campaigning
by the
Railway Development
Society Limited

Policy Group

The Brown Review
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Dear Sirs,

SUBMISSION TO RICHARD BROWN RAIL FRANCHISING REVIEW

INTRODUCTION: Railfuture seeks the opportunity to make a submission to this review, which has been prepared by the Policy Group, with contributions from other specialist Railfuture Groups.

Railfuture is a national voluntary not for profit organisation limited by guarantee, and structured in England as twelve regional branches and two national branches in Scotland and Wales.

SUMMARY: The fundamental problem facing franchising, which has derailed the West Cost competition, is the difficulty in reconciling the following conflicting objectives:

- To incentivise the TOCs to invest in developing their market so that services grow, improve and become profitable - this requires long franchises so that the TOCs can recover their investment
- To transfer the risk of the operation from government to the private sector, without the residual risk of the franchise failing.
- To predict future revenue when macro-economic circumstances over the next 7 to 20 years could vary greatly.

In our view the creation of complex economic models is the wrong approach to reconcile these objectives. We propose that:

- TOCs should pay their full share of Network Rail costs, rather than Network Rail receiving the network grant directly from DfT. The true profitability of the franchise then becomes clear, and subsidy can be provided to the TOC if necessary.
- Franchises are offered on the basis of a profit (or loss) share – the percentage share does not have to be linear
- Franchise competitions are judged on the development commitments and the amount of money that the franchisee is prepared to invest, rather than dubious predictions of future revenue.

THE PROBLEM: Railfuture has become increasingly concerned that franchising as currently applied to rail operations is not achieving the best outcomes for passengers and efficiency and there is a growing need for change. The current hiatus caused by the failure to satisfactorily re-let the West Coast main line franchise creates an ideal opportunity to reappraise the whole question of franchising and some fundamental questions need to be addressed before proceeding with the next round of re-franchising.

- Is franchising the best option for all types of operation?
- Should alternatives like concessions be considered and if so to what type of operation would they be best suited?
- How do we better incentivise private sector investment in the railway?
- Are longer franchises better than short ones of seven to ten years?
- Should premium payments be replaced by profit sharing or revenue sharing agreements?
- If profit/revenue sharing were to be introduced, should it be shared between the TOCs and DfT or with Network Rail?
- How best do we address perverse incentives?
- Are there still too many franchises and should the franchise map be redrawn to align better with Network Rail's devolved routes?
- Should Inter City services be let as a single combined national franchise?
- Should Micro Franchises involving local authorities be created on the German model for rural routes?

All of this assumes that rail operations remain in private hands and are not re-nationalised as some people are now advocating.

Other problem areas concern perverse incentives between train operators and Network Rail such as delay attribution and the need for compensation payments to TOCs when Network Rail interrupt services to carry out essential maintenance and renewal work and so on. Performance targets can militate against maintaining connections, particularly where different operators provide services.

The current trend towards Alliances is to be welcomed and some of these anomalies can hopefully be eradicated, particularly with the 'Deep Alliance' between Network Rail and South West Trains, but what happens when Stagecoach are faced with expiry of their current SWT franchise? Suppose Stagecoach lost the franchise, then what – start all over again at considerable cost and disruption while new teams get bedded in?

The old adage "If it ain't broke, don't fix it" still applies and the current system fails to capitalise on management experience and knowledge learned from previous years of operations.

In addition, the current system of Cap & Collar/Revenue Share agreements which are designed to protect franchise holders in the event of revenue failing to meet predicted levels through no fault of their own on one hand, while producing an income stream to government should revenue exceed predictions on the other, acts as a strong disincentive to drive growth. Since government takes up to 80% of any surplus revenue while also providing up to 80% of any shortfall in revenue, where is the incentive to drive fares growth? Furthermore, with this degree of protection, Cap & Collar agreements can encourage over optimistic franchise bids. However, the replacement of Cap & Collar with a GDP based system inevitably makes revenue predictions far more difficult to forecast.

The impossibility of predicting the future and maintaining franchise contract agreements to make Premium payments to government has already seen some high profile failures, notably GNER and National Express with the East Coast franchise, in the latter case after only two years in the job. More recently, and unsurprisingly, First Group relinquished its option to continue with the Great Western franchise due to over optimistic predictions to pay high premium payments in the final 3 years. To many observers, the recent wildly optimistic bids for the West Coast main line franchise were bound to end in tears. Nobody can predict the future over such a long term with any degree of accuracy, let alone assume growth of over 10% year on year every year for 13 or more years.

THE NEED FOR STABILITY: It is widely recognised that railways perform best with minimal interruptions to management and structure and it is therefore vital to get these right from the start. Evolution is better than revolution. Lessons from the past must be learned and acted upon. Micro management and interference from government and the Department for Transport has been rightly criticised in our view.

Currently the railway is leaderless and needs a governing body independent from government. Fragmentation of the industry introduced at privatisation is widely recognised as a major cause of increased costs, inefficiency and duplication. Railfuture welcomes the setting up of the Rail Delivery Group, which will help to reintegrate the industry, and we suggest this should be developed to take over management of the railway and most of the responsibilities currently undertaken by the DfT. This could become the National Railways Agency perhaps.

FRANCHISING VERSUS CONCESSIONS: The way forward will need to consider alternatives to franchising but it is acknowledged that one size will not fit in all cases. The long term concessions introduced on Merseyside and in London are proving to be very successful, with service provision, investments, fares and revenue risk being undertaken by the concession holder leaving the operator to focus on honing operations with appropriate incentives to do so. Long-term concessions also provide stability and an incentive to invest, as there will be enough time to realise a return on major investment schemes. We note Merseytravel have recently gone out to tender for new rolling stock for example.

In London, TfL have ambitious plans to expand the Overground network and have already invested heavily in new trains, new and upgraded stations and reopened routes. Service reliability has been greatly improved and ridership increased massively.

It seems, therefore, that concessions could be the best way forward, certainly for large conurbations and this would fit in well with the Government's plans for devolving powers to the English regions. However, franchising still has some merits appropriate to longer distance cross-country, inter regional and inter city services. There is no doubt that patronage growth has been at least partially driven by innovation and improvements to services introduced by the franchised operators but if franchising is to survive and vitally important private sector investment encouraged, there will have to be some radical changes made as suggested below.

The devolved governments in Scotland and Wales both wish to explore other models including not-for-profit or not-for-dividend operators. Railfuture would strongly support the full devolution of control over rail services to the devolved governments, thus allowing them to decide what model is best for <u>their</u> needs.

SHORT VERSUS LONG FRANCHISES: The purpose of privatisation was supposedly to bring benefits resulting from competition. In practice, the only time competition is evident is during the franchise bidding process and this points in favour of short-term franchises. Open Access operators provide the only true competition but even these are hampered by having calling points restricted so as not to abstract traffic from franchised operators on the same route and so far they have only been awarded limited access to the East Coast main line. Nevertheless, they have fulfilled a very useful function by satisfying niche markets and have generated passenger flows new to rail. This form of competition should be encouraged and facilitated rather than impeded.

However, the franchising process is very costly (compensation payments to the bidders for the failed West Coast main line franchise is likely to cost the tax payer more than £40m, for example) and if ownership of a franchise changes there follows considerable expenditure on new liveries, station signage, uniforms, promotional leaflets and hundreds of thousands of pocket timetables etc., printed and old ones thrown away. New management has to spend much time learning the ropes and the only time significant investment takes place is in the early years of the franchise and even this will be limited if the pay back period is short.

The shorter the franchise, the more frequently they will need to be renewed and the higher the costs, especially to the DfT and therefore to the taxpayer. The usual pattern associated with short franchises is a flurry of activity at the start but with no assurance of renewal of tenure, signs of neglect creep in towards the end.

On the other hand, there can be no doubt that long term franchises do encourage private sector investment. Chiltern Trains stand testament to this with their 20-year franchise. In addition to the acquisition of new trains and introduction of innovative services, over £600m has been invested in improvements to the route since the beginning of the franchise and Adrian Shooter has stated that this would not have happened with a short-term franchise. The argument that this investment would have happened anyway because Network Rail has funded it is invalid because NR will recover its investment by applying higher track access charges and the operator has to take the risk that passenger growth will be generated from the investment sufficiently to cover their increased costs before the end of the franchise. Otherwise there would have been no incentive to drive forward these improvements.

One thing is certain however, the Premium Payments system has become unworkable, particularly for longer terms and if franchising is to survive, alternative arrangements will have to be introduced. Railfuture suggests premium payments are replaced by profit and/or revenue sharing agreements, thus providing the essential flexibility needed to cope with fluctuating market conditions. Alternatively, franchisees could pay an annual fixed rent with a revue every 5 years or so. This would provide stability and help stimulate confidence needed to invest. The present Government has indicated it wants train operators to take over responsibility for acquisition of new rolling stock from the DfT but it can only happen with long term franchises.

Profit sharing would seem to be more applicable to long distance inter city operations while a rental system allied to revenue sharing arrangements would seem to be more suited to regional and operations.

Railfuture also suggests that operators should be given first refusal to renew their franchise providing they have fulfilled all their obligations and performed well. This would provide a good incentive to optimise performance and to invest, helping to remove uncertainty and the costly and time consuming process of bidding for the next franchise term.

MICRO FRANCHISES AND COMMUNITY RAIL PARTNERSHIPS (CRP's): Benefits in terms of passenger growth generated by promotional activities undertaken by CRP's have been ably demonstrated but the hoped for operating and maintenance cost savings associated with secondary and rural routes have not materialised. Greater involvement from Local Authorities and businesses with their rail service in the form of Micro Franchises on the German model could be the next step. Micro Franchises could be entirely separate or off shoots from a larger parent franchise that could avoid the need to acquire small fleets of rolling stock.

CONCLUSION: From the foregoing, we suggest concessions should replace franchising in the major conurbations and ITA/PTE areas as are operated in Merseyside and London.

For inter city and longer distance inter regional services we suggest longer franchises would be appropriate but with safeguards provided as outlined above. Premium payments must be replaced with profit or revenue sharing agreements. Stability and genuine incentives to invest must be provided together with flexibility needed to cater for unpredictable changes in market conditions.

We suggest serious consideration should be given to uniting inter city operations as one national franchise but with separate route managers, and the franchise map simplified and aligned better with Network Rail`s devolved routes, helping to strengthen alliances. British Rail ran its Inter City services as one brand very successfully. This would result in fewer franchises overall, also helping to reduce industry and tax payer costs accruing from the renewal bidding process.

Each franchise would have its own livery as exemplified by the ScotRail brand. This would avoid the extremely wasteful process of repainting everything whenever franchises change hands and help passengers to identify their services.

We commend these suggestions to the Richard Brown Franchise Review.

Yours faithfully,

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Head of Policy Group