ANNEX 7

CASE STUDY
GREAT BRITAIN

CASE STUDY – GREAT BRITAIN

1. Scope

This analysis is restricted to Great Britain; it does not therefore include Northern Ireland. In Northern Ireland, for a variety of historical and technical reasons, railways have developed separately and were not, for example, ever part of the state owned "British Railways". An entirely different regulatory structure applies to Northern Ireland Railways, which remain state owned and vertically integrated. Although it should be noted that the regulatory bodies in Great Britain (for example, the Rail Accident Investigation Board) are increasingly also becoming the competent bodies for Northern Ireland. It is therefore not fanciful to believe that, subject to EU legislation, that the regulatory structure for the railways of Northern Ireland will ultimately evolve to be similar to the remainder of the United Kingdom.

In accordance with the Specification for the Study, this analysis does not consider metro and light rail systems, or heritage railways[1], although a few of the latter do provide some services targeted at local residents, in at least one case with local government financial support.

[1] Currently comprising some 803 km and 356 stations in the United Kingdom, source: Heritage Railway Association.

2. Regulatory Structure

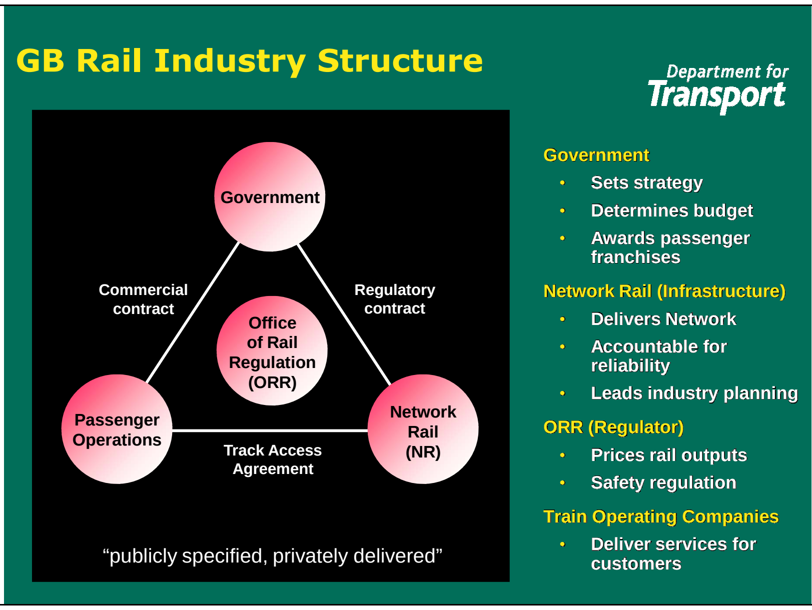
2.1. Overview of current regulatory structure

In Great Britain, some 98% of passenger services are franchised, that is to say operation of a set of services is competitively tendered and then contracted out to a railway undertaking for a period of time. The undertaking has an effective monopoly (but see below) and pays or receives a fee for those rights. The competition is thus not within the market but for the market.

> *"The principal argument for franchising rail services via a competitive tendering is that it permits the preservation of an integrated network of services, subsidised where necessary, whilst introducing competitive pressures, leading to incentives to reduce costs and (depending on who bears the revenue risk and what other incentives are in place) improve quality of service. Compared with the alternative of open access competition as a way of introducing competitive pressures into the rail passenger industry, competitive tendering is especially useful in cases in which competition in the market is not feasible because of the need for subsidies or a lack of capacity"* Taken from Nash and Smith 2006[2]

Figure 1 below shows the structure, the players and summarises their roles:

Figure 1. Structure of the GB Rail Industry



Source: UK DfT

2.2. History & evolution of regulatory structure

It is important to note that British railways were developed by private enterprise and were run as private companies until 1948. This has had two effects with lasting importance. Firstly, there was an on-going commercial tradition. Even when nationalised, British Railways were

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[2] Nash, C A, Smith A S J *Rail Passenger Franchising-British Experience* ECMT Workshop on Competitive Tendering for Passenger Rail Services 2006

not part of the state apparatus[3] but rather a commercial corporation expected to break-even financially "taking one year with another". Secondly, the railways were largely run as a series of independent networks (note the twelve terminal stations[4] in London), a fact which facilitates the franchise concept. The concept of a clearing house for common industry issues was also part of railway history.

It should also be noted that the political structure of Great Britain allows a single solution for rail services to be adopted. In this way whilst there are franchises based on Wales and Scotland, they are to the same model[5] and other franchises, based in England, are able to operate services into Wales and Scotland without problem, and *vice versa*.

The present system of regulation was largely set up by the *Railways Act 1993*[6]. The act set up the regulatory structure itself and provided for the system of franchising which forms the core of the present arrangements. It was part of a major reorganisation in which the state-owned "British Rail" was split into over one hundred organisations which were all privatised.

At the time the Railways Act 1993 was being debated, the main motivator for the changes was the philosophical conviction by the government of the day that private enterprise was inherently better than public ownership. Oliver Letwin, a prominent Conservative, was quoted as having said *"we had a fundamental distrust in the state running things"*[7]. A second objective was to raise money to reduce the public sector borrowing requirement. The policy was also expected to reduce the level of financial support required for rail services through competitive tendering in the context of an expectation that the demand for passenger services was in long-term decline. Accordingly a system of a separate infrastructure manager, outright sale of the freight business, creation and sale of rolling stock leasing companies, and franchising the rights to operate passenger services was decided on. The original concept provided for an Office of Passenger Rail Franchising (OPRAF) to handle the franchising process. Economic histories[8] point out that the development of policy was pragmatic, almost haphazard, and that the current model is derived from practical rather than theoretical considerations. It might be assumed that the model is intended to be responsive and that its development will continue.

Significant amendments to the 1993 Act were made in the *Transport Act 2000*[9] and the *Railways Act 2005*[10]. Firstly, the Strategic Rail Authority (SRA) was set up to take on the duties of OPRAF and act as a coordinator and policy engine for the rail industry. The SRA was subsequently wound up and its duties absorbed into government and the Office for Rail Regulation. The abolition of the SRA was said to be due to the government's belief that the SRA had failed to keep the costs of franchises in hand[11] (see section 3.4.1 below). In its January 2010 report the DfT takes particular care to point to a comment from the National Audit Office "*better value for money for the taxpayer … since the Department took over from*

[3] There was no Minister for Railways, for example

[4] Fenchurch Street, Liverpool Street, King's Cross, St Pancras, Euston, Marylebone, Paddington, Waterloo, Victoria, Charing Cross, Cannon Street, London Bridge. Two more, Holborn Viaduct and Broad Street, were closed in the past two decades.

[5] Management of the Scottish and Welsh franchises is devolved to the Regional Governments

[6] http://www.opsi.gov.uk/acts/acts1993/Ukpga_19930043_en_1

[7] Quoted in "All Change, British Railway Privatisation" eds Freeman & Shaw McGraw-Hill

[8] See, for example, "British Rail 1974 – 1997, Gourvish, Oxford University Press

[9] http://www.opsi.gov.uk/acts/acts2000/ukpga_20000038_en_1

[10] http://www.opsi.gov.uk/Acts/acts2005/ukpga_20050014_en_1

[11] Britain's Railways 1997-2005 Gourvish, Oxford University Press p 220.

the SRA". These changes therefore mainly affected the players rather than the principles. The description below refers to the current system. The sections below examine the role of the various players and in particular the system of franchising passenger services. A useful presentation for an international audience is available on *www.mobilit.fgov.be/data/rail/librail2008-07.pps.*

Details of the freedoms and constraints that franchising involves are given below, but it should be noted that in principle the franchise holder keeps the revenues[12] and pays for the costs of operation. The franchise holder may be paid for running a specific franchise to the specification or may indeed pay a premium if the underlying revenues justify that. The services to be franchised are put together by the Department for Transport to form a coherent group. Most now have a mix of services, both long and short distance; although there are franchises with just one or the other. The composition of the services to form the franchise is decided by the Department for Transport and there have been changes to provide better balance, to allow all services into one terminal to be operated by the same franchise holder or to reflect revisions to service specifications. In practice, overlap between the franchises is negligible and competition between them rare (but see below for open access).

There are currently nineteen franchise holders and four open access railway undertakings. International services are not subject to the franchise regime.

The length of franchises must be long enough to allow franchise holders to be encouraged to invest but short enough to encourage franchise holders to remain attentive to service quality. Policy on the length of franchises has changed and re-changed. Current policy is for franchises of seven to ten years, normally with a review after five years. As this report was being drafted, it was reported that the British Government had let a study to review options for the future. The issues to be considered are outlined in section 7 below[13].

ATOC[14] argues for longer franchises. They draw lessons from the fact that the three railway undertakings with the highest scores on performance and passenger satisfaction have franchises of fifteen years or more. (It might be added that the franchises in question are also manageable, self-contained units with good infrastructure). Their arguments are much as outlined above, providing stability to allow for investment and avoiding short-termism. The Department of Transport pointed out that although there are some successful survivors with long franchises, other long franchises had to be renegotiated.

2.3. Role of the Regulator

The Rail Regulator is responsible for economic and safety regulation; regulating both railway undertakings and the infrastructure manager. The Department for Transport (a government department) has a role in fares regulation and the Rail Safety and Standards Board also has a safety role. The Rail Regulator is essentially an independent body with duties set by statute. Regulation is funded by the industry though levies on the infrastructure manager and railway undertakings.

[12] Two urban franchises (in London and Liverpool) operate differently. The local transport authority awards the franchise and pays a fee for the service, but keeps the revenue itself. The term "concession" has been used to differentiate these operations.

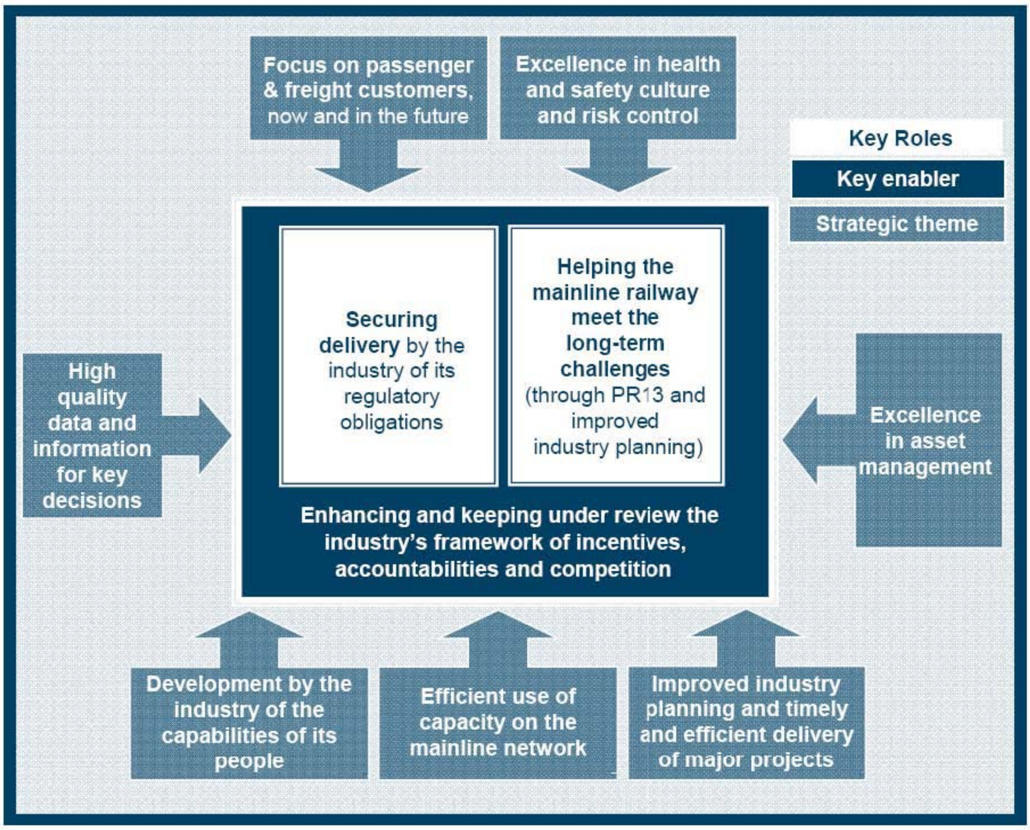
[13] Report in the Financial Times 30 December 2009

[14] The Association of Train Operating Companies: see below

Network Rail, the infrastructure manager, thought it was very important that the Regulator had control of both safety and economic issues. This ensures a measured attitude to safety issues is taken. In this way safety initiatives can be ranked and political reactions to incidents can be put into context. Employee representatives assert that pressure to reduce costs compromises safety and that separation of the roles would therefore be desirable, no other consultee held this view however.

The Figure 2, below, illustrates the Regulator's strategy:

Figure 2.   Regulatory Strategy in Great Britain



Source: Office of Rail Regulation

The Regulator has six tasks:

- independent economic and safety regulation;
- enforcement of health and safety legislation;
- determination of the infrastructure manager's revenue requirement, access charges and outputs;
- monitoring of the infrastructure manager and enforcement of his network licence;
- establishing the access and licensing regime and approving applications;
- acting as the competition law authority.

Independent determination of the infrastructure manager's revenue requirement is a key factor. This is done by the ORR in "periodic reviews". These ensure that the infrastructure manager is adequately funded and is able to keep his assets in order and that he is forced to become more efficient. A 21% reduction in unit costs has been set for the 2009 - 2014 period and the infrastructure manager is said to be on-target.

Central Government control of investment is provided by means of a *High Level Output Statement* (HLOS) and a *Statement of Funds Available* (SFA) both set by the Government. The HLOS and SFA both apply to the railway as a whole (and therefore to investment in infrastructure and rolling stock). Options are iterated until these two match. Once funding has been decided for a five year period, it is fixed.

One stakeholder welcomed the fact that the Regulator gave the infrastructure manager guidance on the priorities to be followed in meeting his statutory duties.

The Regulator pointed out his role in monitoring the infrastructure manager and instanced the fines of GBP 14 million levied when the infrastructure manager failed to complete engineering work on time.

The Rail Regulator does not consider he has or should have any role in the optimisation of scarce resources, either train paths or rolling stock. Any such optimisation follows therefore from direct action by the Department for Transport. In a specific case, there were insufficient paths for all railway undertakings' aspirations on the East Coast mainline (from London to Doncaster). After one railway undertaking challenged the refusal of a train path through the courts, the Regulator refused to intervene. After criticism of the infrastructure manager's timetabling practices (the infrastructure manager had accepted bids for paths which made poor use of the capacity) more capacity was found by adjustments to train paths. The infrastructure manager runs regular *Route Utilisation Studies* (RUS) to assess options for the more congested routes. These typically look at a whole range of options, longer trains, extra infrastructure, timetable amendments, etc. One open access railway undertaking was more scathing about the process, saying there was no certainty that the RUS would come to a sensible conclusion and there were cases in which inadequate account was taken of open access.

3. The Rail Passenger Market

3.1. Overview

The population of Great Britain is concentrated in a triangle with Newcastle in the North East, Blackpool in the North West and Brighton on the South coast. This concentration provides the potential for substantial passenger flows and sows the seed of road congestion. Within this area, road and rail share the market (air services operate between London, Manchester, Leeds and Newcastle but have low modal shares).

With 471 cars per thousand inhabitants[15] most families have access to a vehicle, so there is choice of mode. There is an extensive network of coaches on trunk routes but with the exception of one axis (London to Oxford) journey times are poor and market share low.

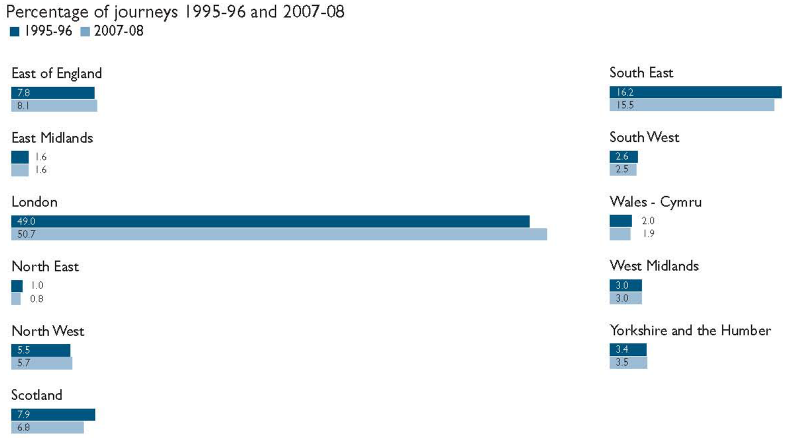
Accordingly, on trunk routes to and from London traffic by rail is high and supports a half-hourly service on most trunk routes within the area above.

For longer distance flows (principally from Scotland) air is the dominant carrier, rail cannot manage journey times less than four hours and this is crucial in making air the choice of both business and leisure travellers.

Outside these London based trunk routes, rail is a marginal carrier with a modal share of less than ten per cent (see the diagram below). Likewise for local journeys rail is a minority carrier except in the London and South East commuter area. In the London commuter area rail is the dominant mode for journeys into the capital.

This imbalance is brought out in Figure 3 below which shows the percentage of rail journeys made from the British regions.

Figure 3. Imbalance in Rail Use in Great Britain



Source: Office of Rail Regulation

Great Britain has only one high-speed line (*HS1*, from London to the Channel Tunnel: it is effectively dedicated to international traffic), nevertheless, because the principal routes were well engineered, 160 km/h is possible along most routes and 200 km/h on many. Fewer lines

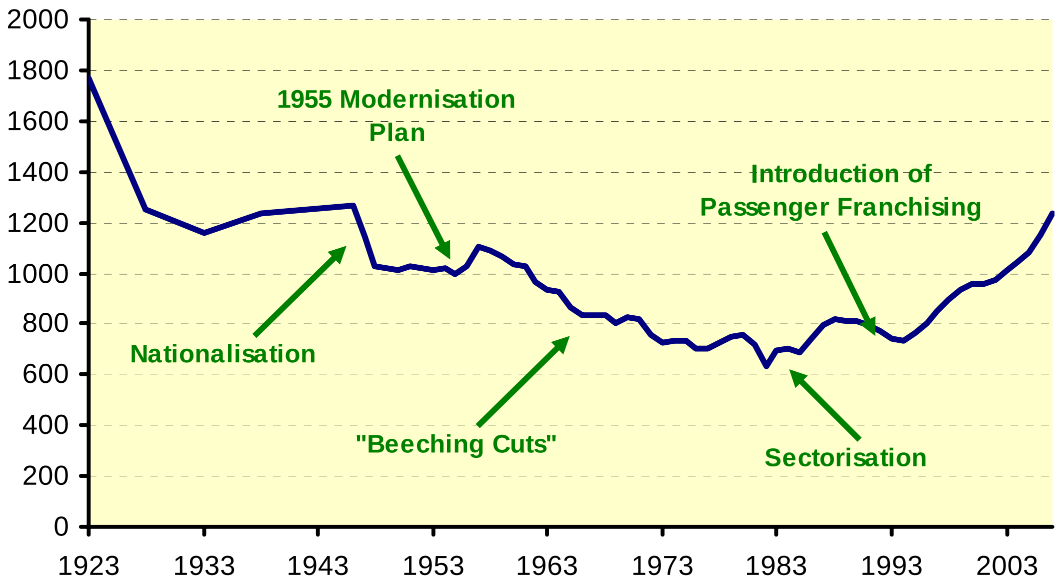
[15] 2006 figures.

are electrified than on the Continent but British railways have developed high-speed diesel trains and there is a fleet of more than two hundred diesel train-sets capable of 200 km/h.

3.2. Market trends

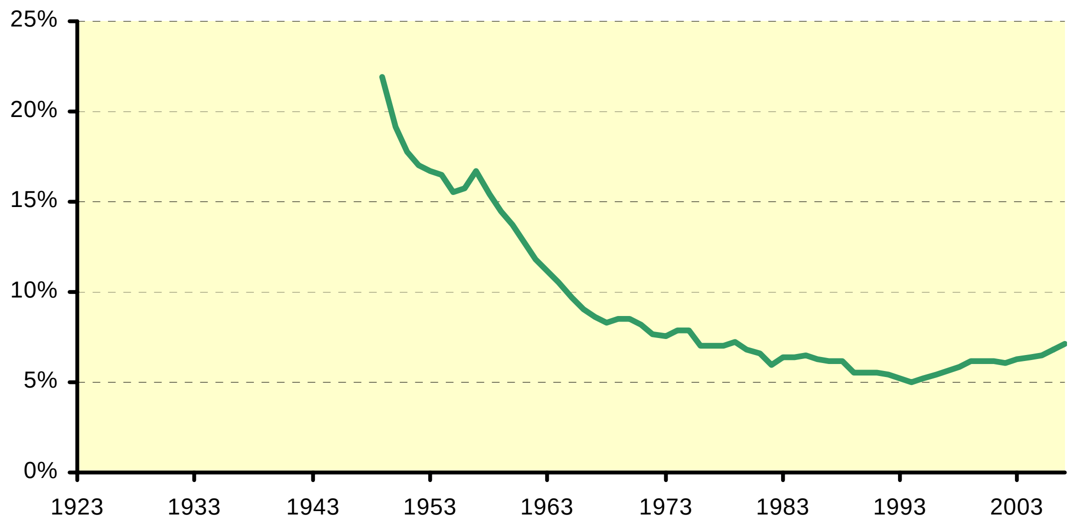
The happy combination of increased economic prosperity (until 2008), increased frequency, new rolling stock and the market based fares system have served to make passenger volumes increase markedly since franchising started in 1993 (see Figures 4 to 6). This reversed the long-term trend of decline since 1919, in which the use of rail actually fell, despite a greatly expanded market. The progressive increase in modal share from just under 5.0% in 1993 to 7.2% in 2007 is particularly noteworthy. In comparison the modal share in 1949, immediately following nationalisation, was 21.9%, the fall to single figures illustrates the nature of the problem. (Note that data for the 1939-45 period is not included in the graphs below, since it would distort the picture, although some distortions remain in the immediate post-1945 period as a result of petrol rationing, which continued until May 1950).

Figure 4. Passenger Journeys on National Rail Network in Great Britain 1923-2007 (in millions)



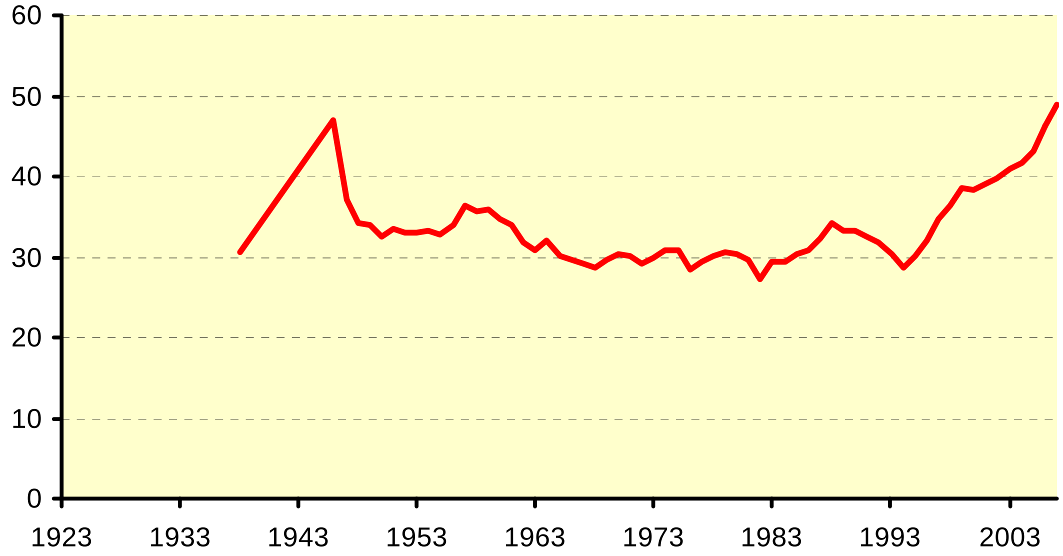
Source DfT: *Transport Statistics Great Britain (TSGB)*

Figure 5. Rail Passenger Modal Share in Great Britain 1949-2007



Source DfT: *Transport Statistics Great Britain (TSGB)*

Figure 6. Passenger Volumes in Great Britain 1938-2007 (billion pass km)



Source DfT: *Transport Statistics Great Britain (TSGB)*

3.3. Passenger rail services

3.3.1 Competition for the market and competition within the market

Essentially the British system for bringing competition into the rail market was heavily influenced by an implicit undertaking by the Government of the day that services would not be downgraded by competition. (There had been active political lobbying that competition would remove all services which were supported for social reasons). This led to a system of franchising all the services then operated by British Railways. The franchises were let as groups of services, using the former BR organisational structure as a basis. At the time, these groups were mainly long-distance, regional or commuter in nature, but some franchises (for Scotland in particular) consisted of a mixture of all three. Bidders then competed for the opportunity to run packages of services which were essentially those scheduled by BR. Open access services were planned in this scheme of things but given the process, there were none at first, and indeed they were not encouraged: the Regulator stating that open access in the passenger market was a longer-term aspiration, and "moderated" competition, stating in 1994 that *"it is necessary for competition between passenger train operators to be substantially restricted, at least for an initial period"*[16]. Even today the DfT have informed the Consortium that the existence of open access services suggested a fault in franchise specification in that viable services had been omitted.

Local participation in the process was not a key element but was not excluded. Thus most of the franchises were let centrally but in three regions with strong self-contained regional flows there was regional involvement (involving outright control in two cases); however, the same franchising model was adopted. The management and financing of local metro networks was not changed, despite sharing tracks, stations and revenue with the franchised services in some cases.

In more recent years open access has been permitted, provided its purpose was not primarily abstractive. The first service, between Hull and London, started in 2000. Open access railway undertakings receive no support from the Government for any social benefits they may bring (that they do bring social benefits by opening up new axes is not in doubt). Open access railway undertakings pay the variable element (i.e. usage related) of the applicable charge for the use of infrastructure. One open access railway undertaking said that that was a key element; it was unlikely that there would be any open access if full allocated costs had to be paid.

Open access services were slow to start, but there are now four distinct groupings. Excluding Heathrow Express, which can be regarded as atypical, they typically have a maximum frequency of up to four trains a day along specific axes. Open access services have opened new markets. Interestingly and perhaps significantly, open access services have been started by groupings which do not hold franchises already although in two cases the operations have subsequently been bought by existing franchise holders.

Open access railway undertakings have to abide by all the rules applicable to franchisees, such as mutual recognition of tickets, mutual recognition of national schemes for reduced fares, etc. but in return gain a share of the total revenue at jointly served stations.

The current situation is therefore that only some 2% of services (by all measures) are open access, the rest are franchised.

3.3.2 Service Frequency

The liberalisation process has led to significantly more frequent train services, as shown in Figure 7. Loaded train miles increased by some 37% from the last year of all-BR operation (in 1993) to 2008.

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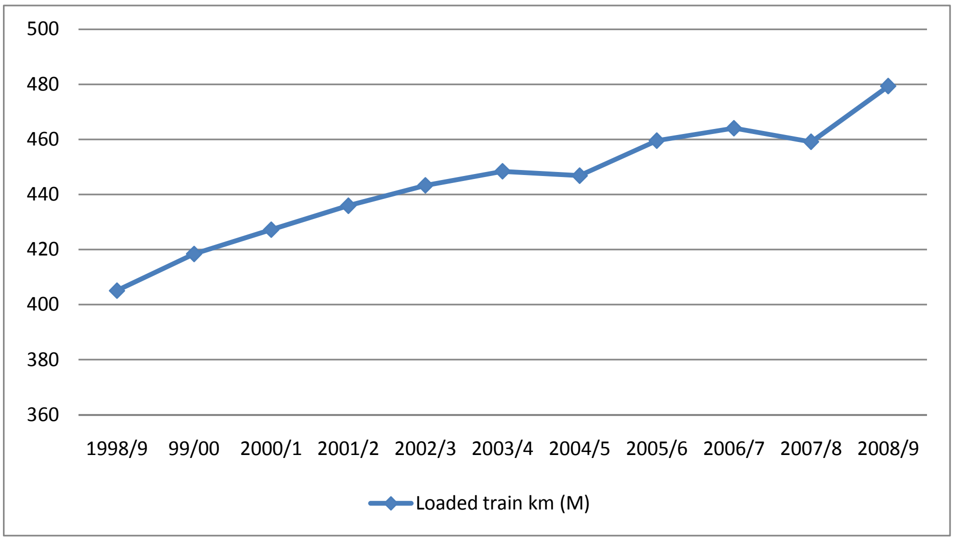
[16] See *Competition for Railway Passenger Services: A Policy Statement,* Office of the Rail Regulator December 1994.

Figure 7. Loaded train km 1998-2009



Source: DfT: *Transport Statistics Great Britain (TSGB)*

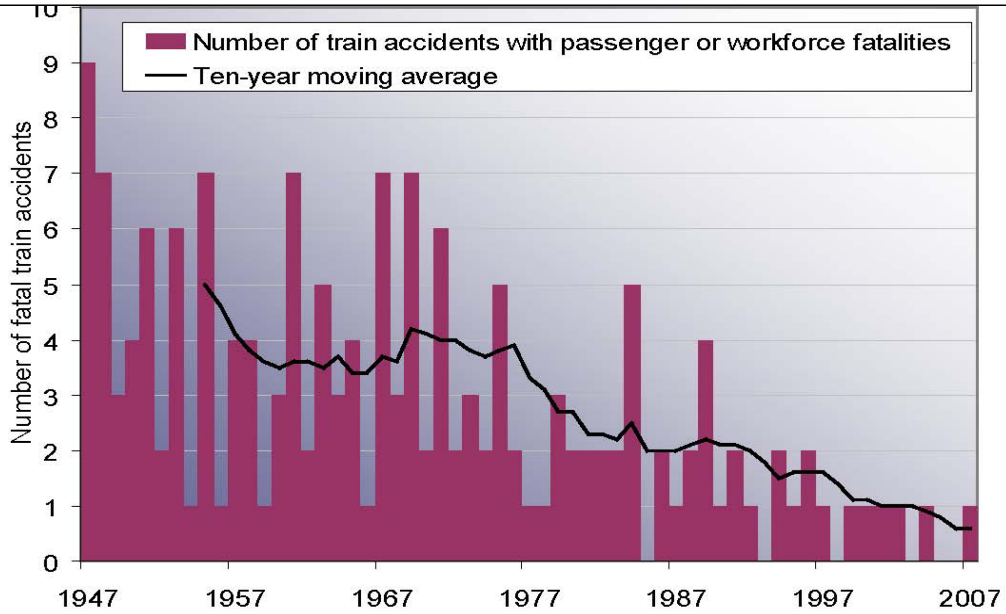
There is therefore more pressure on train paths. Availability of train paths has been a crucial issue for open access operations and there have been legal challenges to the infrastructure manager's refusal of paths.

3.3.3 Safety

It had been expected that the long term trend of accident reduction would be slowed or reversed by handing the operation of the railway to private commercial organisations. This has not happened; indeed academic research[17] shows the reduction in accidents has been more marked. In so far as accidents to staff are concerned, the changes in working practices outlined in Section 4 below have been an important contributory factor. Commentators also suggest that the accelerated rate of reduction in accidents may be due in part to better definition of roles and responsibilities. Figure 8 shows this trend.

[17] Evans A W *Fatal Train Accidents on Britain's Main Line Railways (an annual analysis).*

Figure 8. Rail Accident Trends 1947-2007



Source:: Rail Safety and Standards Board

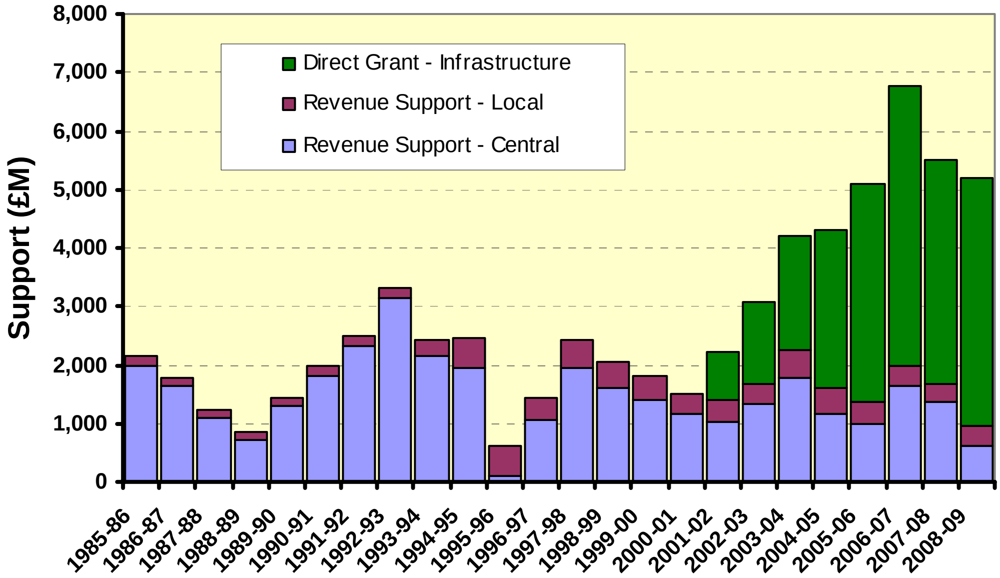
3.4. Commercial issues

3.4.1 Overall Cost of System

The cost of public support for rail services has risen quite markedly in recent years (see comments above relating to abolition of the SRA). Costs have risen for a number of reasons, some connected with the process of liberalisation (the costs of hiring in rolling stock which was previously owned, transaction costs within the industry, and franchise holders' profits, for example), some quite independent (such as increased costs for maintenance of infrastructure, higher standards for rolling stock). Figure 9 below shows this when adjusted to 2009-2009 prices. It will be noted that the element that has increased is support for the infrastructure manager (the reason for this is dealt with below in 4.1.3). In addition to pressure for economies, the Government recently adopted the policy of real increases in fares to reduce the level of public support.

This followed a fall until the 2000-2001 financial year, following completion of the franchising process in 1997.

Figure 9. Government Support to the Railway Industry 1985-2009, at 2008-2009 prices



Source: *National Rail Trends 2008-09 Yearbook*, ORR, adjusted using RPIX data from National Statistics

3.4.2 Fares

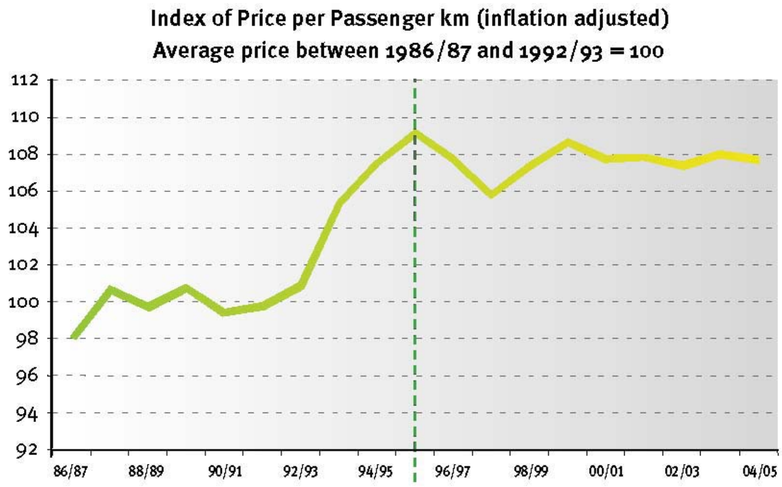
A lot of thought was given to the structure of fares given that:

- there is a need to find a balance between the contribution provided by the fare box and that provided by public support;
- there is a need to prevent exploitation of monopolies (such as commuter services);
- franchise holders need to be given flexibility to act commercially.

Franchise holders are required to offer a certain range of walk-on tickets (tickets on open sale which do not need to be bought in advance). These regulated fares typically represent 40% of the franchise revenue, and include off-peak tickets and weekly season tickets. Tickets between any pair of stations may be bought from every staffed sales point. The issuing railway undertaking is paid a commission for issuing the ticket. Each fare has a sponsoring franchise holder which sets that fare (this does give rise to anomalies, but despite press comment they are neither great nor numerous). Fare changes take place on the same date each year, nationally. The government imposes limits on the amount that regulated fares may be changed; the limits are set on a basket of fares for each franchise, so that there is some flexibility for individual fares. Other fares, such as "anytime" fares and first class fares are not controlled at all, but the existence of regulated fares exercises some restraint. The formula to calculate permitted changes takes account of inflation. In recent years, governments have deliberately permitted real increases in fares (retail price index + 1 %) to reduce the support required from the public purse.

British train fares have been market-priced since the 1970s. This process has been has been taken much further under market liberalisation. For example, the most expensive fare from London to Manchester is £193.50 but the same journey can be made for £11.00 (subject to conditions)[18]. In this way railway undertakings can exploit the consumer surplus and those of limited means can still travel. Whilst being an effective business practice and delivering social benefits, the high headline fares have given rise to a great deal of adverse criticism and the fare structure is widely regarded as being too complex[19].

Figure 10. Average rail fares per km at constant prices



Source: ATOC

Figure 10 above shows that average fares largely kept pace with inflation in the period 1996-2005; current initiatives to move more of rail costs onto users by increasing fares at 1% above the rate of inflation will, of course, change that relationship in the future. It should be noted that this rise in fare levels is associated with an increase in government control of the industry, thus reverting to the long-term trend of rising fares that was a feature when the industry was state owned, as can be seen for the 1986-96 period. Government has tended to have an overriding objective of reducing the cost of the rail industry to the public purse. It can be argued that decisions on fare increases have tended to be driven more by political considerations of the impact on the commuter vote than anything else. It may be that pressures on UK Government finances in the next few years will lead to a requirement for even more of the costs to be met by users.

Over the years the restrictions on regulated fares have given rise to anomalies. Walk-on tickets only available at certain times of day (the fares for which are regulated), have become disproportionally cheap compared to the "anytime" fare (which is not regulated). This has caused franchise holders to restrict the availability of the cheaper fare and caused friction with passenger bodies. Passenger Focus, the passenger representative body, said "*it is important, however, that regulation also applies to ticket validities (e.g. when you can use it)*

[18] National Rail and Virgin Trains websites November 2009

[19] Passenger Focus said *"Passengers tell us in no uncertain terms that they find the fares and ticketing system confusing and unfair."*

and not just price. Not doing so effectively allows operators to introduce 'back-door' fare increases". Likewise season tickets (some of which are regulated) have become much better value (over long distances a weekly season pays for itself after two journeys).

3.5. Employment

Historically, British railways tended to undertake most activities in house; at the time of privatisation substantial rolling stock design and construction, infrastructure design and maintenance, and some infrastructure new work was in BR hands. These activities were sold and thus former rail employees were then regarded as working in heavy engineering, consultancy, or construction. Official employment statistics therefore contain significant discontinuities and are not particularly useful. However, according to a study by the Rail Freight Group and others[20], employment in the rail industry has remained at roughly the same level as at liberalisation in 1994. *"Excluding manufacturing, the total has remained at around 115,000. There are now many different companies providing various services on or around the industry and, contrary to the expectations of many, it is working well. Such a consistent level of jobs alongside the 40% growth in passenger traffic and the 60% growth in freight traffic over the same period also demonstrates the efficiency savings made which themselves contributed to the growth in traffic."*

Table 3.1 - Estimate of rail employment 1994/5 and 2004/5

	1994/5	2004/5
Network Rail: maintenance	n/a	16 450
National functions	n/a	6 170
Operations and customer services, etc.	n/a	8 210
Network Rail renewals contractors	n/a	25 000
Passenger Train operators including maintenance	n/a	46 200
Freight train operators	n/a	7 244
Eurostar UK (EPS in 1994)	885	1 500
Rail Gourmet (on board services)	n/a	1 100
Rolling stock leasing companies (passenger)	n/a	300
British Railways Board Rail	115 546	n/a
Property Board	677	100
Totals	117 546	112 278

Source: Successes and lessons of Rail Liberalisation in the UK, Rail Freight Group & others November 2007

[20] *Successes and lessons of Rail Liberalisation in the UK*, Rail Freight Group, in association with ATOC, Network Rail and the RIA, November 2007.

Prior to rail market opening in the UK the number of BR employees had been in long term decline as rail's market position declined, reducing for example from 194 500 in 1976 to 144 000 in 1986[21]. Rail market opening appears to have stabilised this trend of long-term decline therefore. Indeed Transport Statistics for Great Britain, 2009, indicates that employee headcount has been increasing as passenger volumes and train km have increased.

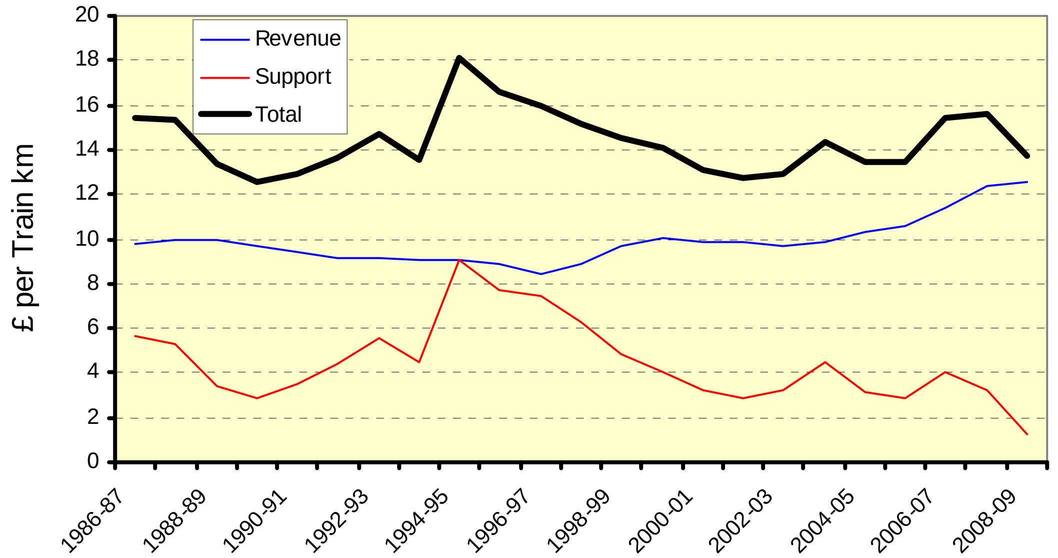
The change from a single rail industry employer to multiple potential employers has meant significant salary increases for those with scarce marketable skills. This applies above all to train drivers who have seen huge increases. Unfortunately, detailed statistics for the full period are not available, however during the period between 2000 and 2009, train drivers moved from being paid 28% more than the national median to 89% more than the national median. Station staff moved from being paid below the national median to 27% above it. Despite the caveat that these figures do not cover the crucial period over the introduction of the franchises, the message that rail staff are now almost all paid more than the national median is clear.

3.6. Productivity

Given the very different structure of the rail industry before and after market opening, it is considered that the best measure of productivity improvements is the cost per unit of output, but even this should be treated with considerable caution.

Understandably, franchise holders do not make details of their costs available. However, a suitable alternative measure might be the payment made by users as customers and taxpayers per unit of output. This payment includes an element for hiring back rolling stock which was sold as part of the privatisation process and of course includes the profits made by the franchise holders. Figures 11 and 12 below show the revenue and direct support per loaded train kilometre and per passenger kilometre, as well as total costs. They must be qualified as being a crude measure but they indicate trends and orders of magnitude.

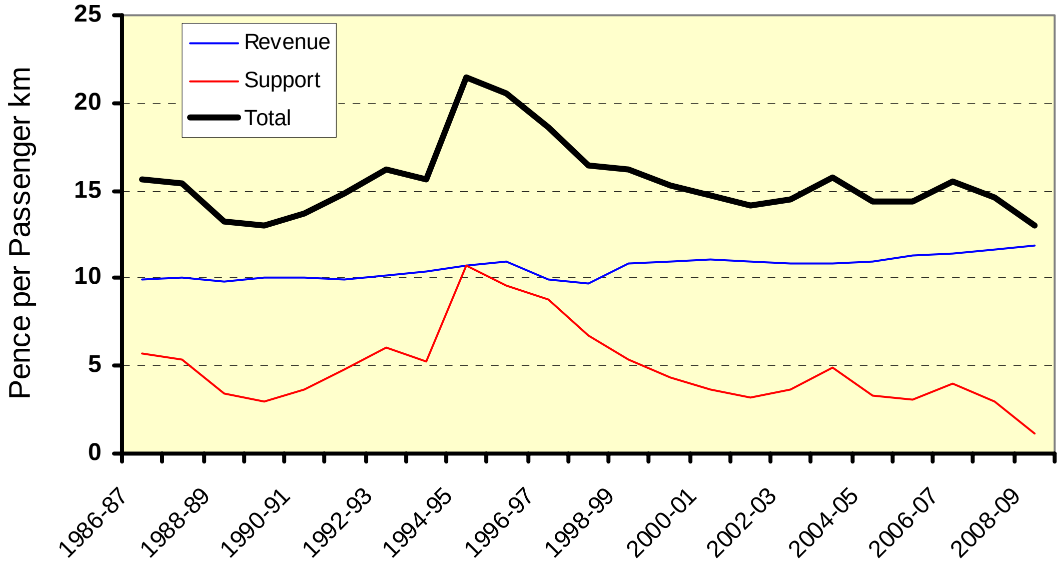
Figure 11. Support and Revenues per Train km (in 2009 prices)



Source DfT: *Transport Statistics Great Britain (TSGB)*

[21] Source: *Transport Statistics for Great Britain 1996.*

Figure 12. Support and Revenues per Passenger km (in 2009 prices)



Source DfT: *Transport Statistics Great Britain (TSGB)*

Both graphs show a clear trend: a trend of increasing productivity after the franchising process was completed, until one year after the establishment of the SRA, since which time performance has been patchy. This followed a trend of declining productivity from the 1989-90 financial year to the introduction of franchising, which the Consortium considers was largely as a result of changes in working practices in response to the Clapham railway accident.

A combination of productivity improvements and increased ridership has enabled the level of central and local government support to railway undertakings to be reduced.

4. Potential Entry Barriers to the Rail Passenger Market

4.1. Access to infrastructure

4.1.1 Timetabling and track access

Timetabling and track access are controlled by the infrastructure manager. Train paths are allocated in a conventional allocation process. The franchising process and the track access process are distinct in that the award of a franchise does not entitle its holder to train paths. However, train paths allocated to a franchise holder are fixed for the duration of his franchise (plus six months to allow for handover). In discussions with the Consortium, the Regulator said that he believed there is a case for a closer link between award of a franchise and entitlement to train paths.

The franchise agreement protects the franchise holder from changes in infrastructure access charges; changes in charges are reflected in the amounts received from/paid to governments.

In the Consortium's discussions with them, all the stakeholders consulted thought that this stability was valuable; ATOC thought the stability in infrastructure charges was particularly valuable.

British stakeholders did not comment explicitly on the virtues of an independent infrastructure manager, but as the Rail Regulator observed, they took this 'as read'. Views on the role of the infrastructure manager as a station manager varied; they are discussed further below.

4.1.2 Open access

The Rail Regulator pointed out that the distinction between the process of open access and the process of track access is an important one which must not be overlooked. One is worthless without the other. The infrastructure manager systematically provides new railway undertakings with (a limited amount of) timetabling support but one open-access undertaking pointed out that to be successful, an undertaking must invest in its own timetabling staff to investigate and progress options.

4.1.3 Funding of infrastructure improvement

The original policy was to channel all support for publically supported services through railway undertakings. Relationships between railway undertakings and the infrastructure manager would then have been wholly commercial. Investment in infrastructure improvement would have been wholly commercial and justified by revenue streams from the railway undertakings. (The infrastructure manager at the time was a private company quoted on the stock exchange.) In fact, partly because of the short franchise durations, almost no franchise holders were ever in a position to fund such developments so instead the government started to fund infrastructure investment directly, bypassing the franchise holder. For example, one franchise holder said "*some major improvements planned in early 2000s failed because Government was not prepared to accept some risk which only they were in a position to take*". It was also claimed that financing in this way allowed the government to present the funds as investment in the railway rather that have it lost in franchise accounts.

The extent to which direct funding has by-passed the franchise holders is shown in Figure 9 on the support provided to the industry. Some investments (such as station car parks) are the infrastructure manager's own.

ATOC drew attention to the substantial investment made in doubling of routes by one franchise holder with a twenty year franchise as evidence of the merits of longer franchises. That franchise holder said the point at which the benefits of longer franchises started to be lost was ten to fifteen years[22]. There was general support from the railway undertakings for returning to the principle of passing funding via the railway undertaking with the concomitant of longer franchises, although Network Rail considered that the current balance of 50/50 funding from railway undertakings and government grants is about right; the grants provide stability and consistency, "a directing mind". The DfT said that some finance was to cover benefits which it was impossible to finance commercially.

ATOC thought that the infrastructure manager's costs were inflated. Two reasons were identified, a lack of accountability and a lack of a competitive market for infrastructure maintenance. One commentator drew a parallel with Spain where infrastructure work is claimed to be more competitive. ATOC believed a more revolutionary approach is required; this might include regional ownership of secondary infrastructure and vertical integration where appropriate. Network Rail said the issue is not who does the work, the out-source and in-source boundary is always flexible but rather how the work is decided on and controlled. For this excellent asset records (which must be held by the infrastructure manager) and a deep understanding of best practice by the infrastructure owner are essential. Coupled with that, a benchmarking process within and outside the railway industry is required to ensure practices are always as efficient as they can be made.

Undoubtedly infrastructure costs have increased since liberalisation of the rail industry in Great Britain; however, the reasons for this are complex and a matter of some contention. The establishment of an independent infrastructure manager in 1994 with an obligation to maintain its infrastructure in perpetuity brought into sharp focus the lack of any meaningful records of asset condition to enable the discharge of this obligation to be monitored. Throughout the life of Railtrack (the commercial organisation, which was the original infrastructure manager), the lack of progress in developing asset condition measures, as well as the meaning of "renewal in modern equivalent form" was a constant source of friction between Railtrack and the Rail Regulator. There is therefore considerable subjectivity and a need to draw on anecdotal evidence when one discusses infrastructure condition.

An accident in October 2000 at Hatfield, caused by poor track renewal practices, focussed attention on the stewardship of Railtrack and the state of British infrastructure. Criminal charges were brought against some of Railtrack's managers. It is not surprising therefore that the quality of infrastructure maintenance and the rate of renewals have increased markedly since the creation of NR in 2001, and that this is responsible for a large proportion of the increased infrastructure costs. In contrast it is debatable whether the fall in infrastructure costs that occurred under Railtrack's stewardship between 1994 and 2001 was as a result of Railtrack continuing the maintenance and renewal standards of the former BR in a more efficient way, or as a result of maintenance and renewal cutbacks, or 'a bit of both'.

Overlying all of this is a factor that makes it hard to distinguish the impact of regulatory structure on infrastructure costs: the impact of the Clapham Junction rail accident in 1988.

[22] Chiltern Railways in evidence to the Competition Commission October 2008.

The resultant public inquiry into this accident revealed certain shortcomings in the safety practices of BR when undertaking infrastructure work, and the *Hidden Report*, which emerged from the public inquiry resulted in the imposition of fundamental changes to infrastructure maintenance and renewal practices, greatly increasing costs (and improving safety standards). These changes had only just fed through 'on the ground' before privatisation, making it almost impossible to disaggregate the impacts of these changes in working practices from those stemming from the change in regulatory structure.

ATOC believes that the railway undertakings should have a greater role in minor infrastructure schemes (station improvements in particular) and in rolling stock. There is a clear link between the length of franchise and these proposals but the life of rolling stock is always likely to be longer than the life of a franchise: a solution for that mismatch will always need to be found. Network Rail did not dissent from that view in principle and said that the issue of the right party to do work in stations was kept under review.

By contrast Freight Operating Companies (FOCs) have always emphasised concern that the development of the national railway network is too much driven by the needs of passenger services and that insufficient notice is taken of the needs of freight. FOCs therefore tend to support the concept of independently planned infrastructure development.

4.2. Access to rolling stock and financing

The new regulatory model was set up at the same time as the various aspects of British Railways were privatised. To allow lightly capitalised companies to bid for franchises[23], ownership of rolling stock was split away from train operation. Bidders were thus expected to hire in suitable rolling stock from rolling stock leasing companies (ROSCO), although in time a free market in rolling stock provision was expected to emerge.

This approach was only partially successful. The rolling stock companies had every interest in not having spare rolling stock. Some rolling stock made spare by the introduction of new trains was sold to other countries; the ROSCOs were successful in placing other stock with British undertakings increasing their services. Much British rolling stock is route specific, given the technically diverse nature of the rail network in Great Britain (either because it is designed for a specific use or for technical reasons such as electrification equipment, or structure gauge). Accordingly, the pool of spare and flexible rolling stock which would have underpinned a free market never arose. One franchise holder believed the theory was itself faulted "*Chiltern thought that a DfT-sponsored surplus would in theory bring about price pressure. However, in practice the cost of procuring, storing and switching the rolling stock would very high, and therefore it was not a realistic proposal.*[24]"

Rolling stock companies have been prepared to accept the risk of rolling stock not finding a use after the franchise which ordered it terminates (particularly for the larger franchise holding groups). One franchise holder said "*there is no real difficulty in obtaining new trains or the funding for them*". Inevitably the franchise holder has to pay for any uncertainty. To resolve this issue, the Government now takes more interest in rolling stock provision and in some cases arranges to provide the rolling stock as part of the franchise (and then to pass it on to the next franchise holder). In February 2009, the Department for Transport set up "Diesel Trains Ltd" to help facilitate this process. The Government does not propose to become a

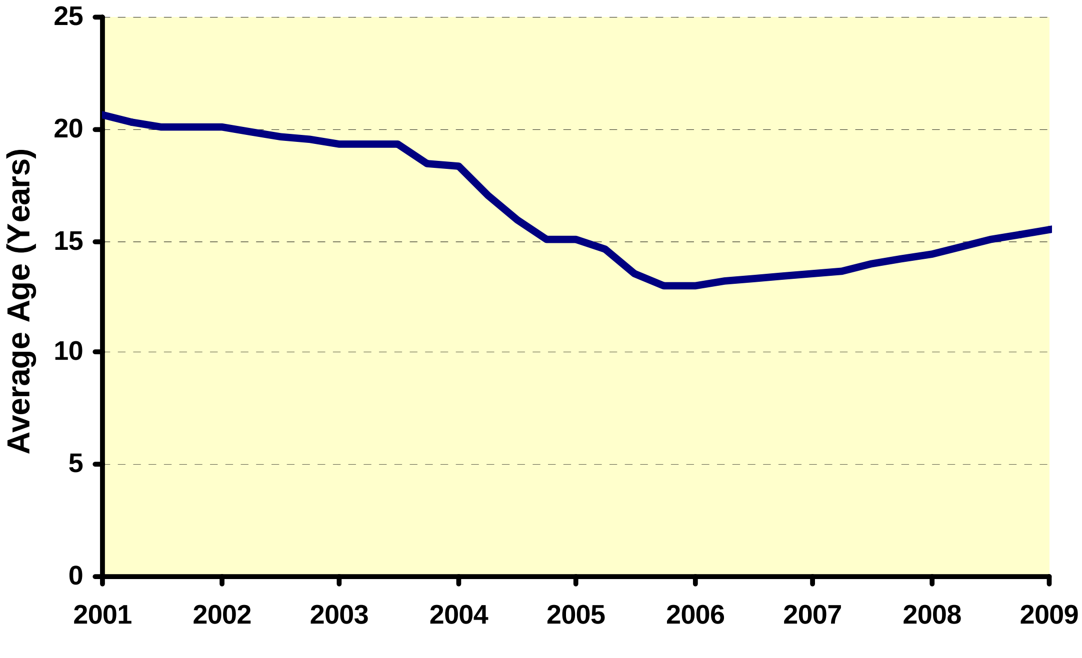
[23] 15% on the annual turnover is the requirement of which half is required in cash and half as a performance bond.

[24] Chiltern Railways in evidence to the Competition Commission October 2008.

long-term supplier of rolling stock. In so far as rolling stock finance companies additional to the original three have been set up, the market for finance (as distinct from rolling stock) is now more competitive. These measures have helped to prevent rolling stock issues stopping railway undertakings (including new entrants) bidding for franchises, although one potential open access railway undertaking told us that the Department for Transport had designated potentially useful unused rolling stock for a future activity and was not prepared to release it. Another open access railway undertaking said that it was difficult to get second-hand high-speed rolling stock and noted that the ROSCOs see the franchise holders as their prime customers.

The franchising process resulted in a large increase in rolling stock orders as a result of the release from the constraints of the public balance sheet and freedom from direct political control of investment. This resulted in substantial reductions in both the average age and the quality of the rolling stock provided. Since mid-2005 years the average age has started to increase again, in part because less rolling stock needed replacement, following the scale of the investment in the early post-privatisation years and in part because of tighter control of investment by government. Figure 13 shows the change in the average age of passenger rolling stock in the years following privatisation.

Figure 13. Average Age of Rolling Stock 2001-2009



Soure*: Nattional Rail Trends* (various editions)

4.3. Access to ancillary services

4.3.1 Access to facilities

Access to facilities is regulated and in practice agreements to access facilities may be negotiated on a level playing field. Having said that, large numbers of new dedicated train maintenance facilities have been built, often part or wholly financed by the rolling stock provider, provided as a part of a total procurement package. These have little spare capacity; nevertheless, stakeholders said that access to facilities is not an issue: the provision of new facilities being market driven.

4.3.2 Station management

Most stations are managed by the largest franchise holder using the station. An open access railway undertaking pointed out that meant that he had to buy services from a direct competitor; this was not satisfactory even though it is subject to regulatory overview. Eighteen major stations however are directly managed by the infrastructure manager. In these cases, passenger contact staff are provided by franchise holders. An open access railway undertaking said that independent surveys had shown that passengers were given incorrect information about his services in 41% of cases. ATOC by contrast said that the infrastructure manager had fewer incentives to reduce costs and that there was a lack of transparency over shared costs (such as those of providing services to tenants on the station). A franchise holder also claimed that Network Rail was "slow" in progressing development projects.

An open access railway undertaking argued for formal standards for stations to bring up standards in general and provide some guarantees that passengers' expectations would be met.

Quite complex rules have been set up to regulate on station activities (display of publicity, for example) to ensure that all railway undertakings using the station have equal treatment. Problems can occur where different railway undertakings have different access policies, gated stations and free access to trains, for example.

5. Market Entry Strategies

5.1. Award of franchises

Franchise award is subject to a bidding process run by the Department for Transport. The Department specifies the services it requires in some detail,[25] effectively specifying the timetable, the fare increase mechanism, and the rolling stock to be used in an invitation to tender. There is a pre-qualification process to reduce the number of bidders to "three to five". The criterion for being short-listed is previous performance in a rail or similar field. This is deliberately designed to encourage new entrants to the rail market. Bidders put together tenders in which they may offer alternatives and "extras". The process is part open and part commercially confidential. The criterion for award of the franchise is "the best, robust proposition, in terms of price and reliability, for operating the base service specification in the ITT"[26]. ATOC claimed that price represents between 40 and 60% of the weighting[27]. Passenger Focus said that it believed "*that one of the key criteria should be the passenger benefits arising from the services in question. Each bid should clearly set out how it will benefit passengers*". The DfT pointed out that the price criterion was only applied after a number of quality criteria had been met. The Department also said that it considered itself to be an informed buyer; it employs consultants to advise on rail operations processes and has a good understanding of costs. Estimating revenue was more difficult however by its nature.

There are two preconditions to running services, a licence and a franchise agreement. The licence is issued by the Regulator and in addition to the conditions set down in Directive 95/18/EC[28] the licence requires its holder to comply with the "network benefit" requirements. Open access railway undertakings also require a licence. The franchise agreement is a contract signed with the Department for Transport.

The bidding process is said to cost each bidder some £3-4 million[29]. Where (typically) there are three bidders, the industry therefore has to find approximately £10 million pounds from traffic receipts or public funds before paying for services. ATOC said that, set against traffic receipts, these were trivial figures and the efficiencies and new initiatives which the franchising process brings to rail service provision needed to be set off against them. The process of franchising also forces railway undertakings to consider strategic issues (such as compliance with national development plans) at regular intervals.

ATOC argued for price having a lower weighting in the criteria for franchise award. They argued for quality (quoting station refurbishment and extra rolling stock as examples). ATOC said that quality was taken into account in contract award in other states, specifically identifying Denmark). Passenger Focus said it was pleased to see that a recent franchise award (and, by implication, the future pattern) had included passenger satisfaction targets in the franchise specification. These set "*output targets for station, train and customer service satisfaction with financial penalties set for poor performance*". The study announced as this report was finalised will consider options to take "quality" into account and options to take the views of passenger representatives (= Passenger Focus) into account.

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[25] Causing one open access railway undertaking to refer to the franchise holders as "Government Railways".

[26] From the DfT website

[27] See http://www.dft.gov.uk/pgr/rail/passenger/franchises/aguidetotherailwayfranchisep3326?page=1 for details of the process.

[28] *Council Directive 95/18/EC of 19 June 1995 on the licensing of railway undertakings* OJ EC L143 of 27 June 1995 (as amended)

[29] Quoted in the Go-Ahead Annual Report 2009 although industry figures said it was normally £5M

It is significant that there is real competition for the franchises between several bidders: a pre-qualification process is used to reduce the number of tenders, in the view of the DfT *"procurement best practice regards three to five bidders as the optimum number to provide adequate competition"*. This may be compared with bids in some Member States for supported passenger services where the competition is between the incumbent and perhaps only one other bidder.

ATOC pointed out that until recently, there has been a tendency for franchises to change hands on renewal. ATOC identified that as a weakness, it tended to reinforce short-termism rather than strategic thinking. (Railway undertakings' poor rate of response to the Consortium's questionnaires would tend to reinforce the impression of short-termism).

Lastly, ATOC wants to see a mix of small and large franchises retained. It is certainly true that a number of smaller franchises with essentially self-contained networks have been very successful at managing their businesses. An open access railway undertaking said that smaller franchises would be desirable; they would allow more local initiatives to be taken. The DfT considered that larger franchises had more flexibility, in redeploying rolling stock, for example. Open access railway undertakings also argued for sponsors (national or regional governments) to be able to tender out individual services outside the franchise when there was a particular reason to do so.

5.2. Revenue risk

The classic franchising model has had the franchisee bear the revenue risk, retaining revenue above expectations and bearing the cost of revenue below expectations, this is intended to concentrate minds. However, the greatest determinant of revenue has been national economic prosperity, something outside the control of the franchise holder. Given the consequences of a wrong judgement, many bidders have been unwilling to make realistic bids on that basis. Since 2006 therefore, franchises in which revenue risk has been shared have been let. In these arrangements, known as "cap and collar" the franchisee accepts full revenue risk for the first years (normally four) after which revenue risk is shared. The structure is complex (and not symmetrical) but typically the franchise holder accepts half the risk/takes half the profit for minor deviations from the contracted amount and then only the first twenty per cent from larger amounts. The remaining risk is borne by the government (by rebating or surcharging the payment made to or by the franchisee). This process can produce large headline winning bids for franchises when the reality may be a much more modest figure. It has thus been found impossible to achieve one of the objectives of the franchising process, to move all risk to the private sector.

ATOC wanted to see the franchise holder better insulated against revenue risk. The issues of where the revenue risk should fall are examined above. ATOC identify a number of options which all have the effect of passing more risk to the state. The study announced as this report was finalised will consider options to restructure the revenue sharing agreement (which had led to high-profile collapses of franchises).

5.3. Specification of services

A policy decision was made at the time of the privatisation of British Rail and the setting up of the franchises that the privatised railway should offer exactly the same services as the public railway had[30]. Subsequently, scope was allowed to vary service levels and this led to a significant increase in service levels (see Section 3.3.2 above) as railway undertakings "sweated their assets" and ran more services (in part to be able to claim a greater share of the revenue: see ORCATS below) but this scope has been progressively reduced and now extends to a complete timetable specification and specification of the rolling stock to be used. Stakeholders in general believed the Department for Transport is poorly equipped to specify services, particularly in detail. There have been instances where DfT inspired changes to service specifications have resulted in public campaigns to reverse them, and indeed debates in Parliament[31]. The Department said that everyone wanted more specification to be in the hands of railway undertakings, but the political reality was that since the Minister was responsible for the contracts negotiated by his staff, he was also forced to specify the detail. This forms a paradoxical contrast to the publicly owned railway; in the days of British Rail, ministers would refuse to answer detail questions on the grounds that it was a matter for BR management.

ATOC said that they thought franchises were micro-managed by the Department for Transport (DfT). ATOC said that railway undertakings would like more freedom of action to adjust services to demand. Railway undertakings they thought, should be given more "opportunity to innovate". One of the two examples they quoted, peak capacity provision, has the ability to cut costs significantly but is clearly an issue which could be political. ATOC explained that they did not seek complete deregulation but thought that detailed regulation is inappropriate certainly where franchise holders make net payments to the Government. The DfT objected to this distinction saying that it is important that the services required [by the public] are delivered whatever the financial status of the franchise. The study announced as this report was finalised will consider options to make service specification more flexible.

An open access railway undertaking said that the DfT's specification often left little room in the timetable for extra services: open access services often had poor train paths in consequence.

5.4. Removal of a franchise

The franchise mechanism contains provisions to monitor franchise performance, impose penalties and in extreme cases to remove franchises. These sanctions are enforced through the franchise contract. As an example of this process, First Great Western was required to double compensation to passengers who were delayed and to forego a fare rise in 2008 following unacceptably high levels of cancellations in late 2007. In three case franchises have been removed. In the first case this was due to the franchise holder not being able to account for the way public funds were spent[32], in the second case the parent company of the franchise holder could no longer comply with the conditions of the performance bond[33]. In the last case the franchise ran at a loss and the franchise holder ran out of funds[34]. Where franchises are taken back, a publicly owned company operates the franchise until the franchise can be re-let.

[30] John Swift, the first Rail Regulator quoted in "All Change" British Railway Privatisation.

[31] For example, following the commencement of the latest Great Western franchise in 2006, which included cuts in service frequency and train lengths on some services, resulting in overcrowding.

[32] For details see: http://www.publications.parliament.uk/pa/cm200506/cmselect/cmpubacc/770/770.pdf

[33] Reported widely in the British press on 16 December 2006

[34] Reported widely in the British press on 6 November 2009

5.5. Open access services

The legislation provides for "open access operation" outside the franchise structure. Open access railway undertakings neither pay a fee to the government nor receive a subsidy from the government. In fact open access is currently very much the exception with just three routes (plus the special case of the "Heathrow Express"). The three routes are typically 300 km in length. Given that franchise holders have a contract with the government which they have based on certain assumptions, open access is restricted. In principle, open access services must not be "primarily abstractive", an issue on which the Rail Regulator is the arbiter. An existing franchise may have been let on the condition that there are no competing services on particular axes; there is also a general right to nominate flows (station pairs) over which open access rights may not be given ("moderation of competition"). The number of flows is restricted to a proportion of the franchise holder's total revenue; this proportion is decreasing through time. Open access railway undertakings may not then offer services between those points. As an example, an open access railway undertaking which operates between London and North Wales is not permitted to offer services between London and Birmingham.

Abstraction of revenue a franchise holder may have expected affects both those franchise holders who are supported and those who pay a premium. The DfT expressed concern that open access could mean the public purse paid more to franchise holders to offset potential franchise revenue that in fact was taken by open access and in this way public funds were indirectly supporting private activities. Where there is not a contractual restriction, the Rail Regulator has therefore to balance public benefits from new services against any loss to the franchise holder. Passenger Focus supported this approach pointing out that useful new services had been introduced. Passenger Focus cautioned however that open access must not "*significantly frustrate the industry's subsequent ability to develop a timetable that maximises capacity and utility to passengers*".

Studies made for the Regulator suggest that whilst open access abstracts revenue from franchised railway undertaking it provides other benefits. A staff member from the Office of Rail Regulation was quoted as saying that open access does have some negative effects in terms of a potential reduction in government revenue, but it has beneficial effects in terms of increasing market size, increasing customer satisfaction and generating economic benefits[35]. The majority of applications, however, have not passed the abstraction test and have been declined.

Open access is now a mature model and open access railway undertakings told the consortium they could now develop schemes with more confidence in their outcome. Finance is not an issue.

Open access railway undertakings pointed out they were the source of many of the most promising new ideas, new routes to serve otherwise un-served towns, more spacious rolling stock, more attentive staff and a more original approach to ticketing. These would be foregone without open access.

Open access railway undertakings must accept regulated fare tickets and in return participate in the revenue sharing arrangements (details of the way this is done are given below). Indeed the franchise holders claim that some open access services are run simply to take a

[35] Paper to the Eleventh Conference on Competition and Ownership in Land Passenger Transport Delft September 2009

percentage of the shared revenue. Open access railway undertakings point out that the revenue sharing model does not reflect service quality and where they offer a higher quality service, they are given no credit for it. Railway undertakings however are by and large satisfied with the operation of the model.

6. 'Network' Issues

At the time that the liberalisation was planned, it was considered important to retain "network benefits". To a large extent this ran counter to the original concept of a structure like the airline industry in which operators are quite independent and compete freely. It quickly became clear however that a system in which operators essentially make no provision for inter-lining and tickets are not inter-available could not be applied to the rail mode.

Passenger Focus said that "*passengers see the railway as a network not a collection of 'private' operations. This extends beyond the physical ability to travel and includes interavailability of ticketing and the provision of information. The value of these 'network benefits' should not be overlooked. It is acknowledged, though, that this does necessitate a revenue sharing mechanism which can add considerable back-office complexity. From a passenger perspective, however, the ability to purchase a single ticket rather than a collection of tickets from different operators far outweighs this.*"

In principle, tickets are available on the services of any railway undertaking. Considerable flexibility in routing is permitted (tickets between London and Scotland, for example, are valid via Newcastle or Carlisle). The ticket revenue from every fare has therefore to be divided between all the railway undertakings providing services which have relevance. Revenue data is assembled from all the railway undertakings using the LENNON computer system (Latest Earnings Networked Nationally Over Night). The LENNON data is analysed by ORCATS(Operational Research Computerised Allocation of Tickets to Services - a journey modelling system which takes each railway undertaking 's frequency and journey time into account) to calculate the revenue due to each railway undertaking[36]. The conclusions of the algorithm within ORCATS are open to challenge and an on-train audit system is run to ensure the algorithm remains realistic. (See below for open access issues). ATOC identified the inter-availability of tickets and this ability to choose railway undertaking and route as one of the great customer benefits of the British model.

Outside this process, franchise holders are allowed to issue cheaper tickets that can be used solely on their own trains; this is the norm for tickets issued for specific trains (often via the Internet[37]). This revenue by-passes the allocation system. Some tickets are franchise specific because of the journey; the proportion of tickets which are limited to one franchise as a condition of issue varies but on long-distance routes is approximately 50%.

Passenger train railway undertakings are required to accept common standards and practices and belong to "industry schemes" such as the settlement plan (above). These schemes are run by the Association of Train Operating Companies (ATOC); therefore in practice membership of ATOC is required. Amongst these network requirements are the requirement to accept a range of tickets, to participate in the revenue sharing scheme[38], to sell tickets impartially, to recognise a variety of railcards (such as that for senior citizens), to contribute to a train enquiry service, to have all services shown in a common timetable, and to use common signage. Additional tasks which otherwise would have had no home have been added voluntarily (such as coordination of lost property services) and ATOC has now acquired a major role as the spokesman of the railway undertakings. Despite that ATOC's coordinating effects are quite limited and there is no provision, for example, to coordinate timetables to

[36] Heathrow Express (a self-contained open access operation) is not subject to this process

[37] ATOC said that overall some 19% of tickets were sold over the internet, , for some franchises it is more like 40%

[38] The Ticket and Settlement Agreement

preserve connections, except those specifically written into the franchise timetable. Academic commentators[39] claim that this deprives Great Britain of a "logical" timetable in which infrastructure is used efficiently and connections maintained.

Some aspects of service are deliberately left out of this coordinating initiative and left to commercial judgement. This can have interesting consequences, for example, first class on some franchises provides a full meal and beverage service within the ticket price, on others just the use of an antimacassar in otherwise standard seating. Passenger Focus pointed out that competition might not provide a complete answer to these issues, "*it could be argued that introducing direct competition will drive up the quality of service offered to passengers without the need for regulation. However, it must be questioned whether we will ever reach this degree of competition. For instance, there are some routes that cannot even support a single operator and which only survive through subsidy – such routes would be unlikely to generate competition."*

Whilst the government has a policy to coordinate various modes of public transport, this is largely left to local implementation and the most active players are local planning authorities. The majority of railway undertakings have "bus-plus" tickets which allow onward carriage by bus/tram after the rail journey is complete. Whilst some large cities like Leeds and London have multimodal local transport schemes, the concept is not common, for example and cities such as Bristol and Sheffield have nothing.

Not to be neglected in this process is a claims handling system that ensures that passenger claims for loss and damage cannot be lost between the interstices of the new companies.

[39] Tyler, European Transport Conference 2009

7. Additional Remarks

The Association of Train Operating Companies (ATOC) released a paper[40] on 30 October 2009 on the changes to franchise policy which they would like to see. ATOC has six recommendations:

- Allow train companies greater flexibility to give passengers what they want;
- Adopt longer franchises as the norm;
- Focus more on awarding franchises on the basis of quality, not just price;
- Structure franchises to improve financial stability;
- Enable train companies to take on greater responsibility for stations, depots and rolling stock;
- Sustain a mix of small and large franchises.

On 30 December 2009, the Financial Times reported a remit given by the Department for Transport to KPMG. KPMG are to study:

- Restructuring of the revenue-sharing agreement;
- Adopting fifteen year franchises as the norm;
- Changing the role of train companies so that they could improve stations and rolling stock;
- Awarding franchises on the basis of quality, not just price;

The Government said however that the review was not intended to be "fundamental" (by which presumably they meant that the system of franchising is not to be called into question).

On 24 January 2010, the Department for Transport published a report on "The Future of Rail Franchising" which is intended to provide information on developing policy options as a progress report on work in hand. It is therefore additional to the KPMG report. Amongst the interim conclusions are that:

- franchise lengths can be longer where that would allow investment to be made;
- the criteria for judging performance during the franchise should be widened;
- the franchising process is to be changed to allow more innovative proposals to be taken into account;
- the franchising process should encourage investment during the life of the franchise;
- the protection against exogenous economic circumstances could be more specifically tied to GDP.

[40] Franchise Reform – a better railway for passengers and for taxpayers http://www.atoc.org/general/FutureFranchisesReport_S8.pdf

8. Summary & Conclusions

8.1. Qualitative

The practical aspects of franchising system have remained fairly stable over the some fifteen years of its existence. Bids are required to run particular packages of services, rolling stock is still largely supplied by third parties, the bidders remain entitled to paths throughout the life of the franchise and remain indemnified against changes in the cost of paths. The same companies dominate the franchise holders. There have been changes in the composition of services which form franchises and the parties involved in regulation have changed but these have not been changes of principle.

Notwithstanding that, the Government has made a number of changes to the model and the process to address issues of the day (some but by no means all of these have been outlined above). This pragmatism might be interpreted as a lack of consistency in the regulatory structure and the objectives of the process, undoubtedly political dogma has also played a role. In essence there can be regarded as three distinct phases of regulatory structure:

- 1993/4 to 2000/1 – privatised IM, considerable freedom for franchise holders, and totally independent economic regulation: a period when costs were kept under control, fares were stable in real terms, service frequency increased, but where there were questions over the adequacy of infrastructure maintenance and renewal.

- 2000/1 to 2006 - ‘not for profit’ IM, less freedom for franchise holders, Strategic Rail Authority set up, complicating the regulatory structure: a period when costs rose, but fare levels remained stable and service frequency continued to increase, quality of infrastructure maintenance and renewal progressively improved to a standard not seen for several decades, but characterised by inconsistent and sluggish leadership from the SRA.

- 2006 to present - SRA abolished, centralised control from Department for Transport, allowing franchise holders little freedom, effectively franchises have become management contracts to tight standards, although total costs have begun to decrease they are still are much higher than in the 1994-2001 period, despite above inflation increases in fares and more risk being held by government, regulatory structure has been simplified, with clearly defined responsibilities and a more integrated structure, but economic regulation is now subject to guidance from government.

Overall, it is considered that three important lessons can be learnt from the British experience in terms of the overall regulatory structure:

1. a private sector, profit seeking, infrastructure manager was a mistake;

2. the regulatory structure was too complex, particularly in the 2001-2006 period when the SRA was in existence: excessively complex regulatory structures led to confused objectives and higher costs;

3. other than in the field of infrastructure maintenance, costs and fares were lower, while the growth in passenger numbers and service frequency were higher in the early years of franchising: as centralised control by government has increased the performance the rail passenger industry has been less impressive,

On an operational level, there are three important lessons that can be drawn:

1. short franchise length - franchise holders are only concerned about the 'here and now', with little thought of the future. Given indeed that most franchises have changed hands on being re-let this has led to extreme short-termism[41]. This is reflected not only in conscious management decisions but right through the organisation, publicity and signage is changed, new slogans adopted, commercial policies change, staff receive new uniforms, staff and their representatives regard the management as temporary and that shows through;

2. Government policy is to make price the final criterion of choice in the franchise negotiation – whilst understandable as the only parameter than can be indisputably quantified, it has wholly logically consequences. Policies, such as those for fares collected on trains, are widely regarded as being unreasonable, indeed rapacious. The British railway undertakings are regarded by the public as "grasping profiteers[42]". This has clear implications for the assessment of the role of rail in British society;

3. problems caused by the definition of service to be provided being made by the central Government - central Government is not well placed to make that judgement (even if it believes the political process leaves it no choice). It is certainly true that price and service content must be balanced in the franchise negotiation and the public must be protected against the withdrawal of socially necessary, but expensive, services, but a move towards more local involvement and/or more specification by the railway undertaking would seem desirable.

8.2. Quantative

8.2.1 Raw data

Passenger volume has increased by 70.1% under the franchising system.

Modal share has increased from just under 5% to just under 7.2% (a relative improvement of some 43.7%) under the franchising system.

Fare levels have increased by 22.7% under the franchising system.

Service frequency has increased by 36.7% under the franchising system.

The level of public support has increased by 114% under the franchising system.

[41] An open access railway undertaking said that there could be merit in keeping on a successful franchise holder.
[42] Typical of one of a hundred selected comments on the BBC website about a fare rise in 2004.

When measured on a unit cost basis productivity has improved by 24.1% per train km and by 39.5% per passenger km.

8.2.2 Adjusted data

As outlined above, there have been quite significant policy changes over time to the regulatory structure adopted for liberalisation of rail passenger services in Great Britain, as well as the way in which the franchises have been permitted to operate. In consequence it is not considered that the raw figures presented above provide an accurate reflection of the changes that would have been experienced, had franchising been implemented on a steady state railway.

In particular experience from elsewhere in Europe indicates that the implementation of public service contracts, on a truly competitive basis should result in a reduction of costs, whereas in Britain the opposite has been the case. As outlined above, there were fundamental changes to the cost of maintaining and renewing infrastructure that occurred around the time of privatisation that have made it difficult to distinguish the costs that can be attributed to the market opening process from those resulting from the implementation of changes in infrastructure maintenance procedures. In addition the fall-out from the Hatfield rail accident in October 2000 resulted in historically large volumes of track renewal work in subsequent years and risk-averse procedures from the infrastructure manager that increased infrastructure costs considerably. The actions of the SRA over the 2000-2005 period appeared to aggravate this problem[43].

As noted above, one of the prime reasons for the substantial growth in passenger volumes was the good performance of the UK economy over the 1994-2008 period. It is therefore necessary to remove the impact of the overall growth in traffic performance to isolate the impact of rail passenger market opening from the overall growth of the travel market (which amounted to some 15.7% between 1994 and 2007).

The Consortium considers that the applicable changes that one could infer from experience in Great Britain of introducing a franchising process for rail passenger services in another EU state on the industry's performance in 2020 would be as follows:

Passenger volume change	+48%	(removes impact of overall traffic growth over 1994-2007 period)
Modal share change	+44%	(relative change to previous figure)
Fare level change	0%	
Service frequency change	+40%	
Productivity improvement	+25%	

Note that the figure for reduction in public support has little transferability to other states as this figure is dependent on the level of state support that is provided by government prior to market opening. A figure for reduction in public support is not therefore quoted above.

[43] See *Passenger Rail Franchising - British Experience*, Nash & Smith, ITS.