
National Audit Office

THE DEPARTMENT FOR TRANSPORT

# Letting Rail Franchises 2005-2007

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1047 Session 2007-2008 | 15 October 2008

Report by the Comptroller and Auditor General

# The Department for Transport
# Letting Rail Franchises 2005-2007

HC 1047 Session 2007-2008

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## CORRECTION

Page 18, paragraph 2.13, last sentence:

| Text reads | Text should read |
|---|---|
| This would imply government support of £926 million for | This would imply government support of £926 million for train services in these eight franchise areas – an overall reduction of about 55 per cent from the previous £2 billion. |

Page 19, paragraph 3.3, 6th sentence (line 13):

| Text reads | Text should read |
|---|---|
| This means that 191 people standing on a 148 seat train would be the maximum for planning purposes, compared to 163 people under the previous standard. | This means that 192 people sitting and standing on a 148 seat train would be the maximum for planning purposes, compared to 163 people under the previous standard. |

October 2008
LONDON: The Stationery Office

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National Audit Office

## THE DEPARTMENT FOR TRANSPORT

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**19 September 2008**

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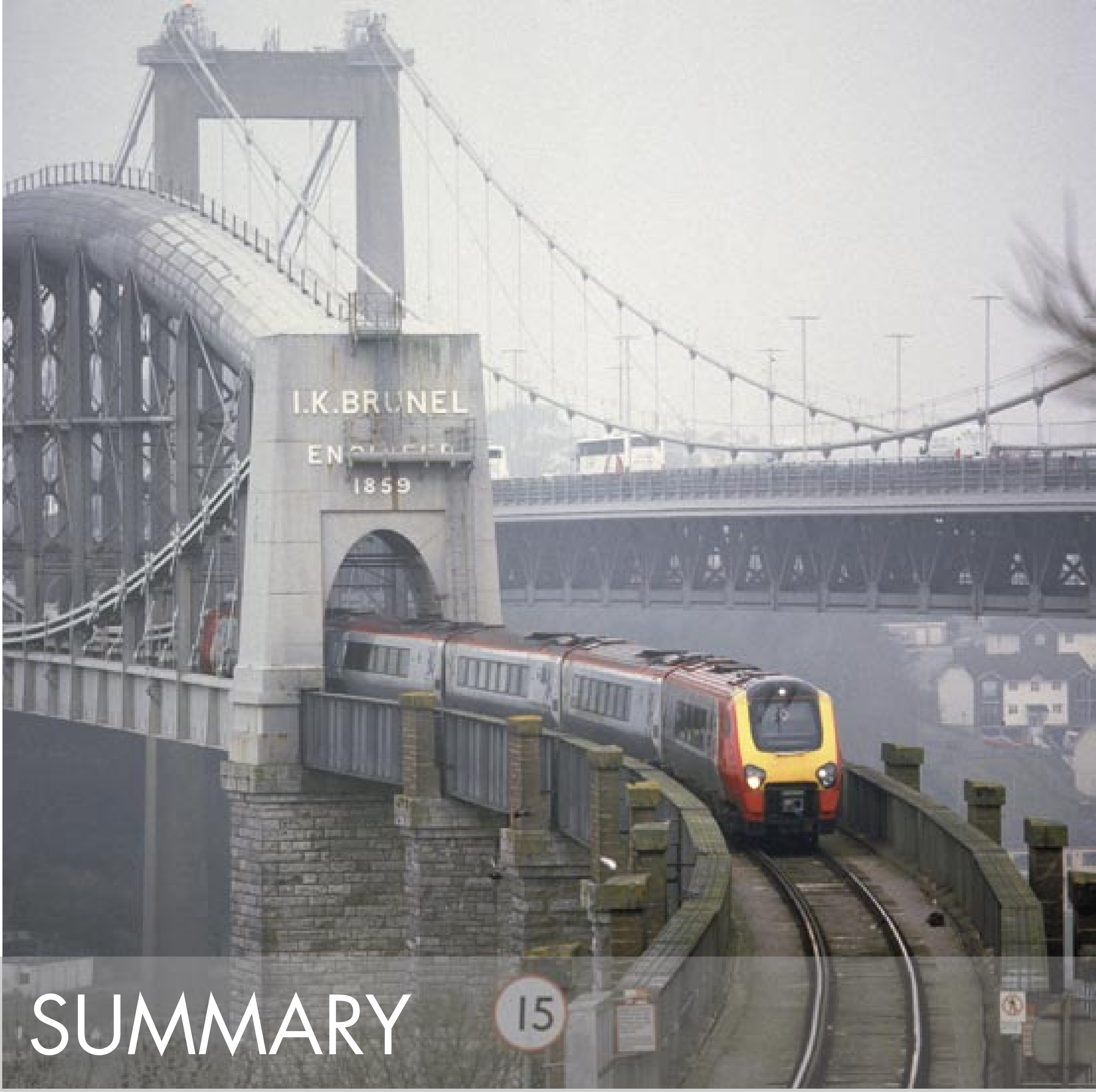



# SUMMARY

**1** Passenger rail services are provided by train operating companies under franchise agreements which generally run for 7–10 years. Responsibility for the operation and condition of the track rests with Network Rail. Strategic decisions on major investment, which also affect service to passengers, are the responsibility of the Department for Transport (the Department). Under the Railways Act 2005, the Department also took over responsibility for the oversight of passenger rail franchising following the abolition of the Strategic Rail Authority (SRA).

**2** The Department's rail franchising objectives have broadly been to provide a safe, reliable and efficient service for passengers that is affordable and value for money. In under three years, since taking over from the SRA, the Department has re-let eight of the sixteen rail franchises that it manages **(see Figure 1)**. Rail passengers have experienced a change of train operator on six out of the eight franchises, along with changes to fares and services. The report examines the:

- franchise competitions (Part 1);
- impact on the taxpayer (Part 2);
- impact on the passenger (Part 3); and
- approach to managing rail franchises (Part 4).

## Key findings

### On the franchise competitions

**3 Throughout planning, procurement and operation the Department has set specific objectives which reflect its overall priorities to control costs, live within the public funding available and improve railway performance.** Although the Department's wider objective of improving the environmental impact of transport was not explicitly stated as an objective in any of the franchises examined, the Department has begun to include environmental issues in its assessment criteria and has added an explicit objective for the South Central franchise (to be let in 2009).

**4 The Department's service specifications are generally well thought through, reflecting the objectives set.** The Department assesses changes from the previously specified level of service in consultation with stakeholders. These changes are clearly linked to the specific objectives for each franchise and alterations are subject to cost benefit and affordability analysis.

**5 Local bodies are consulted on specification but are not involved in bid evaluation and negotiation.** The Department asks relevant local bodies, such as Passenger Transport Executives (PTE), for their views on the service specifications for each franchise. PTEs are not, however, closely involved during subsequent bid evaluation and negotiation.

**1** Rail Franchises and Concessions in England and Wales in June 2008

| Train operator | Franchise area or name | Parent(s) | Start Date | Expiry Year |
|---|---|---|---|---|
| c2c | London, Tilbury and Southend | National Express Group plc | May 1996 | 2011 |
| Virgin Trains | West Coast Main Line | Virgin Group and Stagecoach Group | March 1997 | 2012 |
| Chiltern | Chiltern | Deutsche Bahn | March 2002 | 2021 |
| Southern | South Central | Govia Ltd | May 2003 | 2009 |
| Merseyrail[3] | Merseyside Region | Serco Group & NED Railways | July 2003 | 2028 |
| Arriva Trains Wales | Wales | Arriva plc | December 2003 | 2018 |
| TransPennine Express | TransPennine | First/Keolis Transpennine Holding Ltd | February 2004 | 2012/ 2017[1] |
| National Express East Anglia | Greater Anglia | National Express Group plc | April 2004 | 2014 |
| Northern Rail | Northern | Serco Group & Ned Railways | December 2004 | 2013 |
| Southeastern | Integrated Kent Franchise | Govia Ltd | April 2006[2] | 2014 |
| First Capital Connect | Thameslink/Great Northern | FirstGroup plc | April 2006[2] | 2015 |
| First Great Western | Greater Western | FirstGroup plc | April 2006[2] | 2016 |
| Stagecoach South West Trains | South Western | Stagecoach Group plc | February 2007 | 2017 |
| London Midland | West Midlands | Govia Ltd | November 2007 | 2015 |
| East Midlands Trains | East Midlands | Stagecoach Group plc | November 2007 | 2015 |
| CrossCountry | New Cross Country | Arriva plc | November 2007 | 2016 |
| National Express East Coast (NX East Coast) | Inter City East Coast | National Express Group plc | December 2007 | 2015 |
| London Overground[3] | London Region | MTR and Deutsche Bahn | November 2007[3] | 2016 |

*Source: National Audit Office analysis – the eight franchises in the outlined box were let by the Department. The table is dated June 2008 as the date when the Gatwick Express became part of the Southern franchise.*

NOTES

1 Extension option. The other franchise expiry dates assume that any relevant extension is earned.

2 Franchises specified by SRA.

3 Merseytravel and Transport for London concessions.

**6 The Department has been successful in stimulating keen competition for franchises.** There were three or more bidders on seven out of the eight franchises awarded by the Department and two on the West Midlands franchise. All the winners of the franchises were established UK companies and there was limited interest from overseas companies. There is no sign that incumbency bestows any clear advantage when bidding for franchises.

**7 The Department has been successful in letting franchises to the timescales initially established.** The Department did not incur any delays, and all four franchises awarded in 2007 were procured by the dates initially envisaged.

## On the impact on the taxpayer

**8 The eight franchise agreements reduce the burden on taxpayers, replacing a direct subsidy of £811 million in 2006-07 with a projected £326 million payment to the Department in 2011-12 (Figure 2).** Six franchises out of the eight received subsidies in 2006-07 averaging £130 million. The number subsidised falls to three franchises with an average subsidy of £128 million in 2011-12. The other five franchises potentially pay over £142 million of revenue premium, on average, with the highest premium being £229 million for the Inter City East Coast franchise. These savings help to fund the Department's proposed investment in passenger services.

**2** The potential impact of the revenues set out in franchise contracts

| Franchise | Direct subsidy or (premium) in 2006-07 actual £ million | Direct subsidy or (premium), per franchise contracts, in 2011-12 £ million |
|---|---|---|
| South Western | 123 | (140) |
| South Eastern | 145 | 65 |
| Thameslink/Great Northern | (14) | (126) |
| Greater Western | 97 | (168) |
| East Midlands | 30 | (46) |
| West Midlands | 212 | 162 |
| New Cross Country | 231 | 156 |
| Inter City East Coast | (13) | (229) |
| **Total** | **811** | **(326)** |

*Source: National Audit Office summary of Department data*

NOTE

See note 1 to Figure 10 to clarify 2006-2007data. The saving in subsidy shown does not take into account the Department's investment plans published in July 2007.

**9 Indirect grant support, to cover Network Rail's maintenance and renewal of infrastructure in these franchise areas, means that there will still be an overall taxpayer subsidy.** The future amount of network grant to be set by the Office of Rail Regulation for the period 2009-2014 is not yet known. Assuming continuation of the current level of grant, this overall subsidy would be £926 million for these eight franchises in 2011-2012 (a reduction of 55 per cent).

**10 The reduction in subsidy is dependent on a continued strong increase in the number of passenger journeys.** If past trends continue, two thirds of the increase in revenue for all franchises in the period to 2013-14 will come from this source. The balance includes revenue from a variety of other sources such as reduced fare evasion, changes in the mix of fares paid by rail passengers and higher fares in real terms to the extent permitted by the Department's regulation of fares.

**11** After the first four years of the franchises, the taxpayer shares demand risk with the train operators. Until then each train operating company bears nearly all financial risks associated with revenue and thereafter still bears the financial consequences if revenue falls two per cent below its projection. Beyond this point, the Department shares the financial consequences with the train operator, by varying the amount of subsidy paid or premium received by the Department. From the outset the taxpayer is also entitled to share in any extra revenue (see Figure 9 on page 17). **Reducing the train operators' risk in this way has resulted in better bids, based on higher revenues, with a firm financial commitment for four years.**

## On the impact on the passenger

**12 Many commuters face increased crowding at peak periods until planned investment delivers more carrying capacity.** For example in the worst affected area, passengers being carried to and from London at peak times in 2006 (the latest date for which information is available) were on average 3.5 per cent in excess of the planned capacity required (up from 2.7 per cent in 2004). The morning peak had reached 4.8 per cent in excess of such capacity. In the short term, most train operators seek to respond to fast-growing passenger demand mainly through making better use of existing rolling stock (such as changing interior layouts and better train plans) and using ticket pricing to try to spread out peak demand. In addition six out of the eight new franchises have an obligation to introduce additional carriages quickly. The franchises we examined provided for an average seven per cent increase in fleet capacity.

**13 The Department also plans to increase capacity in most franchise areas by negotiating changes in franchises to introduce 1,300 more carriages (see Figure 11)**. This will involve commercial negotiations between the Department and most train operators before the end of each franchise period. These negotiations will focus on the impact on the train operator's revenues after allowing for increased costs they incur for leasing extra carriages.

**14 The Department has negotiated commitments to improve the quality, reliability, accessibility and security of passenger services, for example through station refurbishment and investment in rolling stock.** Crowding and fare increases may offset some of the impact of these commitments on passenger satisfaction. There is to date, however, no established trend in passenger satisfaction on the recent franchises that are already in service and it is too early to assess those let in 2007. There have, however, been difficulties for one train operator (First Great Western) in meeting its first year plans and the Department has issued a formal notice requiring remedial action to reduce train cancellations.

**15 Since June 2003, most commuter and other regulated fares have risen at one per cent above the retail price index, although some increases in non-regulated fares have been substantially higher.** Some fare increases have been significant. For example, Stagecoach South West Trains raised some unregulated fares by 20 per cent in 2007. Incentives to travel outside peak and shoulder peak periods, however, have been maintained, or increased by special low fare offers, to ease crowding for commuters paying increased fares.

## On the approach to managing rail franchises

**16 The Department's arrangements for identifying and managing risks, including handling the failure of a train operator, are well planned and follow good practice.** Appendix 3 sets out the key risks we have identified and the main mitigants. The right to impose a remedial plan was invoked, for example, when First Great Western breached its franchise agreement (see Figure 16, case example on page 23). A key risk for the Department is maintaining sufficient numbers of staff with relevant industry knowledge and commercial skills to manage delivery and negotiate mid-term changes to franchise contracts. The risk of reduced revenues following an economic downturn is partly mitigated by the Department using more conservative budgeting assumptions, regular updates of budgets and train operator contingency plans to reduce costs and adjust discretionary services. In an extreme case, the Department also has contingency plans ready to step in as operator of last resort.

**17 The cost of managing franchises decreased from £7.3 million in 2004-05 to £5.7 million in 2007-08.** The main reason was the reduction in the number of staff involved in franchise management. The relevant Department Directorate, Rail Service Delivery, had 72 staff in post in June 2008 whereas the equivalent parts of the SRA had over 100 staff in post in early 2004. The Department can operate with fewer staff as a result of an approach that allows train operators to 'self certify' that low risk obligations have been delivered. After reviewing experience with this approach in early 2007, the Department has strengthened its compliance activity by requiring more data checks.

## Value for Money Assessment

**18** The Department's approach to rail franchising produces generally well thought through service specifications and generates keen bidding competition. This approach has resulted in better value for money for the taxpayer on the eight franchises let since the Department took over from the SRA. The Department has been able to gain a commitment to some improvements in quality, reliability, accessibility, security and capacity at the same time as negotiating a sharp fall in subsidy. The combined contracted subsidy of £811 million in 2006-07 should turn into a payment to the Department of £326 million by 2011-12. The Department does, however, bear up to 80 per cent of shortfalls from contracted target revenues after four years and the bids assume continued high passenger growth. Slower growth would lead to subsidies falling by less than projected. Although there will be some service improvements passengers overall will pay more. Crowding will increase for many commuters until expected investment delivers more carrying capacity.

# Recommendations

## On letting franchises

### Involving regional decision making bodies

**1** Local decision making bodies (such as Passenger Transport Executives (PTEs)) have plans for other transport modes that need to be integrated into the long term planning of the rail network. Consultation generally works well at the specification stage, with options for increases or reductions in services. Local bodies, however, are not closely involved in bid evaluation and subsequent negotiations.

*The Department should include additional local expertise when negotiating franchises, for example, by making use of short term secondments from relevant PTEs. These secondees would provide local knowledge to support the Department's evaluation of bid options.*

### Evaluating alternative options in bids

**2** When interviewed, most companies admitted that they do not put as much effort into working up requested options as they do on meeting the base level specification. As a result, the alternative options are priced on a 'take it or leave it' basis and may not be fully specified.

*In the technical evaluation, the Department should consider taking into account the value for money and affordability of options. This approach would provide bidders with greater incentives to develop options competitively. The number of such options should be limited to avoid an excessive increase in bid costs.*

## The impact on the taxpayer and the passenger

### Transparency on financial support for franchises

**3** Information on the extent to which fares cover the overall costs of passenger rail services, taking into account grant support to Network Rail, is not available. Increased visibility of the overall Government support to the railways would lead to better informed debate.

*Information on the overall support, e.g. per passenger mile, that franchise services receive from the taxpayer should be made available. It should take into account additional support including grants paid directly to Network Rail.*

### Transparency on service quality standards

**4** The Department seeks to achieve improvements in service quality (covering such aspects as train and station cleanliness, the provision of information and the attitude and helpfulness of staff) through agreeing measurable standards and setting targets to achieve year-by-year improvements on a baseline measured in the handover period. The targets and scores are not publicly available.

*Service quality standards and the results of the train operator's quality audits should be more transparent. In particular, the Department should develop scores, based on existing franchise terms and conditions. The targets and scores should be made publicly available and more intelligible for passengers. To strengthen scrutiny by passenger groups, Passenger Focus should commission and make public the results of periodic "mystery shopping" (see Glossary) surveys.*

## The approach to managing franchises

### Negotiating for extra capacity

**5** The Department plans to provide additional passenger capacity through investing public funds itself or through Network Rail. The Government's July 2007 plans provide for 1,300 additional train carriages. Investment is also planned, for example, in lengthening railway station platforms. Securing this investment involves commercial negotiations about the cost of the additional rolling stock to train operators compared to the extra revenue they generate. If the Department does not adjust the contract revenue target, train operating companies may enjoy a windfall of extra revenue.

*The Department should calculate the net incremental revenues that it expects the extra carriages to generate. It should then use this as a target in its commercial negotiations with train operators about contract revenues.*

**6** Adequate staffing is important given the strategic importance of rail franchising and the potential to reduce direct subsidies. The Department has difficulty in recruiting and retaining experienced and skilled staff particularly in its Rail Service Delivery Directorate. So there is a risk of insufficient capacity, or the wrong mix of skills, to operate effectively in future.

*The Department should staff the National Networks Group adequately and not rely unduly on agency staff. This may require flexible recruitment practices to attract and retain staff of the right calibre with railway industry knowledge and commercial skills.*

# Background

## The public and private bodies involved in rail franchising

i The **Department for Transport** (the Department) sets the overall framework and strategy for railways and provides public funding in England and Wales.[1] In Scotland, Transport Scotland has similar responsibilities. In Wales, the Welsh Assembly Government specifies, funds and manages the majority of the Arriva Trains Wales franchise. The Department took over these responsibilities from the Strategic Rail Authority (SRA) in October 2005, which was abolished by the Railways Act 2005. The Department's National Networks Group (NN Group) specifies, procures and oversees private Train Operating Companies' (TOCs) delivery of franchises. The Department has responsibility for 16 rail franchises in England and Wales but not for two rail concessions. The Merseyrail concession was awarded by Merseytravel PTE and the London Overground was specified and procured by Transport for London, which has rail responsibilities within London (Figure 1). In some cases the Department specifies and procures additional rolling stock, generally provided by rolling stock leasing companies and made available to TOCs.

ii **Network Rail**, a company limited by guarantee, owns and operates Britain's fixed rail infrastructure, including rail stations, which it mainly leases to train operators. It is responsible for the reliability of the network and leads on performance and industry planning. The Department provides grant funding and train operators pay Network Rail station access and track access charges.

iii The **Office of Rail Regulation** (ORR), is an independent statutory body led by a Board. ORR regulates Network Rail's stewardship of the network; secures compliance with relevant health and safety law; licenses operators of railway assets; and enforces competition law in the rail sector.

iv **Train Operating Companies** (TOCs) are special purpose companies, owned by one or more of eleven parent organisations (see Figure 1), which hold each rail franchise.

v **Rolling Stock Leasing Companies** (ROSCOs) own the majority of rolling stock that is then leased by the Train Operating Companies.

vi **Passenger Focus** is a statutory body funded by the Department to protect passengers' interests by ensuring that passengers' views are represented whenever decisions are taken that affect the rail network. It is responsible for the National Passenger Survey.

vii **Passenger Transport Executives** plan and develop public transport in six of England's major conurbations, receiving funding directly from the Department or indirectly via local Passenger Transport Authorities. They are consulted on franchise specifications.

## The place of passenger rail franchising within the rail industry structure

viii Rail privatisation in the early 1990s separated the operation of rail services into two broad elements. The first consisted of the national fixed rail network, i.e the tracks, signalling, tunnels, bridges, stations and depots. The second was train operations. Passenger and freight train operating companies run trains on the tracks though, in most cases, they do not actually own the trains but lease them instead from one of three rolling stock leasing companies.

ix Responsibility for maintenance and renewal of the rail network lies with Network Rail though most stations are leased to the principal train operating company using them.

x Rail franchises confer the right to run, subject to the ORR's approval of access to the network, passenger services for a specified period on a specified part of the network. Train companies bid for franchises on the basis of the quality of service they intend to offer and the amount of funding they require (subsidy) or the premium they would be prepared to pay to run these services. Passenger service provision generally requires a net subsidy from government. Train operators can generate more revenue through attracting more passengers, raising unregulated fares and other commercial income.

## The funding of passenger rail services

xi It is Government policy that passenger rail services are publicly specified, procured and, where necessary, funded, but are privately delivered by train operators.

xii In 2006-07, the passenger railway in England and Wales cost nearly £9 billion, with £4.8 billion funded from passenger revenues received by train operators, £0.8 billion from the Department's net subsidy support to train operators, £3.1 billion from Department grants to Network Rail (part of which meets train operators' track access charges), and £0.3 billion from Department grants to Passenger Transport Executives.

1 Some franchises also run services from England into Scotland.

# PART ONE
# The franchise competitions

**1.1** This part of the report examines the Department's objectives for rail franchising, the robustness of the specification and procurement processes, and the costs involved. Appendix 4 describes franchise letting in greater detail, including the bid evaluation process and our examination of the financial model provided with the winning bid for the South Western franchise.

## The context

**1.2** In the British rail industry[2], train operating companies (TOCs) provide passenger services but the condition of the track and investment plans are the responsibility of Network Rail. It is Government policy that passenger rail services are publicly specified, procured and, where necessary, funded, but are privately delivered by TOCs under franchise agreements. Franchises confer the right to run passenger services for a specified period – usually seven to ten years – on a specified part of the network. Train companies bid for franchises on the basis of the Department's specification, service quality and the amount of subsidy they require or the premium they would be prepared to pay to run these services.

## Objectives for franchising

**1.3** The Department's rail priorities are to control costs, live within the funding available and improve railway performance[i]. These priorities are reflected in the objectives the Department has set for the rail franchising process **(see Figure 3)**.

**1.4** In general, these objectives are reflected in the Department's objectives for individual franchises. The Department's 2007-08 Business Plan expanded on these earlier objectives and included delivering the PSA Target to improve rail performance and the punctuality and reliability of rail services. However, the Department's wider objective to improve the environmental performance of transport was not explicitly reflected in any of the objectives for individual franchises. It has nevertheless increasingly been taken into account in franchise awards. There were no explicit environmental

**3** The Department's wider transport and franchising objectives

| | |
|---|---|
| DfT wider transport objectives | ■ to improve the environmental performance of transport;<br>■ to enhance access to jobs, services and social networks, including for the most disadvantaged;<br>■ to sustain economic growth and improved productivity through reliable and efficient transport networks; and<br>■ to strengthen the safety and security of transport. |
| Rail Franchising Objectives (Stakeholder briefing documents and tender invitations) | ■ to maintain high standards of safety;<br>■ to improve operational performance and sustain a level of service quality consistent with meeting customer needs as they develop;<br>■ to deliver an efficient service within public expenditure constraints that represents value for money for passengers and taxpayers; and<br>■ to secure accountable, viable operators who are able to demonstrate a culture of excellence and continuous improvement and a vision for the future direction of the franchise. |

*Source: National Audit Office summary*

2 Arrangements in Northern Ireland differ and do not involve TOCs and Network Rail.

criteria against which bids were assessed on the South Western franchise awarded in Autumn 2006. But the four franchises (West and East Midlands, New Cross Country and Inter City East Coast) awarded between June and August 2007 all had environmental issues included within the assessment criteria.

## The Service Specifications

### Developing the service specifications

**1.5** Before inviting bids from companies interested in providing franchise services, the Department must first set out the services required for each franchise. It does so through a series of documents called service specifications.

**1.6** Service specifications are developed by the Department following wide consultation with stakeholders generally seeking improvements to passenger services. For example, as well as widely consulting with all possible stakeholders in the region covered by Stagecoach South West Trains, the Department held regular three-weekly tri-partite meetings with two major stakeholders, Network Rail and Transport for London. Most potential improvements are agreed only if they pass a cost benefit analysis, although some of the security and safety measures proposed may be adopted even if they show net costs. Additional services must also pass an assessment by Network Rail that they will not interfere unduly with other operations. It is also possible for Passenger Transport Executives, and other bodies such as County Councils, to choose to fund local services even if they fail the Department's cost benefit and affordability tests (see 1.10 overleaf).

**1.7** In setting service specification, there is always a balance between providing a clear statement of what is required, and leaving scope for bidders to innovate. In these eight franchises, there has been some industry criticism that the Department takes an overly prescriptive approach. Bidders are able to innovate within the constraints of the specification if no extra cost for the taxpayer is involved. In the South Western franchise, for example, the winning bidder proposed changing some rolling stock to carriages with more seats in each row as a response to the original service specification. This has increased the number of seats provided on some longer distance routes and created more standing room on suburban services.

### Consultation with stakeholders and local transport authorities

**1.8** The Department aims to be transparent in its approach to franchising.[3] It publishes key franchise documents on its website along with descriptions of the procurement process. In the past it has not, however, publicly released the Invitation To Tender (ITT) until the procurement process is completed although a detailed Stakeholder Briefing Document is released at the same time as the ITT. Passenger and staff representatives sometimes felt that they were left in the dark about the likely direction of some bidder responses, for example on fares.

**1.9** In deciding on the specifications for a franchise, the Department asks relevant local bodies to contribute their views on the Department's proposals.[ii] The feedback helps the Department decide whether to alter the level of service provision within the service specification. Alternatively, the Department could include service level changes as possible options to be purchased in the ITT. (See text box at **Figure 4** as an example of how consultation can affect services purchased.)

**4** Example of how local consultation can influence the rail services to be purchased: the South Western franchise

The Department's initial analysis of the cost of services between Salisbury and Bristol questioned their value for money. The business case for the franchise award in May 2006 showed that costs far outweighed the benefits on services running between Bristol and Waterloo via Salisbury.

The Department had therefore publicly proposed to remove these services from the base case specification. Following the public consultation in late 2005 and early 2006, there was local opposition to this proposal. As a result, the Department decided to still exclude services running between Bristol and Waterloo via Salisbury from the base case specification but to include these services as a priced option in the ITT issued in March 2006.

On receipt and analysis of bids, it was apparent that the winning bidder considered this priced option to be viable. Its bid gave a positive net present value of £3.2 million for operating the Bristol to Waterloo trains via Salisbury. Following consultation, the Department accepted the bidder's ability to operate the services between Bristol and Waterloo via Salisbury and so the service has been continued under the new franchise.

*Source: National Audit Office summary*

3 The Department's approach was set out in the July 2006 publication *Rail Franchise Replacement Process Manual*.

**1.10** Where these options have a direct relevance to the appropriate local PTE, then the PTE can purchase the option, if necessary by providing a subsidy, once the preferred bidder is selected. The July 2004 White Paper provided the ability for the relevant authorities to vary service specification or fares provided they bear the cost.[iii] However, such options do not form part of the Department's evaluation of bids which may reduce the incentive for bidders to put in competitively priced options. In our interviews with the train operating companies, we were given a range of descriptions of the approaches taken when putting together proposals for options. Most companies admitted that they do not put as much effort into working up options as they do on meeting the base level specification. Only one company explicitly said they put as much effort into scoping and pricing options as they do on the base level specification.

**1.11** Since the Railways Act 2005, PTEs have not been co-signatories to a franchise containing routes that overlap with transport services that they provide locally. In these cases, the PTEs play no role in the assessment of bids. The Department therefore runs the risk that local knowledge is overlooked.

## Competition in Passenger Rail Franchising

**1.12** The Department has generated keen competition in bidding for passenger rail franchises, though the competitions have been dominated by established UK rail companies.

**1.13** The Department regards three to five bidders as the optimum number to provide adequate competition[iv] and has generally been successful in achieving this level of interest. Seven out of eight competitions attracted three or more bidders **(see Figure 5)**. Only the West Midlands franchise did not. Although the Department pre-qualified three bidders, it attracted only two final bids. MTR Corporation of Hong Kong dropped out after deciding to concentrate on bidding for a rail concession from Transport for London which they won.

**5** Details of Franchise Competitions

| Franchise | Franchise Winner | Previous train operator(s) | Number of bids submitted |
|---|---|---|---|
| Integrated Kent Franchise (April 2006) | Govia Ltd | South Eastern Trains, a subsidiary of the SRA. (Prior to this it had been run by Connex) | 4 |
| Thameslink/Great Northern (April 2006) | FirstGroup plc | Govia (Thameslink)<br>National Express Group plc (Great Northern/WAGN) | 5 |
| Greater Western (April 2006) | FirstGroup plc | FirstGroup (Great Western and Great Western Link)<br>National Express Group plc (Wessex) | 3 |
| South Western (February 2007) | Stagecoach Group plc | Stagecoach (South West Trains)<br>Stagecoach (Island Lines) | 4 |
| East Midlands (November 2007) | Stagecoach Midland Rail Ltd | National Express Group (Central)<br>National Express (Midland Mainline) | 4 |
| West Midlands (November 2007) | Govia Ltd (London and Birmingham Railway Ltd) | National Express Group (Silverlink)<br>National Express Group (Central) | 2 (a third company was prequalified but declined to bid) |
| New Cross Country (November 2007) | Arriva plc | Virgin Cross Country<br>National Express Group (Central) | 4 |
| Inter City East Coast (December 2007) | NXEC Trains Ltd (National Express Group plc) | GNER | 4 |

*Source: Department for Transport*

**1.14** All the successful bidders in the franchise competitions let by the Department were established UK rail companies. There was limited interest from some overseas based companies, including MTR Corporation of Hong Kong and Danish State Railways, but none were successful in winning a franchise let by the Department. NedRailways (with Serco) has previously been successful in winning the Northern and Keolis[4] (with FirstGroup) the TransPennine franchises. In 2008, Deutsche Bahn acquired Laing Rail, operator of Chiltern Railways and 50 per cent owner of the operator of the London Overground concession. The Department has told us that it intends to solicit more interest from overseas based transport companies in its marketing of future franchise competitions.

**1.15** Only two franchises were awarded to incumbents (see Figure 5).[5] This suggests that the procurement process did not advantage past incumbents.

## Costs of franchise specification and procurement

**1.16** We looked at two aspects of the costs of the franchise process: the direct procurement costs incurred by the Department, and the costs incurred by bidders.

**1.17** The Department's costs are lower than those of its predecessor **(Figure 6)**. The level of franchise activity varies from year to year, and some are more complex than others, making comparisons difficult.[6] **Figure 7 overleaf** shows the total external costs (on advisers and other bought-in items) for each franchise. The Department does not record staff costs for each individual franchise process.

**1.18** We were unable to gather reliable data on the direct costs to bidders of the franchising process. As an alternative, we interviewed train operating companies, examined their public statements on costs, and reviewed the length of bidding documents as a proxy for direct costs of bidding.

**6** Total specification and procurement costs since 2003-04 (£'000)

| | 2003-04 SRA | 2004-05 SRA | 2005-06 (part) SRA | 2005-06 (part) DfT | Total 2005-06 SRA + DfT | 2006-07 DfT | 2007-08 DfT |
|---|---|---|---|---|---|---|---|
| Specification | | | | | | | |
| Internal (Staff + Admin) | N/A | 505 | 247 | 898 | 1,145 | 1,493 | 1,632 |
| External | N/A | 3,229 | -6 | 3,390 | 3,384 | 1,641 | 584 |
| **Total Specification** | N/A | **3,734** | **241** | **4,288** | **4,529** | **3,133** | **2,216** |
| Procurement | | | | | | | |
| Internal (Staff + Admin) | 1,004 | 1,632 | 986 | 490 | 1,476 | 928 | 1,325 |
| External | 21,011 | 10,587 | 3,233 | 5,080 | 8,313 | 6,227 | 3,512 |
| **Total Procurement** | **22,015** | **12,219** | **4,219** | **5,570** | **9,789** | **7,155** | **4,837** |
| **Total Specification + Procurement** | **22,015** | **15,953** | **4,460** | **9,858** | **14,318** | **10,289** | **7,054** |

*Source: Department for Transport*

NOTE

Internal costs consist of the Department's (and previously the SRA's) staffing and associated administrative costs. External costs are invoiced costs, including advisers' costs. N/A: Costs for specifying franchises were included in procurement costs in 2003-04.

4 Keolis also holds a 35 per cent stake in Govia Ltd.
5 Included amongst these two is the Greater Western Franchise, an amalgamation of three previous franchises. The winner, FirstGroup, was the previous incumbent on two of these franchises.
6 Four franchises were awarded in 03-04, two in 04-05, four in 05-06, one in 06-07 and four in 07-08.

**1.19** Some train operating companies said that bidding costs for franchises are too high, querying the amount of detail required, the quality and availability of accurate data, and the expense involved.[v] In its evidence before the House of Commons Transport Select Committee in 2006, the Association of Train Operating Companies estimated that it cost each bidder between £3 million and £5 million to bid for a franchise.[vi] If this estimate is accurate, and assuming four bidders for a franchise, then bidding costs would represent about three per cent of the average annual running cost of a franchise (£505 million based on the first year running costs of the eight franchises examined). Over a typical franchise life, this amounts to less than half of one per cent of total running costs.

**1.20** The Department is seeking to reduce the administrative burden of bidding. For example, for the South Western franchise, it had specified a limit of 3,500 pages to bid submissions but has since decided that future bids should be restricted to between 1,000 to 1,500 pages. Train operators have told us that this change is unlikely to reduce the costs that they incur although DfT costs will reduce.

**7** External specification and procurement costs by franchise (£000)

| Summary Project Costs | Specification | Procurement | Total |
|---|---|---|---|
| Inter City East Coast (let by the SRA to GNER) | N/A | 2,362 | 2,362 |
| Integrated Kent Franchise (incl. Depots and Rolling Stock)[1] | 261[2] | 10,699 | 10,960 |
| Thameslink/Great Northern | 826[2] | 2,122 | 2,948 |
| Greater Western | 593[2] | 2,181 | 2,774 |
| South Western | 999 | 1,278 | 2,277 |
| Central Trains Remapping Project (for 3 Midlands franchises) | 2,093 | N/A | 2,093 |
| West Midlands | 656 | 1,886 | 2,542 |
| East Midlands | 541 | 1,610 | 2,151 |
| New Cross Country | 689 | 1,991 | 2,680 |
| Inter City East Coast (let to National Express) | 212 | 1,047 | 1,259 |

*Source: Department for Transport*

NOTES

1 The figures for the Integrated Kent Franchise are large because expenditure on infrastructure and rolling stock projects in the Kent area, which includes a new high speed domestic service, were included in the relevant cost centre in the SRA accounts, but are non-standard costs in franchise procurement.

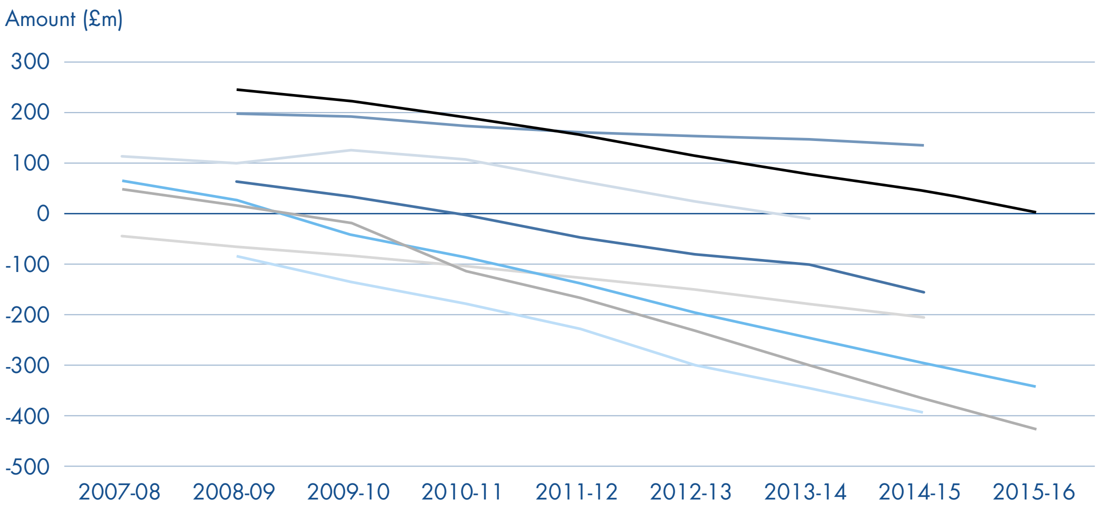
2 Specification costs incurred by the SRA.

# PART TWO

# The financial impact of franchises on taxpayers

**2.1** This Part looks at how the Department's approach to letting franchises reduces the amount of subsidy that will be payable by the taxpayer for new franchises. Direct subsidy is paid to train operators and a grant is also paid to Network Rail and provided to support new investment programmes.

**8** Planned payment trend for eight franchises (negative amounts are premia)




| | 2007-08 £ | 2008-09 £ | 2009-10 £ | 2010-11 £ | 2011-12 £ | 2012-13 £ | 2013-14 £ | 2014-15 £ | 2015-16 £ |
|---|---|---|---|---|---|---|---|---|---|
| Southeastern | 114 | 100 | 126 | 108 | 65 | 25 | –9 | | |
| Stagecoach South West Trains | 64 | 25 | –41 | –86 | –140 | –198 | –248 | –£296 | –343 |
| First Great Western | 47 | 15 | –20 | –111 | –168 | –233 | –302 | –£364 | –428 |
| First Capital Connect | –44 | –65 | –83 | –103 | –126 | –150 | –178 | –£205 | |
| East Midlands Trains | | 64 | 34 | –2 | –46 | –80 | –100 | –£155 | |
| London Midland | | 198 | 193 | 174 | 162 | 154 | 148 | £136 | |
| CrossCountry | | 245 | 222 | 190 | 156 | 114 | 78 | £44 | 6 |
| NX East Coast | | –85 | –133 | –179 | –229 | –301 | –346 | –£395 | |

*Source: Department for Transport*

NOTE

Subsidies for the franchises or predecessor franchises in 2006-07 total £811million. The data shows planned payment values at contract signature date. All amounts in real terms for the base year and month shown for each franchise: Southeastern – February 2005; Stagecoach South West Trains – January 2006; First Great Western – October 2005; First Capital Connect – October 2005; East Midlands – January 2007; London Midland – January 2007; CrossCountry – February 2007; NX East Coast – January 2007.

## Falling direct subsidies to franchises

**2.2** For the eight franchises let since 2005 the Department expects to move from paying £811 million in direct subsidy in 2006-07 to receiving £326 million premia payments in 2011-12 (see totals in Figure 10 following paragraph 2.13). These savings, together with other reductions in network costs, enabled the Government to propose increased investment over the next five years.[vii] The actual contract subsidy/premia levels will depend on the outcome of the next regulatory review by ORR. The projected figures shown here assume that track access charges (see Glossary) remain at the levels set for the current regulatory period ending on 31 March 2009. By 2011-12, only three franchises are predicted to need direct subsidies.

## Reasons for the decline in subsidy

### Growing passenger demand is the main driver of predicted revenue growth

**2.3** The main driver of predicted revenue growth is increased passenger numbers. In the case of South Western, our analysis suggests that more than three quarters of the revenue growth predicted is related to volume growth. The balance comes from a variety of other sources including allowed ticket price changes (see paragraph 3.10), reduced fare evasion, electronic ticketing, station and car parking facilities.

**2.4** Rail passenger volumes are already showing strong growth rates. Journeys grew around 7½ per cent in 2006-07, with revenue up by 12 per cent as a result.[viii] Recently-let franchises that are already operating reflect this acceleration, with growth ranging from 11 per cent (the lowest rate in a franchise) to 14 per cent (the highest rate in a franchise) for the first year. Growth rises in aggregate to 47 per cent (the lowest overall level in a franchise) to 62 per cent (highest overall level in a franchise) after five years, but it is difficult to identify how far capacity constraints, resulting in overcrowded services, may reduce some of this growth because franchise financial models do not treat crowding consistently.

**2.5** The Department forecasts that total revenue for all train operating companies will rise from £5,000 million in 2007-08 to £7,440 million in 2013-14 (in 2006-07 prices) across all franchises. Train Operating Companies project higher growth, but if the volume growth in their bids does not materialise, the lower assessment in the Department's forecasts still shows subsidy reductions of about one third.

**2.6** Continuing economic growth is an important variable in these revenue projections. For example, in one bid we examined, the expected impact of continued GDP growth was £830 million (net present value). Nevertheless, the direct impact on franchise revenue in any one year is limited. For example, if the assumed rate of GDP growth is halved, the effect on a single year is limited to two per cent of revenue.

### The Department's approach encourages bidders to maximise their predicted revenue receipts

**2.7** During the franchise letting process, bids must first demonstrate that they are deliverable (see Appendix 4). Thereafter, the key differentiator between bids is the lowest subsidy or highest premium. Prospective bidders therefore are incentivised to put forward proposals for maximising revenue from factors that they control (termed endogenous factors). Such factors include: ticket sales & marketing; changes in ticket prices; prevention of ticketless travel; train performance and timetable reliability; and refurbishment of rolling stock.

**2.8** Train operating companies also encourage travellers to spread their usage of available train capacity (see paragraph 3.12). One immediate impact has been sizeable unregulated fare increases in some franchises. For example, there was no forewarning to passengers of 20 per cent increases on some fares in the South Western franchise when it was awarded. These increases applied to passengers travelling just after the peak fare period, in the period now known as the "shoulder peak", partly offset by very low pre-booked fares at the least popular train times. But transparency for passengers has improved with subsequent announcements of franchise awards.

### The Department takes a sensible approach to assessing the realism of the revenue implications of bids

**2.9** The Department makes adjustments to bids as part of the evaluation process to reflect a cautious view of potential receipts. To ensure a fair comparison between bids, revenue assumptions relating to factors outside the control of bidders (termed exogenous factors) are automatically adjusted to reflect the Department's own assumptions. These factors include: growth in GDP per capita; growth in employment; demographic change; and changes in car ownership.

## The Department's approach to sharing revenue risk

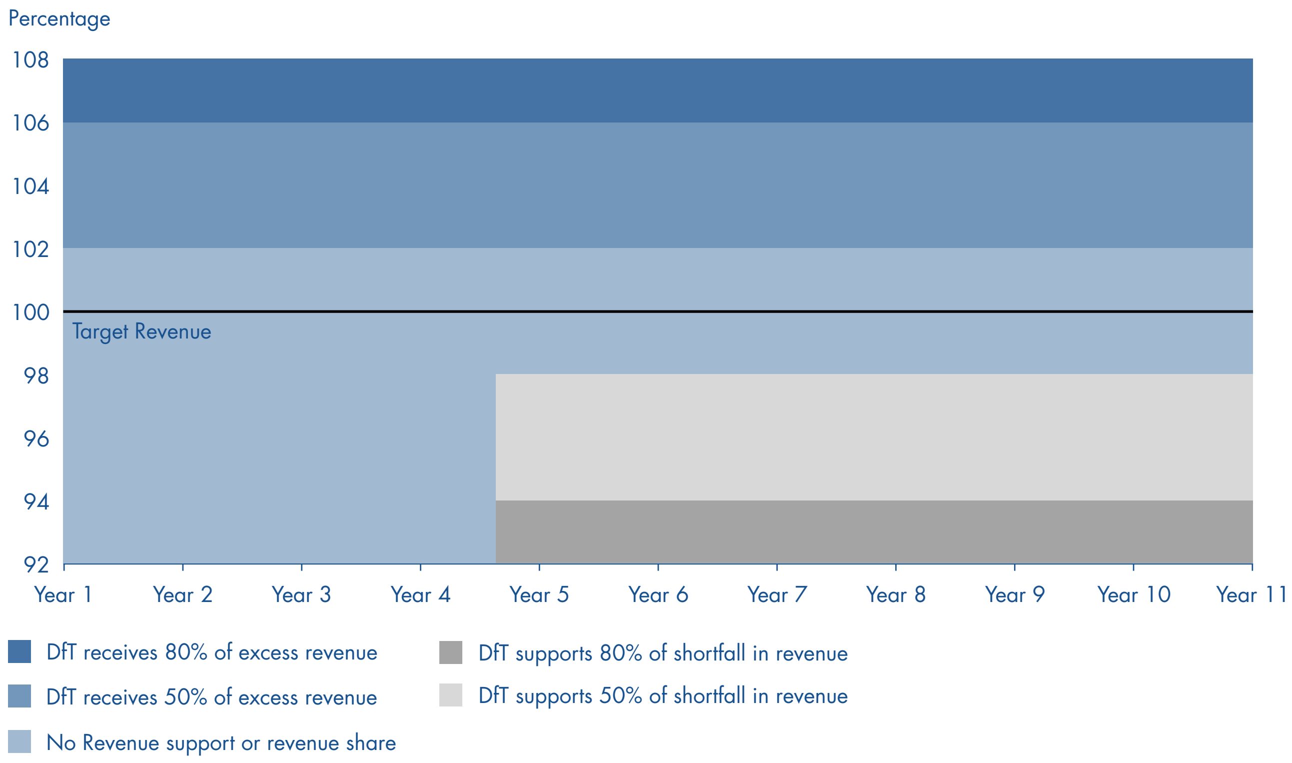
**2.10** The franchises include a risk sharing mechanism on train operating company revenue receipts.[ix] Under the franchise agreements the Department has rights to a share of revenue above 102 per cent of the target revenue stated in the contract. On the downside the Department accepts the risk of force majeure events (for example, terrorist acts) and, after the first four years of each franchise, shares in the shortfall if actual revenue falls below 98 per cent of target revenue **(Figure 9)**. The risk sharing mechanism does not expose the taxpayer to revenue shortfall in the first four years, but thereafter shortfalls in revenue are shared between public and private sectors.

**2.11** Figure 11 (on page 20) shows that five out of the eight franchises can expect increased passenger carrying capacity under the Department's future investment plans (see paragraph 3.5). The standard clauses in rail franchise agreements[x] give the Department contractual rights to seek value for money from any franchise amendments that have to be negotiated mid-term. These changes may involve agreeing a higher level of target revenue to reflect the higher capacity and help avoid windfall gains for train operators.

## The need for continued taxpayer funding of rail provision

**2.12** The projected fall in direct subsidy over the period does not mean that passenger fares will cover the full costs of the rail service available. Every five years, the Office of Rail Regulation undertakes a review of charges that train operators should pay for using the rail network (the track access charges). Since the June 2003 Access Charge Review, train operators no longer pay Network Rail the full amount needed to renew and maintain the network. The Department has elected to pay part of the subsidy, related to capital spending, directly to Network Rail. The change enables network renewal and enhancement spending to be shown as investment. This removes a previous distortion from the Department's accounts because under the previous arrangements no part of subsidies to train operating companies could be categorised as investment. **Figure 10 overleaf** illustrates what franchise subsidies would have been in 2006-07 if train operators had been required to pay Network Rail in full.

**9** Revenue share/support arrangements during franchise term




*Source: Department for Transport*

**2.13** Figure 10 shows that taxpayer support for train services in the eight franchise areas was around £2 billion in 2006-07 once £1.25 billion of grants to Network Rail are included. The Department's support for Network Rail for 2011-12 has not yet been determined and so a figure for total taxpayer support for the eight franchises in 2011-12 is not available. For the purposes of calculation, we have assumed that the Department's support for Network Rail remains constant at £1.25 billion. This would imply government support of £926 million for

**10** Franchise related subsidies adjusted for those given via Network Rail

| Franchise | Direct subsidy or (premium) in 2006-07 £ million actual | Illustrative total subsidy (£m) if train operators were to pay Network Rail in full in 2006-07 | Direct subsidy or (premium), per franchise contracts, in 2011-12 £ million |
|---|---|---|---|
| South Western | 123 | 298 | (140) |
| Integrated Kent Franchise | 145 | 307 | 65 |
| Thameslink/Great Northern | (14) | 96 | (126) |
| Greater Western | 97 | 337 | (168) |
| East Midlands | 30 | 79 | (46) |
| West Midlands | 212 | 350 | 162 |
| New Cross Country | 231 | 437 | 156 |
| InterCity East Coast | (13) | 159 | (229) |
| Total | 811 | 2,063 | (326) |

*Source: Office of Rail Regulation National Rail Review Q2 2007-08, p.10. (Table3) and National Audit Office analysis*

NOTES

1 The 2006-2007 data shown is for the most directly comparable previous franchise, specifically: Midland Mainline (East Midlands); Central Trains (West Midlands) and the Cross Country franchise (New Cross Country).

2 The saving in subsidy shown does not take into account the Department's investment plans published in July 2007.

# PART THREE The impact of franchises on passengers

**3.1** This Part considers what passengers can expect in terms of capacity, service quality and fare increases and what the initial passenger satisfaction ratings show.

## Overcrowding

**3.2** Growth in the number of passenger journeys has resulted in an increasing problem of overcrowding. The eight new franchises let since 2005 face severe capacity pressures on a number of routes, with increasing levels of crowding on peak commuter services notably to London, the principal destination for six of these franchises. On average in 2003, for example, morning and evening peak passengers being carried to and from London were at 2.7 per cent in excess of the planned capacity of the services(PiXC – see Glossary). In 2006 this average had increased to 3.5 per cent and the morning peak had reached 4.8 per cent in excess of the planned capacity.[7]

**3.3** Rail passenger journeys have increased by about 27 per cent since 2003.[xi] In re-letting franchises the Department generally required bidders to provide for expected growth. In addition, on any route, bidders should provide no less passenger carrying capacity than that provided at the end of the previous franchise. In re-letting the West Midlands franchise in 2007, the Department substituted a national standard for the previous regional standard on acceptable loading of passengers on trains. CENTRO, the Passenger Transport Executive for the West Midlands, told us that in effect the definition of full standing capacity had been raised from 110 per cent of seating to 130 per cent. This means that 191 people standing on a 148 seat train would be the maximum for planning purposes, compared to 163 people under the previous standard. The PTE voiced concern that overcrowding might influence potential train travellers towards car usage instead. In most franchises the national standard already applied.

**3.4** In addressing the issue of crowding, the Department seeks to improve the efficiency with which rolling stock is used. It requires franchise bidders to set out how they plan to reconcile available rolling stock with passenger demand to minimise overcrowding. Newly appointed train operators therefore must deliver on commitments to increase passenger carrying capacity (see Appendix 5). The train operators are seeking to achieve this through:

- **Better use of rolling stock and additional rolling stock when available:** this includes varying train formations and frequency of stops at stations to maximise capacity and altering interior layout so there is more seating and standing room. Greater use of load weighing equipment measuring the number of passengers on a carriage should enable train operating companies to understand passenger flows and make better use of rolling stock;
- **Managing passenger demand, particularly morning and evening peaks:** on long distance services this includes using airline-type pricing techniques, so that unregulated ticket prices for a given long distance journey are more closely related to the demand for that specific time.

There are also requirements to add further car and cycle parking at stations.

**3.5** In addition, the July 2007 White Paper included a High Level Output Statement which set out the Department's desired improvements in rail capacity and a statement of the funds available. These plans seek additional carriages and physical infrastructure, such as lengthening platforms and remodelling junctions, so that franchises can operate longer trains. Taken together the plans would increase rail capacity by more than 20 per cent by 2014. **Figure 11 overleaf** shows the total planned increase in fleet capacity after the 1,300 additional rail carriages have been brought into service.

7 National Rail Trends annual report for 2005-06. Five out of nine train operators into London had exceeded the Department's 'acceptable levels' of passengers in excess of capacity of 4.5 per cent in one peak and 3 per cent across both peaks.

**3.6** Train operators decide how to make best use of additional stock. They are likely to use the rolling stock to increase provision at those main city stations that suffer from crowding. Five franchises plan an immediate increase in peak passenger carrying capacity that meets or exceeds the Department's estimate of growth in peak demand 2008-09 to 2013-14. First Capital Connect will also provide peak capacity in excess of forecast demand through the Thameslink project, as will London Midland through the Department's rolling stock plan. The East Midlands franchise plans a nine per cent initial increase in peak capacity.

## Improvement in passenger services

**3.7** The Department has sought to build on existing service levels. It has negotiated commitments from train operators to deliver improvements in train service performance, service quality, passenger security, accessibility and ticketing and compensation arrangements. The franchise agreements set measurable standards and targets to achieve, for example, half of one per cent year-by-year improvements in service quality on a baseline measured in the handover period. There are also commitments by the train operators to make specific investments in station and added rolling stock – mainly through refurbishment (see Appendix 5). Delivery of some investment obligations depends on other bodies. For example, the installation on time of ticket gates at Waterloo Station depends on Network Rail, and the interface with "smart cards" depends, in part, on Transport for London. If these parties perform, Stagecoach South West Trains will also be able to meet its commitments. The Department sets out to help manage these risks through liaison with the third party responsible.

**3.8** The Department has set various contractual benchmarks for step-by-step improvements in train service performance, in terms of delay minutes caused by the train operator (see Glossary), cancelled trains and 'short-formed' services. These are services which operate with fewer than the scheduled number of carriages or seats. Not all franchises include such a benchmark – for example, it does not apply to the First Great Western franchise. The agreed targets vary from franchise to franchise, as shown in the table opposite **(Figure 12)** summarising delay minute targets.

**3.9** The Department is taking other steps to improve standards building on the approach introduced in 2004 by the SRA for the Greater Anglia and Northern franchises:

**11** Increased fleet capacity based on passenger rail carriages

| Train Operating Company | Franchise term (including extension periods) | Initial increase contracted under franchises (per cent) | Increase during franchise through the DfT Rolling Stock Plan[2] and Thameslink Programme[3] (per cent) | Total planned increase in capacity (per cent) |
|---|---|---|---|---|
| Southeastern | 2006-14 | 11 | 7 | 18 |
| First Capital Connect | 2006-15 | 9 | 62 | 71 |
| First Great Western | 2006-16 | 6 | 11 | 16 |
| South Western | 2007-17 | 3 | 8 | 11 |
| East Midlands[1] | 2007-15 | 5 | 1 | 6 |
| London Midland | 2007-15 | (1) | 22 | 21 |
| Cross Country | 2007-16 | 23 | 4 | 27 |
| NX East Coast[4] | 2007-15 | 11 | 0 | 11 |
| **All 8 franchises** | | **7** | **15** | **22** |

*Source: National Audit Office analysis of Department for Transport data*

NOTES

1 The initial increase in capacity (third column) includes the refranchising and subsequent changes made to franchise agreements up to April 2008. East Midlands data is based on seating only (excluding catering vehicles) and no standing allowance has been factored in.

2 The January 2008 Rolling Stock Plan (updated July 2008) set out how to deliver the capacity increase outlined in the White Paper *Delivering the Sustainable Railway*.

3 First Capital Connect (column 4) is the main participant in the Thameslink programme which envisages "more than 50 per cent increase in capacity" to be delivered by 2015.

4 The increased NX East Coast capacity is for additional long distance services outside peak commuting times.

- **Station security:** The NAO report *Maintaining and improving Britain's railway stations*[xii] recommended that the Department encourage more train operators to participate in the secure stations scheme, which specifies high standards for crime management. For South Western, the Department has required the train operator to achieve secure station accreditation for stations handling 80 per cent of passenger volume by 2010 and purchased a priced option to extend this to 95 per cent by March 2013. There are similar commitments for the other new franchises as well as commitments for increased investment in CCTV on trains and in stations and for travel safe officers.
- **Disabled access:** Each of the new franchises includes a £250,000 per annum budget for the franchisee to carry out minor improvements such as additional seating and signs at stations. In April 2006, the Department for Transport announced a 'Railways for All' strategy to improve the accessibility of rail travel in Great Britain. In addition it includes a £370 million 'Access for All' fund to be spent, over a 10 year period, on Network Rail delivering targeted access improvements to hundreds of stations, including making some stations step-free.
- **Ticketing:** Recent franchise agreements include obligations to introduce "smart card" ticketing by specified dates (see Appendix 5) over the next seven years.
- **Recompense:** For the franchises awarded in 2007, the Department introduced new, and more generous, 'Delay/Repay' arrangements to compensate passengers for delays in their rail services. Under these, passengers will receive a 50 per cent single refund for delays of 30 to 59 minutes, a 100 per cent single refund for delays of 60 to 119 minutes, and a 100 per cent return refund for delays of 120 minutes or more. Additionally, season ticket holders will be compensated for delays to journeys they have actually taken, not on the basis of overall performance. Passenger Focus generally supports these new arrangements.

**12** Shows the variation in train operator delay minute targets

| Train operating company | Target reduction (per cent – rounded) | Target period for delivery |
|---|---|---|
| NX East Coast | 29 | 7 years |
| CrossCountry | 25 | 8 years |
| Southeastern | 14 | 4 years |
| First Great Western | 13 | 6 years |
| Stagecoach South West Trains | 10 | 8 years |
| First Capital Connect | 4 | 9 years |

*Source: National Audit Office summary*

## Rising prices, particularly on unregulated fares

**3.10** Most passengers can expect to pay higher regulated and unregulated fares in the future. Nearly all fares regulated by the Department for Transport, which account for 43 per cent of revenues, increase on average at the rate of one percentage point above the retail price index (RPI). This rate is applied to a basket of fares on a weighted average basis so that individual fares within the basket can increase by up to five per cent more or less than the average. In the case of Southeastern's franchise, however, regulated fares will increase annually by three percentage points above RPI for five years to reflect investment in the network.

**3.11** Train operators are free to set unregulated fares which relate to about 40 per cent of passenger journeys. **Figure 13 overleaf** shows unaudited figures for the average unregulated (and regulated) fare increases in January 2008, as published by the Association of Train Operating Companies (ATOC) for the eight franchises. Not all unregulated fares have increased: some train operators make low priced fares available for advance purchase on special terms.

**3.12** Greater use by train operators of yield management techniques has resulted in some significant restrictions on use and price variations within travelling categories under these new franchises. For example, to manage peak demand, First Capital Connect in June 2006 imposed restrictions on the ticket categories allowed to return during the early evening peak and, in May 2007, Stagecoach South West Trains increased by 20 per cent the fares paid by passengers travelling to London after the morning peak but arriving before 11am.[8] Such measures seek to incentivise travel outside the peak and increasingly crowded shoulder peak periods and thereby spread demand over a wider travel period. Some passengers, however, may elect to move, following the price rise, from the shoulder peak into the peak period. The Government has also worked with the Association of Train Operating Companies to introduce a simplified fares structure – Anytime, Off-Peak, Super Off-Peak and Advance – to replace the former complex ticket offer. In urban areas simplification will take the form of zonal pricing.

8 Examples of increases, which were first announced in March, include a cheap day return from Alton, in Hampshire, to London rising from £15.80 to £19 – a 20 per cent increase. A Bournemouth to London cheap day return will go up from £36.40 to £43.70 – a 20 per cent rise.

## Passenger satisfaction ratings

**3.13** The National Passenger Survey is based on a sample of between 25,000 and 30,000 self completed questionnaires. Scores tend to fall in the spring because of train performance problems in winter and following annual price rises. Taking this into account, **Figures 14 and 15** show trends on recently let franchises that are already in service, albeit at an early stage in the franchise lifetime. All four, like other London and South East commuter franchises, historically score below the national average on ticket value for money. Three of the four score below the national average for overall journey experience, with only Stagecoach South West Trains exceeding the national average on this score.

**13** Table of fares rises by TOC in January 2008

| Train Company | Average Regulated Fares Rise (year on year) (per cent) | Average Unregulated Fares Rise (January) (per cent) |
|---|---|---|
| CrossCountry[1] | 4.8 | 7.0 |
| East Midlands Trains | 4.8 | 7.0 |
| First Capital Connect | 4.8 | 4.8 |
| First Great Western | 4.8 | 6.1 |
| GNER (for NX East Coast) | 4.8 | 6.6 |
| London Midland[2] | 4.8 | 4.8 |
| Southeastern | 6.8 | 4.8 |
| Stagecoach South West Trains | 4.8 | 4.3 |

*Source: ATOC*

NOTES

1 CrossCountry: No increase in Advance Purchase fares.

2 London Midland: Some cheap day returns increase by 3.8 per cent.

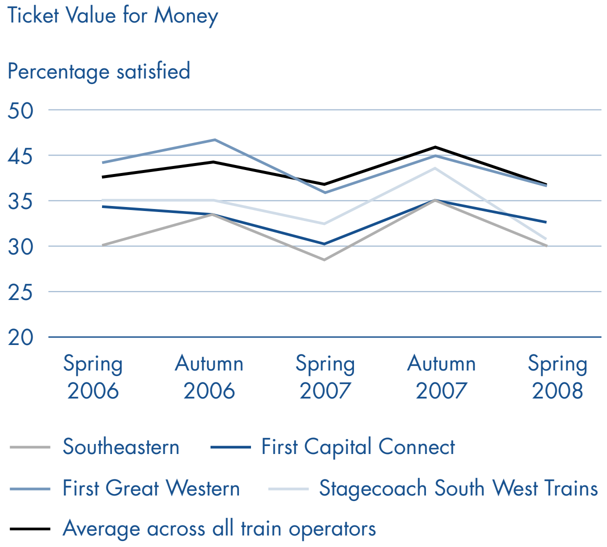
3 Until 2003 regulated fares increased yearly at the rate of one percentage point below RPI. The July 2007 RPI figure was 3.8 per cent and the January increase is based on the previous July's RPI value plus one per cent.

4 Details of which fares constitute regulated fares are contained in the Glossary.

5 Overall percentage of revenues from regulated fares are shown as reported by the Association of Train Operating Companies in January 2008.

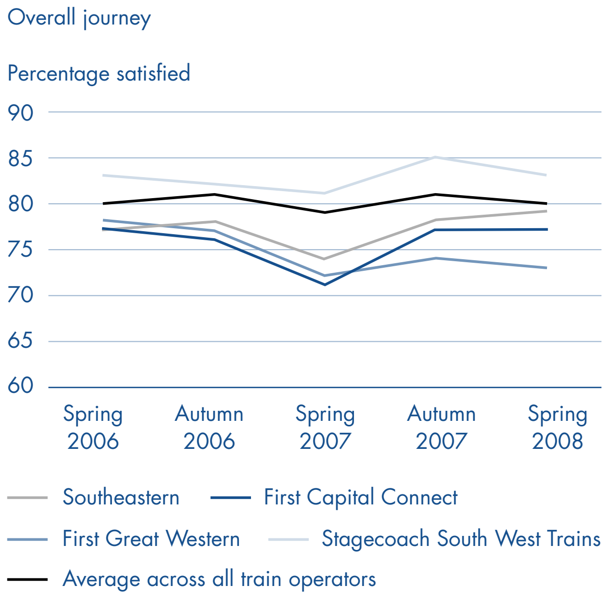
**3.14** In Spring 2008, First Great Western (FGW), at 73 per cent, was furthest below the national average of 80 per cent for overall journey satisfaction. Passengers on some FGW routes had not received the expected level of service and the case shows both the extent of problems experienced by passengers and the corrective action taken by the Department and the train operator. (See case example at **Figure 16**.)

**14** National Passenger Survey trend in ticket value




*Source: Passenger Focus*

**15** National Passenger Survey trend journey satisfaction




*Source: Passenger Focus*

## 16 Case Example – First Great Western

The FGW long distance franchise was awarded to FirstGroup plc in December 2005 and is due to run for ten years from April 2006.

**Why problems arose**

FirstGroup, then the incumbent operator for the Great Western part of the merged franchise, put in an aggressive and innovative bid. This involved trying to undertake three major changes: timetable change; rolling stock changes; and moving the train service depot from Cardiff to Bristol – accepting the risk that a new depot would not be open in time.

**Timetable and rolling stock change**

The new franchise planned changes in the train timetables in December 2006, with 28 rolling stock vehicles being given up early in the period to December 2007 although introducing refurbished high speed rolling stock with additional seats increased fleet capacity by six per cent overall. Passenger Focus warned the Department in Spring 2006 that the December 2006 timetable would lead to "an inability to meet existing demand". The capacity proposals had been accepted by the SRA, and then by the Department, as being sufficient to meet the required level of service.

- there is increased peak capacity for London – Reading services (see Appendix 5)
- there were reductions in little used Wessex Trains services (some were reinstated).

**Depot change**

The new franchise was based around moving maintenance of the Diesel Multiple Unit (DMU) fleet from Cardiff to Bristol, to secure financial savings and improve reliability. Delivery of the new depot was scheduled before the December 2006 timetable change, but ran late and the depot constructor went into receivership. There was a build up of rolling stock awaiting repair and in early 2007 FGW's operational fleet was too stretched to meet demand.

**Corrective action and lessons learned**

The DMU depot change was a risk allocated to and assumed by FGW, which they now recognise they could have managed better with contingency planning. When the resulting problems materialised, FGW voluntarily provided additional services (June 2006) and entered into a 40 point recovery plan (March 2007), including hiring and deploying extra rolling stock units, and bore the increased depot building and constructor costs. They also worked with the Department to improve on the December 2006 timetable. Overall, FirstGroup's changes to the franchise agreement contributed a net present value of £23 million, some of which may be recovered from revenue growth. A lesson for the Department is to increase the rigour in the assessment of the deliverability of major franchise changes.

**Prospects for service recovery**

Although revenue held up, punctuality performance by Wessex Trains declined and, in respect of train cancellations, FGW has been in breach of its franchise commitments (notice issued on 26 February 2008) and now has to comply with a Remedial Plan which increases standby arrangements such as holding trains in reserve. This should improve reliability, although Passenger Focus expects capacity may come under renewed pressure after three to five years depending on passenger growth rates. FGW also agreed to provide supplementary carriages, accelerated train refurbishment and improved fare offers as a package of passenger benefits.

*Source: National Audit Office Summary*

# PART FOUR

# Managing Rail Franchises

**4.1** This Part of the report examines the Department's arrangements for identifying and managing risks, including the failure of a train operator.

## The Department's risk analysis

**4.2** In specifying, procuring and then managing franchises, the Department considers risks and ways to mitigate these at each stage. In Appendix 3 we have identified the key risks to value for money within the franchising process and the mitigants. We conclude, on balance, that the arrangements are robust.

## The Department's franchise management

**4.3** The Department builds on arrangements introduced in 2004 by the SRA to ensure that each train operator delivers its contractual obligations. These include: committed investment obligations (see paragraph 3.6 and Appendix 5); agreed performance improvements (paragraph 3.8); and agreed service quality (paragraph 3.7). The Department follows a risk-based approach on:

i **committed investment obligations:** The Department requires train operators to 'self certify' that lower risk obligations have been delivered and, for those judged to have a higher risk, provide supporting evidence of delivery, for example photographs, purchase orders or invoices. In some cases, if a commitment is delivered late or not in full, the train operator must deliver the commitment and may need to make a payment to the Department.

ii **performance improvements:** The train operator reports each month on its performance. If it falls short of contractual benchmark, it must develop, agree with the Department, and then implement a 'remedial plan' to get back on course. Non compliance may lead to an enforcement order and, if there is further non compliance, to an event of default. Earlier franchises under OPRAF and the SRA had attached financial penalties and rewards to a train operator's performance. The Department has not done so because there were penalties and rewards flowing in both directions and experience showed that the net amounts were too small to influence behaviour. Instead, it incentivises train operators by making the last two to three years of the franchise dependent on the franchise meeting performance benchmarks.

iii **service quality:** The Department does not attach financial penalties or rewards to service quality performance and does not undertake direct monitoring. Instead, the train operator must put in place arrangements to monitor service quality, which the Department approves. The train operator reports regularly on the outcome of these audits and if targets are missed, it must develop and implement a remedial plan.

**4.4** The Department's approach has helped bring savings in its franchise management and monitoring costs, from around £7.3 million in 2004-05 to £5.75 million in 2007-08, with fewer staff needed. In June 2008, the Rail Service Delivery (RSD) Directorate, responsible for franchise management and monitoring, had 72 staff-in-post, down from 100 staff in the equivalent parts of the SRA in early 2005.

**4.5** There are two potential issues with this contract management approach:

i **self-certification of lower risk obligations places reliance on train operators' systems.** Following a review of self-certification in early 2007, the Department found a lack of consistency in systems and in information provided by train operators. This raised concerns that some train operators' self-certification processes were not robust enough to give full assurance on compliance. One franchise team found an isolated case of errors of fact in the compliance evidence that had initially been accepted as assurance by the train operator. As a consequence, the Department carries out checks on train operators' data to test their consistency.

**ii** there is limited transparency for passengers: "Adopt a station" initiatives involve passengers in ongoing monitoring of service quality. They can increase the intelligence available to the Department for franchise management and monitoring. However, currently Passenger Focus and London Travelwatch do not have access to the service quality audits carried out by train operators. And the Department has not fully explored with Passenger Focus how it might help.

## Maintaining the right skill set and knowledge

**4.6** Negotiating and managing the performance of franchises requires experienced, skilled staff. The Department set up its Rail Group (now the NN Group) with 40 per cent fewer staff than had been employed at the SRA[9], carrying out a job-matching exercise to identify which staff it most needed.[10] The Department has tried to recruit staff from the rail industry, but has found difficulties competing on salary and because of perceptions of a less innovative ethos than the SRA. Within two years of its formation in 2005, 30 per cent of the Rail Service Delivery Directorate's franchise management staff had left. These posts have been filled without any major impact on delivery to date. Difficulties have also been encountered in recruiting permanent finance managers to support the Rail Service Delivery Directorate, so the Department has temporarily had to fill some of these posts with agency and short-term contract staff.

## Handling franchise failure

**4.7** Franchises could fail for two reasons: firstly, because of problems specific to the train operator or its parent, or secondly, because they are unable to cope with a prolonged downturn in the economy, which affects adversely passenger demand.

**4.8** On the specific risks faced by individual franchises, the Department has improved its monitoring of the financial performance and business risks of train operators and of parent companies. The franchise agreements require operators to supply it regularly with more detailed and forward looking financial information, including business plans and rolling forecasts. The Department now produces 'traffic light' early warning reports on the financial position of each operator.

**4.9** Ultimately, where a train operator can no longer continue operations, the Department has a statutory duty to intervene and become 'operator of last resort' until the railway is re-franchised. Each train operator must deposit a performance bond for the benefit of the Department. Should the franchise default, the Department would recover termination costs from the performance bond.

**4.10** In 2006, the Department's arrangements for dealing with a franchise in difficulties were tested when the parent company of GNER, the operator on the East Coast Main Line, was unable to support GNER during a period of financial difficulty. The Department negotiated a solution which protected taxpayer's interests **(Figure 17 overleaf)**. The original franchise had been let by the SRA in 2005, with a net present value of £1,200 million in franchise premium, payable by GNER over the life of the franchise. In August 2007, following a new competition, the Department let the franchise to National Express for future franchise premium with a net present value of £1,300 million (in 2005 values).[xiii]

**4.11** On the risks caused by an economic downturn, the revenue risk sharing arrangements protect train operators to some degree from economic downturns (paragraph 2.11). But significantly lower economic growth would cause commercial problems for some franchises.

**4.12** To manage this risk, the Department reviews the plans put forward by each bidder to cope with, typically, a ten per cent shortfall in revenues and then calculates the amount of additional financial support that the bidder's shareholders might need to guarantee. These mitigants are designed to cope with relatively short-lived declines in revenues. For more sustained declines, the re-letting solution adopted in the case of GNER would be available. But re-letting may be more difficult in an economic downturn because franchise values would be reduced resulting in a lower premium or a higher subsidy.

9 The Rail Group at the Department covers all staff involved in overseeing the railway industry, not just those involved in the specification, procurement and management of franchises.

10 In April 2007, the Department told us that a sixth of Rail Group staff were still on a 'mark time' arrangement holding their salaries constant until they came within the relevant pay band.

## 17 Showing the outcome of re-letting the Inter City East Coast franchise

**GNER – the re-letting experience**

**The original franchise:**

A seven year franchise was let in May 2005 by the Strategic Rail Authority (SRA), renewable for a further three years if GNER met targets. GNER committed to make premium payments with revenue risk sharing from the outset. GNER had committed to investing: up to £75 million to refurbish and improve High Speed Trains; £25 million on station modernisation; at least £3 million on improving passenger security and £5 million elsewhere.

**Management Agreement with GNER:**

A year and a half into the franchise, GNER approached the Department forecasting difficulty with meeting financial obligations at a time when its Bermuda registered parent company Sea Containers was facing bankruptcy. In December 2006, the Department and GNER negotiated a deal to pre-empt an event of default in making franchise premium payments during 2007. As part of a settlement, GNER's parent company agreed to pay £2.5 million to cover the Department's external costs and costs of re-letting the franchise early. Some project plans were affected by the early termination, causing some delay in benefits for customers.

**Incentives to protect franchise value:**

Instead of a management fee, GNER retained certain cost savings and above target revenue was shared equally with the Department, aiming to increase franchise value. At re-letting the Department has secured the prospect of an additional £100 million premium over a shortened franchise life.

**The new Inter City East Coast franchise:**

On 14 August 2007, the Department announced a new contract with NXEC Trains Ltd, a subsidiary of the winning bidder National Express Group plc. It runs from 9 December 2007 to 31 March 2015 with the final 17 months conditional on set performance levels being reached.

**Increased revenue-sharing provisions compared to GNER:**

In the event of excess revenue between two per cent to six per cent above target revenue, the Department will receive 50 per cent (up from 40 per cent), increasing to 80 per cent (up from 60 per cent) for revenue greater than six per cent above target revenue. The provisions for revenue support, if needed, commence after four years (improved from an immediate risk share).

**Passengers:**

Passengers will benefit from increased capacity, reduced delay minutes, a simpler website and more environmentally friendly elements to the journey. From December 2010, 25 extra train services will be run on weekdays, with up to 40 new carriages providing 14,411 extra seats, subject to Network Rail's strategy for the route. Among the extra services will be new London–Lincoln and London–York services operating at two hourly intervals as well as faster journeys to places like Leeds, York and Edinburgh. There will be a £7.4 million upgrade to stations and increased car parking. NX East Coast is committed to achieving an overall reduction in delay minutes attributable to NX East Coast of 29 per cent by the end of the franchise.

*Source: National Audit Office Summary*

# APPENDIX ONE

# Methodology

**1** We designed this study to evaluate how successfully the Department has assumed responsibility for passenger rail franchises, examining:

- how well it specifies and procures franchises, including how the specifications link with the Department's wider transport objectives;
- the likely financial impact of the franchises;
- the likely impact on passengers; and
- how well the Department identifies, allocates and manages franchising risks.

**2** The Department has let eight franchises (Figure 1). The first three of these were awarded in 2005 and had been specified by the SRA. The most recent four were being negotiated and let during 2007, while we were carrying out our fieldwork. For these reasons, we examined in detail the South Western franchise, which was the first franchise specified and procured under the Department's new processes and procedures. From this work, we obtained an in-depth understanding of the Department's approach. This enabled us to identify the key documents we later examined for the other seven franchises.

## Detailed examination of the South Western franchise

**3** The methods we used in the examination of the South Western franchise were:

**a Review of files and management information**

- **For specification and procurement:** We examined the following key documents: the Business Case, Stakeholder Briefing, Invitation to Tender, Office of Government Commerce Gateway reports, evaluation assessments, the franchise agreement and the submissions to Ministers;
- **For management and monitoring:** We examined: the franchise agreement and related National Rail Franchise Terms; the service level agreement; the service quality plan, standards and monitoring system; the revenue protection plan; the business plan; minutes of the monthly franchise management meetings between the Department and the operator, along with related documents supplied by each party; and financial and performance data held by the Department and by the Office of Rail Regulation.

**b Interviews**

- **For specification and procurement:** We interviewed the staff in the Department who had been involved in the specification and procurement, the winning and losing bidders, and the train operator link manager from Passenger Focus.
- **For management and monitoring:** We interviewed the Department's Director of Rail Service Delivery, divisional manager and franchise manager, contract manager and finance manager, and the Passenger Focus link manager.

**c Analysis of the financial model**

- We appointed DS+A Ltd to provide us with expert consultancy advice on how well constructed are the franchise financial model and associated templates that the Department uses for analysing the revenue and cost implications of bids and for making risk adjustments to bidders' assumptions. In addition, we carried out sensitivity analysis on the Department's assumptions about subsidy profiles over the medium term.

## Examination of the other seven franchises

**4 On specification and procurement:** We interviewed relevant specification and procurement staff at the Department to establish in what ways the approach differed from that followed for South Western. We also interviewed the NN Group's Director of Procurement, Director of Finance and Planning, winning and losing bidders, and the Chief Executive of CENTRO, (the West Midlands PTE), in connection with specification of the West Midlands franchise. The key procurement documents we examined were submissions to Ministers, evaluation reports on franchise awards, and details of the franchise awards.

**5 On franchise management and monitoring:** For the three franchises which began operations in 2006, we interviewed the Director of Rail Service Delivery, divisional managers, franchise managers, contract managers and financial analysts in the Department's Rail Group, and the rail performance manager, head of human resources and the head of the Rail Services Directorate to obtain the Department's perspective on how it now managed and monitored franchises. To triangulate this evidence, we reviewed supporting documents, including minutes of monitoring meetings, risk registers and financial and performance monitoring reports, data on human resources, internal audit reports and key franchise documents, such as the franchise agreement, business plan, revenue protection plan and subsequent reports and service quality monitoring reports. We also obtained the perspective of passengers through interviewing the train operator link managers at Passenger Focus and the chair and chief executive of London Travelwatch, and analysed the results of the National Passenger Surveys and performance trends. We also interviewed senior staff at First Capital Connect and First Great Western.

**6 The case of GNER:** We interviewed the Department's officials who were involved with monitoring GNER and negotiating the December 2006 agreement and we reviewed related documents, including those on lessons learned and monthly financial returns.

## To understand the franchising context

**7** We examined a range of other documents, including the evidence and findings of the Transport Select Committee's November 2006 report on Passenger Rail Franchising, the Department's July 2007 White Paper, *Delivering a sustainable railway,* and the research publications of Passenger Focus. In addition, we met the following stakeholders:

- the head of the HM Treasury spending team on transport issues;
- the chairs of Passenger Focus and London Travelwatch;
- senior management from the established UK Rail companies: Arriva, Govia, FirstGroup, Virgin Trains, National Express and Stagecoach, to ascertain their views on the Department's approach to procuring and monitoring franchises;
- David Quarmby, formerly SRA Chair, and Pen Kent, formerly of the SRA's audit committee, to identify changes from the SRA's approach;
- The rail liaison officer for Transport for London (TfL), to understand TFL's franchising approach for London Overground;
- the head of the Association of Train Operating Companies, to obtain a broader industry perspective; and
- representatives of Network Rail and the Office of Rail Regulation.

## Expert Advisory Panel

**8** We established an Expert Panel to advise the study team on our emerging findings, conclusions and recommendations. The panel members were selected to provide us with a range of views on passenger rail franchising. The panel members were:

- Professor Stephen Glaister, Imperial College, London
- Mr Richard Goldson, Non-executive Board Member, ORR
- Mr Michael Hewitson, Policy Manager, Passenger Focus
- Professor John Preston, University of Southampton
- Derek Salkeld, Principal, DS+A Ltd

APPENDIX TWO

# A concise history of rail franchising (1996-2004)

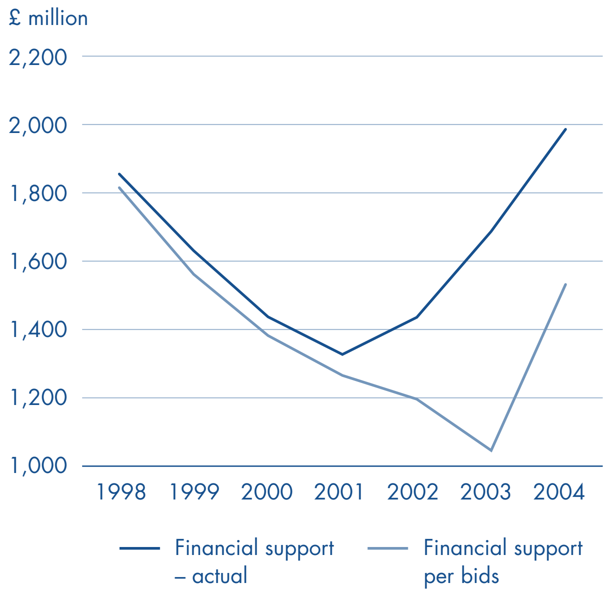
**1** Since the mid 1990s, the delivery of passenger rail services has been through a number of rail franchises, procured through a competitive tendering exercise, covering the rail network. Each franchise agreement is essentially a contract between the Government and a private train operating company (TOC) for the provision of passenger rail services in a particular geographical area. The first franchises were let in 1996-97 by the Office of Passenger Rail Franchising (OPRAF). The train operators were required to run a minimum level and quality of services – set at the level inherited from British Rail – and the main criteria for awarding franchises was the level of Government subsidy required over the lifetime of the franchise (i.e. the lowest bid won). Most of the 26 initial franchises were for seven to ten years with five being for longer terms of 15 years each.

**2** The planned subsidy profile of these first franchises was for Government to pay high subsidies in the early years followed by a reduction in payments towards the end of the franchise, as the private TOCs were expected to be able to reduce their operating costs and grow their passenger revenues. However, the results of the first franchises did not proceed to plan. As seen in **Figure 18**, in 2002 the Government ended up paying the TOCs around £300 million more subsidy than expected when franchises were originally let. TOCs' costs had been higher than anticipated and a number of them experienced financial difficulties.

**3** In February 2001, the Government established the Strategic Rail Authority (SRA) to deliver strategic leadership to the railway industry. The SRA took over OPRAF's franchising responsibilities and published, in November 2002, a *Franchising Policy Statement*. This revised approach to franchise letting evaluated bids to take account of what was realistically deliverable. The SRA took the view that it should be more prescriptive, specifying service levels and quality standards with the private sector being charged with delivery. This differed from the previous model which sought to create a set of business opportunities, subject to regulation, with obligations not to let services fall below specified base levels.[xiv]

**18** Government subsidy payments to TOCs, 1998-2004

Overall subsidy paid to the TOCs




*Source: SRA, KPMG analysis*

**4** Concerns about spiralling costs in the rail industry and the perceived inability of the SRA to deliver effective outcomes led to a Government review of the structure of the rail industry and publication, in July 2004, of the White Paper, *The Future of Rail*. This stated that the rail industry's key priorities were to control its costs, live within the public funding available to it and improve its performance, and that Ministers should take charge of setting strategy for the railways. As a consequence, the SRA was abolished and the procuring and monitoring of the delivery of passenger rail services passed to the Department for Transport between July and October 2005.

# APPENDIX THREE

# Major risks to value for money considered in letting

| Outline of risk(s) | Main arrangements that reduce or mitigate the risk |
|---|---|
| **Planning stage – specifying the level of passenger services** | |
| Franchise planning assumes a level of demand that is too low[11], and/or Cost Benefit Analysis does not address all relevant economic and social issues, with the result that forecast demand cannot be met. If such risks crystallised they would result in setting the service level too low to meet growing demand. | The Department could plan additional capacity, using forecasting tools and research, as part of the High Level Output Specification (HLOS). The HLOS exercise precedes each five year regulatory period and can, subject to affordability constraints, update the Department's rolling stock strategy.<br><br>If events invalidate planning assumptions, the Department expects train operators to propose additional capacity, varying franchise contracts as appropriate, or at the time of the next franchise competition. |
| Investment of public funds towards making additions to the network during the life of a franchise, sponsored by the Department (from HLOS) and/or Network Rail, may provide windfall profits to train operators. | The Department is entitled to re-run the financial model to revise the level of target revenue and shares in any revenue increase more than two per cent above the target level.<br><br>The target revenue will be reset during the next franchise competition. |
| Stakeholder expectations are unrealistic or are not met, leading to stakeholder dissatisfaction and potential loss of reputation.<br><br>Specifications do not meet future planned network or local transport developments because of:<br>■ unreliable data at time of letting<br>■ changes in local priorities<br>■ unplanned changes in the network during the life of the franchise. | Consultation with all relevant parties.<br><br>Consultation may add services to the base specification, or seek a price for an optional service, although implementation will depend on value for money and/or affordability.<br><br>If the options priced during contract bidding are not acceptable – as in the case of settling the future use of the Eurostar platforms at Waterloo – a contract variation may be developed during the franchise term.<br><br>In some cases an alternative will be a postponement until a subsequent franchise competition. |
| Encouragement of electronic ticketing technology to increase rail travel and boost revenue can result in complicated price differentials. This may lead to unintended impacts on passengers and their travel decisions. | Making public any implications for the policy on fares regulated by the Department, with communication on fare proposals during the consultation stages. This provides bodies such as Passenger Focus with the opportunity to make representations on behalf of passengers.<br><br>Industry-wide fares simplification proposals that aim to improve transparency and passenger understanding of fare choices. |
| **Purchasing stage – securing competitive tenders** | |
| Bidders make inaccurate cost forecasts, perhaps because the incumbent provides data late, or lacking in sufficient detail.<br><br>Bidders put in misleading revenue targets in the revenue risk sharing years towards the end of the franchise and/or confuse the attribution of revenue across delivery plans and operating criteria in order to win a bid. | Revenues and costs are risk adjusted and normalised, although this commercial risk is endemic and bidders will keep varying their approach.<br><br>The Department tests the level of parent company financial support and sets it at an appropriate level. |

| Outline of risk(s) | Main arrangements that reduce or mitigate the risk |
|---|---|
| A winning bid is assessed as deliverable, and is accompanied by well thought through implementation plans. Nevertheless it potentially overloads a bidder's management capability to deliver the amount of change in the bid. | The Department considers the track record and management capability of each bidder during prequalification. Network Rail is included in making the assessment of deliverability of proposed changes and implementation plans.<br>If the train operator subsequently fails to deliver the promised level of service, the Department can impose a remedial plan (as set out in the next section). |
| Large multi-modal transport groups abuse a dominant position in a travel corridor. For example three such multi modal transport groups hold nine franchises with potential implications for fares. | Referral by ORR of the winning bidder to the Competition Commission.<br>If appropriate, sanctions under Competition Law will be applied. |
| **Managing stage – monitoring service delivery** | |
| Not having industry expertise in key posts, and/or sufficient skilled staff leading to weaker negotiation of contract changes. | Plans to maintain the current level of rail industry experience in key posts within the Department. If vacancies increase, the Department can step up interim staffing and revise plans to attract and retain suitably skilled staff. |
| Passenger and media dissatisfaction if a TOC fails to deliver the promised level of service, in particular during the period following a hand-over from the previous incumbent. | Monitor service levels and assess feedback from Passenger Focus. The Department can agree informal arrangements to remedy poor performance with a train operator (as in the case of First Great Western). This can be followed, if necessary, by a remedial plan to cure a breach of contract. |
| Train operator self-certifies compliance with standards but does not supply all the information the Department needs to support the certification. | The Department checks data quality (see para 4.5) and can seek supporting information to show that standards are enforced. This can be followed, if necessary, by a remedial plan to cure a breach of contract. |
| Poor cooperation with Network Rail on improving network reliability, resulting in failure to achieve satisfactory train service performance. | Joint performance improvement plans between the train operator and Network Rail.[12] |
| Lower than predicted revenues, for example when train operators face a national economic downturn or costs exceed forecasts.<br>Financial failure if parent company support is exhausted.[13] | The train operator can implement contingency plans (such as those evaluated when the franchise was let) with steps to reduce costs and/or discretionary service provision.<br>Department budget projections make allowance for possible revenue risk sharing. If the train operator fails, the plans for the Department to act as operator of last resort have worked in practice and, to date, re-letting has been on similar or improved economic terms. |
| Risks retained by the Secretary of State appear likely to crystallise. In each such case, risk retention had to pass a value for money test to show that it represents the least worst outcome. | The Department monitors and reports on such risks. It has influence to manage some such risks actively, for example to encourage Network Rail to perform, but at other times may lack contractual levers. |

NOTE

This summary does not consider catastrophic risks that are classed as Force Majeure and likely to impact the Department's budget on a basis that is not franchise specific.

11 There is a symmetrical, but generally lower, risk of a forecast being too high.

12 Scope to improve in a related area is set out in the Comptroller & Auditor General's report on 'Reducing passenger delays by better management of incidents' HC308 March 2008.

13 The outcome will depend on the sensitivity analysis conducted in each case. Termination, or refusing a contract extension, might suit a train operator in financial difficulty.

# APPENDIX FOUR

# The Department's franchise replacement process

## Responsibilities for overseeing the franchise programme

**1** The Department's National Network Group follows good practice by establishing clearly separate responsibilities for determining what is to be bought, awarding the franchise contract and monitoring contract implementation. It describes this approach as 'Plan – Buy – Do':

| | **'Plan'** (Specification) | **'Buy'** (Procurement) | **'Do'** (Service Delivery) |
|---|---|---|---|
| Responsible Person | Director of Rail Strategy and Stakeholder Relations | Director of Procurement | Director of Rail Service Delivery |
| Summary of Responsibility | Senior Responsible Officer for the project<br>Management of the overall Franchise Replacement process and individual projects<br>Defining and maintaining the specification to ensure the right strategic fit | Management of the overall procurement process, i.e. the bidding process and evaluation of bids<br>Providing contractual approval for the Franchise Agreement | Overseeing the mobilisation of a new franchise and ensuring that Franchise Agreement obligations are delivered |

**2** The Department's governance structure for franchising involves three internal bodies with their responsibilities clearly delineated, as set out below:

| **Body** | **Membership** | **Remit** |
|---|---|---|
| Rail Investments Board | Director-General (Chair) and Directors of NN Group within the Department | The Board reviews papers and advises the Director General National Networks on the financial approvals and contract award endorsement. |
| Franchise Award Committee | The Director or Head of each function in 'Plan – Buy – Do'. | Approves public advertisements and invitations to tender; evaluation weightings; recommends contract award and generally ensures best procurement practice. |
| Franchise Replacement Steering Group | Representatives of 'Plan – Buy – Do' responsible for the specific franchise. | Consider and inform the specification; review the risk register; confirm readiness at each stage; consider major procurement issues arising; and consider mobilisation issues. |

*Source: National Audit Office summary*

**3** The franchising process is subject to review through three mechanisms:

- External review by the Office of Government Commerce (OGC) which carries out a gateway review at critical stages of the franchising process. OGC has not had any major or unresolved concerns in its reviews of the franchising process.
- Internal review of the process by the Department's Internal Audit function.
- Review by the NN Group itself after each franchise award. This can lead to changes, for example, setting more precise criteria for judging financial risk in summer 2007.

## The Department's Rail Specification and Procurement Staff

**4** The October 2005 transfer of responsibilities from the SRA to the Department involved a risk of staff departures damaging the Department's ability to perform effectively. Our review shows that, although tightly staffed, this risk has not materialised. Fourteen of the Department's 23 rail procurement staff transferred over from the SRA including key employees preparing for the South Western franchise. OGC reviews of the South Western franchise award noted that initially there was not a full complement of staff but concluded that the following stage of the procurement process was fully staffed and were complimentary about staff quality.

**5** For historical reasons the number of franchises awarded each year vary. This bunching means that it is not cost effective for the Department to be staffed up to deal with peaks of work. The Department, therefore, may engage outside support, such as using inward secondees for handling the West Midlands franchise, one of the four let in 2007, as well as advisers to provide legal, technical and financial advice for each franchise. The Department is seeking to manage the forward programme to reduce peaks and troughs in letting franchises.

**6** The Department has been successful in letting franchises to the timescales initially envisioned and not delaying any award – all four franchises awarded in 2007 were procured by the dates initially envisioned when the Prior Information Notices were issued.[14] This was not the case for either of its predecessors, OPRAF and the SRA. Our 1996 report on rail franchising noted that OPRAF had not met the Secretary of State's target of awarding six franchises by the end of 1995; the SRA had a number of proposed franchise re-awards that were delayed or cancelled, for example the cancellation of the Central Trains re-franchising in June 2001, or the delays to the re-award of the Inter City East Coast franchise.[15]

## The specification and procurement process

**7** The key steps and activities in the specification and procurement process are set out in **Figure 19 overleaf** and are advised to bidders on the Department's website.

**8** The first step in the procurement process is the release of a Prior Information Notice which sets out the anticipated programme for procuring a specific franchise or franchises and includes a brief specification of what the relevant franchise or franchises will comprise and likely procurement programme dates. Secondly, advertisements are placed in domestic, European and international journals, trade press and other publications informing potential applicants of the opportunity in more detail and asking for expressions of interest. Those interested are able to download a pre-qualification document pack from the Department's website.

**9** In parallel with pre-qualifying bidders, the Department undertakes a consultation exercise relating to the services which it proposes to include in the franchise contract. This consultation precedes approval of the base service specification and issuance of the tender documentation. The consultation provides an opportunity for rail users, Passenger Focus, London Travelwatch (where appropriate) and local authorities to comment on the pattern of services (see Section 1, paragraphs 1.8 to 1.11) and options they may wish to pursue.

**10** The base service specification sets out the frequency of services to be provided to destinations along the route(s) and any other essential requirements. A bid which does not comply with the base service specification will be rejected. Bidders are, however, free to include bidder generated options. Those most likely to be accepted are ones which do not make additional demands on Government funding, e.g. station improvements which pay for themselves by generating increased passenger numbers. Other options might propose changes to a service pattern that would improve reliability or the financial performance of the franchise, while going beyond the bounds set in base service specification.

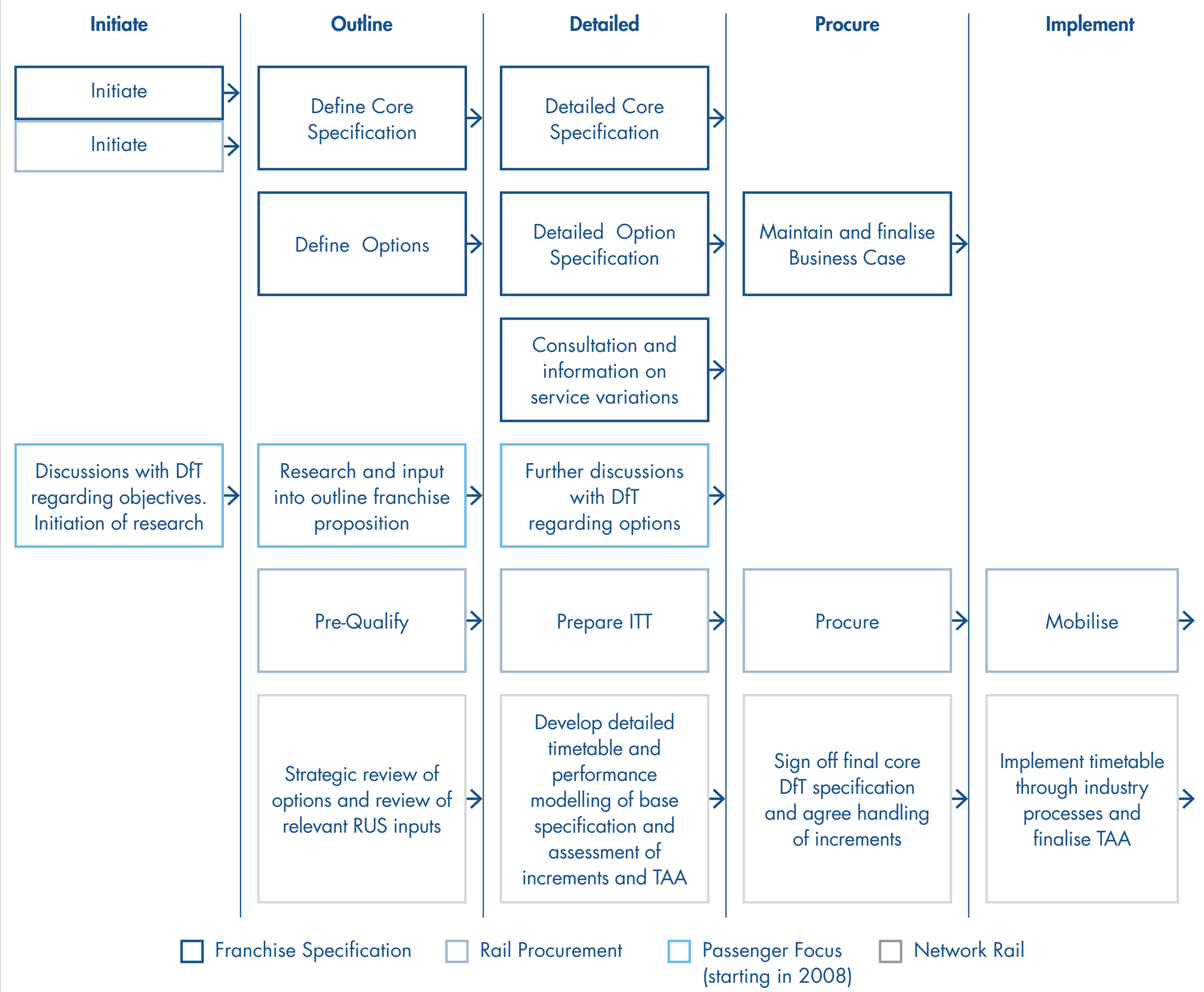
14 Prior Information Notices are issued, right at the start of the procurement process, to alert the market.
15 The reasons for these delays were not always within the control of the SRA.

## The prequalification of bidders

**11** The Department's evaluation methodology is risk focused to help ensure the selection of the bids that are likely to deliver contract commitments in practice. The franchise award is made following a two stage assessment: a pre-qualification process that filters out applicants on the basis of an Accreditation Questionnaire (AQ); and, for those who prequalify, an Invitation to Tender (ITT). The AQ provides assurance that an applicant has the basic ability to deliver a passenger rail service. Scoring predominantly assesses the applicant's record of running a passenger rail or similar service.[16]

**12** For the South Western Franchise procurement, which was the first that the Department was fully responsible for, 70 per cent of the marks available were based on experience and past performance, 15 per cent on business and quality management and 15 per cent on the approach to bidding and mobilisation of the franchise.[17] The weightings were reviewed and changed slightly on the subsequent four franchise procurements but the 70 per cent for experience and past performance was maintained. Five per cent of marks were for the approach to bidding and 25 per cent for the approach towards mobilising and running the franchise.

**19** The Department's procurement process gateways




*Source: Department for Transport as revised by the National Audit Office*

NOTE

RUS stands for Route Utilisation Strategy. TAA stands for Track Access Agreement.

16 This assessment is based not only on the response given by the applicant but also incorporates performance data that the Department holds in respect of punctuality and reliability and National Passenger Survey (NPS) results.

17 There were also simple pass/fail criteria for the applicant's structure, governance and financial history and for the applicant's approach to its safety, health and safety and environmental policies.

## Evaluation of bids and delivery plans

**13** The Department selects the bidder judged to offer the best value for money for operating the base service specification. Only once it has selected its preferred bidder does the Department then consider the priced options and other options put forward by that bidder. To enable comparison between bids, the appraisal is conducted using the following method:

- The bidder's price is adjusted to take account of Departmental passenger growth forecasts, not bidder passenger growth forecasts
- The price is discounted using the standard Department rate to give a Net Present Value (NPV) for the bid over the period of the franchise
- Consideration of other discriminating factors including, but not limited to, comparative performance offers, focus on cost-efficiency, achievement of Passenger Focus aspirations and quality of Bidder-generated options.

**14** In response to the ITT, a bidder must produce three principal delivery plans setting out how it will improve the reliability, reduce the cost and increase the revenue of the service. The bidders must use each of the operational criteria specified for the franchise to demonstrate how they meet the requirements of the delivery plans[18]. There are 22 criteria in the case of South Western, reduced to 14 for the Midlands franchises in 2007 **(see Figure 20)**.

**20** Showing operating criteria by delivery plan

| Operating Criteria – South Western | Principal delivery plans | | | Midlands Franchises (14 criteria) |
|---|---|---|---|---|
| | Performance | Revenue | Cost | |
| Rolling Stock | | | | |
| Train Presentation | | | | |
| Depot and Maintenance | | | | |
| Security | | | | |
| Performance Improvement | | | | |
| Marketing | | | | |
| Ticket Sales | | | | |
| Fares and Revenue Protection | | | | |
| Demand Management | | | | |
| Other Revenues | | | | |
| Human Resources | | | | |
| Train Crews | | | | Franchise Management[1] |
| Station Management and Staff | | | | |
| Station Cleaning and Maintenance | | | | |
| Station Enhancement | | | | |
| Business Organisation/Quality Plan | | | | |
| Service Recovery | | | | Timetable Plan & Resources[1] |
| Service Control | | | | |
| Stakeholder Management | | | | |
| Customer Information | | | | |
| Customer Services/Charter | | | | |
| Mobilisation | | | | |

*Source: National Audit Office summary*

NOTE

1 These are additional criteria.

18 The Department's terminology will be changing in future franchises to "delivery criteria" and "operational plans".

**15** The Department will select a winning bidder by risk assessment of delivery plans. This is based on three key questions against each criterion.

- What is the risk of failure?
- Are the potential adverse impacts of failure limited to the financial position of the bidder, or could they impact on the taxpayer and the travelling public?
- Would the failure be one that would emerge progressively, giving the bidder and the Department time to take corrective action, or could it emerge very abruptly?

**16** The Department has not weighted the operating criteria so far although it is re-examining that approach and intends to give bidders guidance in the future. For the South Western franchise the Department invited bidders to express their own views on the importance to be attached to individual operating criteria. Our examination of how bidders allocated revenue in their bids on the South Western franchise showed that neither the Department nor the bidders used consistent and clearly defined categories for attributing revenue growth across the operating criteria. This could give rise to double counting although the potential problem may well have been reduced on the subsequent franchise awards as, with a reduced number of operating criteria (down to 14 – see Figure 20), we would expect a better consistency amongst bidders in allocating revenue growth to the same operating criteria category.

**17** Bids must pass a compliance check and are then subject to both a technical and a financial evaluation. The technical evaluation is an assessment of the risks inherent in the three deliverability plans with a score allocated to each operating criteria for each delivery plan (i.e. 66 scores for the South Western procurement). This creates an onus on bidders to document and evidence clearly the deliverability of their bids. Only bid scores assessed overall as having a medium or low level of risk pass this evaluation.

**18** In the financial evaluation, price becomes the determining factor once the Department is confident that the bid is deliverable. The decision is then primarily based on the lowest risk adjusted net present value of the subsidy required or the highest premia bid. In 2007, on a competition for a Midlands franchise, the bidder submitting the highest revenue proposal was not selected. In this case the Department's advisers and Network Rail assessed deliverability of the bid as involving too great a timetable risk because other services would have been badly disrupted if the bidder had been unable to join and split trains in the time intervals proposed.

**19** The Department has put in place an approach to evaluating bids that encourages bidders to focus their bidding attention on planning for ways of maximising revenue receipts on the franchise and keeping operating costs down to those necessary to meet passenger service requirements. As seen from **Figure 21**, Selection of Winning Bid on the South Western franchise below, bids must demonstrate that they are deliverable but thereafter the key differentiator is the lowest subsidy or highest premium.

**20** The former evaluation approach has been duplicated on subsequent procurements although the two and one half per cent band at step 3 above has been amended to reflect the relevant realities of the procurements.[19] In each case the choice of the band, and the extent of permitted price difference, has been set in advance and adjusts the balance between overall technical quality and the bid price. The Department has expanded the process for selecting the winner based on other discriminating factors including, but not limited to, comparative performance offers, achievement of Passenger Focus aspirations and quality of Bidder-generated options.

**21** Selection of Winning Bid on the South Western franchise

**Step 1:** Select bids that are affordable based on available resources.

**Step 2:** Discard any bids that fail the technical assessment of deliverability.

**Step 3:** Select the bid that offers the best risk adjusted premium on net present value (and retain any other bid within two and one half per cent of the best bid).

**Step 4:** If more than one bid passes step 3, consider which bid has the best result in the technical assessment. Retain the leading bidder from step 3 as the winner provided that bid either (i) has a greater than two and one half per cent advantage in the technical assessment, or (ii) is not weaker than the next bid by more than two and one half per cent.

**Tie breaker:** If no single bid passes step 4, consider the financial risk of bidders in contention, preferring lower risk **– if still close consider monetising the passenger benefits of each bidder's performance improvements**.

*Source: Department for Transport*

19 In the case of franchises that predict a relatively small subsidy or premium payment, prices that are within one percent of the net present value of sales turnover are taken to the technical scores (step 4 in Figure 19).

## The financial models for evaluating bids

**21** In examining the financial model for South Western our adviser found that although the model met bid requirements it was not a fully robust tool for medium or long term use on three grounds:

- the large size of the business model and its complexity[20];
- the absence of built in supporting analysis for the revenue calculations – for example, the impact of crowding is a separate analysis – and for comprehensive evaluation of risk; and
- the limited documentation provided to the Department explaining its use.

**22** This means, in particular, that the model will not be easy to use for calculating the impact of a risk that the Department retains. It will also not be easy to use, as intended, to help reach agreement on re-setting the target revenues after substantial investments have been made by the Department or Network Rail.

## Control of costs by successful bidders should be stronger than in the past

**23** In the first wave of rail franchising, bidders lacked a real understanding of British Rail's operating costs and expected to be able to make substantial savings which were not achieved. The operators could not reduce staff levels as much as planned and competition pushed up drivers' wages. For example, on their South Eastern franchise, between 1997-98 and 2001-02 Connex expected to cut controllable operating costs by 11 per cent but they actually increased by 27 per cent.[xv]

**24** In the future, the Department considers that operating costs are well understood and does not consider cost pressure an important risk. This is because:

- Bidders appear to take a similar view on costs going forward. For example, on the South Western procurement, all four bidders predicted costs at a slightly higher level than the Department's historic shadow bid calculation then averaging four and one half per cent.
- The Department's evaluation of bids identifies weaknesses in bidders' assumptions about costs and makes appropriate adjustments to their financial predictions.

**25** This should mean that there is greater certainty and robustness to the operating costs within winning bids. As a result, bidders for the last five franchises have mainly competed on their revenue projections. Operating costs within bids were, on average, within five per cent of costs estimated by the Department. Passenger representatives, however, still find some mobilisation costs baffling and told us that re-painting carriages in the corporate colours of the new franchise operator – perhaps within months of previous scheduled repainting – annoys most rail passengers.

**26** Following award, the Department provides the winner and losing bidders with feedback on their bids and the bid evaluation process for that specific franchise.

20 The overall model is so large that the opening of only two components: the Revenue Model and the Financial Model is enough to exceed the capacity of most computers. The developers supporting the Stagecoach bid must themselves have found this as shown by their solution to integrating the calculations: the cutting and pasting of large output data sheets from one model as input to the other. Such a vertical silo structure is difficult to maintain and after a period of no-usage, silo models can prove difficult to re-assimilate with confidence.

# APPENDIX FIVE

# Summary of improvements expected from franchises

| Train operator | Forecast train punctuality and reliability | Passenger security[1] | Station improvements |
|---|---|---|---|
| Southeastern (2006-14) | 93.7 per cent by 2014, with 14 per cent fewer[2] delay minutes | £17.6 million CCTV investment | £5.6 million investment |
| First Capital Connect (2006-15) | 4 per cent fewer delay minutes by 2015 | 12 more "secure" stations | £8 million investment in first four years (cycles £100,000) |
| First Great Western (2006-16) | 90 per cent by 2012, 13 per cent fewer delay minutes by 2012 | 105 stations by 2008 and 63 more by 2009 | £5 million by 2008 and further £9 million by 2010 |
| Stagecoach South West Trains (2007-17) | 10 per cent fewer delay minutes by 2015 | 80 per cent by 2010 then priced option for 95 per cent | £36 million investment incl 700 cycle spaces |
| London Midland (2007-15) | 90.7 per cent by 2015 | 80 per cent by 2009, with priced option for 95 per cent | £11.5 million investment |
| East Midlands Trains (2007-15) | 90.4 per cent by 2015 | 80 per cent after two years with priced option for 95 per cent | £5 million investment<br>400 more bicycle spaces |
| CrossCountry (2007-16) | 25 per cent fewer delay minutes by 2016 | 80 per cent by November 2009 | This train operator is not a station operator |
| NX East Coast (2007-15) | 29 per cent fewer delay minutes by 2015 | All stations where NXEC is station operator | £7.4 million investment |

*Source: National Audit Office summary*

NOTES

1 Number or percentage of franchise footfall to be covered by Secure Station Accreditation.

2 Delay minutes in this column are those caused by train operator, not Network Rail.

| Car parking | Capacity | Rolling stock | Ticketing |
|---|---|---|---|
| Planned improvement within station spending | London morning peak arrivals up by 10 per cent | £25 million investment in rolling stock for new CTRL commuter services | Automatic gates at three stations |
| £1.6 million + 600 car spaces by 2010 | Dependent on future Thameslink programme | Refresh interiors of Class 319 rolling stock | Automatic gates at 11 stations |
| 500 new car spaces by 2008; +700 by 2010; +500 by 2016 | 20 per cent (morning) and 30 per cent (evening) increase in peak capacity London – Reading | Refurbishment of high-speed train fleet (and some link fleet and local fleet). New maintenance depot | Automatic ticket gates at 5 stations and website improvements |
| 2,000 car spaces by 2011 | 21 per cent seats increase in mainline peak and 20 per cent capacity increase in suburban peak | Refurbish Class 158/159 rolling stock and 17 additional Class 450 | Automatic gates at 14 stations including Waterloo |
| At least 1,000 new car park spaces by April 2009 | New half-hourly London to Crewe semi-fast service and extra services from Birmingham to Liverpool and Northampton | Fleet of new electric trains by July 2009. 217 new, replacement carriages by April 2010 | Rollout of smart card technology by 2010 |
| 1,250 new car park spaces | 9 per cent increase in peak capacity for London St Pancras; and more seats Liverpool to Nottingham | £20 million investment on enhancing rolling stock | Introduction of smart card technology by 2010 |
| | 3,000 more seats each day on busiest routes at peak time | Refurbished High Speed train units | New web-based ticketing system by December 2009 |
| 2,000 new car park spaces by 2015 (33 per cent increase) | From December 2010, an 18 per cent increase in weekday trains and 14,411 more seats | High Speed Trains re-engineered to reduce fuel consumption | Smart cards by 2010 |

# GLOSSARY

| | |
|---|---|
| **Department for Transport** | The Department for Transport is responsible for overseeing the delivery of Britain's transport system. Following the abolition of the Strategic Rail Authority (SRA) under the Railways Act 2005, from July to October 2005 it took on the SRA's strategic and franchising roles in relation to the railway. |
| **Delay minutes** | Delay minutes are measured for a single train against its timetabled journey time between two points where three minutes of delay or more are incurred. The Delay Attribution Guide, produced by a board comprising representatives from Network Rail and Train Operating Companies, gives guidance on the proper coding and attribution of delays. |
| **Franchise Agreement** | The agreement between the Department (and formerly the SRA or OPRAF) and the Train Operating Company setting out the terms and conditions on which the TOC can operate train services. |
| **HLOS** | The High Level Output Statement (HLOS) sets out for the ORR information about the improvements in safety, reliability and capacity that the Secretary of State wants to secure during the ORR review period 1 April 2009 to 31 March 2014 (CP4). The HLOS was published as Appendix A, Railways Act 2005 Statement accompanying the July 2007 White Paper Delivering a Sustainable Railway. |
| **Mystery Shopping** | Mystery shopping is a tool used by market research companies to measure quality of service or gather specific information about the condition of passenger facilities. Mystery shoppers in the role of customers perform specific tasks – such as purchasing a product, asking questions, itemising service condition or behaving in a certain way – and then provide detailed reports in an agreed format to record their experiences. |
| **National Passenger Survey** | A survey carried out since 1999 every six months by consultants commissioned and funded, from 2005, by Passenger Focus (the national rail passengers' consumer watchdog), and previously by the Strategic Rail Authority, to monitor passenger satisfaction with train services. It is based on a sample of between 25,000 and 30,000 self-completed questionnaires from across the country. |
| **Office of Passenger Rail Franchising (OPRAF)** | A non-ministerial department, which awarded the franchises to run passenger rail services by March 1997. It was superseded by the Shadow Strategic Rail Authority in July 1999. |

**Office of Rail Regulation (ORR)**

An independent statutory body established on 5 July 2004 under the Railways and Transport Safety Act 2003. Its primary economic function is to apply independent, fair and effective regulation to ensure that Network Rail manages the network efficiently and in a way that meets the needs of its users. ORR secures compliance with relevant health and safety law; licenses operators of railway assets setting the terms of access by operators to the network and other railway facilities; and enforces competition law in the rail sector. It replaced the Rail Regulator in July 2004.

**Passengers in Excess of Capacity (PiXC)**

Passengers in Excess of Capacity (PiXC): Passengers in Excess of Capacity (PiXC) – the measure is derived from the number of passengers travelling in excess of capacity on all services, divided by the total number of people travelling, and expressed as a percentage. Capacity is deemed to be the number of standard class seats on the train for journeys of more than 20 minutes. For journeys of 20 minutes or less, an allowance for standing room is also made. The allowance for standing varies with the type of rolling stock but, for modern sliding door stock, it is typically approximately 35 per cent of the number of seats.

**Premia**

Sums paid to the Department by certain Train Operating Companies in consideration of their franchise to operate passenger rail services.

**Public Performance Measurement (PPM)**

The measure of train punctuality, setting out the percentage of scheduled trains that arrive at their destinations within 10 minutes of their planned arrival times (or within five minutes for shorter journeys) including all delays and cancellations, regardless of cause.

**Regulated Fares**

Standard class season tickets and those listed below are subject to price regulation capped at the retail price index (rpi) plus one percent. If significant investment in new services has been provided – for example in Kent – a higher margin above RPI may apply, RPI plus three per cent in the Kent case.

Pursuant to the Railways Act 1993 and Transport Act 2000 there are currently two types of fares regulation:

Commuter Fare regulation

(including standard day singles and returns and season tickets (weekly, quarterly, annual) within the London Travelcard zone and certain other major suburban areas such as Leeds and Manchester and

Protected Fares regulation

(including: weekly season tickets other than those included in the Commuter Fare's basket, Saver tickets for journeys where a weekly season/Saver ticket existed in February 2003).

Commuter Fares and Protected Fares are regulated through a mechanism called a 'fares basket', where a limit or 'cap' is applied to a weighted average of the relevant fares on each train operator. Fares policy was reviewed by the SRA in 2003, and the cap on each operator's Commuter Fares basket and Protected Fares basket was set at the 2002-3 value of each basket, increased by RPI+1% in January 2004 and cumulatively each year after that. TOCs have a degree of flexibility to adjust individual fares within their fares basket by more or less than the average increase for the basket, as long as the value of the fares basket as a whole does not exceed the cap, and as long as the increase in any one individual fare within that basket does not rise more than six per cent above the rate of inflation compared with the price charged for that fare in the previous year.

| | |
|---|---|
| **Secure Station Accreditation** | A voluntary accreditation scheme launched in 1998 and directed by the Department for Transport, in partnership with the British Transport Police and Crime Concern, which sets standards for station design and crime management. |
| **Strategic Rail Authority (SRA)** | The Transport Act 2000 set up the SRA to provide strategic direction and leadership for Britain's railways, let and manage passenger franchises and freight grants, disburse public funds, develop and sponsor major infrastructure projects, and to be responsible for some aspects of consumer protection.<br>It operated under Directions and Guidance (D&G) from the Secretary of State for Transport, the Scottish Minister for Transport and the Mayor of London.<br>It formally came into being on 1 February 2001 and was abolished by the Railways Act 2005. |
| **Subsidies** | Sums paid by the Department to certain Train Operating Companies to support their provision of rail services. |
| **Target Revenue** | The revenue that, under the terms of the franchise contract, a train operator is required to generate, or deemed to generate for a specified period. After the specified period if the train operator fails to deliver 98 per cent of the target revenue the risk is shared with the Department. Actual revenue that exceeds the target revenue by more than two per cent is shared between the Department and the train operator throughout the term of the franchise. |
| **Track Access Agreement** | Agreement between a train operator and Network Rail setting out conditions for use of the network. The Office of Rail Regulation regulates the agreement. |
| **Track Access Charges** | Payments made by train operators to Network Rail meet its cost of operating, maintaining and renewing rail infrastructure. The Office of Rail Regulation determines the level of charges for five-year control periods after an Access Charges Review. The Department for Transport meets some of these costs through grants it provides to Network Rail. |
| **TOC** | Train operating company |

# ENDNOTES

i *The Future of Rail*, Department for Transport (July 2004), p.6.

ii The Department's approach to consulting with local transport bodies is set out in two key documents: *Guidance on the Role of Transport for London in the Department's rail franchising process* (July 2007); *The new system for the role of PTEs in the rail franchising process* (2006).

iii July 2004 White Paper *The Future of Rail*, p.81

iv *A Guide to the railway franchise procurement process.*

v House of Commons Transport Committee, *Passenger Rail Franchising*, HC 1354 (Oct. 2006), Ev.6, 14, 200.

vi ibid, p.22.

vii *Delivering a sustainable Railway*, Department for Transport, July 2007, paragraph 12.4 page 123

viii *Office of Rail Regulation: National Rail Trends Yearbook 2007-08,* tables 1.2a and 1.3a

ix Strategic Rail Authority, *Franchising Policy Statement* (November 2002), p.15–16.

x National Rail Terms - schedule 9

xi *ORR National Rail Trends Yearbook, five years to 2007-08 (rounded)*

xii National Audit Office, *Maintaining and improving Britian's railway stations*, HC 132, Parliamentary Session 2005-06

xiii £1,400 million in 2007 values

xiv Strategic Rail Authority, *Franchising Policy Statement* (November 2002), p.9.

xv National Audit Office, *The Southeastern Passenger Rail Franchise*, HC 457, 2005-06, p. 15.

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