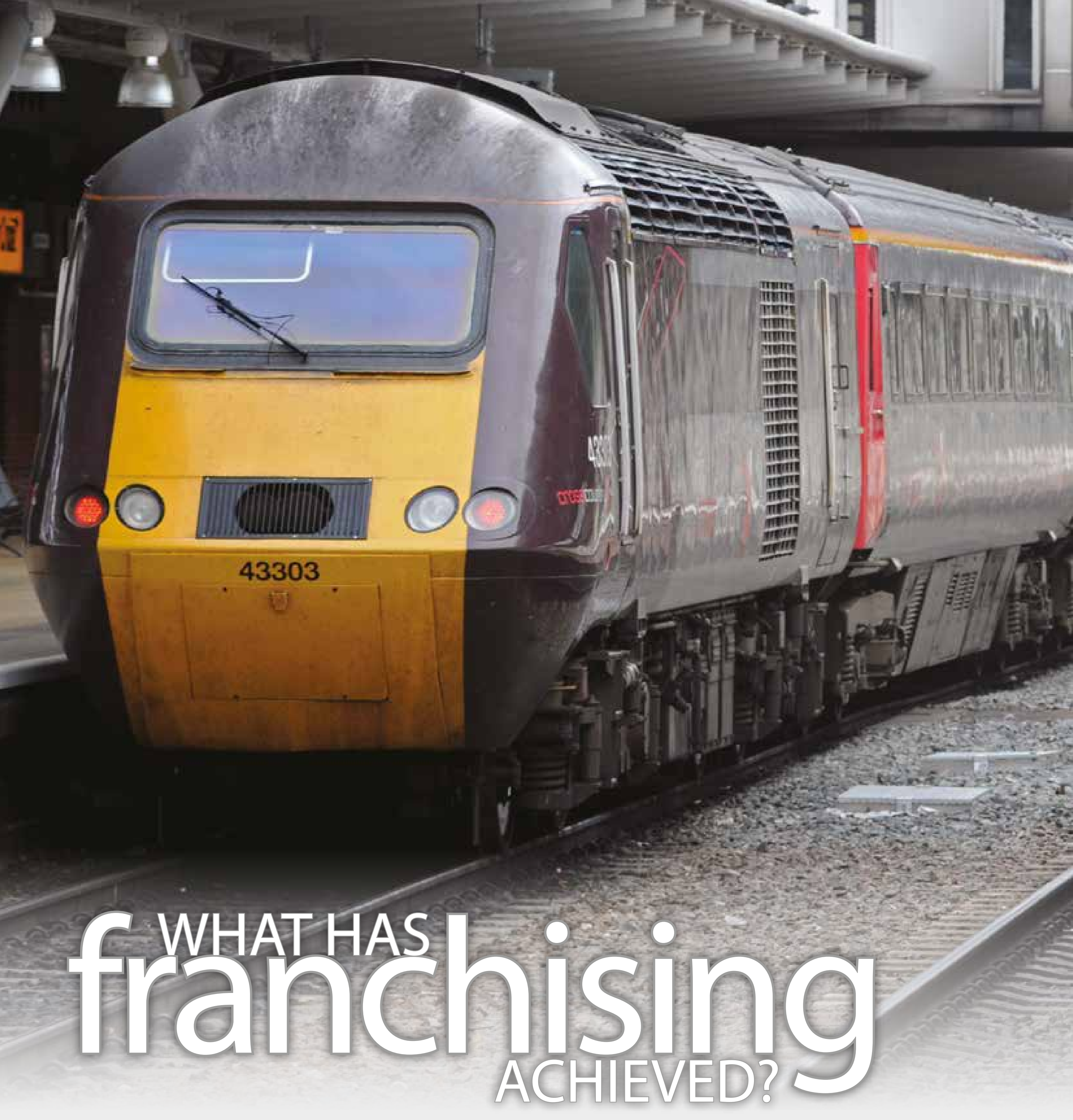

WHAT HAS franchising ACHIEVED?

Transport Journalist **CHRISTIAN WOLMAR** continued the Railway Study Association's theme for the year as he put forward his view on privatisation

Franchising started off with the wrong premise, and the whole house of cards is built on sandy foundations. It began with the mind-set of the people who privatised the railway. Why did they do it at all? Their assumptions were:

- British Rail was inefficient;
- there was too much subsidy;
- the unions were too strong and there were too many strikes;
- there was no commercial flair; and
- there was no competition.

But how true was any of this?

INEFFICIENCY

BR may have had its inefficiencies, but it did shed 500,000 of the 650,000 staff it inherited at nationalisation. There were still some guards, but South West Trains hasn't managed to change that in the last 20 years. BR was by and large a success story and was broken up for ideological reasons – the purpose was not to improve the lot of passengers, or indeed taxpayers.

SUBSIDY

Subsidy has grown with privatisation, not decreased. In the final days of BR it was around £1 billion to £1.5 billion in today's money. This went up to £6 billion at its peak and is now around £4 billion. Added to that, a debt of £30 billion has been built up by Network Rail over the past 20 years; that has now been put on government books. This adds perhaps another £1.5 billion per year to the level of subsidy, but is never factored in. So there is a subsidy of around £5 billion a year throughout the history of privatisation.

To be fair, there has undoubtedly been more investment, but it is still a substantial cost. This is mostly due to fragmentation, duplication, complexity and the lack of a Fat Controller.

BR heritage: CrossCountry HST at Derby on 7 July 2010. Paul Bigland

Branding bungle? Unit No 156422, carrying 'one' livery, crosses the swing bridge at Reedham on 22 April 2006. Paul Bigland

One basic issue needs to be got straight. The railways are a public service that deserve subsidy, because of the external benefits that they provide. Paying for themselves is a nonsense in economic and social terms, but that doesn't mean the level of subsidy shouldn't be driven down. Privatisation has achieved the opposite.

Remember that InterCity was profitable, while Network SouthEast broke even and was starting a programme of Total Route Modernisation.

UNION POWER

The unions have not done badly out of privatisation, with ASLEF's drivers being paid far more than they would have earned in the public sector. The RMT has one of the fastest growing union membership rates. The unions are far from having been broken.

COMMERCIAL FLAIR

Has the privatised railway put out anything as good as the InterCity TV advertising campaign, or created a brand for London commuting? Franchisees by their nature do little marketing and some of it has been downright awful. Remember 'one', which led to the famous announcements at Cambridge of the first train being the 'one' train and the second train being the First train.

COMPETITION

This brings us to competition, the real driving force behind privatisation. Competition is difficult on railways; there is generally only one set of tracks and BR had done much to filter out duplicate routes.

Moreover, they are often pretty full. Coordination rather than competition should be the watchword.

But the structure of a track authority was created precisely because the Treasury wanted competition. Competition was defined as good, monopoly bad, which together implied that cooperation was also bad.

The 21-page document *New Opportunities for the Railways* set the tone. 'The government wishes to encourage the greatest possible development of commercial rail services. It will therefore establish a framework and procedures through which companies wishing to provide new railway services … will have a right of access to the network.'

Only that didn't, and couldn't, happen. If you have a franchise, you are operating a suite of services, the profitable and the unprofitable. You are providing a public service.

OPEN ACCESS

Open access operators, who incidentally pay only marginal track access costs, will not want to run loss-making services. The result is cherry picking, with the franchise correspondingly devalued and a loss to the taxpayer. So we got moderation of competition and, oddly, Virgin being allowed a monopoly while the East Coast was something of a free for all.

So open access became a marginal issue, with perhaps 30-40 passenger trains a day (excluding Heathrow Express). All are on the East Coast main line. The people of Hull and Sunderland may have benefited, but it has inconvenienced many others and has been a form of revenue extraction (ORCATS raids).

What then is the purpose of franchising? 'Franchising was designed to transfer risk and to protect customers while doing so' is an answer given by Jim Steer, one time Chairman of the Strategic Rail Authority, though he wonders if that is being achieved in the present structure.

HISTORY OF FRANCHISES

In what was a quite remarkable administrative feat, the Office of Passenger Rail Franchising (OPRAF) managed to let all 25 franchises between the end of 1995 and March 1997. Now it seems that DfT is confined to letting a couple of franchises a year, if it is lucky.

Overall, the lowest bidders for subsidy got the franchises, provided they could obtain the required bank guarantees. There were management buy outs (MBOs), but bus operators predominated and a new arrival, Prism, got four. It soon found itself in financial difficulty and had to be rescued by National Express, which ended up with seven.

There have been numerous variations of the franchise offer:

- seven year lengths;
- combined franchises from London stations (Thames and Great Western);
- competitive franchises (Great Eastern and Anglia);
- longer discrete franchises (c2c and Chiltern);
- franchises with open access competition (East Coast);
- franchises without effective competition (West Coast, mostly);
- management contracts;
- cap and collar;
- state takeover (Connex and National Express East Coast);
- devolved franchises (Merseyrail, Scotland, Wales, London Overground);
- a desire for longer franchises, which resulted in the West Coast fiasco.

What, then, might franchises achieve?

MONEY SAVER?

There is no one there to drive down costs, nor is there any real incentive so to do. The consultancy, Just Economics, estimated that the cost of interface between Network Rail and train operating companies (TOCs) was £290 million annually. Sir Roy McNulty explained why:

'Having multiple industry players, together with misaligned incentives and the existing railway culture, has made it difficult to secure co-operative effort at operational interfaces, or active industry engagement in cross-industry activities which need to be undertaken for the common good, such as the Rail Safety & Standards Board (RSSB).'

He added 'these same commercial interests, particularly within the scope of relatively short franchises, can lead to an unhelpful degree of short termism in an industry that requires long term planning for its proper development. In addition, and most importantly, the fact that the TOCs are insulated from changes in track access charges … means that they have no incentive to minimise Network Rail's costs, and there is currently no effective mechanism to encourage them to do so.'

Profit is earned for taking risks and for investment, but neither are applicable in this industry. Much of the risk is taken on deliberately by companies overbidding to gain market share, but why should the taxpayer subsidise that?

How much profit is made by franchisees? The Rail Delivery Group estimates it to be in the order of around £230 million, but that excludes administration costs. The regulatory paraphernalia and bidding costs add substantially to franchising costs.

For a discussion of compensation costs, see the panel opposite.

SMOOTH OPERATION?

There have been a number of fiascos resulting from franchising. The issue of accidents was the first and most disastrous. Thankfully, the railways have been exceptionally safe in the past 15 years, but there is no doubt that the causes of Southall, Ladbroke Grove, Hatfield and Potters Bar had their roots in privatisation and fragmentation.

Another, probably the most costly, was the Railtrack European Rail Traffic Management System (ERTMS) West Coast episode. Suffice to say here that no integrated railway would have been dumb enough to think that you could install moving block signalling on one of the busiest lines in Europe when the technique was still in its infancy. Quite apart from having spent £250 million on developing the technology and then abandoning it, the débâcle ended up in being a gift to Virgin, which had the company at its mercy when renegotiating its access contract.

Then there was the lack of available power for the new trains ordered by the three Southern franchises. This started in 1998, but no one had thought about the extra traction power that they would need. So hundreds of new trains began to be parked in sidings as finally Railtrack, bullied by the Strategic Rail Authority (SRA), started to rectify the situation.

Devolved: the Merseyrail franchise is awarded under an operating concession by Merseytravel. Units No 508112 and 508127are seen at the network's most northerly point, Southport, on 30 May 2008. Paul Bigland

Interface: the South Western alliance has brought operations and infrastructure under one umbrella. Unit No 455729 leads a service into Guildford on 23 April 2014 while the 'orange army' is hard at work next door. Paul Bigland

ENGINEERING WORK COMPENSATION

Train operators are paid compensation by Network Rail when work is carried out on the lines they use, which is designed to improve their service. Compensation for planned work typically adds £150 million a year to the cost of the railway, and perhaps the same again for unplanned work. The formula takes into account:

- extra mileage the trains may have to run;
- missed stations;
- missed monitoring points (usual places on the route that are omitted because of diversions);
- the number of cancellation minutes; and
- extended journey times.

This is set out in an equation based on minutes, which are then multiplied by three factors:

- a 'busyness' factor, assessed on the number of trains that pass the particular monitoring point (and not on the number of passengers);
- a marginal revenue effect (which turns time into £ and is based again on a model); and
- the notification factor.

The latter means that the earlier Network Rail tells the operator about the closure, the less it has to pay.

There are now two other components. The compensation payment is reduced for trains not run, since energy costs have been saved. If the train has to go further, extra energy costs are added.

The original model did not recognise the costs of bus replacement. A formula means that for every mile of closed railway there is a fixed payment. This is multiplied up, not by the number of buses, but by the number of trains cancelled. Thus the same payment is made whether the train is a Pacer or an 11-car Pendolino.

The National Audit Office found that 'there had been an unplanned additional subsidy of £760 million from the SRA to four TOCs' and various other costs, as well as the £700 million that Railtrack spent on the upgrade, which itself was more costly because of the rush.

INVESTMENT

The desire to get TOCs to invest has led to several efforts to introduce longer franchises. However, it is simply impossible for bidders to take risks over a period of longer than maybe five years, so you end up with attempts to mitigate the ups and downs. But since train operators have no assets, why should they invest? What happens to the residual value if they do?

A STABLE SYSTEM

Over the 20 year period of franchising, there have been no end of permutations of franchise area and franchise size as well as length. Name changes have been a great cause of confusion; only the franchise system could come up with Thameslink, Southern and Great Northern, which manages to incorporates both Southern and Northern in the same name!

So what is the optimum size? Was the lot of Thames commuters improved by becoming part of Great Western, or not? If they are better off, is it not logical that London Midland and Virgin should be combined? Why were Great Eastern and Anglia merged when the system is supposed to be encouraging competition?

RISK TRANSFER

Sir Roy McNulty's report encompassed risk transfer well: 'The Government's recent (2010) review of franchising has highlighted a number of barriers … including franchise periods which are too short, overly-prescriptive franchise agreements, insufficient use of residual value mechanisms … and insufficient risk transfer to the private sector from Government. [They are also] difficult to vary in the light of emerging market developments or changes to policy, resulting in inflexibility.'

The Brown review got to the nub of the problem by stating that franchisees should be responsible for the risks they can manage, and should not be expected to take external macro-economic or external revenue risk.

But how are risks classified? If a huge housing estate is built near a station, the railway can count itself lucky. But if the estate was built precisely because the railway was there, maybe it was because the operator had a good reputation.

Or, taking another example, growth of Gross Domestic Product (GDP) has in the past been in line with passenger growth. In recent years, passenger growth has actually well exceeded that of GDP. Why did this happen and will it continue into the future, or might that relationship even be reversed?

No formula can ever take all that into account, which means that franchisees will sometimes benefit and sometimes lose out. So what is the point of transferring risk?

INSTABILITY

There have been 33 train operators, including a couple of open access ones, which have gone out of business in the years of franchising. This leads to redundancy costs as well as the cost of setting up a new company and rebranding. But what about the staff, who are fearful for their jobs? Does the company lose its focus, with services becoming run down and the business suffering accordingly?

All that is quite apart from the bidding costs.

FOREIGN OWNERSHIP

Deutsche Bahn now operates in 16 countries and has a turnover that far exceeds that of the whole railway industry in Britain. Conceivably, British

Better together? London Midland unit No 350235 calls at Stafford on 18 October 2013 as Virgin Pendolino No 390006 speeds north on the through lines. Paul Bigland

Rail, with its expertise in consulting, technology development and research, could have done much the same.

Instead, DB operates a substantial part of our network. So not only has privatisation prevented us from developing a large railway company able to expand abroad, but we have allowed our network to be taken over by foreign interests. Why are foreign governments allowed to own franchises, yet ours is not?

Barriers: passengers negotiate the gateline at Leeds on 1 June 2011. Paul Bigland

TRUST

Passenger Focus provides annual statistics on trust and no operator scores more than 50%. This is due to the nature of the business. People just don't think that the private sector ought to be operating a monopoly public service, even with all the checks and balances that are in place.

Can anybody argue that today's customer experience is wholeheartedly better than British Rail? The answer seems to be that it is patchy.

REVENUE PROTECTION

How much effort do TOCs put into revenue collection? The introduction of ticket barriers seems to have given operators a false sense of security in this regard, but the barriers are often left open. This is particularly the case when it involves collecting another company's revenue.

Companies with extensive on-train ticket checks, notably those operating long distance services, are unlikely to make much use of platform barriers during periods when the main beneficiaries will be the operators of suburban or short distance services.

LEAST WORST OPTION?

So there is a lot that franchising has not delivered. The railways have been a success in recent years and revenue has been boosted, but showing that there is any correlation between franchising and this growth is impossible.

Nothing can take us away from the fact that the system causes the 'three Cs' of cost, complexity and confusion. Even so, is franchising the least worst option?

There are alternatives. The Railways Act 1993 precludes public sector bidders, but it doesn't say that the railway has to be franchised. So as things stand they can be allowed to wither away and simply be taken back in house.

The Labour Party has suggested that there should be a public sector bidder for franchises, but this would entrench the present situation without offering compensatory savings.

Compass, a left wing group, is looking for an overall guiding mind, a GB Rail, which would take over the franchises, but with regional boards overseeing the operation of local railways.

There are many possible structures. Wales is looking at a cooperative model. But to accusations that this is going backwards, there is a simple answer. Should we or could we recreate the monolithic BR?

No, and nor would we want to. But we can do a sight better than continuing with a structure that is costly, complex, unaccountable and not fit for purpose.

Here's a target: 'The railway should seek to provide a high quality service that passengers understand, with simple system-wide ticketing and affordable fares.'

Does franchising help it to do that? *John Glover*