Written evidence submitted by Rail Delivery Group (RFG0019)

Introduction

1. The Rail Delivery Group (RDG) was established in May 2011. Its purpose is to enable train operators, freight operators, and Network Rail to succeed by delivering better services for their customers. This ultimately benefits taxpayers and the economy.

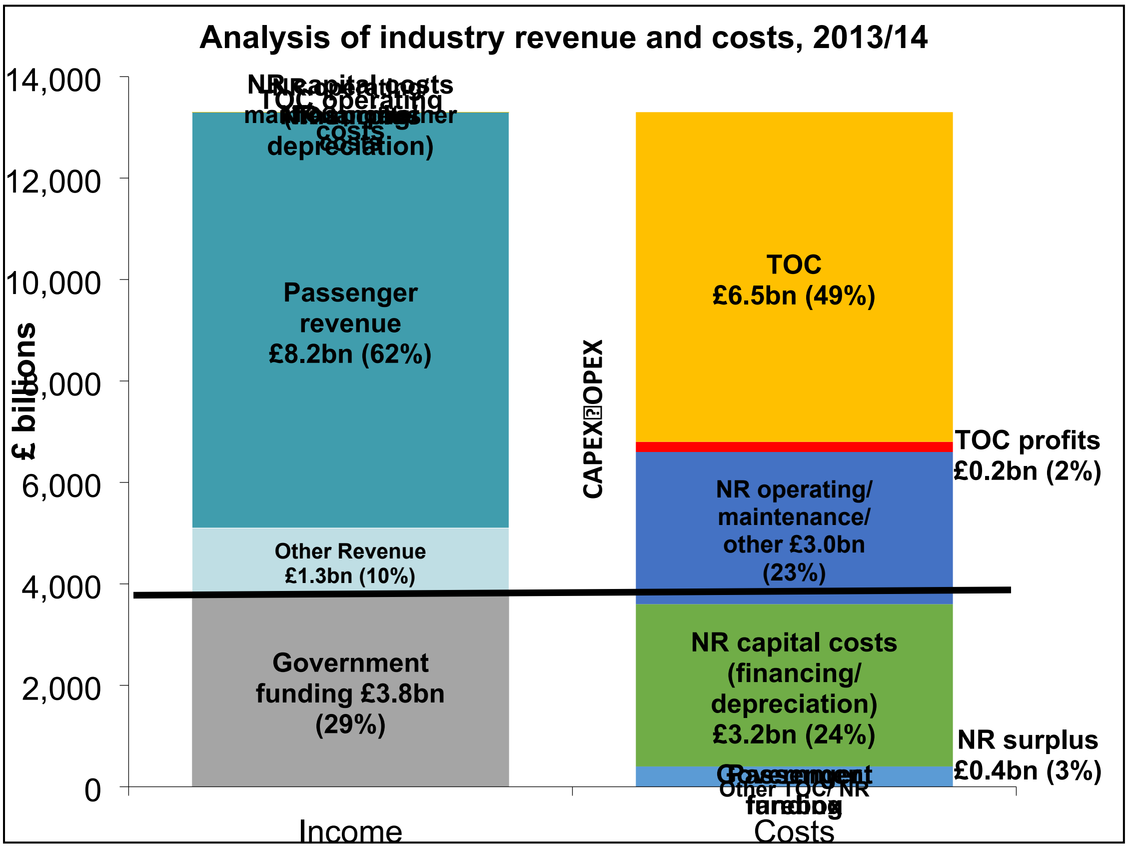
2. RDG welcomes the opportunity to provide a submission to the Select Committee's Inquiry on Rail Franchising on behalf of our members, who include passenger and freight operators and Network Rail.

Overview

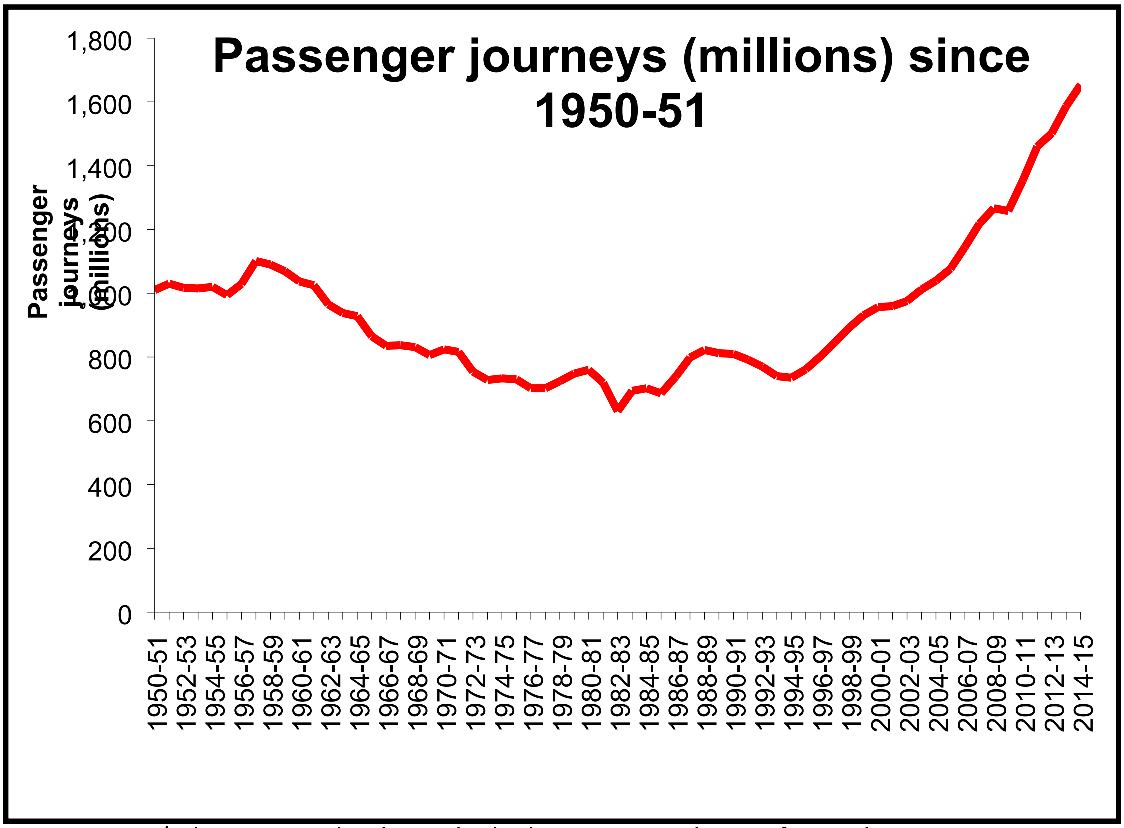
1. RDG would agree with the Competition & Markets Authority report, *Competition in passenger rail services in Great Britain,* published on 8 March 2016 which states; "Great Britain's railway sector has undergone a remarkable renaissance".

2. There have been significant improvements in GB railways since the industry was restructured, including the introduction of franchising, in the mid-1990s. The annual rail industry dataset prepared by KPMG on behalf of RDG shows the improvements delivered and this is available on our website. The key points to note include:

    a. In 1997/8 industry revenue covered 72% of operating costs, whereas by 2013/4, revenues equalled 99% of operating costs, and therefore it now effectively covers day-to-day costs. This is due to a combination of cost control and increased revenue (source ORR and analysis of company accounts).



b. Passenger journeys have more than doubled from 801m in 1996/7 to 1,654m in

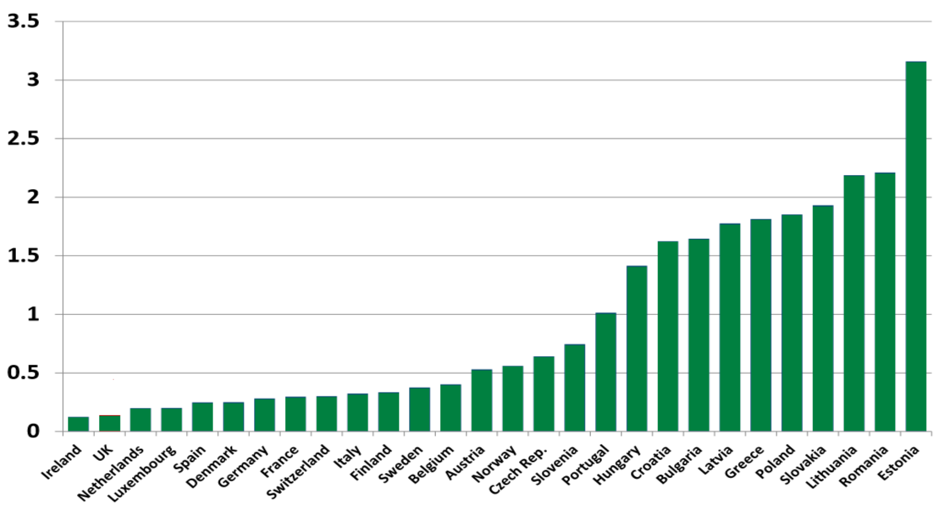


2014/5 (source ORR). This is the highest sustained rate of growth in Europe.

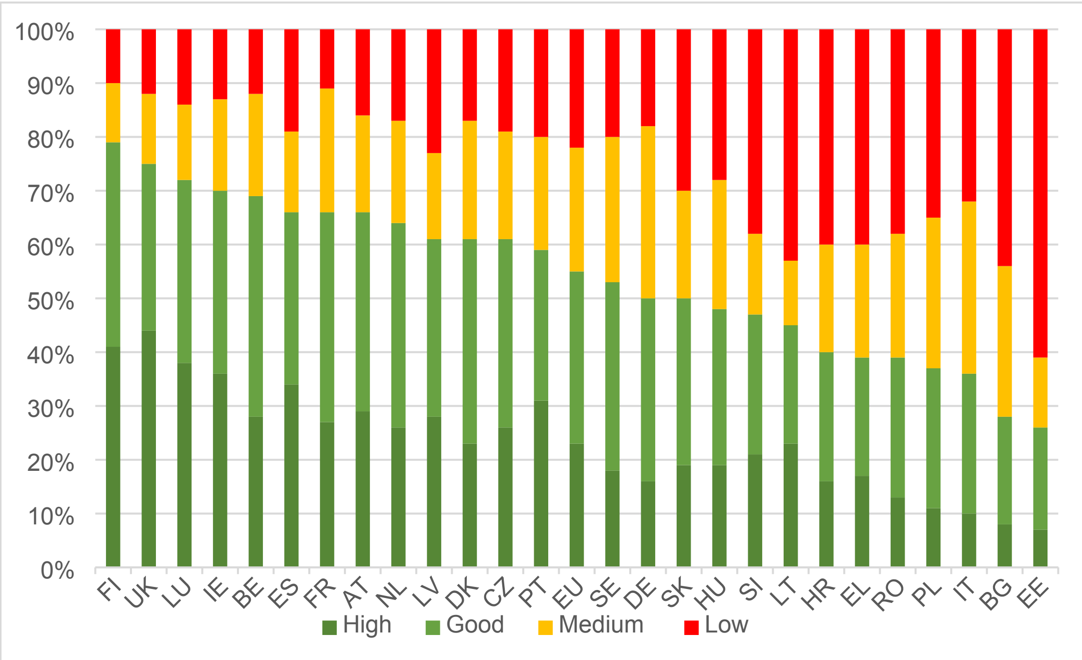
c. Since 1997/8 there has been a 27% increase in the number of train services (from 15,586 in 1997/8 to 19,791 in 2016/7 services per day) and performance measured by PPM (Public Performance Measure) is at 91.3% despite the intensive use of the network.

d. The UK rail industry has a very strong safety record, second only in Europe to Ireland in terms of accidents per million train km between 2010 and 2013. There were no passenger fatalities in train accidents during 2015/6, for the ninth year in succession (source ORR).

Average number of accidents per million train km



e. Passenger satisfaction in 2015 was 83% as measured by the National Rail Passenger Survey (NRPS). When looked at alongside other comparable networks in the European Union, passengers in the UK are more satisfied with their rail journeys and



stations.

European Railways Passenger Satisfaction

Key Issues

3. In this section we have responded to the specific issues which the Committee has raised.

Issue 1: The extent to which the Department for Transport's approach to rail franchising is achieving its key policy intentions of transferring financial risk to the private sector and promoting competition in the market, while at the same time improving rail passenger experience

4. Risk transfer to the private sector takes place within a franchising process framework set out by the Department for Transport (The Department). This involves a tightly specified contract and also regulations including those associated with fares and the management of stations. Train Operating Companies (TOCs) also have to conform to legislation such as the Consumer Rights Act. The more tightly specified the contract and the more regulation imposed, the more constraint there will be on innovation to improve services for passengers and to lower costs.
5. The transfer of revenue risk to the TOC is now bespoke to each franchise. For the Thameslink, Southern and Great Northern (TSGN) franchise, it was considered inappropriate to transfer revenue risk. This was because the franchisee has little control over construction risks. In contrast for the East Coast franchise revenue risk is transferred but there is a GDP mechanism which shares the impact if the national economy doesn't grow as assumed in the contract. The TransPennine Express and c2c franchises have full revenue risk.
6. TOCs take full cost risk, except for track access charges which may change as a result of ORR determinations. They are also protected from changes in law (such as fares regulations) but have to control all their fixed and variable costs including staff, rolling stock and property.
7. The franchise process has resulted in increased payments to the Department. The NAO report on reform of the rail franchising programme published on 15 November 2015 highlighted the 82% average increase in payments to the Department across three franchises compared to the Department's forecast. In addition, these franchises have delivered improved outcomes for passengers with increased peak hour capacity into London.
8. There has been an impact on the market to bid for contracts at the current levels of profit margin, as there is a perception that more risk is being transferred to the TOC. This includes an increasing pressure to accept infrastructure risk by accepting joint performance targets which are affected by infrastructure failures, including signalling equipment. These risks cannot be managed by the train operator.
9. The Department is protected from the risk of franchise failure by the provision of Parent Company Guarantee which is normally achieved with a Bond. The amount of bonding (or Parent Company Guarantee) required by the Department is linked to the revenue predicted by the bidder and is highly dependent on the comparator model used by the Department, the development of which is kept confidential.
10. Franchising has promoted competition "for" the market in that companies compete to win the right to operate individual franchises. Whilst there is little opportunity in the current structure for competition "in" the market between individual operators, the Department have developed franchise areas that compete at the margins such as London to Bristol,

Birmingham and Crewe, and on the northern stretches of the East and West Coast Main lines. The current arrangements for open access were conceived as a way of filling marginal capacity, but there have been few of such operations which now account for 0.13% of passenger journeys.

11. It should be noted that TOCs, along with Network Rail, take full responsibility for safety risk for passengers, staff and the public. The industry has focussed on all aspects of safety and the UK has a very safe railway, as shown above.

12. TOCs have proposed investments in their bids to deliver improvements to the passenger experience and this has included provision of:

    a. More frequent and faster services across the network.

    b. Improved rolling stock – Private sector investment has delivered replacement and refurbished rolling stock across the network. This included the replacement of slam door trains on the commuter networks into London from Kent, Sussex, Surrey and Hampshire, and new trains on the West Coast and CrossCountry franchises. By 2020 new train carriages worth £9.3 billion will be in service carrying passengers on faster, more comfortable and more reliable journeys.

    c. Improvements in ticket retailing – TOCs have introduced modern ticket vending machines with ever-improving functionality including: smartcards; collection of tickets bought on line or via telesales; and, most recently, the ability to speak to an advisor via a video link before purchase. This has supported the move to new forms of retailing and reduced costs whilst improving customer satisfaction. In 1996 over 80% of tickets were sold "over the counter" in ticket offices and in 2014 this had reduced to below 30%.

    d. Improved access to/from stations with expanded car parking, new bus stops, improved taxi pickup/drop off, cycle access and storage.

    e. Improved passenger facilities on stations including toilets, waiting rooms and customer information systems. They have also facilitated the improvement and expansion of catering and other retail outlets.

    f. Improved support and access for Passengers with Reduced Mobility (PRM) with step-free access at an increasing number of stations, on board provision and assisted travel which includes providing help to and from trains. Between 2005 and 2020 the percentage of passengers using step-free stations will have risen from 55% to 81%.

Issue 2: The extent to which the Department for Transport's approach to franchise bid evaluation strikes the right balance between cost, service quality and deliverability

13. The Department sets out in its Invitations to Tender (ITTs) the criteria for franchise bid evaluation. The three criteria are:

    a. Cost to the Government (measured as highest premium or lowest subsidy).

    b. Service quality – This has been defined as producing outputs which exceed the level set in the ITT. Thus it is not the actual quality of service which is evaluated but the number of initiatives in the bid plans which are above the specification.

c. Deliverability – this is assessed using the evidence provided within a bid and it will impact on the overall quality score.

14. Evaluation has now become a complex process taking some six months to complete, whereas previously it was completed in two to three months. The ITT sets out the scoring methodology and how evaluation of sub-plans will be considered in the round using judgement. However, some bidders consider that it can be unclear how quality will be used to differentiate between different aspects of a bid, such as the delivery of additional capacity compared with improved passenger information. The approach to evaluation of quality used on the East Anglia competition has not been repeated in subsequent competitions and appears to have been discarded.

15. Cost is still the overarching factor considered by the Department. The government wants to maximise the financial return from each franchise and this means that other factors are only assessed when the cost gap between the top two bidders is small. It is understood that since the Brown review all franchises have been awarded on the basis of cost.

Issue 3: The Department for Transport's franchise management capability and capacity and its ability to cope with high levels of planned franchising activity in 2016 and 2017

16. The Department's franchise management capability has evolved in recent years and has been significantly strengthened since the Brown Review.

17. Setting the franchise specification including the size and shape is very important as bidders need to understand what is expected and it needs to fit into the overall rail vision. Franchise size and complexity has grown in recent years and the Department has increased the requirements by adding to the specification.

18. The procurement phase requires a dedicated team at the Department which has demonstrated how it can expand resources to meet short term procurement needs, indeed it did so to restart the franchise programme in spring 2013. However, the limitations of civil service salary levels do impact on the quantity of permanent staff with sufficient experience in this specialist commercial field. Delays to the South West Trains and West Coast competitions and Passenger Services Business Change Programme means that RDG is less confident that the Department is able to secure sufficient temporary resource with the appropriate skills to cope with the increased level of contract letting during the period 2016-7. The use of additional interim resources at the Department during this period will impact on the wider franchising market and could result in increased costs and shortages in some specialisms which are essential for owning groups during bid preparation.

19. Effective management of the contract depends on good relationships and high quality staff. RDG has been pleased to see the Department's efforts to improve its contract management approach and increasing staff capability in this area. Long contracts require flexibility and the ability to agree change. This remains a problem area as the Department's preferred approach is to use the escrow models built as part of the franchise bid to make changes. This is complex and time-consuming, it requires high-level expertise and means that decisions to change a contract are not made on an assessment of value for money based on current information, but out-of-date information.

Issue 4: The costs of bidding for franchises and the extent to which increasing costs may be dissuading new entrants to the market

20. The cost of bidding for Department-led competitions has progressively increased and is now a deterrent to both existing train operators and new entrants. The recent Northern bid had a page count limit of 1000 pages and the written submission was supported by a suite of complicated financial and operational models. The models have to be submitted for a best practice review and supported by a letter from the financial advisor which together costs £200k for each bidder. Owning groups estimate the cost of each bid submitted to the Department is £5-10m.
21. The Franchise Agreement is a very large and complicated contract which has grown in recent years as the Department has inserted additional requirements to deliver wider government policies and incorporates a large number of Committed Obligations. RDG has made suggestions to the Department on how the bidding process and the contract could be modified to reduce substantially the costs to all parties. The Franchise Agreement Review by the Department has looked at individual sections of the Agreement, but a further strategic review is required to consider how all the incremental changes have changed the overall structure and incentives in the contract, including the cost of operating the franchise.
22. In addition to the cost of preparing a submission, bidders now have to consider the risk of an investigation by the Competition and Markets Authority (CMA) for which bidders budget an additional £0.5-2m. The current CMA investigation into the Northern Franchise demonstrates this risk.
23. Before deciding to submit a bid Owning Groups have to consider the quantum of the Parent Company Guarantee which the Department will require to be provided by the winner. Currently this is an issue which is not fully transparent as the Department has not shared its methodology. For the TransPennine franchise, Parent Company Support in excess of £200m was required in a mix of bonds and contingent loans. This was substantially higher than the predicted minimum level of £57m. The c2c and East Coast franchises required Parent Company Support of £140m and £232m respectively.
24. The franchise bid process is evolving further due to the progressive devolution of franchised train services to the Scottish and Welsh Governments, Transport for London and Transport for the North. RDG is working with these devolved authorities who are adapting the franchise bid process and the contract to suit their particular circumstances.

Issue 5: Actions which could be taken to encourage new entrants to the market

25. RDG welcomes new entrants to the rail franchise market. RDG offers associate membership to organisations who intend to bid for passenger rail contracts. Associates have access to information which is shared with members.
26. The RDG Franchise Strategy Group (FSG) considers all aspects of franchising and is attended on a regular basis by staff from organisations which let rail contracts including the Department, the Scottish and Welsh Governments, Transport for London and Transport for the North.

27. The creation of smaller franchises would encourage new entrants to the market. There are a number of very large franchisees with revenue of over £1bn which, due to their size, are risky even for large owning groups and require very large Parent Company Guarantees. There is some evidence that new entrants will be prepared to provide the necessary level of parent company support. However, there is also evidence that there are fewer bidders applying for franchise competitions.

Issue 6: The opportunities, risks and feasibility of a significant increase in Open Access Operators on the rail network

28. Open Access operators have achieved high passenger satisfaction scores on the limited number of routes where they operate. The CMA report *Competition in passenger rail services in Great Britain* sets out the financial implications of increased Open Access. Although net rail revenue will increase there could be an impact on premium payments to the Department.

29. It is important that there is a consistent approach to Open Access so the market understands how capacity allocation issues are considered. Bidders also want to be able to assess the potential impact of Open Access before they submit a bid to operate franchised services. A lack of consistency will result in significant tension within the market and potentially fewer and lower bids for franchise competitions.

Issue 7: Practical recommendations to better manage the effects of rail infrastructure works on rail franchisees, including through improved coordination with Network Rail and better management of major infrastructure projects

30. The rail industry must prioritise the needs of passengers when planning network enhancement projects. The Shaw report recommended the devolution of more authority to Routes and this should improve the "line of sight" to passengers. The Route should work with TOCs and FOCs to develop an asset management plan and this must consider the impact on passengers.

31. The franchising process also provides an opportunity for bidders to set out how they would work with the organisations responsible for major enhancement projects (normally Network Rail) to minimise disruption. This is very difficult in the short bidding period and therefore it is vital that franchise contracts provide for a Change process which enables all parties to adjust plans in the most appropriate way.

32. At working level, the RDG Asset, Programme and Supply Chain Management (APSCM) Working Group brings together Network Rail, TOCs, Freight Operating Companies (FOCs) and contractors to find ways of improving efficiency through improving collaboration. This work reduces cost and also the impact on passengers and supports Industry Access Planning.

Summary

33. Rail's renaissance, in which franchising has played a significant role, has brought benefits to passengers and government. The ticket and other income generated by rail services now equals the day-to-day operating costs of the industry and the burden on taxpayers has been reduced.

34. Since 1996 investment in infrastructure, rolling stock and at stations has improved the quality of the journey experience for passengers has improved. There are more services, on more routes and the safety record is equal to the best in Europe. The ongoing investment planned for the remainder of the decade will ensure that passengers continue to benefit from improved services.

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