authorities and operators (remember, eg Hatfield, Potters Bar, Aldwarke). It has also led to a mismatch between length of operating franchises and lifetimes of assets (rolling stock, signalling, trackwork). Under wiser leadership the SRA, now defunct, could have shown the way to reintegration, but the DfT lacks the technical competence and the will to enforce a radical change of policy. Sir A Morton had argued for longer franchises but made no progress, and his successors were concerned not to offend the DfT and the Treasury, so that policy tended towards looking for the lowest bids with but feeble requirements to improve services and to enhance the system. The opportunity to review state involvement in operations for comparative purposes was lost when South East Trains, which performed tolerably well as a state entity, was dogmatically offered for refranchising. The relation between access rights and franchising was never worked out, but DfTs micro-prescription in franchise specifications has produced inflexible cutbacks in services—witness the appalling FGW timetable for branches in Devon and Cornwall. The cutbacks show how disingenuous was the talk of Mr Darling, Mr Twigg, and others about Community Rail Partnerships.

The GNER bid was successful but it was made before Sea Containers were known to be in financial trouble. The bid (together with a promise of a large premium to the Treasury to go to general taxation, not back into the railways) depended upon a significant enhancement, namely the electrification from Leeds to the Hambleton Junctions to permit running through Leeds without reversal. ORR, being more concerned with open access than with betterment of the infrastructure has, by approving additional paths to Hull and others to Sunderland, made the GNER scheme unworkable. There could hardly be a more vivid instance of the inherent folly of the present organisation. Meanwhile the Treasury has been approving, before cost overruns, enhancements to the M1 near Milton Keynes of £36 million—per mile, but “optimism bias” is used to stop tramway projects in the English provinces.

Some franchises have been so ruinously misjudged by bidders that they have been adjusted to “management contracts” (Virgin Cross Country is an example); it is hard to find a polite economic description of such arrangements. Perhaps subsidised, riskless, capitalism would do.

The gradual restoration of vertical integration will be a long business. DfT makes matters harder by constant tampering with franchise boundaries and routes, as in the East and West Midlands. Talk of virtual vertical integration is operationally and fiscally meaningless. However, it is necessary to start somewhere. Partly thanks to devolutionary Danegeld, the Scottish Executive can afford to think more rationally about railway organisation than can the DfT and its masters in the Treasury. The notion of vertical reintegration has received some favourable comment among Scotch politicians and the Scot Rail TOC has also considered reintegration of track, signalling, and operations because it is almost self-contained. Infrastructure moreover can be jointly owned; the buspersons in the DfT railway division have short, or no, historical memories. Before nationalisation in 1948, and before the grouping, two or more railway companies operated joint lines, and also exercised running powers. In the long term the need is not so much for a new SRA as for a kind of Railway Clearing House. Network Rail’s objections to Merseyrail’s proposal to take over track and signalling were strongly expressed, but they were more oratorical than rational. (Franchising has entailed another kind of subsidised capitalism—the pretence that Network Rail, whose mute stakeholders, bound by the Official Secrets Act, are powerless, can function as an autonomous company. The charade even extends to Mr Armit and other executives awarding themselves each a grotesquely large bonus at the expense of taxpayers from whom the infrastructure was taken.)

Another possible candidate for take-over of track by a TOC is Chiltern Railways, one of the more efficient TOCs. The association with Laing would make a coherent operation of trains and track workable. It is noteworthy that Chiltern is run by Mr Adrian Shooter, an old-time, highly competent professional
railwayman of the kind dismissed in numbers by suited accountants, open-necked bus functionaries, promoters of obscure or semi-literate nomenclature such as “One” or “C2C”, and photo-opportune airline executives, after privatisation.

Until the confusions between ORR, DfT, passenger and freight operators, Network Rail, and the Treasury are worked out, long-term planning and pompously named High Level Output Statements cannot but be incoherent and transitory (how long did Mr Prescott’s grandiose “plan” last?) It is not true even to say that “the shape of ‘third generation’ franchise agreements have (!) emerged”. Franchising is a mess, and without a coherent and positive vision for the railways (something that the chauffeur-driven oligarchs of the Treasury institutionally and traditionally lack), there can be no reliable forward thinking. While blocking further electrification, the DfT cannot even coordinate the design of a new diesel HST2.

There is an astonishing reluctance in DfT to admit that main and branch line railways can be palliatives of congestion. Instead the Department champions an enlarged Heathrow and blocks tramway schemes in the English provinces. It was said that Mr Darling was a “safe” pair of hands at Transport. He was not safe: he was paralytic, and he lacked the guts to suspend Mr Mitchell from duty in DfT until the outcome of the court case. Despite the opportunities given by an unusually long tenure, he failed to provide the basis of equitable treatment of heavy and light rail in relation to road and air. Nearly 60 years after rail nationalisation the questions of road, rail, and air track costs and of the unclaimed debt interest upon the historic capital cost of the road system have still not been addressed honestly.

The answers to the questions listed are hard to give. Here are some attempted replies:

1. Nobody in Government knows what the purpose is.
2. By definition it is not: there is no discernible purpose.
3. It is chaotic.
4. Very little, with passengers having none at all. Transport Focus is powerless. The abolition of the provincial RPCs was a deliberate diminution of democracy.
5. Well, some persons moved easily from SRA to DfT Rail.
6. The franchises are of the wrong type (TOCs do not control infrastructure); there are two many companies; franchises are too short.
7. That is a secret of the Treasury.
8. No principle, other than the bottom line, can be seen; social benefits are rarely calculated.
9. No. We have on average the highest fares in Europe.
10. No. ROSCOs in particular are scandalously profitable and so passengers suffer even more inflated fares.
11. Under micro-prescription by DfT very little scope exists.
12. There is plenty of competition between road, rail, canal, and air, but air and road have unfairly institutionalised advantages. On-rail competition is not desirable and there has been little of it ever since the environmental. disaster of closing allegedly duplicate main. lines. We do need serious vertical reintegration.
13. By experience, no, except for freight.
14. Yes, under a single company or administration—regional rather than nation-wide: Western, Southern, Welsh, Midland, Eastern, North-Eastern, Scottish operations are needed; they must be capable of cooperating with TIL and PTE railways in metropolitan areas; when suitable, a mixture of light and heavy rail operations should be possible together with paths for freight trains. The notions of Joint Lines and Running Powers should be revived. We must not be too proud or too lazy or to insular to study the municipal practices in local transport of our continental neighbours; and where is the British N to SLGV?

In short, franchising is a failed economic device; it is confused and costly; and it should be gradually be eliminated in the interests of sound railway practice and of political prudence.

Memorandum submitted by Professor Richard Knowles

THE PURPOSE OF PASSENGER RAIL FRANCHISING

The outcomes from rail passenger franchising need to be measured against the objectives set by Government. Potentially, rail privatisation offers the opportunity of providing leaner, more efficient and market-based services which are both more attractive to the customer and cost the taxpayer less in government subsidy.
The objectives of passenger rail privatisation have been to:

— reduce the level of public subsidies for rail passenger services;
— produce consumer benefits by attracting additional passengers through more attractive services and ticket prices;
— lever in sufficient private sector investment in infrastructure and rolling stock, through competition for franchises, to create a more reliable railway with fewer capacity constraints; and
— produce the conditions to deliver the Government’s 10 Year Transport Plan target of a 50% growth in rail passenger traffic by 2010–11.

The four stated objectives of the SRA’s November 2002 Franchising Policy were to:

— deliver a safe, more reliable service of consistently high quality for rail passengers;
— provide clarity of service specification so that industry partners work together for passengers;
— deliver a value for money service for passengers and taxpayers; and
— secure accountable, viable operators who are passionate about delivering for their customers.

(see Knowles, 1998 and 2004)

Are the franchise contracts the right size, type and length?

Analysis of first round franchise commitments demonstrates that franchise bidders are not prepared to invest heavily in rolling stock and infrastructure without a franchise period of at least 10 and preferably 15 years (Knowles, 1998).

A new template for a franchise agreement was developed by March 2003 with industry partners including the Association of Train Operating Companies. Second round franchises were cut to a norm of a five to eight year period, with good performance offering the prospect of an extended franchise. These short to medium term franchises are not generating the significant levels of private sector infrastructure investment in Britain’s railways envisaged in the government’s 10 Year Transport Plan (Knowles, 2004). This was a contributory cause of the Government abandoning its Ten Year Transport Plan target in July 2004 of a 50% growth in rail passenger traffic by 2010–11.

At the time of the 10 Year Transport Plan, refranchising of passenger rail services for 10 to 20 year terms was intended to generate billions of pounds of private capital investment in infrastructure, rolling stock and services, many times greater than that achieved from first round franchises when 18 out of 25 franchises were let for shorter periods of up to seven years six months. With the loss of private sector confidence following the Hatfield derailment, Railtrack’s demise and the unsustainable Annual Financial Improvement requirements of many first round franchises, most of the new franchises are for much shorter periods than 10 years, offer less investment in rolling stock, fewer service upgrades and very little infrastructure investment.

The strategy of consolidating franchises operating out of major termini to simplify journey planning and improve services for passengers would be logical if applied to major provincial cities like Leeds, Manchester and Sheffield and not just to London.

Do we need more competition and vertical integration?

Open access competition is only fair if there is a level playing field in terms of track access charges for the incumbent franchisee and the open access competitor. If the open access competitor only pays marginal access costs they have a substantial and unfair advantage against the incumbent franchisee. This is compounded if track capacity constraints prevent the franchisee from delivering its franchise service commitments because an open access competitor has been allocated all the spare train slots.

Vertical integration, where the train operator is also the track operator, could be advantageous when one train operator operates all or most train services on a particular network. There would be more incentive to prioritise investment and maintenance in line with train operators’ preferences. Vertical integration would also incentivise a reduction in the length of service disruption during routine maintenance.

Conclusion

Rail privatisation has succeeded in growing rail passenger traffic to record levels, assisted by continuing economic growth and increasing road traffic congestion. However, annual subsidies have not decreased in real terms; in 2002–03 they were almost identical to those received before privatisation by British Rail in 1993–94.

The policy of accepting the lowest subsidy bids for first round franchises proved to be unsustainable (Knowles, 2004, p 2078).
Regions outside south-east England have suffered the most negative consequences of rail privatisation as Regional sector franchises faced the twin challenges of the highest annual financial improvements to replace declining subsidies and a dearth of capital investment. The average age of rolling stock is now, for example, much higher in the Northern franchise than in the south-east commuter franchises.

Refranchising has not in most cases levered significant private capital investment in infrastructure, rolling stock and new services.

REFERENCES


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