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Rail Franchising

Purpose of Report

For information and discussion.

Summary

At the last meeting of the Board, Members agreed that they wanted to discuss a response to the Government's consultation on the specification of the new InterCity West Coast franchise to develop a local government position in relation to reforms to franchising. An LG Group response should focus on the key issues that franchising raises for local authorities rather than the local circumstances of the individual franchise.

This paper sets out key issues for discussion in formulating an LGG position on local government's role in franchising, investment and improvement of rail services in future. Subject to Members' views resulting from discussion of those issues, these will form the basis of the LGA submission to the consultation.

Recommendation

Members are asked to comment on key issues underlined in the paper at paragraphs 7, 13, 14, 18, 20, 24.

Action

Officers to progress recommendations agreed by the Board and submit a final response to the consultation by the 21st April deadline.

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Rail Franchising

Current policy developments

1. The Coalition Government is reviewing current arrangements for rail with the objective of reducing costs of supporting the rail network. Following a consultation on Reforming Rail Franchising (July – October 2010), the Department for Transport (DfT) published a policy statement on changes to the rail franchising system. The new approach is designed to attract more investment from the private sector through longer franchises (typically for 15 year terms), with less detailed specifications, increased operational freedom and more incentives for operators to deliver efficiencies and invest in improvements. The InterCity West Coast is the first of the franchises to be consulted on to which these policy announcements will apply. InterCity West Coast Consultation document is available on the DfT website.
<http://www.dft.gov.uk/consultations/open/2011-01/consultationdocument.pdf>.
2. Government has also commissioned Sir Roy McNulty to conduct a study into value for money in rail. That study is assessing how the costs of running the railway can be reduced whilst continuing to invest in capacity enhancement and improving passenger satisfaction. Conclusions from the work are likely to have a large impact on key elements of the franchise contracts and will need to be reflected in future franchise policy. It is expected that the first outputs of the review will be reflected in the final bidding document for the InterCity West Coast Franchise. The executive summary of the interim report of the McNulty study is attached at **Annex A**.
3. The Office of Rail Regulation (ORR) has announced that it will begin the 2013 periodic review (PR13) in April 2011. The review will define Network Rail's outputs, revenue requirement and access charges, and incentives across the railway, for the period from 1 April 2014 to 31 March 2019 (control period 5 – "CP5"). The review will also take account of the outcomes of the McNulty study and DfT's franchising review, both of which will have significant implications for the industry. The PR13 process provides an opportunity for the LGG to influence the future regulatory framework for Network Rail to improve accountability and integration with local transport investment. LGG officers have had initial discussions with ORR officials and will pursue these following the Board's discussions.
4. A timeline setting out the milestones for the key policy developments over the coming months is attached at **Annex B**. Key information on current franchises

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including their timespan and whether they operate a surplus or with subsidy is included at **Annex C**.

5. A summary of roles and responsibilities of Train Operating Companies (TOCs) and Network Rail is set out at **Annex D**.

Developing LGG policy positions on rail franchising

The role of Local Transport Authorities (LTAs) and Integrated Transport Authorities (ITAs) in rail franchising

6. There are currently only two devolved franchise concessions: the London Overground concession, led by TfL, and the Merseyrail franchise, led by MerseyTravel.
7. Under current arrangements, the Secretary of State must consult relevant ITAs and Transport for London (TfL) before issuing an invitation to tender for franchise agreements which affect their area. Members are asked for views on whether this requirement to consult should apply to all Local Transport Authorities.
8. All ITAs and LTAs and TfL have the ability to propose increments or decrements (extra services or improvements to stations) to the base specification but are required to fund additional requirements.
9. However, in practice, Local Transport Authorities have:
 - 9.1 A limited role in the specification process for these increments,
 - 9.2 No role in procurement,
 - 9.3 No ownership of the decision making process; and
 - 9.4 No formal ability to hold franchisees to account for delivery of the contracts.
10. The Government's response to the consultation on rail franchising recognised that where there has been greater involvement of transport authorities in specifying franchises, there has been a positive effect on patronage and levels of customer satisfaction. It also recognised that there would be resource costs for local authorities in managing the costs and risks associated with franchising. The response suggests that DfT would consider ITAs' role in franchising on a case by case basis.
11. The LGG has consistently argued that transport networks, including rail, are crucial to the sustainable economic development of cities and local economies. Therefore decisions on rail investment need to be integrated with plans for local

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economic growth and employment and land use planning to ensure that local transport networks serve the needs of the local economy and promote growth.

12. Delivering this integrated approach will require greater involvement of strategic transport authorities in the franchises to ensure that they:
 - 12.1 Are properly integrated with other modes of transport and responsible to a single strategic transport planning body;
 - 12.2 Are integrated with land use planning, facilitating increased investment from developers;
 - 12.3 Are managed cost effectively alongside other transport services in the light of local knowledge about what standards and specifications need to be prioritised;
 - 12.4 Are accountable to local people.

13. There is a spectrum of options for facilitating greater local authority involvement in franchises, encompassing:
 - 13.1 Making investment in increments or decrements a more attractive option for local transport authorities by giving them a role in decision making and increasing TOC's accountability to them as the funding body;
 - 13.2 Granting Local Transport Authorities co-signatory status with DfT for suburban parts of the route covered by the franchise;
 - 13.3 Devolving parts of the franchise that serve predominantly urban or suburban routes to local transport authorities.

Members are asked to comment on these options.

Role of Local Economic Partnerships

14. Given that Local Economic Partnerships (LEPs) are being developed with a remit for promoting and supporting growth and employment in functional economic areas, they are well placed to take on a strategic transport role and influence the future development of the rail network to ensure it supports economic growth and prosperity in their areas. Members are asked for views on the role LEPs might have in ensuring that rail franchises support local economic development.

Reform of franchising – key issues for local authorities

15. A stronger role for local authorities in franchising would offer a solution to a number of the issues raised by the consultation paper. Members' views are invited on the following key issues.

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Shape of the current franchise system and balance between InterCity and local services

16. The new arrangements for franchises place emphasis on ensuring TOCs can exploit the full potential of the route and maximise capacity. There is a risk that, as has happened in the past, this leads to increases in frequency of intercity services at the expense of local services and improved journey times on long distance journeys by removing intermediate stops. This can have significant impacts on local economies. In granting TOCs greater operating freedom, mechanisms to protect local services must be maintained.
17. The Intercity West Coast Franchise consultation document suggests there is potential for remapping of the overall franchise map. This provides the opportunity to consider whether the shape of the franchise network is the correct one, or whether there should be more focus on connectivity between centres outside London, for example east to west connections.
18. Members are asked for views on these issues and whether suburban and regional services ought to be treated separately from the London-centred interurban long distance routes.

Franchise length

19. Government is seeking to agree longer franchise agreements (typically 15 years). The LGG has supported longer franchising as a means of attracting increased private investment in station improvements, better trains and higher quality services. There are, however, risks associated with longer franchise period. It is much more difficult to forecast demand trends over 15 years than seven years, especially in times of economic change. This is a particular issue in the current fiscal climate: rail is on a strong underlying growth trend and there is a risk that the new franchises will be based on a perceived conflict between demand and the availability of public money that could be addressed more intelligently.
20. Members are asked to comment on the following potential ways of managing this risk:
 - 20.1 Franchise lengths should be decided on a case by case basis in the light of planned local developments and circumstances (timescales for investment in other infrastructure, for example);
 - 20.2 The new franchising arrangements should include a mechanism to ensure that assessment of demand and appropriate investment continues throughout the duration of the franchise period, rather than up-front investment followed by a long period of deterioration;

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- 20.3 Franchises should include provision for local authorities to negotiate with TOCs to capitalise on opportunities for the local economy that arise within the franchise period;
- 20.4 Ways should be explored to encourage franchisees to look beyond public subsidy to other models for transforming potential revenue growth into investment.

Balancing cost to the tax payer with investment requirement

21. The Government's objective through its reforms to rail franchising is to reduce the cost of rail to the public purse through maximising efficiencies and encouraging private sector investment. The McNulty VfM study has identified substantial scope for savings from reducing Network Rail and TOC costs and improving value for money. The study estimates that this could yield £50-100 million in year 2014/15, increasing to £600 million - £1 billion by 2018/19. In this context, it would seem likely that new franchises will be focused on reducing the need for public investment and maximising the premium payments to Government. Clarity is needed on the extent to which improved incentives for operators will deliver the investment required and that savings or enhanced premium payments are reinvested in the rail network where these needs cannot be met by the operators.

Priorities for investment

22. In many areas of the country where overcrowding is a serious issue, there is an urgent need for additional carriages, which may need to be given priority in letting the new franchises. However, the investment required is not limited to additional rolling stock on overcrowded parts of the network, but extends to investment in infrastructure such as platform lengthening, new platforms and electrification of key routes. How can Government, and rail users, be sure that the greater flexibility afforded to operators in the new franchising arrangements will result in investment in the right priorities?

Managing performance and delivery

23. Passenger Focus currently has a role in monitoring performance and satisfaction with services provided by the TOCs, and in providing advice to the Secretary of State on new franchises. Passenger Focus' monitoring work is largely survey-based and will not be able to capture local understanding of performance and delivery issues.
24. Members are asked to comment on whether LTAs and ITAs should also have a stronger role in the monitoring the performance and delivery of rail services,

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particularly if they are to be encouraged to work more closely and invest in partnership schemes around stations.

LGG submission to InterCity West Coast Consultation

25. Subject to comments from the Board, it is proposed that the issues set out above provide the basis for the LGG's response to the InterCity West Coast consultation, and a letter to the Secretary of State setting out the LGG's views on rail franchises.

Financial Implications

26. The proposed action can be delivered within the Board's existing work programme budget.

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Annex A

Executive summary of Rail Value for Money Study – Interim report
(Published December 2010)

- 1 The RVfM Study has now completed a significant amount of work. The work to date suggests that there is substantial scope for change and for improvements in railway costs and value for money.
- 2 As regards costs, we consider that the initiatives we outline later could yield significant savings. Our interim view is that, it should be possible to achieve further savings in the range £50-100m in year 2014/15. Looking further ahead, we consider that it should be possible to achieve additional annual savings in the range £600-1,000m by year 2018/19 over and above the Department's current projection for that year, which already assumes further savings in Network Rail costs in Control Period 5.
- 3 The Study still has a long way to go, and much work to do to complete its evidence-gathering and analysis, as well as recommendations and implementation planning. Accordingly, we stress that this is an **interim** view of potential savings and that we are at an early stage in quantification. However, based on the work done to date, we consider that there is potential for savings of at least the dimensions indicated above.
- 4 As well as enabling the savings summarised above, the initiatives we are proposing will, in our view, assist achievement of the efficiency improvements already required from Network Rail in CP4 and assumed for CP5.
- 5 Delivering these potential savings will depend on implementing a package of wide-ranging and inter-dependent initiatives aimed at:
 - 5.1 Greater clarity and better alignment of objectives, particularly in relation to costs;
 - 5.2 Greater clarity of roles between Government and industry, with Government involved in less detail, and the rail industry accepting greater responsibility for delivering the broad objectives set by Government;
 - 5.3 Industry accepting responsibility for helping to develop, and then implementing, a comprehensive set of industry-level strategies to meet the broad objectives set by Government, particularly those for cost reduction;
 - 5.4 A much stronger focus by the industry at all levels on costs and cost reduction, and on the investment needed to reduce future costs;
 - 5.5 Structuring the industry for cost reduction – the principal key to delivering cost savings is how organisations and people work together, and there is a pressing need to develop structures which enable/require infrastructure managers and train operators to work together in much closer partnership to meet cost reduction objectives;

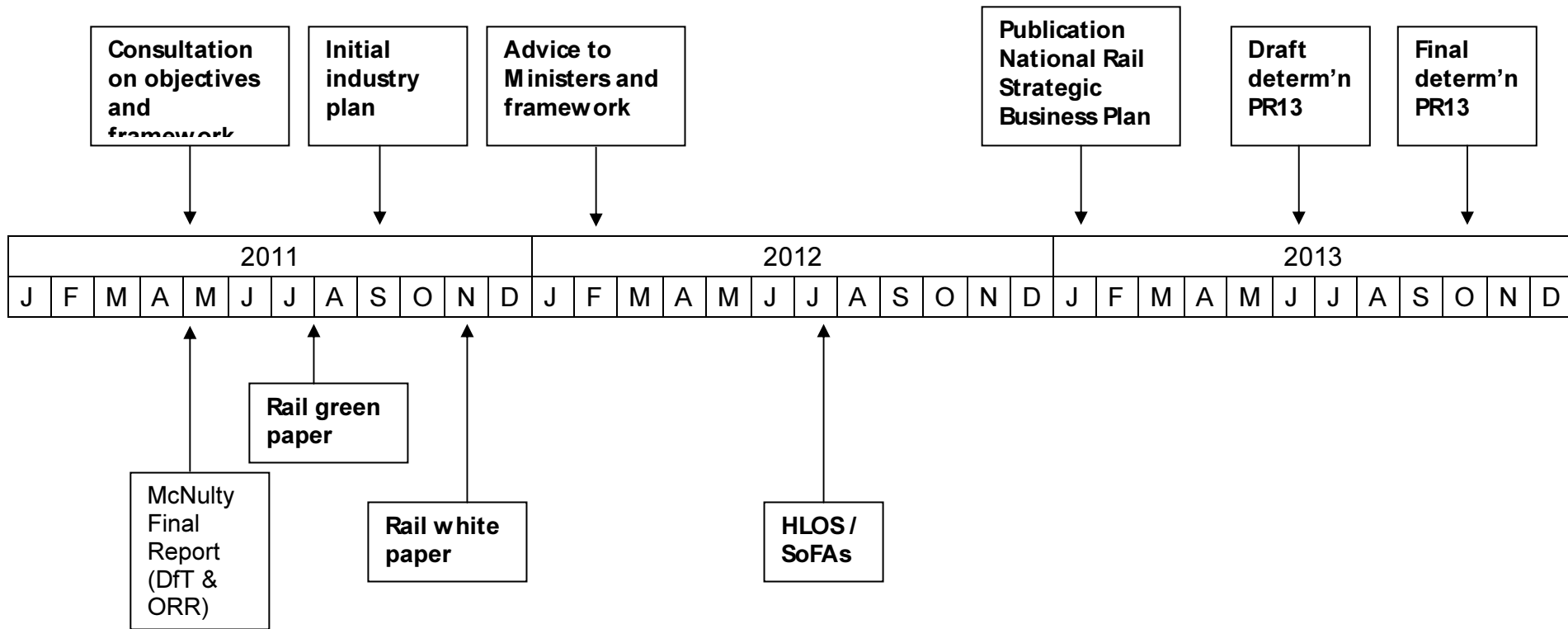
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- 5.6 Stronger incentives which better focus and align the interests of Network Rail and train operators towards delivering lower costs, in line with objectives set by Government;
 - 5.7 Reform of franchising arrangements to facilitate cost reduction; (Government is already addressing the area of franchising, and this Study has further ideas to put forward);
 - 5.8 Leadership for cost reduction; making the changes required to realise potential savings will present major challenges, which can be met only if there is strong and aligned leadership from Government and the Industry;
 - 5.9 Improved planning and decision-making, on whole-system and whole-life bases, with a stronger focus on costs and value for money;
 - 5.10 A more cost-effective approach to standards and rail safety (whilst continuing the drive for improved safety performance);
 - 5.11 Major improvements in asset management, programme and project management, and supply chain management; and
 - 5.12 Improved management of human resources.
6. These initiatives are extremely inter-dependent and few of them will achieve much impact without the others.
- 6.1 To date, the Study has focused principally on issues such as the above, directly related to cost and cost reduction. We have, however, also identified a number of issues which relate more broadly to Value for Money and are summarised later in this Submission, which we will address in the period ahead.
 - 6.2 Of course, whether or not the savings we have indicated are eventually delivered depends on the ability and preparedness of all concerned to make the significant changes required – including Government, ORR, Network Rail, TOCs and FOCs, ROSCOs, the supply industry, trade unions and their members, as well as a range of industry bodies.
 - 6.3 The significant changes that need to be made in the timescales required will present major challenges and many risks for all concerned. However, delivery of each element of change is unlikely to require the GB railway industry to do more than has already been done in railways elsewhere or in other industries in the UK. We believe that that the task is challenging but achievable if all concerned play their parts. The keys to success will be building a **powerful guiding coalition** in support of a comprehensive programme of change, and **effective leadership** in delivering that change.
 - 6.4 Success with a programme of change and cost reduction along the lines we have indicated is crucial for GB Rail, as it seems clear that the only alternative in the financial climate ahead would be much less investment and/or a radically smaller network.

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Annex B - Timeline of key milestones for ORR Periodic Review and DfT rail policy development

Office of Rail Regulation



Department for Transport