This is the response of **West Coast Rail 250**. **West Coast Rail 250** is a non-party political organisation, which has long-established and excellent working relationships with network Rail, the relevant Train Operating Companies, and the Department for Transport, and:

> ***"campaigns for improved and environmentally sustainable rail services along the West Coast Main Line to support the economic development and social cohesion of communities along the WCML rail corridor."***

These Aims are supported by the following key objectives:

1. Increased capacity for passenger and freight services
2. Faster and more frequent long distance services
3. Improved links between local and regional centres
4. Improved facilities for passengers

Our membership extends from London to Wales and Scotland, and includes large urban and rural local authorities, Integrated Transport Authorities, district councils, industry stakeholders and user groups / representatives.
We have members along the route of the WCML and also some distance from it and need to access it via the feeder services provided by other Franchisees.
We are grateful for the interest and the support of Parliamentarians through the West Coast Main Line All Party Parliamentary Group.

The General Council of **West Coast Rail 250** approved this response on 7 October 2010.

<u>2. Introduction</u>

West Coast Rail 250 hopes that revisions to the franchising process will further its aims including:

<u>Support for the economy:</u> The overriding value of the WCML to our members is that the services provided on it should help our local economies, as well as the national economy, to prosper. We note that the whole of the route along which the West Coast franchise operates is used by other franchisees/TOCs that have a relatively local remit and provide links with regional towns.

<u>Achieve carbon reduction and improved air quality:</u> We advocate that rail should be required to play a major part in achieving modal shift from car and lorry, thus helping to reduce emissions.

<u>Reducing costs:</u> We hope that the franchise process will contribute to lower cost operation for the West Coast corridor, but we acknowledge that the most substantial cost reductions will come from the McNulty report's findings where our priorities would be rolling stock and infrastructure costs.

We believe that the above aims are shared with the Coalition Government. We suggest that government include in the new franchise models, mechanisms that will require the franchisee to achieve modal shift and support local economies, which will benefit the franchisee's 'bottom line' and ultimately reduce net public subsidy.

- We note that the West Coast franchise is a revenue provider for DfT, albeit that the TOC benefits from some inputs that do not fully reflect the cost of provision.

- We hope that a relatively simple franchising model, fit for purpose for the WCML, and which encompasses the needs of other TOCs / FOCs, can be achieved.

- We appreciate that the McNulty report's interim and final findings[1] will be taken into consideration.

- We understand that investment decisions, which are awaiting the CSR announcement on 20 October, could materially impact on a franchise's premium and operation. For example, electrification enables local and long distance services to mix (on the assumption that appropriate rolling stock is available). It is important that investment programmes, whether to be by government or private sector, are published and adhered to.

- We note also that the European Commission[2] is progressing legislation concerning the organisation and operation of railways with the intention of opening up the railways to competition. We are aware that themes in the proposals for rail legislation include longer time scales and greater certainty regarding funding and investment strategy to benefit infrastructure development.

This consultation response takes the current division of responsibilities as its starting point i.e. that TOCs provide services. Perhaps it will become appropriate to consider alternative models. We would invite the Secretary of State to consider (re)examining the case for rail services to be provided by either the train leasing companies or the infrastructure companies as the lead organisation. Current issues of concern to West Coast Rail 250 and government include insufficient funds for rolling stock and infrastructure investment and the costs of maintenance, all of which impact on the quality of services provided, and the ability to generate revenue / profit and achieve modal shift. The Train Leasing Companies could assume responsibility for rolling stock procurement to levels established with DfT; the amount of rolling stock required to be operated could be based on targets of modal switch for the franchisee to achieve. Alternatively, the Infrastructure Companies as lead organisations could assume responsibility for all operations on a defined part of the network.

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[1] The study has eight broad themes: industry objectives, strategy and outputs; industry leadership, planning and decision-making; interfaces, incentives and structure; revenue; asset management; supply chain management; innovation, standards and safety; and people

[2] on 17 September 2010

3. Comments

Our membership, which has knowledge and experience of different parts of the corridor, is diverse and all have concerns about local franchises as well as the West Coast Main Line. This being the case and in response to the requirements of this consultation (but recognising also that the railway industry could experience significant change in the near future), our response is pitched at a general level.

We hope that we will be invited to contribute to the detail of a franchise specification for the WCML at a subsequent stage in the revised franchise arrangements.

In summary we favour

- Premium to be paid by Franchisee as West Coast franchise is commercially viable, and has benefited from substantial investment
- Govt specifies a minimum public service obligation (PSO)
- Franchisee identifies enhanced services to complete a package for tender
- Cross subsidy between PSO and enhanced services
- Profit is derived from delivery of the complete package which is contractualised
- Clear rules including trigger points to require action by TOC and DfT without relying on sanctions and over complicated monitoring mechanisms
- Penalty payments go to DfT/HM Treasury.
- Share of additional profits, to be reinvested in railway or in public private joint ventures, to benefit local economies

Our response to this consultation is from our perspective of desired outcomes for the West Coast Mainline.

(i) General comments

We welcome this consultation document as evidence of government's commitment to securing additional investment in railway infrastructure and improving the customer experience that will benefit the national network and serve also discrete local and regional communities.

We note comments of Transport Ministers[3] that the interests of passengers including satisfaction with the quality of services provided, which themselves meet demonstrable need, is regarded as paramount.

We hope that reforms to the franchising arrangements, and thus our benchmarks of success, will result in

- Improved public perception of public transport, especially rail
- No detriment to current WC franchise services

[3] for example, Parliamentary Questions, Transport Oral Questions, 22.7.2010, Rail Franchising, Mrs Villiers.

- No detriment to current regional and local services using WC corridor
- Improvements in track availability
- Greater levels of investment in rail infrastructure and rolling stock than has occurred using predominantly public purse funding, specifically station improvements and new and well-maintained rolling stock
- Lower costs through efficiencies in operations and maintenance and from pressure to reassess railway operating standards
- Faster and more frequent long distances
- Improved local economies at all locations along the corridor, achieved in part by providing closer links between towns and cities along it and between individual towns and their hinterlands
- Greater rail modal share as a contribution to climate change mitigation strategy

We know that a rail service providing fast and semi-fast trains linking principal and intermediate locations along the various routes may not be a business model that generates the greatest return for the TOC. Our members require services such as these that link their towns and cities with others as well as London. To ensure this, some of specification will be necessary. Consideration should be given to cross-subsidising services within the franchise.
We are aware that this model could be compromised e.g by open access operators abstracting customers and revenue. Draft specifications could thus benefit from adequate consultation.

We are concerned, too, that the effect of revised franchising rules should not result in the displacement of local and regional services (which, for example, without electrification, may be qualitatively different, for example, operating at slower speeds) without alternative provision being made before the event. This provision may have to be at the franchisee's expense, if it monopolises existing capacity. Dedicated track may be appropriate which could be achieved by segregating trains by speed and purpose, or alternatively for example constructing new track or reserving existing track; examples include Merseyrail, HSR2 and tram-train in south-east Greater Manchester.

We particularly welcome the station management and investment proposals which suffered a considerable set back with the abandonment of the *Better Stations* strategy of the previous government.

We would question whether the WCML would be the appropriate candidate for the first franchise under the new regime. It is, for instance, substantially more complicated than the East Coast Main Line. It may be that smaller franchises such as those serving East Anglia would be more appropriate and have less risks attached.

<u>(ii) Responses to questions as grouped within the consultation document</u>

These are set out below.

Franchise specification

- **Is the suggested model of specification practical and would it deliver good outcomes for passengers and taxpayers? What are the key unresolved issues? Are there alternative models that work better, and what are these?**
- **What factors should be considered in determining franchise length?**
- **Would the proposal to supply an initial "affordability" figure for premium or subsidy help bidders submit realistic proposals?**

We support a franchise length of 15 years or greater for WCML in the knowledge that this requires the TOC to make investments. We accept that longer-term franchises, with investment requirements but without income guarantees will require compensating criteria such as opportunities to generate income... Should a franchise length greater than 15 years be chosen, it would be important to include break points, to allow both parties to evaluate performance and reconsider aspects of the specification. The Merseyrail Electrics' and Chiltern franchises provide models for consideration.

We consider that a requirement for the franchisee to invest is an opportunity that should be grasped by DfT / HMT as currently there appears to be a long-term trend of organic growth which provides some risk mitigation. Greater efforts by DfT to achieve modal shift could reduce the risk premium. Benefits to the TOC and to other stakeholders should be greater if additional innovation and maintenance requirements were contracted.

Longer franchises would contribute to a better business environment in which to establish and benefit from joint ventures e.g. with local authorities and/or other land owners particularly in relation to station (re)development including car parking and public transport integration. Joint ventures with infrastructure providers might also provide cost benefits, especially in an industry that is moving towards vertical integration

We express concern that longer franchises could lead to a long-term monopoly which might operate against customers' interests unless there is robust specification and / or monitoring and review. Also, steps should be taken to prevent an entrenched franchisee presenting too formidable a barrier to entry, for example, for Open Access Operators.

Our concern with the suggestion of stating an 'affordability figure' is that this may risk bidding up to that figure. We would rather government require that franchisees offer a premium based on a package of services which encompass a public service obligation and enhanced services (with an element of cross-subsidy and all contractualised) which when achieved would provide shareholders with an acceptable return, and which if developed either organically or by acquisition could lead to larger profits in return for risk. Failure to achieve the contractualised package would result in penalties to benefit the exchequer. We would suggest that additional profits should be applied to rail industry schemes or public private joint ventures along the corridor, which would contribute to a virtuous circle of economic development.

We suggest the revised franchise contract requires the dominant user of a route to take the lead in seeking timetable opportunities to create acceptable interchange times to regional destinations, thereby integrating hinterlands with the corridor.

The West Coast routes serve the metropolitan areas. We suggest that new franchise contract lists specific requirements for the franchisee to work with Transport and other Authorities including investment plans and providing funding.

Franchise procurement

- **What are the benefits and downsides to the procurement process outlined in the document?**
- **How can we reduce the complexity of bidding, while still protecting taxpayers and passengers (especially given a greater focus on quality)?**

Procurement is a costly exercise and takes a long time to go through its various stages including consultation on the draft specification. Care should be taken that the selected franchisee has sufficient time to mobilise, and make arrangements for example regarding staff transfer and restructuring, and pre-franchise investment. (We note that in Germany, contracts can be let up to 2 years in advance)

Broadly, procurement based on detailed specification is risk averse and could stifle innovation, and is costly to both government and bidders. This model is more suited to a labour-only model in a weak or non-existent commercial market, and where the product can be specified, at least in general, for the length of the contract.

As government leans towards longer franchises, investment and greater private sector risk-taking, and where there is less certainty of product and demand, a procurement process that focuses on required outcomes is appropriate. We would expect a mix of public service obligation provision and market led services which would be the source of profit for the franchisee. Product safeguards should be sought and the taxpayer protected by robust rules and monitoring / penalties.

We would welcome an opportunity at the output specification stage to join DfT and interested parties to contribute to service specifications proposed by

a) DfT, to provide a minimum spec incorporating non-commercial criteria, and

b) others including ourselves as a representative group and Transport Authorities along the WCML contributing service suggestions

Our members have specific suggestions, each important to them, which need to feed into the proposition from bidders. For example, MK council supports improved services to/from the North West and Scotland; Cumbrian authorities are concerned to improve services to/from their principal stations. Many have views about the adequacy of of-peak, early morning and late evening services.

At assessment stage, it is understood that DfT will likely wish to select a franchise on the basis of maximum premium gained. However, we would expect that if these services were not to be provided by the selected franchisee, then the opportunities could be taken up by Open Access Operators. This being the case, we would not wish to see restrictions on their operation being included in the franchise documents.

Contract design and management

- **What services, outcomes and commitments should be contracted?**
- **What is the best way to structure outcome measures based around passenger satisfaction levels?**
- **What sanctions should be used to ensure operators deliver their commitments, including outcome measures?**
- **What levels of performance bond and/or parental guarantees are appropriate?**

It is understood that Coalition Government policy includes promotion of modal shift. It is suggested that this aim should be incorporated in the outcomes. Potential franchisees might identify a benefit to their 'bottom line'. Consideration should be given to quantifying the requirement and the use of targets. For example as a proxy for a percentage change in modal share, a requirement to run a fleet of a specified size for which a profit might likely only be available if high occupancies 18/7 were to be achieved. This could be refined by specifying volume / modal share between specified towns and cities and be included in the base level specification required by DfT.

The WC franchisee contributes also to local and regional services, for example in Greater Manchester and Lancashire / Cumbria as well as carrying commuters to the principal cities such as Glasgow and Birmingham. They provide essential services along the corridor such as early morning and late evening services. They also provide the links between key regional centres in the north west, for example Warrington to Wigan and Preston, over route sections not served by local trains. Together with local TOCs, they provide a coherent package of services, which must be taken into account in the development of the service specification for the West Coast franchise. We suggest that this level of provision should be retained and contracted
We recognise that major income streams derive from the flows to/from London, and that speed of journey is a significant factor in choosing the rail mode. Although these services are commercial, we feel that the proposals made by the franchisee should be contractualised. (We also consider that fares require a regulatory mechanism, and that fares increases should not be allowed to compensate for poor stewardship of the railway.)
We are concerned that without contractualisation, there could be a drift towards reducing station stops e.g. skip stopping. This could be an understandable tendency particularly in difficult economic times. But this is precisely the time when those towns and cities, especially in sparsely populated counties, faring less well, will need the assurance of train services linking them with London or, often as importantly, with other places on the WC routes. Their hinterlands, too, need regular connections to make journeys by rail a viable proposition, which is a matter for the regional and local franchise specifications.

We are concerned that specifying services should not remove incentives from the franchisee to develop opportunities. But we take the view that there needs to be a balance against a market solution failing to provide desirable services. Provision is made in the draft model for the franchisee to propose additional services which would be the source of a greater profit margin.

We suggest that there should be a typology of service provision for consideration at the franchise consultation stage. For example:

1) Services such as ‘station calls’ based on non-economic criteria requiring public purse underwriting such as for example provision in Dumfries and Galloway (Lockerbie);
2) Services based on economic criteria but still requiring public purse underwriting, which would be reviewed periodically to assess continued support, for example, support for regeneration efforts;
3) Market led services which would be the source of the franchisee’s profits

<u>Passenger based outcome satisfaction levels</u>

Passenger Focus identifies key concerns of passengers. Assuming survey samples can give statistically significant results, we suggest use of these. And just as the basket of goods in the RPI changes as tastes change, so provision should be made for the basket of KPIs over the franchise period to reflect changes in e.g. expectations of service quality change (e.g. higher standards, new facilities – such as, recently, WiFi).

<u>Sanctions</u>

Sanctions are a sign of failure and can involve argument and litigation. We suggest an approach based on rules established at the beginning of a franchise. For example, at a trigger level of crowding, new investment is mandatory which will add to fixed costs and thus incentivise the TOC to innovate further and develop its service. In this case it would be the TOC’s responsibility to procure. Over time we would expect this to read to a vertically integrated railway.

We are aware that patronage could be suppressed by manipulating fare levels. However, we note that Fares Policy is not included within this consultation. We therefore merely repeat the statement made above that fares need a regulatory mechanism

We note that a system of penalties has been developed for Private Finance Initiatives and other contracts and these could be considered, also.

Break points in a contract provide a structure and timeline for investment as well as assessment of performance. We suggest that an investment programme and capital strategy be a requirement and that whilst innovation is expected throughout the length of the contract, innovation is made contractual in the first part of the contract.

Assuming that innovation is likely to fall off towards the end of a contract, then we suggest the contract be front-loaded. It may then be necessary to have a longer run-in period. This presents franchisees with an opportunity to establish joint ventures with infrastructure partners.

Revenue risk

- **Should the risk inherent in forecasting revenue over a longer period be shared between operators and government, and if so, how? What are the merits or drawbacks of review points? What are the merits or drawbacks of economic indexation compared to the existing revenue support/share or leaving revenue risk entirely with the operator?**

Both parties, franchisee and DfT, will base their estimates on imperfect information, and it would be reasonable to assume that both parties will make compensating arrangements to mitigate this. A franchise successfully running the length of its term cannot be guaranteed.

We would support government in its desire to seek commitment to a franchise from the franchisee. We favour the legal and financial risk of default being borne, to a significant level, by the parent company (or companies in the case of a JV).

There may be a case for government bearing some of the risk, but the greater that cover is reduces the incentive to the franchisee to make a success of its franchise. If review points are relatively frequent, then the case for government bearing risk is much reduced, perhaps to zero.
Review points within a franchise can cover changes to specification as well as changes in the business environment. They should include material effects of government policy not acknowledged or current at the time of the franchise specification.

We acknowledge that revenue risk can provide a powerful incentive to operate efficiently and effectively, for example, benefiting customer service and collection of fares.

<u>Franchise investment</u>

- **How can we add to incentive from longer franchises to remove the barriers to private sector investment?**
- **How can we encourage investments with long payback periods throughout the franchise term, not just at the start?**

Private sector investment will be dependent on a sufficient payback period. If this is longer than the remaining duration of the franchise, then this will require a mechanism to guarantee an acceptable return to franchisee.

All franchise bids should include an investment plan and the budget for this should be included within the bid documentation, and be contractualised. The assessment of a bid should take into account the shape of the investment plan and the involvement of third parties especially expertise and financial resources.

Investment at or before the start of a franchise should be encouraged. Benefits would accrue to the incumbent as well as the new franchisee. This could be assisted by a 2 to 3 year lead-in period to the new franchise. The franchisee might consider it to be sensible to establish a JV or seek help from an infrastructure investment company.

We suggest encouraging the franchisee:

- to consider non-rail ventures which may help to build brand awareness and revenue streams;
- to enter into JVs to fund investment in infrastructure resulting in a leasehold vertically integrated structure. A JV company could operate independently and also not be constrained by the length of the franchise.
- to enter into JVs to increase the value of the bid e.g with local authorities seeking town centre regeneration based on redevelopment of the station area. This approach may require rapid decision making by, for example, local authorities and Local Enterprise Partnerships.

A franchisee will expect a return on its investment. Such investment will have to be agreed by the Freeholder or a nominee. A mechanism is needed to gain the return, but it should be accepted that there is always a risk of failure of an investment during or following a franchise. Thus the residual value of an investment should be assessed at the end of a franchise and then subsequently. Two broad options are suggested:

1. DfT or Network Rail buys the investment and it is then added to the stock of infrastructure which is then part of the subsequent franchise;
2. No sale of asset, but it is transferred to the new franchisee. The departing franchisee retains ownership and in return for its assets becomes a shareholder / Board Member of the new franchise until such time as an adequate return has been received.

Cost control and efficiency

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

The major costs are labour, infrastructure charges and investment and train leasing costs. A franchisee has direct control over only labour and some access charges. Expertise to deal with labour costs exists in the industry. Access charges could be reduced, for example, by not stopping at a station. But then revenue may be lost and integrity of the service questioned by travellers. West Coast Rail 250 would resist the deletion of more stops from the current timetable as changes, particularly since December 2008, have resulted in considerably worse services for some of our members particularly in Cumbria and Dumfries and Galloway and elsewhere (Cheshire, Bucks).

Unless external pressures control other costs borne by the franchisee, the only way for the franchisee to control or reduce them is through exercising the functions itself through competition or assuming responsibility instead of the current providers which would move the franchisee towards a vertically integrated operation. Such a structure can be beneficial when resources are in short supply, but can work against a company when there is a contested market and cheaper providers are available. We suggest that franchisees be able to exercise those functions that impact greatly on their cost base.

A monopoly supplier, theoretically, has less need to consider costs, as would operators in a contested market. We would also recommend that the franchise should provide for Open Access Operators to use the west coast corridor in order to provide a challenge to prices charged and a spur to innovation

Other suggestions include:

- Cap fare increases to incentivise the franchisee to focus on cost control and maximise sales (which may help to achieve a modal share target).
  Couple this with a requirement to fund investment through fare income (including regulated fares) to reduce borrowing costs.

- Govt could require a review of Rules and Regulations applicable to the railway – e.g. consider safety, fit for purpose, etc. – resulting in reduced costs across the country

- Station investment – encourage investment early in franchise to achieve payback and further benefits earlier; - require asset management and investment plans; - require TOCs to enter into joint ventures thereby sharing some costs.

- Network Rail's charges – challenge charges if equipment not fit for purpose; alternatively invest in infrastructure to reduce TOC's costs and recharge Network Rail, which, again, effectively moves the franchisee towards a vertically integrated railway.

- o Assume control / responsibility for the routes from Network Rail and also responsibility for providing paths to local and regional TOCS. With this would come a responsibility to invest in new infrastructure.

- o Consider integration / ownership of local and regional TOCs into a West Coast franchise. For example absorbing feeder TOCs that receive government subsidy would gain a revenue stream