House of Commons Transport Select Committee

Inquiry into Passenger Rail Franchising

Submission from *pteg*

pteg welcomes the opportunity to submit evidence to the House of Commons Select Committee Inquiry into Passenger Rail Franchising. This evidence is presented on behalf of the English Passenger Transport Executives: Nexus, Merseytravel, Greater Manchester PTE, Metro, South Yorkshire PTE & Centro.

What should be the purpose of passenger rail franchising?

Passenger rail franchising should be the mechanism by which the public sector can specify the standard and quality of passenger rail services it can afford. The process as a whole should secure for the public sector the best value for money rail service that meets both national and local objectives. The process should drive up quality in particular through:-

- Improved train service performance
- Improved quality of train services (in terms of both capacity and quality of passenger environment)
- Improved safety at stations and on trains
- Improved integration with other rail services and other modes
- Improved facilities on trains and at stations (including in the longer-term all facilities brought up but to be fully accessible)

It provides an opportunity to import best practice and innovation particularly through allowing private sector operators to make reasonable returns, act commercially and be innovative in delivery mechanisms. The overall aim of passenger rail franchising should be to deliver consistent and improving standards across the network.

Is the current system achieving that purpose?

To a considerable extent but with caveats relating to specification and funding constraints.
The franchising process has evolved significantly since the first franchises were developed by OPRAF. They, the SRA, and now the DfT, have had to balance the extent to which services are tightly specified with allowing Train Operating Companies sufficient incentives to exercise innovation. This has led to swings between quite tightly prescribed franchises and the emerging DfT approach which is more focused on outcomes. ***pteg*** believes that services in its areas often need a higher degree of specification than elsewhere as the commercial incentive to deliver service levels and quality can be lower. Conversely, for more commercial franchises, such as East Coast Main Line, the base specification can be less prescriptive in those requirements.

The process that the DfT is putting in place through its work on Regional Planning Assessments (RPA), Route Utilisation Strategies (RUS) and the Higher Level Output Specification (HLOS) should lead to greater clarity in what the public sector expects to secure for its investment in the rail network. It will, however, take some time to get these aligned. These steps and wider involvement in the franchising process through the SRA and DfT are leading to better franchises than those that were originally let. The first round of franchising in the conurbations that the PTAs represent led to over-ambitious bids, poor performance and ultimately failure.

The franchising process has to address the inherent tension between national and local objectives. The letting of the Northern Franchise in 2005 illustrates this tension. The basis of its letting was with no additional investment and therefore implicitly on a no or limited growth basis. On the other hand the Local Transport Plans, the statutory planning document of the constituent authorities within the Northern Franchise, contain targets for rail patronage growth which require greater capacity. In West Yorkshire the franchise was without enough capacity to cope with even existing passenger numbers, ie some trains already had more passengers than national standards and some routes were overcrowded to the extent that passengers were regularly left behind. It is likely that such an approach does not lead to best value for the public sector and it is to be hoped that the improvements that the DfT have made, and which are set out above, will be reflected in the forthcoming round of franchises in the West and East Midlands and on Cross-Country.

As referred to above, there is an emerging high level strategic planning framework established by the SRA and reinforced by the DfT which sets out a clearer route for defining franchise specification - Regional Planning Assessments followed by Route Utilisation Strategies which in turn feed into individual franchise specifications. This is a good theoretical process but the problem has been that in practice the process so far has been slow and disjointed. For example, the RPA in Yorkshire and the Humber has only just started and that for the North West has yet to be published. A Route Utilisation Strategy for the East Coast Main Line was started by the SRA, abandoned and restarted by Network Rail, alongside the Yorkshire and Humber and North West Route Utilisation Strategies. The East Coast Main Line franchising process was carried out amid this process. Subsequent to its completion, competing bids for track access have been received and decisions have had to be made without the benefit of any strategic framework.

The ECML access issue highlights a failing of the strategic planning and franchising process. GNER is seeking to provide additional services to Leeds and Grand Central is seeking to fill in gaps in the current service provision (through providing through services between Bradford and Halifax to London). Both of these are priorities to support the economic growth of the Leeds City Region. In part, this situation is as a result of the failure of the franchise specification to properly reflect local needs but it also highlights a significant flaw in the industry planning process. The SRA/DfT has let a franchise yet others (such as ORR) are taking decisions apparently without the benefit of a strategic framework and without reference to impacts on franchises.

There is also an issue surrounding the South TransPennine service between Liverpool, Manchester, Sheffield, Nottingham and Norwich which are currently part of the Central Trains franchises. Merseytravel, Greater Manchester PTE and South Yorkshire PTE all expressed a strong preference for this service to be transferred to the TPE franchise to provide an integrated service on the South TransPennine route. However, the baseline specification it currently proposes is that it is part of the East Midlands Franchise on cost grounds.

Until the Railways Act 2005, the PTEs were co-signatories to franchises in line with our wider transport powers under the 1968 Transport Act and the Railways Act 1993. The co-signatory process has worked effectively to enable PTEs to continue to invest in improving rail services since privatisation. The PTEs lobbied strongly against the loss of automatic co-signatory rights during the passage of the Railways Bill. We still believe that the proposed new arrangements as outlined in the Draft Guidance Note between the DfT and PTEs will make it harder for us to deliver better rail services.

The management style contract approach, which is effectively what the Northern Franchise has allowed greater control of cost and some degree of best practice to be developed, for example, Rolling Stock Maintenance. However, the length of the franchise and other aspects do not necessarily create the optimum opportunity for investment. Merseytravel, who have submitted separate evidence, have operated on a different basis. The Merseyrail concession is a 25 year franchise. This has already shown the benefits of investment in reinfurbishment of rolling stock.

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

The DfT have set out a clear inclusive consultation process for franchises which so far they have adhered to. Relevant PTEs have been involved in the current East Midland and Cross Country Franchises. The DfT has been consulting Centro on the proposed new West Midlands Franchise and they have had the opportunity to influence the design and specification. Negotiations are on-going currently on detailed issues. However, there will inevitably be areas of disagreement (such as on crowding standards) where it is likely that the DfT's financial constraints will mean that Centro's current specification in the Central Trains Franchise will not be transferred into the new West Midlands Franchise.

The Draft DfT/PTE Guidance Note outlines a process of increment/decrements whereby a PTE can alter the DfT's specification. This process has yet to be properly tested, and the PTEs are concerned that the complexities of contracting directly with the DfT for the provision of enhanced services will lead to difficulties for both parties, particularly where the PTE is prevented from being a co-signatory to the franchise.

Has there been a smooth transition of franchising agreements from the SRA to the DfT?

In general, there has been a smooth transition from the SRA to the DfT and the consultation process appears to be more transparent.

Are franchise contracts the right size, type and length? What criteria and processes are used to determine the nature and length of franchises?

The main thrust of the former SRA approach was that fewer franchises were better. This led to the creation of the Northern Franchise and separation of the TransPennine Franchise on the grounds that it was an Intercity-type franchise. In general, fewer franchises would seem to be better and to date there do not appear to have been any adverse issues arising out of the amalgamation of 2 franchises into Northern Rail. Indeed, there has been a number of benefits. Similarly the TPE Franchise has allowed a focus on that route but it is a relatively small franchise and as indicated above PTEs believe it would benefit from taking over the Liverpool, Manchester, Sheffield, Nottingham service. ***pteg*** also believes that there are distinct differences between Intercity-type franchises and local franchises. It, therefore, believes that combining the Lincolnshire services of Centro Trains with the Midland Main Line Franchise to create the new East Midlands Franchise potentially creates a franchise with unclear objectives. There is no reason why in the longer-term this could not have been subsumed as a separate business unit within the Northern Franchise.

There may also be circumstances where a more locally focused franchise could be appropriate, for example, coinciding with the emerging City Region agenda where the provision of rail, bus and tram services could be integrated under one provider.

As set out in its separate evidence the longer franchises, such as the Merseyrail concession, can provide greater opportunity for private sector investment. This is evident in the Merseyrail and Northern Franchises, both of which are operated by the same company. The forward plans of Northern Rail – who have performed to a very high standard over the first 18 months of their franchise – seem to be tempered by the realisation that their franchise has only 7 years left to run. Given that the conventional capital investment horizon is 30 years, the duration of franchises gives franchisees little incentive to make speculative investment over and above their franchise commitments. This is particularly relevant given rolling stock issues such as Pacer replacement.

What criteria and processes are used to evaluate franchise bids?

Experience on the Northern Franchise is that the SRA/DfT have a very robust and rigorous process for evaluating franchise bids. The criteria are based on value for money and certainly unsustainably cheap bids (as with the first franchises) are not encouraged or accepted. The process must adequately balance the subsidy/premium with other factors, and allow the franchise to not necessarily be awarded to the most financially attractive bid if there are doubts about deliverability, or other bidders are offering significantly better outputs for similar subsidy. However, it is clear that in recent awards the overriding criteria has been affordability. This has limited the base franchise specification (ie reduced the ability to influence the base) and meant that options put forward by the bidders (or requested by DfT or other third parties) have not generally been taken up. The Virgin Group has already expressed its concern that the new Cross Country Franchise may have a substantially lower cost base than its predecessor and has threatened not to take part in the bidding process should this turn out to be the case. This emphasis upon cost containment at the expense of service quality will reduce the ability of the railway to cope with increasing levels of demand. There is clearly a significant cost to bid development and evaluation (the SRA/DfT relies heavily on the use of consultants). Whilst rigorous evaluation of such large procurement contracts is right and proper, this does need to be balanced against the number and length of franchises, ie fewer, longer franchises would cost less to develop and evaluate.

The PTEs were fully involved in the process of the award of the Northern Franchise and have no concerns about the way in which that was done.

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

In general, franchise holders do deliver value for money. Where there have been problems these have often been rooted in the lack of robust original bids, for example, in the case of Arriva Trains Northern and First North Western. Generally, if a TOC is operating in a financially viable environment then they are able to focus on service quality and are more able to invest in improvements. However, if a TOC is struggling financially, this can lead to behaviour that is not in the best interest of passengers.

Tighter specification of franchises (in terms of outputs) is likely to lead to better value for money for the franchising authority (DfT) and, in general, the increased focus on performance in the latest franchise specifications has contributed to the overall rise in performance. However, value for money for the franchising authority is not always the same as value for money for passengers. For example, the GNER franchise achieves over £.1.3 billion in premium payments for DfT but, as a result of this, GNER is increasing unregulated walk-on peak fares significantly. This is likely to lead to poorer value and issues of social exclusion

The relatively short duration of franchises does tend to see most investment and improvements occurring early on as a TOC can rarely make a business case when there are only a few years left on which to make a return. The DfT needs to ensure that any good ideas for improvements towards the end of franchises are not stifled as a result.

Are risks suitably apportioned between the Government and franchise holders?

Risks vary widely according to the characteristics of individual franchises. GNER would no doubt claim that their franchise is highly risky, given the emergence of an open access operator. However, where there are substantial payments to the franchisee, such as with the Northern Franchise, the level of risk appears to be substantially skewed against the Government, with the franchisee more or less guaranteed success on the basis of meeting specified targets, rather than as a result of displaying entrepreneurial flair.

The balance between risk and reward needs to reflect the circumstances of each franchise. On a franchise which requires high subsidy (and thus low dependence on farebox revenue) and few delivery risks, then the risk profile would be different to where an operator would be taking high commercial risks and is funding committed service improvements through predicted revenue growth. On routes such as the West Coast Main Line, where significant public funding has been invested in improvements, it is not unreasonable that the Government should ensure that it can benefit from the financial returns.

New franchises include risk and profit sharing between franchisees and the DfT which is an improvement on previous franchises. In general, however, franchisees are not incentivisied to take risks, particularly as base profit margins have been squeezed. This is particularly apparent when PTEs are implementing enhancements where franchisees are often unwilling to take risks unless they are suitably rewarded or 'insured' against risk. There are also problems where 'risks' overhang the end of a franchises (eg procurement of new rolling stock) and DfT is often unwilling to pick up any residual risk.

What is the scope for improving services through franchise agreements?

The PTEs have actively used franchise agreements to improve services in their areas. Whilst we are keen to continue to do this, much will depend on the contractual and funding position in future. Over-focusing on costs will give relatively little scope for further improving services through franchise agreements. Whilst the overarching requirement by the DfT to drive down costs and get a proper control of industry costs was clearly essential, this has led to stagnation of some franchises, for example, the Northern which was let on the basis of no growth.

Do we need more competition and vertical integration? Is franchising compatible with open access operations?

Recent events such as the ECML and Grand Central Trains issue have highlighted a tension between franchising and open access passenger and freight operations. Ultimately this comes back to how the Government takes a view over what it wishes to buy for its public sector input. It is not easy to see how there can be a mix of franchises specified by Government and open access operators, particularly on a network whose capacity is constrained. If future franchises are properly specified through a route that takes into account regional and local objectives fully then there should be no need for open access operators to have to plug the gaps. In summary, the DfT through the HLOS process should decide what sort of railway it wants and then specify it clearly through franchises.

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

The recent transfer of responsibility for performance to Network Rail and development of integrated control centres has led to clear benefits in terms of improved performance. Network Rail now has more incentives to improve customer service, but they could be given even more incentives (such as growing passenger numbers to drive enhancements).

The PTEs certainly consider that the rolling stock market is not working effectively and have experienced franchised services being potentially undermined at the end of a franchise by a ROSCO trying to transfer rolling stock away to where it could earn greater returns. There appears little incentive on ROSCOs to invest in improving PTE commuter rolling stock and the limited franchise length, and uncertainty over long-term usage, are often cited by the ROSCOs as a reason for not investing.

ROSCOS currently do not have incentives to necessarily behave in the interests of passengers. Their incentives are mainly financial and lead to perverse decisions such as the inability of train operating companies to rid themselves of unsuitable rolling stock, or to employ vehicles currently stored out of use for short periods of time. Improved horizontal integration is also required.

Where a station has a fairly infrequent service provided by a number of operators, there can be a reluctance to take responsibility for the consequences of service disruption. As an example, Chester-le-Street station is served by Northern Rail, First TransPennine and Virgin Cross Country services in roughly equal proportions. When services are cancelled, there tends to be a lack of information or bus replacement provision. There is a perception that this is as a result of a lack of ‘ownership’ on the part of any one Train Operating Company.

Merseyrail have recently sought to achieve a vertically integrated railway and this is specifically dealt with in their response.