



FINAL

CONSULTATION RESPONSE

Reforming Rail Franchising

pteg Submission

October 2010

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1. Introduction

- 1.1. **pteg** represents the six English Passenger Transport Executives (PTEs) in England which between them serve more than eleven million people in Tyne and Wear ('Nexus'), West Yorkshire ('Metro'), South Yorkshire, Greater Manchester, Merseyside ('Merseytravel') and the West Midlands ('Centro'). Leicester City Council, Nottingham City Council, Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of **pteg**, although this response does not represent their views. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions, with the aim of providing integrated public transport networks accessible to all.
- 1.2. Since their inception, the PTEs have invested heavily in their local rail networks – funding new trains, routes stations, park and ride facilities, and higher service standards. Rail patronage has increased in every PTE area, up almost 160% since 1995/96.
- 1.3. The consultation document sets out the issues facing the franchising process in detail and sets three high level objectives around:
 - securing better quality of services for passengers (as users of the railway);
 - delivering better value for money for taxpayers (as funders of the railway); and
 - creating a more sustainable railway.
- 1.4. Using these principles as the basis for reviewing the franchising process is to be welcomed. However, our response draws attention to the inherent difficulty of balancing these objectives when reviewing the franchising of the heavily subsidised railways that operate across PTE areas.
- 1.5. In our response we have also sought to reflect the overarching objectives of the Coalition Government, including the need to generate private sector jobs and growth; the need to rebalance the economy; and the desire to decentralise government and pass more powers and responsibilities to the local level.
- 1.6. The PTEs have high ambitions for city region rail networks in their areas. We believe that any franchising reforms need to allow for the devolution of rail powers, responsibilities and funding necessary to unlock the local rail's potential in our areas, in a way which also meets the government's wider objectives for rail and more broadly for the economy.
- 1.7. Our vision for the future of city region rail is based on a desire to see more local influence and control over our rail networks so that they can play a key role in delivering the wider, high quality, integrated public transport networks our cities need.
- 1.8. In practice this means:
 - Modern, efficient and primarily electric commuter rail services with adequate capacity to cope with the demands of rush-hour
 - Stations that are safe and welcoming places to be and which act as wider hubs for local communities and their local transport networks
 - Stations that are easy to access on foot and bike
 - Simple fare and smartcard ticketing
 - Rail services that are branded and marketed as part of a wider public transport offer to the city regions

- 1.9. Set out within this document are our arguments about the future reform of franchising and how it can operate in the conditions prevalent in the city regions outside of London. We believe that there is a significant overlap between the objectives of the government and our own aspirations.
- 1.10. Allowing greater local input into local rail services the reform of franchising can:
- **deliver improved services for passengers:** ITAs/ PTEs are close to their passengers and are accountable to them in ways that DfT or Train Operators are not; and can plan and deliver services in a much more responsive way;
 - **deliver for the taxpayer in securing greater value for money from the rail network:** be that through processes which are more responsive to local needs, making services more closely integrated with other modes locally, taking a greater role on sharing the risk on local railways to help stimulate investment, or by facilitating private sector involvement; and
 - **make our rail networks more economically sustainable:** PTEs are the long term partners in the city regions with a considerable track record in delivering investment to the railways, and given a greater role can help sustain and support an environment which brings in investment by Train Operators and other partners
- 1.11. Our aspirations to deliver integrated transport, and to promote wider economic, social and environmental goals for our city regions, mean that we want to take more responsibility for local rail networks. We are willing to engage with government in constructive dialogue as to how we can, together, take these issues forward.
- 1.12. Our consultation response relates to the main franchises that provide urban rail service across our areas and that would be directly affected by the franchising reform process - i.e. London Midland, Northern Rail and TransPennine Express.

2. The Context for Local Rail

Rail in the City Regions

- 2.1. Rail services have been a major success story in supporting the growth of city region economies over the past decade, leading to a significant growth in passenger numbers - upwards of 40% in the past decade for many of our areas. Almost 200 million passenger journeys are made each year on rail networks wholly or largely within PTE areas, one in seven of all rail journeys in Britain¹. This trend is likely to continue over the medium to long term – Network Rail forecast an increase of over 100% on regional, urban rail services by 2034² – and even in the recessionary period, Train Operators have been reporting continued passenger growth.
- 2.2. Rail carries significant volumes of passengers at peak times into city centres, but in most cities driving and parking in the city centre remains a feasible option for most commuters, unlike for commuters into London. This means that commuters are especially sensitive to changes in fares and other prices, and that acting without taking account of this could have significant impacts on our cities (for example, through increased road congestion).

¹ National Rail Trends Yearbook 2008-2009 – ORR, 2009

² Planning Ahead 2010 – The long term planning framework

- 2.3. Local rail services in our areas are heavily subsidised – in the region of £300m per annum public subsidy across all PTE areas. This is in part due to the nature of commuter rail markets. While the length of the average commute has extended over the years, in general the average journey length remains quite short, particularly when compared to London, and this means that the average fare is quite low. This limits the opportunity to generate large revenue streams from fares.

The economic importance of urban rail

- 2.4. Local rail is a crucial part of how our cities' economies function and fulfils an important function in sustaining economic recovery, jobs and growth. A growing proportion of commuter journeys are now made by rail – for example, around a quarter in Birmingham and Manchester – and rail's modal share is growing at a faster rate than other modes. Research has shown that rail commuters are often more highly-skilled and employed within the knowledge economy³.
- 2.5. Whilst not underplaying the importance of inter-regional rail services to city region economies, it is true to say that journeys within PTE areas are largely self-contained – with around 80% of journeys starting and finishing in the same city region. This highlights the importance of commuter rail to our cities.
- 2.6. Making the connection between rail, the economy and wider city regional objectives can only be realistically done through strategic bodies such as PTEs. Understanding the important role that rail can play in achieving these wider objectives is therefore critical in understanding how our railways should be delivered.

Challenges for city region rail

- 2.7. The rail networks in our areas face a number of significant challenges, which are set out below. Future franchising policy will play a critical part in resolving these issues.

Capacity constraints

- 2.8. Peak hour overcrowding is high with 50-60% of peak hour arrivals into Leeds, Manchester and Birmingham carrying standing passengers. Overcrowding is at such a level that passengers on some routes are left standing at intermediate stations as trains are too full to carry additional standing passengers.
- 2.9. For the Northern Franchise, the current franchising system has not delivered for passengers or the taxpayer, and the letting of the two previous franchises on 'no-growth' basis was a serious failing of the process, particularly given the spectacular growth in patronage (34% since 2004).
- 2.10. The current approach is failing to deliver for passengers and for our cities' economies. Direct control of local rail services from Whitehall has not led to an adequate response to growing demand in our areas.

Complexity of current arrangements

- 2.11. A contributory factor to the increasing cost of railways is the problematic way that rail networks are run. Control over local rail networks is fragmented across national government,

³ On Track – Why rail matters – Centre for Cities, 2010

infrastructure owners, and a number of train operators, and overlaid with a complex web of legal, commercial and regulatory arrangements. As a result, it is difficult, costly and time consuming to influence rail services for the better in the city regions.

Lack of transparency

- 2.12. Combined with a complex set of industry structures, there is a lack of transparency over the industry's costs and how these are apportioned. Costs are currently hidden and not disaggregated so it is hard to tell what the real costs are locally. This is compounded by processes and procedures which are bureaucratic, opaque and which hinder delivery. For example, relatively modest station enhancements can take much longer to deliver through Network Rail's procedures than if delivered locally. The relative remoteness of decision-makers means that issues are not always understood or addressed in most appropriate way; and decision-makers not accountable to passengers. The lack of transparency makes it difficult for local partners, such as PTEs, to get involved as to do so without such understanding would invite risks that cannot be addressed.

Lack of influence

- 2.13. PTEs role has been successively marginalised as the Department for Transport's policy to date has been to systematically remove co-signatory rights for franchises as each franchise is renewed. Co-signatory status has been an important tool in allowing PTEs to contribute to the franchising specification and management processes. PTEs bring local knowledge around market conditions, passenger expectations and local political ownership of the issues, and have, we argue, facilitated improvements that would not otherwise have occurred. We welcome the fact that the issue of co-signatory status has been acknowledged in the consultation document.

High subsidy railways

- 2.14. Rail services also deliver external benefits in the form of reduced emissions from car travel, lower road congestion, reduced accidents and improved social mobility. These are not valued by train operators and need to be subsidised where services are not commercially viable. Service specifications need to be reviewed at regular intervals as demand requirements change. Passengers' expectations of quality also increase over time.
- 2.15. Urban rail services across the city regions will require public subsidy on an on-going basis if they are to be provided on any meaningful basis. The uneconomic nature of urban rail is particularly the case outside of core hours. Even peak commuter services which carry high volumes of passengers and earn substantial revenues have quite marginal costs, so operators are not incentivised to improve services.
- 2.16. There is a fundamental point about the railways which needs to underpin value for money arguments. Given the high levels of fixed costs of running urban railways, options for improving the returns (or reducing the net subsidy) are strongly driven by investment. For example, net subsidy can be reduced by maximising rail capacity and thereby increasing the passenger revenue.

3. Localism for City Regions' Rail Networks

Devolving responsibilities for rail

- 3.1. We strongly believe that more local input into all the key aspects of the franchising process will lead to significantly improved local rail services, delivering accountability, integration and value for money that cannot be achieved by a more centralised approach or one that is left largely to the private sector.
- 3.2. Research we have commissioned from Atkins⁴ shows clearly that, based on experience from the UK (London, Scotland, Wales and Merseyside) and Europe, devolution delivers better outcomes for passengers:
 - rail is given greater priority, with stronger incentives and influence on network and service operators to acknowledge local priorities, maximise performance and deliver a better service for passengers;
 - investment levels rise, for example, in terms of rolling stock, new or enhanced stations or promotion of re-opened or upgraded lines to cater for, or foster, increased passenger demand;
 - operational performance rises, level of service improves, feeding into higher customer satisfaction; and
 - decision making is more fully integrated across modes and policy objectives, including capital investment, integrated fares and ticketing and branding.
- 3.3. A more detailed summary is attached as Appendix One.
- 3.4. The research highlights that a devolutionary gap in the UK on rail has emerged, which has seen further and more significant devolution on rail responsibilities in Wales, Scotland, London and Merseyside; but significant centralisation of control over networks in PTE areas. The research highlighted the model used in the Netherlands. The Dutch approach advocates the division of the rail network into a set of core 'national routes' and second tier of networks of local and regional importance. By following such an approach, it would be possible for Ministers to retain primary responsibility for strategic decisions and funding related to the core national network, with a presumption in favour of developing adequate powers and resources to appropriate sub-national levels. Checks and balances could be developed to ensure that conflicts between the two are avoided and minimum standards for transparency, efficiency and good governance are met. Evidence from the Netherlands' experience of franchising shows that this can be done effectively⁵.
- 3.5. Devolving powers and responsibilities over local rail networks is of course not the only answer to all the challenges the industry faces. However, more devolution means that when finance is available from local and regional sources that funding can be more easily and rapidly channelled into the rail network. Granting local transport authorities greater control

⁴ Enhancing the PTE Role on Rail in the City Regions – Atkins, 2010 available from: <http://www.pteg.net/NR/rdonlyres/78F41B84-5F10-49CC-A7EA-0BE22ADB457D/0/PTEGRailpowerspaperfinal.pdf>

⁵ Public Transport Tendering in the Netherlands – Inno-V 2010 available from: <http://www.pteg.net/NR/rdonlyres/7760B2F2-E2C5-4372-88AA-E43378AB5431/0/PTtenderinginNL20100723small.pdf>

over local services also has the benefit of allowing Train Operators to focus their efforts on improving more profitable inter-city services, benefiting these passengers as well.

- 3.6. We recognise that the complexity of operations in our areas means that such clear distinction between national and regional frameworks may not be straightforward to achieve, but we believe that this needs to be an important part of the future discussions over the railway and devolving responsibilities. Being clear about the role of the various parts of the railway will allow different approaches to be taken and in turn offer greater opportunities for improving value for money.
- 3.7. Importantly, moving toward a more devolved approach has benefits for national government. By transferring responsibility (and therefore technical, financial and political risks) for local rail networks to bodies that are better placed to address these risks, Ministers would be better able to focus on the strategic development of the railways, whilst being assured that accountability for local services is maintained through local transport authorities. Of course, such a transfer of responsibilities and liabilities needs to occur with a full understanding of the risks involved by all sides.

Accountability

- 3.8. As the accountable representative bodies for transport in the city regions, the ITAs have a unique role in providing oversight of local transport policy and delivery. Consisting as they do of locally elected councillors from across their areas, ITAs are able to represent their communities' interests and provide an important link between the passengers that use local rail services and the providers, in a way that DfT cannot.
- 3.9. Currently decision-making is done by national government departments who are unfamiliar with the local context, rather than by locally accountable transport authorities. Devolving more power to local transport authorities would provide a step change improvement in delivering value for money railway operations and enhancements because locally accountable transport authorities understand how important transport (including rail) is to the local economy, environment and quality of life. Locally accountable transport authorities have a greater and more immediate incentive to resolve problems quickly than officials in Whitehall.
- 3.10. This means that as well as passengers being able to hold decision-makers more clearly to account (and knowing who to hold to account), ITAs can, and will, take decisions in the best interests of their communities and the wider transport networks they serve. Given a greater role on local rail services will mean that the choices made will reflect local priorities more closely and be more likely to gain local support.
- 3.11. More fundamentally, where there is a requirement for public subsidy to support the operation of urban rail networks, there is a debate to be had over whether this subsidy is better directed from a national or local body. **pteg** believes that having a strong local body overseeing the expenditure of public subsidy for the delivery of an essential local service will deliver better value for money for taxpayers.

Integration

- 3.12. Greater involvement from PTEs would allow local rail to be better integrated into urban transport networks and realise potential synergies between modes, particularly at stations. This fits with the ITAs role in developing and delivering Local Transport Plans. This could

include greater integration with smartcard ticketing offers locally; sharing of passenger information resources; integrating rail more closely with travel planning, cycling and walking facilities (as part of a wider 'smarter choices' offer); as well as more routine opportunities in terms of cleansing, maintenance and security work.

- 3.13. More devolution of responsibilities for local rail also offers the opportunity to tie in land use and transport planning, facilitating the link between developers, development funding, and transport improvements. PTEs would effectively act as a catalyst, understanding and delivering what key local partners want from their local transport networks.
- 3.14. For example, one of the frustrations of the present system is that there is no obvious mechanism for pooling of developer contributions (Section 106 agreements, for example) to provide extra capacity on the rail network. A stronger responsibility for PTEs on rail services would allow them to use their role in integrating transport to provide a suitable mechanism for pooling such investments across their areas and directing them to fund extra rail capacity. Similarly an enhanced role for PTEs will allow them to make the most of new funding streams, such as Tax Increment Financing or other local sources⁶.

Achieving Value for Money

- 3.15. Given the high levels of subsidy received by train operators across the city regions, achieving greater value for money and reducing the cost base will be a key requirement of the franchising process. However, this needs to be balanced against the wider economic benefits that rail brings to our city regions. Based on our submission to the McNulty review, we believe that PTEs can help improve value for money from local rail services by tackling some of the immediate problems in how the railway is managed and through realising opportunities to integrate local rail services more effectively, and facilitating private sector involvement.

On stations

- 3.16. There is the potential for PTEs to take a greater role on local stations, by, for example the PTEs becoming the long term leaseholder. Potential benefits could include:
 - Better integration of local rail with other modes, including park and ride facilities, bus feeders, and networks of cycling and walking routes
 - more attention to the smaller stations and to quality aspects, such as staffing
 - common branding and passenger information as part of a single local integrated public transport offer
- 3.17. An initial analysis of how this might work in practice identified no insurmountable issues in principle in doing so, provided that adequate funding is passed across. More detailed discussions are currently taking place with Network Rail.

On project delivery

- 3.18. The current processes and procedures generate additional costs to the railway, which are not transparent locally; and the processes are not always appropriate for the scale or type of investment proposed. For example, a new station built by Network Rail is estimated to be

⁶ Funding and Planning for Infrastructure – LGA, 2010

143% of the price of a new station were it to be built by Metro. Additionally, research carried out by TfL indicates that there is scope to reduce the cost of infrastructure significantly (between 5 and 30%) in some cases through more focused project sponsorship.

3.19. There is considerable potential to build on PTEs knowledge and experience to deliver projects more cost effectively. The advantages of greater PTE involvement include:

- PTEs understand and are already engaged with the local market for suppliers
- PTEs have considerable experience in delivering local transport infrastructure at good value for money on a wide range of projects (ranging from major interchanges to bus shelters)
- Avoiding over-specification that can come with the rigid application of single sets of national standards and protocols

On fares and incomes

3.20. The current system does not incentivise PTEs to take greater share of risk/reward from investing in local railways (though they have done so in spite of these difficulties); and it does not result in funding raised through fares increases, or other income, being reinvested locally. Metro funded extra trains partly using fare increases for the 'Yorkshire 6' project – however, the complex mechanisms involved required considerable effort and resource (in terms of consultancy and legal costs) which could be avoided if PTEs were to have more influence. Greater local responsibility for fares and income generation would provide a direct link between fares changes and investment in the local rail network. It would also bring further opportunities for greater integration of rail fares within wider local integrated fares offers (including those delivered by smartcard).

On standards

3.21. A national approach to railway standards has seen successive levelling up of standards and costs, which are not always appropriate for the nature of some of the networks that operate in the city regions. There is also the opportunity to look at operating and staffing costs – e.g. moving to driver only operation; or adopting LRT operating models. A further distinction between local/regional rail and long-distance/ national rail may also help identify routes which could be operated differently, i.e. with different vehicle specification such as LRT or tram train. The potential benefits include more frequent trains, carrying more passengers and therefore generating greater revenue (as well as reducing operating costs).

On rolling stock

3.22. The current models of rolling stock procurement are expensive over the longer term and limit the ability of PTEs to enter or support the market. The variety of rolling stock in use (e.g. twelve different types by Northern) adds to expense. Potentially, a lower specification and/or LRT type replacements for some services has to be a future option. However franchises are dependent upon a national process of rolling stock procurement and cascade, which has been in disarray for some time, and which is unlikely to deliver the kinds of capacity improvements that the city regions need. The lack of a national rolling stock strategy that covers diesel replacement, electrification, tram, and tram train is also hindering progress. Such a national plan would create a framework which local partners could support, where appropriate.

- 3.23. Given a better defined role, the PTEs would feel more confident in supporting and intervening in the market. We are currently looking at options for developing PTE involvement to see what the issues are and how the market could be influenced; as well as what a PTE specification for a low cost commuter train might look like.

What devolution doesn't mean

- 3.24. In seeking greater involvement, we want to be more integral to the planning and development of the rail networks in our areas. However this does not mean that we would want to specify without being held accountable for fair and reasonable costs, nor would PTEs seek to add unnecessary costs via over-specification. We recognise that with greater responsibility for decision-making on local rail networks should come greater responsibility for the risks and financial implications of those decisions. We want an appropriate degree of devolution recognising the role of the private sector and that the rail networks in our areas often carry freight and longer distance passenger traffic, which is also vital to our cities. We know how important inter-city links are to our areas and would not seek to compromise this connectivity solely in favour of local services.

Towards a more devolved approach

- 3.25. The options for devolving powers, responsibilities and funding will vary according to the nature of the franchise and the geography that it covers. Ultimately, in some areas it would see the PTEs taking on the role of franchising authority for local rail services. We see retention of co-signatory status as a building block on which to develop more sophisticated and locally tailored solutions to secure PTEs role in the future. Much work has been done through the discussions over city region pilots for Leeds and Manchester about new arrangements. We recognise that this is an evolutionary process, with arrangements being developed that best suit local circumstances (reflecting the differences between areas), so we have not set out to prescribe a single model. PTEs have a good record of collaborative working between them, and by building on this and work with city region partners, the geographical issues of a larger overall franchise could be overcome.
- 3.26. As an initial proposal, we believe that PTEs should take over responsibility for the local rail stations in their areas directly. Given the limited commercial opportunities that exist at most urban stations, Train Operators are not incentivised to provide better facilities for passengers, and are dependent on the public sector to provide the subsidy. PTEs are in a better position to deliver station improvements, integrate them more into local transport networks and with local communities. This will simplify the current fragmented arrangements, and allow the Train Operator to focus purely on the delivery of rail services, thereby also allowing further simplification of the franchise arrangements.
- 3.27. We would want to explore with government how we can make a more localised approach work and how this fits with overall franchising policy and process. Our starting point would be the retention of co-signatory status, which PTE wish to keep in the absence of other arrangements, but we would look to develop more sophisticated models of local involvement over time.

4. pteg response to Consultation Document

- 4.1. We welcome the broad principles that the revised franchising policy is trying to achieve – more private sector investment, more constructive relationships with Train Operators and

significant improvements to the industry cost base. However on heavily subsidised, urban railways, achieving these principles is not straightforward.

- 4.2. We fully accept that on commercial franchises which operate without subsidy, that there is a strong argument for longer franchises. Similarly, in 'steady state' operations, such as Merseyrail, there is a case for properly constructed longer franchises (such as already exists). However, on heavily subsidised franchises, such as those operating local rail services in our areas, we believe that it would not always be in the interests of the passengers, the taxpayer or the sustainability of the railway to have longer franchises of the type set out in the consultation document.
- 4.3. Longer franchises for subsidised, local rail potentially:
 - exclude local transport authorities for very long periods of time if co-signatory (or similar arrangements) are lost
 - may not deliver the scale of investment required to deliver growth on the subsidised railways
 - may result in higher costs to the taxpayer through increased risk premiums offered by bidders
 - continue to disincentivise PTEs from investing and sharing in risk, where the returns on investment are wholly lost to an area
- 4.4. We feel that decision-making on services is often remote from the needs of passengers in our areas, does not deliver their aspirations to travel by rail, nor seize the opportunity to integrate rail more effectively into achieving wider economic and social objectives. The reform of franchising policy is an ideal opportunity to address those weaknesses.

Franchising Length and Risk

- 4.5. The consultation document states that longer franchises reduce the procurement and bidding costs faced by government and industry. However, the report acknowledges that by awarding longer franchises there is the danger that operators may decide to front load costs, take a more cautious approach to risk and therefore the overall bill may be higher; in addition the report states that regular market testing helps to keep costs down and clearly with longer franchises there is less opportunity to test the market. Break points will help to reduce that risk but they also reduce the benefits of competition. The consultation document also stresses that quality aspects will be important, which we support.
- 4.6. **pteg's** view is that longer franchise lengths will not necessarily improve the levels of investment in the railways, reduce risk or provide better services for passengers. Our reasoning is based on our fundamental belief that each franchise should be assessed against a range of criteria and circumstances to best determine its length and structure, recognising that each franchise will be different. The Department's own research by KPMG supports this approach. The analysis by KPMG highlights that there was 'no conclusive evidence of the impact of contract length on performance across the sample of operators' studied.
- 4.7. Furthermore, the research highlighted that the levels of investment secured were largely dependent on a range of factors other than franchise length – including quality of management, macro-economic trends, alterations to the operating environment and so forth. The research also highlighted the role that franchising authorities and third party investors

(such as PTEs) have played in driving up performance on the railways – i.e. in Wales and on the Merseyrail system. The findings indicate that on regional railways, investment has been driven by local stakeholders rather than the Train Operator. This correlates strongly with our research that shows that where devolved responsibilities on rail are granted, greater investment levels follow. Overall the KPMG research highlighted ‘that there is no single “correct” answer to the optimal form of franchise contract’ – which serves, in our opinion, to reinforce the need for franchises to reflect local circumstances and have strong local input.

- 4.8. On franchises where the public purse is paying for services, we believe that it is right that the public sector is closely involved in specifying the service. Moreover, we would argue that the public sector role is best filled by those closest to the delivery of the services, i.e. at a more local level. For this reason, we urge the government to consider a further option that allows for the controlled devolution of responsibilities and funding of rail to a more local level. Additionally, we believe that it would be undesirable for the public sector to be locked into a long-term detailed service specification without the ability to review it regularly on subsidised networks.
- 4.9. **pteg** would like to see a system that offers a greater number of options for sharing of revenue risk not just between the operator and the Department, but also with local partners such as PTEs. In the right circumstances PTEs are willing to take on a greater role in sharing risks and reward as part of their desire for greater input on local rail and this option needs to be recognised explicitly. Any such model would need to be determined on the basis of a PTE’s involvement, but the key benefit from a local partner being involved in sharing risk and reward is that the returns are likely to be re-invested locally or that the hard decisions over priorities can be managed locally for the best outcome for the passenger. As part of the proposed greater role of PTEs in franchises, PTEs wish to discuss how risk sharing can be best managed between local and national government. This is in the context of PTEs taking the revenue risk in the past and the ability to take risk in the future and will also be a function of the level of funding available.

Performance bonds and parental guarantees

- 4.10. We have no specific comments to make in relation to performance bonds and parental guarantees.

Level of specification

- 4.11. The level of service specification required depends on the type of franchise. Rail provides a social and economic service and not all benefits can therefore be captured through the farebox, even for a long distance operation. It is therefore essential that a minimum level of service should be specified and procured by government; given government has a legitimate interest in the continued delivery of those social benefits where a Train Operator has commercial incentive to provide the service.
- 4.12. It is important to stress that the rail franchise/s in our areas will continue to be heavily subsidy dependent. Whilst more could be done in the next franchises to motivate the franchisee to reduce this subsidy, under-specification based purely on the most profitable (or rather least subsidy hungry routes) could potentially lead to some extremely undesirable service reductions that would have a hugely negative impact on the local economy, accessibility to employment, road congestion and carbon emissions. Train Operators do not naturally act in the best interests of passengers on urban rail networks, as their commercial

drivers encourage them towards cutting costs rather than generating patronage. Therefore, it is essential that there remains a strong public sector oversight of urban rail provision and we strongly believe that local interests, represented by the PTEs, need to be involved in the specification of services.

- 4.13. DfT proposes to specify a base level of service and quality with bidders setting out how they propose to meet the specification and adding commercial improvements. We support the basic structure for base specification outlined and agree that this is a sensible method of laying out specifications.
- 4.14. The document also proposes some flexibility would be allowed during the franchise period. This would allow for reductions in service level if demand did not materialise. There are risks to this approach because a franchisee would only take account of commercial factors in deciding whether a service was viable, without taking account of social or strategic implications. There are also complex arrangements and interdependencies currently in place across many service patterns in our areas which would require changes to be carefully thought through to avoid unintended consequences and cost increases. We would add that flexibility is likely to be strengthened by the involvement of PTEs, who can bring local knowledge to the process.
- 4.15. We support the need to early engagement with bidders. We believe that PTEs should be involved in such discussions.
- 4.16. With regard to ensuring delivery by looking at outcomes, we believe that directly involving PTEs in the management of the local rail franchises in their areas will strengthen the monitoring of delivery. For example, PTEs regularly carry out market research into passenger satisfaction and are well-placed to provide other information on the performance of franchisees.

Investment

- 4.17. We agree that the private sector has the key role in bringing investment to the railways. However many of the benefits ascribed to the role of the private sector can also be achieved by an enhanced role for PTEs – for example in relation to improvement works and stations. Therefore we would wish to see the role that public sector bodies, such as PTEs, can bring to investment in the railways explicitly recognised. A greater role for PTEs would allow them to either commit to more investment directly or underwrite investments made by the private sector.
- 4.18. A greater role would also allow PTEs to take on greater responsibilities for stations and invest in them. We believe that, for all but the largest stations in PTE areas, there is a good case for the relevant PTE to become responsible for the management of these stations. Moving to such a model, would bring a number of benefits around better integration of local stations within the urban transport network, opportunities for consistent branding and marketing, links to passenger information services and generally improving the quality of the offer to passengers. We are currently looking at models of how this will work in practice.
- 4.19. We would also like to see this augmented by PTEs being able to deliver projects that do not directly affect the operational railway and for which Network Rail is directly responsible at present. We think there are significant savings to be had by local delivery of often small scale improvements.

Residual Value

- 4.20. We believe a more effective mechanism for assigning residual value may result in increased private sector investment on subsidised franchises. This may include the PTE, for example, acting as the underwriter or owner of assets, to ensure that they are retained into the next franchise and/or the taxpayer is properly protected.
- 4.21. Private sector investment from Train Operators should be encouraged if commitments can be extended beyond the current franchise length and thus be transferred to any new franchise commitments; so an operator with three years of a franchise life left may not, for example, be willing to load investment over a three year period but may agree to invest if a subsequent franchisee takes over later responsibility. A methodology which allows the PTEs and DfT to “enforce” investment may be needed in later years.

Procuring Future Franchises

- 4.22. We believe that PTEs need to be fully involved during the procurement stage. This would allow more local ownership of the procurement process and outcomes; as well as testing outcomes against local knowledge and experience.
- 4.23. The current procurement process is time consuming and expensive for both bidders and government and therefore we support the objective of reducing the costs of the process whilst at the same time ensuring that franchising delivers value for money. DfT proposes selection of the winning bidder on the basis of the compliant, affordable and deliverable bid, offering acceptable commitments in terms of crowding, customer satisfaction and other specified targets. To get value for money from a competition, bidders must offer comparable levels of service and investment.
- 4.24. We believe that the reforms to the procurement process outlined in the document offer a sensible way forward. We support bids being judged both qualitatively and quantitatively, with the winner putting forward the best combined financial offer of premium/subsidy, investment and broader economic benefit. This last category can embrace service quality issues such as journey times and frequency. We also support giving bidders a clear picture of the process, criteria and weights given to each factor. We support the need for discussions with bidders during the procurement process and the need for appropriate mechanisms to conduct this by. Naturally, given our arguments for greater involvement, we would wish to be included within these arrangements.

Managing Future Franchises

- 4.25. We believe that local engagement in the ongoing management of a franchise once awarded is important to achieving ongoing value for money, increasing responsiveness to change in local circumstances and making railways more accountable.
- 4.26. Experience shows that financial penalties are necessary to incentivise the right behaviour from Train Operators. Current mechanisms, which allow for breaches in quality without any material penalties do not work. It is therefore important that penalties and enforcement mechanisms are set at a level that cannot simply be factored into the financial bid from the outset and have real ‘teeth’. Financial penalties should extend to the provision of planned peak capacity as well as punctuality and reliability.
- 4.27. The right to terminate the franchise early must be retained

5. **pteg response to Consultation Questions**

Franchise specification

Is the suggested model of specification practical and would it deliver good outcomes for passengers and taxpayers? What are the key unresolved issues? Are there alternative models that work better, and what are these?

- 5.1. The model for specification builds upon the previous approaches to the issues and is practical in terms of its deliverability. However, we do not believe that it is one that necessarily offers good value for the passenger or the taxpayer.
- 5.2. The unresolved issues are:
 - how to make local rail services more accountable to local people
 - how the model addresses specification of heavily subsidised franchises, such as those operating local rail services in PTE areas
 - how investment can be achieved in high subsidy franchises through this model
 - how the net subsidy can be reduced through the franchising process
- 5.3. **pteg** has set out what an alternative model might be for the city regions in the body of our response, that is, one where local transport authorities are given a much greater role in the franchising process and in which powers and responsibilities are devolved.

What factors should be considered in determining franchise length?

- 5.4. Different types of franchise will have different requirements, which reflect their makeup and the ability of the market to support investment. Longer distance franchises will be able to benefit from higher fares and are more likely to offer commercial opportunities for investment. Urban rail services have relatively lower fares and higher subsidies, which limits the opportunities for investment – and therefore generally points towards shorter franchise lengths for these types of franchise. Additionally, where subsidies are involved, it makes sense for the public sector (local or national) to be involved at regular intervals in specifying franchises to ensure good value for money for the taxpayer.

Would the proposal to supply an initial “affordability” figure for premium or subsidy help bidders submit realistic proposals?

- 5.5. Yes. In conjunction with a move towards what outputs such a subsidy or premium will provide. This should give Government and stakeholders a realistic view of what to expect during the course of the franchise.

Franchise procurement

What are the benefits and downsides to the procurement process outlined in the document?

- 5.6. A revised process delivering a winning proposal that offers benefits for passengers and focuses on long-term, as well as short-term, value is supported.
- 5.7. Allowing for ongoing dialogue with bidders is attractive if it can meet the necessary transparency tests. In the past PTEs have had to tightly specify their additional requirements

which the bidders price separately. This inevitably maximises the additional cost of the proposal and so a dialogue about how the key outputs could be accommodated in the bid at minimum cost would deliver better value for money and lead to more enhancements ultimately being delivered for passengers.

- 5.8. PTEs have substantial experience in procuring public transport services (in both tram and bus services infrastructure investment and maintenance) and have the necessary local knowledge to obtain and monitor local rail services.

How can we reduce the complexity of bidding, while still protecting taxpayers and passengers (especially given a greater focus on quality)?

- 5.9. For urban rail franchises, we believe that there needs to be a clear statement of what outcomes are to be achieved, but that this must be more than a reliance on measures such as customer satisfaction etc, as the benefits that urban rail can deliver are often related to wider economic, social and environmental objectives.

Contract design and management

What services, outcomes and commitments should be contracted?

- 5.10. In heavily subsidised railways such as those in the North and Midlands, it is inevitable that a tighter specification will be required as the commercial signals are weaker. As large sums of public money are being invested it is right and proper that mechanisms should ensure value for money.

What is the best way to structure outcome measures based around passenger satisfaction levels?

- 5.11. We support a mix of passenger satisfaction measures (including as measured through PTEs' own customer surveys where appropriate) and output measures (e.g. quality of trains and stations).
- 5.12. The current KPI regime is not fit for purpose and is being reviewed jointly by DfT and the PTEs. We would expect the outcome of this work to be incorporated into future franchise specifications.

What sanctions should be used to ensure operators deliver their commitments, including outcome measures?

- 5.13. Incentives should focus on creating positive behaviours by Train Operators; and where incentives fail, the sanctions should be proportionate to the breach in contracts and enforceable. If quality measures are to be part of the franchising process, then real sanctions must apply when they are not met.

What level of performance bond and/or parental guarantees are appropriate?

- 5.14. No comment.

Revenue risk

Should the risk inherent in forecasting revenue over a longer period be shared between operators and government, and if so, how? What are the merits or drawbacks

of review points? What are the merits or drawbacks of economic indexation compared to the existing revenue support/share or leaving revenue risk entirely with the operator?

- 5.15. Review points make sense, particularly where longer franchises are being proposed.
- 5.16. As part of the proposed greater role of PTEs in franchises, PTEs are willing to discuss how risk sharing can be best managed between local and national government. This is in the context of PTEs taking the revenue risk in the past and the ability to take risk in the future and will also be a function of the level of funding available.
- 5.17. Economic indexation would be possible, but is likely to be complicated and prone to bias (particularly if London or national indicators are used).

Franchise investment

How can we add to incentives from longer franchises to remove the barriers to private sector investment?

- 5.18. Franchise lengths of around 7 to 10 years in urban areas combined with specifications which detail where investment is to be targeted, coupled with a sensible method of calculating residual value for investments will be helpful.
- 5.19. PTEs can play a role in supporting private sector investment by acting as the long-term partners, providing certainty and helping to effectively 'underwrite' investment.

How can we encourage investments with long payback periods throughout the franchise term, not just at the start?

- 5.20. Residual value methods need to make sure that the process adequately reimburses / encourages funding from franchise operators.

Cost control and efficiency

How can the government incentivise operators to control cost increases over the life of the franchise, and to improve cost efficiency?

- 5.21. We have outlined in our response areas where we think value for money can be improved by PTEs having a greater role and working alongside train operators.

Appendices

A. Table 1 – Summary of Benefits and Evidence for Devolution of Rail Powers and Responsibilities

Benefit	Justification and Evidence
Increased Investment	<p>Where rail powers have been devolved, local and regional agencies either invest in enhanced infrastructure and services themselves, or create the conditions for the private sector to do so:</p> <ul style="list-style-type: none"> • new train fleets on order in for London Overground and ScotRail which will have greater reliability, operational efficiency and passenger comfort than the trains they replace. In the Netherlands, the introduction of new lighter passenger trains has reduced operating costs and wear and tear on the track; • the long-term Merseyrail franchise has provided for investment in train modernisation and enhanced methods of maintenance has dramatically improved rolling stock reliability; • new or improved stations have been delivered, such as Liverpool South and Brunswick on Merseyrail, a deep clean, staffing, branding and modernisation of all stations on London Overground, and Transport Scotland’s Station Regeneration Fund; • line have been reopened or upgraded, including the Airdrie to Bathgate Rail Link in Scotland, the East London Line Extension and the Ebbw Valley Railway in Wales; and • in France and Germany, regional administrations can invest in enhanced rail infrastructure and services from taxes, such as the Versement Transport, which are raised locally.
Focus, Drive & Incentivisation of the Industry	<p>Where rail powers have been devolved, infrastructure and service operators are more closely incentivised to improve or maintain their performance and customer service by direct support, scrutiny and challenge by local politicians and officers who are closer to passengers, understand the daily travel experience and know where improvements are required:</p> <ul style="list-style-type: none"> • ScotRail’s franchising relationship is with Transport Scotland which working directly on behalf of “locally” elected Scottish Ministers, with a franchise extension agreed to 2014 in return for strong performance and an additional £73 million of investment for passengers; • Merseytravel is able to develop a close partnership and hold Serco-NedRailways directly to account for the performance of its services, with political pressure for high investment, service quality, responsiveness & customer focus from the company; • TfL takes revenue risk on the London Overground concession, but backed by the Mayor, monitors LORAL’s performance, and makes

	<p>incentive or penalty payments;</p> <ul style="list-style-type: none"> the five Northern PTEs believe strongly that franchise co-signature gives them a “seat at the table”, more regular contact, a stronger degree of influence, and easier capacity to secure changes to the operations of Northern Rail on a day-to-day basis than would otherwise be feasible, with benefits for passengers; and passenger service tendering arrangements in the Netherlands means provincial bodies can re-incentivise or replace operators periodically within an increasingly competitive market.
<p>Responsiveness and Flexibility to Local Priorities</p>	<p>Devolution enables local and regional aspirations, needs and challenges to be addressed at least as much as overarching national goals:</p> <ul style="list-style-type: none"> long-standing evidence, for example from the Core Cities Group, Centre for Cities and Northern Way, shows that there is a close relationship between local and regional economic competitiveness and the extent to which economic and social powers, responsibilities and resources are devolved, with investment in urban transport generating economic multipliers of up to 25-30% on top of “traditional” transport benefits; the Government’s own Sub-National Review, Local Transport Act, and Local Democracy, Economic Development and Construction Bill, and City Region Pilots set out an ambitious agenda for city and sub-regions, rather than Central Government Departments, taking or influencing key decisions on investment in infrastructure and services; PTEs contend that proposing and making changes to franchises when they are at least a co-signatory is easier, quicker and more efficient than where they are not. Centro’s experience of London Midland, with co-signature removed, appears to support this view; and in Europe, regions and city regions specifying, funding and awarding or franchising rail infrastructure and services for sub-national networks is the rule rather than the exception.
<p>Stronger Performance</p>	<p>The evidence suggests that devolved rail networks show strong operational performance, increases in patronage and rising customer satisfaction:</p> <ul style="list-style-type: none"> Merseyrail has been transformed from a failing railway to one of the best performing on the national network. Around 96% of trains now arrive on time, compared to around 80% prior to franchising by Merseytravel. Some 91% of passengers are satisfied with the service which has shown year on year patronage growth since 2002; ScotRail – Since the current franchise was let and transferred to Scottish Ministers, service delays have reduced by 50% and passenger volumes have risen by 20%. Around 90% of services now arrive on time and 89% of passengers are satisfied with the service; TfL investment in London Overground through replacing track and

	<p>points and upgrading signals is expected to improve reliability and allow for increased frequency with signs that on completion of engineering works and introduction of new trains, customer satisfaction levels will rise, with 75% satisfied in Spring 2009 already up 10% on a year earlier; and</p> <ul style="list-style-type: none"> whilst directly comparable data from Europe is not available, there is evidence that investment in new regional infrastructure, rolling stock and services in many areas has been accompanied by increasing level of service, patronage and levels of customer satisfaction. Public transport use in and around Lille, for example, increased 47% in a decade and the introduction of tram-train in Karlsruhe has transformed patronage levels in and around the urban area.
<p>Integration</p>	<p>Devolved specification, funding and management of rail allows closer integration with other public transport modes, policies and wider transport interventions:</p> <ul style="list-style-type: none"> Transport Scotland's Strategic Transport Projects Review (STPR) allowed evaluation of the case for rail alongside investment in roads, local public transport and maintenance; Merseytravel has been able to plan and deliver interchange enhancements across Merseyside has improved physical interchange with buses, and invested in walking, including Merseyrail winning funding as a Cycling Demonstration TOC and obtaining Secure Station status for all 66 stations across its network. 75% of station car parks are also Secure; Transport for London implemented Oyster PAYG on all London Overground stations soon after taking over responsibility for the franchise, allowing equal access to all other public transport modes in London within a single ticketing arrangement; the Scottish Government, Welsh Assembly Government & Northern Ireland Assembly have introduced or are developing integrated bus and rail ticketing products across bus and rail; passenger service franchising arrangements in the Netherlands allow for combined franchising, management and branding of rail and bus services within a single area; and Merseytravel, Transport for London and Transport Scotland have introduced common branding for railway stations, trains, and information and promotion alongside other public transport modes and initiatives, providing a consistent image and identity to the passenger and reducing costs of rebranding, if and when franchise operators are replaced.
<p>Efficiencies and</p>	<p>There is evidence that devolution can provide for efficiencies and cost</p>

<p>Cost Reductions</p>	<p>savings which can be re-invested back into benefits for passengers:</p> <ul style="list-style-type: none"> • in London and Scotland, direct purchase or procurement of new rolling stock from manufacturers may be cheaper than reliance on one of the existing private sector ROSCOs; • in London and Scotland, focused project specification, procurement and management is enabling Airdrie-Bathgate and the East London Line to be delivered on time and on budget; • in Merseytravel, economies of scale in bringing rail planning, business case development and franchise management alongside other functions into a single organisation; • in London, Scotland, and Merseyside, there are cost savings from maintaining a single rail brand which does not change with the replacement of a franchise operator; • Merseytravel estimate that implementing vertical integration on the Merseyrail network would create cost savings of £33 million over the life of the existing franchise and provide a cost comparator to Network Rail. Separate evidence from Northern Ireland suggests lower capital and operating costs of the vertically integrated NIR network compared to Great Britain ; • direct franchising responsibilities in Transport Scotland, TfL and Merseytravel removes duplication of focus – and therefore cost – with franchise managers within DfT; • potential for bespoke local standards and specifications (e.g. on rolling stock specification, asset management regimes, station design standards) to reduce costs; and • combined bus-rail franchises in the Netherlands reduces management costs for the franchise operator with the potential for savings passed onto the franchising authority.
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