INFORMED SOURCES e-Preview July 2016

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Most of this month's column deals with the politics and regulation of our industry, but I promise it will be back to the practical issues of the here and now next month.

What next for the passenger railway?
Periodic Review – here we go again
DfT underlines rolling stock market uncertainty

It is hard to believe that two decades have passed since the first franchises took over Britain's passenger services. Between 4 February 1996 and 1 April 1997, OPRAF let 25 franchises. On two days during that time, 13 October 1997 and 2 March 1997, five franchises were handed over simultaneously.

Today, the aim is to let no more than three franchises a year. Compared with the 1990s the stakes are much higher.

In modern money, when South West Trains became the first franchise to run in 1966, its annual passenger revenue was around £350 million. Today, it is over £1 billion. Intercity West Coast revenue was also around £350 million in 1995. It is now a fraction under £1 billion.

Perhaps unsurprisingly only two bidders have come forward to bid for South Western: incumbent Stagecoach and FirstGroup. Stagecoach Group's revenue in the last financial year was £3.2 billion of which the UK Rail Group represented £1.5 billion. That was before the acquisition of Intercity East Coast, but you can see the potential impact of losing SWT.

Track record
One lesson we can draw from two decades of franchising is that continuity pays. But bid evaluation does not take into account proven good performance. Stagecoach, which has held SWT since 1996, had to bid aggressively to win the current 10 year franchise – but this came at a price to DfT and the Treasury.

In 2014-2015, SWT paid the highest premium of all TOCs at £552 million. Yet at £177 million SWT also received the highest level of revenue support.

But I would argue that had Stagecoach forfeited the franchise with a less 'sporty' bid, the railway would be worse off, not least because of the way SWT management has taken the lead in driving through the integrated programme of rolling stock and infrastructure enhancements to increase capacity into Waterloo in the current Control Period 5 (2014-2019)

You might think that this support for DfT's aspirations would be valued. But when it came to negotiating a Direct Award contract, which would have kept Stagecoach in charge through to the completion of the Waterloo CP5 programme in 2019, DfT thought the Stagecoach offer was a rip off and now Stagecoach and FirstGroup have to fight to the financial death, incurring anything up to £20 million in bidding costs.

Of course, it can be argued that whoever owns a franchise, the daily railway would keep on delivering. That you simply transfer the workforce to the new owners, change some of the executives and the flog everyone to meet the new owner's financial targets.

But the general lack of continuity, the absence of reward for the successful and DfT's obsessive belief in a pool of organisations that despite zero experience of UK style franchising could do the job better suggests to me that the franchising experiment has run its course.

State owned
And this was before the reclassification of NR as a public body. As DfT Permanent Secretary Philip Rutnam observed recently 'we're moving towards a situation where the government is much more clearly the customer and Network Rail the supplier'. Add in the stampede to devolve power to NR's eight Routes and where does this leave franchising?

As a franchised train operator your customer is DfT. Now, your major supplier, NR, is also owned by your customer.

Of course the aim of the South Western Alliance was to bring track and trains back together under unified management. But it would be a brave franchise operator who signed up to a commercial deep alliance with DfT. The old joke about the pig and hen alliance to sell bacon and eggs refers.

ScotRail is the exception that proves the rule. The combination of competent civil servants interpreting a clear political vision through one train operator and a single infrastructure provider could be seen as an unfair advantage. Rather than a Deep alliance, a national alliance is gathering strength north of the border.

Needs and means
What is the basic requirement that franchising was meant to satisfy? I suggest the answer is 'to run and develop the passenger railway efficiently and economically on behalf of the state'.

This, taken from the DfT's ICWC 'Overview & vision document, is the official interpretation.

"Through franchising, Passenger Services aims to encourage a flourishing, competitive passenger rail market which secures high performing, value for money services for passengers and taxpayers whilst driving cost effectiveness. We aim
to stimulate innovation in order to advance our vision of a world class railway that creates opportunity for people and businesses, including by promoting continuous
improvements in passenger experience and boosting the efficiency and sustainability of the railway".

For those who enjoy this sort of thing here's a link (http://bit.ly/1TYubGI). The meaningless guff starts on Page 37.

In the real railway any replacement franchisee will have to deal with NR's accelerating devolution programme. This will see TOCs grappling with quasi-independent Routes – encouraged to do things differently. As reported above, the role of ORR is still being debated.

Stability

In this changing uncertain world what the passenger railway will need over the next decade is stability. DfT has already recognised this with the GTR Management Contract covering the Thameslink construction programme – and even that has seen the operator's margin halved. The Direct Award franchise agreement taking Great Western through the Great Western Route Modernisation programme is a step in a similar direction, involving little revenue risk.

In the case of Crossrail, TfL has awarded MTR an eight year concession spanning the fitting out through to the initial period of normal operation. MTR is being paid to run the railway, with payment subject to performance adjustments bonuses and penalties.

It seems perverse, then, that with the imminent re-run of ICWC franchise replacement DfT is proposing a conventional revenue risk-based franchise. In addition to the general chaos of devolution, there will be the specific disruption of HS2 works, particularly at Euston, plus the need to support the run up to, and integration with, the opening of the new high speed services.

So why not a management contract or concession. Similar considerations apply with the current replacement South Western franchise – big money, big projects, big contingencies which the conventional franchise was not designed to handle.

I hope that this extended analysis will start readers thinking about how passenger services should be organised in the new state-controlled railway environment, radically different to franchising in 1996. Obviously change has to be progressive and start from where we are.

Periodic Review – all change

A 21st Century plague which has blighted this column has been the quinquennial Periodic Review of track access charges. This is when the Regulator resets how much money the infrastructure operator should get to operate, maintain, renew and enhance the railway for the next five years. Even though Control Period 6 doesn't start until 1 April 2019, last month, not even halfway through the current CP5, the Office of Rail & Road launched Periodic Review 2018 (PR18) with an initial consultation documents'

Why PR18? Well, just to confuse everybody, ORR refers to Periodic Reviews by the year in which it makes its Final Determination. For CP6 this will be towards the end of 2018.

Past Periodic Reviews have followed a well-worn process, with Industry Business Plans, ORR responses, Government High Level Output Specifications and draft and Final Determinations, all interspersed with consultants battling over the same numbers, interminable consultations and the odd confrontation.

Because I believe that if we don't understand how the industry's finances are determined we can't make sense of the railway, with previous Periodic Review Informed Sources has analysed the key documents and tried to explain the policies and numbers behind the blankets of regulatory prose and smoke and mirrors of political bloviating.

Not very exciting, and it runs the risk of alienating the readership, but I believe necessary.

However, the good news is that PR18 is going to be different. As ORR explains in its initial document, the reclassification of NR as a public body will require 'a number of changes to how we regulate Network Rail which, taken together, mean that this review is likely to be significantly different from previous ones'.

With NR now part of the Department for Transport, the need for ORR, or, at least, the scope of its duties, is being challenged openly. DfT Permanent Secretary Philip Rutnam sees a new world where the government is the customer and Network Rail the supplier and ORR has a diminished role. NR Chairman Sir Peter Hendy believes his company must focus on its 'real customers' rather than the ORR.

Already ORR has given up trying to control enhancement costs. Because new enhancement projects for delivery during CP5 were being specified late into PR13, ORR had to base its Final Determination on NR's preliminary cost estimates. The theory was that when the final numbers came in ORR would assess whether NR's estimate for each project was fully justified using the Enhancement Cost Adjustment Mechanism (ECAM).

As we know significant differences have emerged between the ECAM efficient costs and NR's actual project costs. With some unbridgeable gaps, ORR has capitulated and is currently discussing with DfT the ending of the ECAM process for England & Wales. The costs in Sir Peter Hendy's Enhancements Review will now provide the 'efficient baseline'.

ORR is also exploring a more flexible approach to investment in the network, where Government wants a more direct role in the monitoring and delivery of improvement projects. In other words cost control will be down to NR, DfT and the Treasury.

Gloom

Overall, ORR takes a gloomy view of CP6. Reclassification, means NR is having to compete directly for funding with other public spending priorities such as health and education, involving Government in a range of spending decisions that were previously left to NR with ORR oversight.

With Government, as NR's sole lender, also imposing binding borrowing limits, NR can no longer raise additional funds on the market to cover overspending. As a result enhancements previously planned for Control Period 5 are sliding to CP6.

Including deferrals from the current Control Period, ORR estimates that around £9.5bn of enhancements are already planned for CP6. It warns that the constrained fiscal environment may limit further public funding for additional major projects.

To complete the financial cheer ORR points out that the 'financial sustainability' of NR's debt, forecast to reach £51 billion by the end of CP5, is another 'issue', particularly as the funding needed to service the debt will also grow. Opening debt at the start of CP5 was £31bn.

Central functions

ORR will continue to regulate NR overall as system operator under what it terms a 'tailored approach'. This central role includes timetabling, capacity management, analysis and long-term planning.

So instead of just another Periodic Review to slog through, it looks like fun and games ahead as DfT and ORR make it up as they go along. I expect the law of unintended consequences to feature.

New trains market rolls on

Normally, I don't cover the various official rolling stock surveys because the short term market is in a permanent state of flux and the longer term unknowable. DfT's, second Rolling stock perspective published in May is largely aspirational waffle. Class-by-class tables show current and future deployment, but, in general, only to the end of the current franchise.

DfT tries to make some serious points. While rejecting 'total standardisation', on the grounds that it would restrict the ability to innovate, DfT is 'considering' discussion with TOCs, NR and ROSCOs whether the industry might agree on standard vehicle dimensions and door positions to simplify infrastructure planning. DfT claims that almost every route is bespoke in its dimensions, but this doesn't seem to have stopped the ROSCOs funding 'standard' designs such as Porterbrook's Eurostars.

Closer collaboration by manufacturers and TOCs with Network Rail is urged. Involving NR in the franchise award process will allow the infrastructure operator to offer advice 'and raise any concerns on a bidder's plans'.

That sounds to me like a restriction 'the ability to innovate'. The next thing will be DfT complaining that infrastructure costs would be much lower if it weren't for the TOCs insisting on running all those trains.

Meanwhile Porterbrook's order for 37 four car Class 387s, initially leased to GWR, reflects the point I made in last month's column about the falling cost of leasing new rolling stock, thanks to a combination of cheaper trains and lower borrowing rates. Combine the two, and leasing costs may be approaching half their historic levels.

Obviously lease rental is only part of the cost of ownership to a TOC, but since GWR started looking for suburban EMUs it has been able to lease progressively more trains for the money it first thought of. With the Class 387 a proven, 110mile/h capable unit, plus early delivery off a long established production line and at a competitive price, Porterbrook had an offer even the Treasury could not refuse.

This coming week could see the announcement of the replacement East Anglia franchise, which is being touted as a mass-extinction event for the existing ex-BR fleets. Watch this space

Roger's blog
A full report next month on the new Class 700 EMU for Thameslink. There was plenty of time at the Blackfriars launch to give the interior a good pummelling with the fist of quality and my Modern Railways colleague Philip Sherratt was also present, which made measuring the interior much easier.

In terms of build quality, I rate the interior Siemens' best yet. But the leg room is miserly and even the First Class accommodation is pretty Spartan. The official excuse for the lack of seat back tables or Wi-Fi is that the specification was written back in 2008, but the deal wasn't signed until 2013 – so that doesn't stand up. Longer distance commuters are not going to be happy.

Sadly my trip to Birmingham to play with Siemens' new WESTCAD-E signalling control system had to be postponed. However I did have my update from NR on the Digital Railway and the transition to ETCS in particular.

Next week's Fourth Friday Club (24 June) incorporates the Modern Railways innovation awards. Guest speaker is ORR Chair Stephen Glaister. June ends with the Stagecoach Summer reception where there will be a lot to talk about.

July starts with a lunch organised by GB Railfreight to discuss the implications for the industry of the collapse of the power station coal market.

This time 40 years ago I was writing an article on how British Rail was gearing up to handle the output from the new Selby coal mine then being developed. Eventual output was forecast at 10 million tonnes a year moved by 50 MGR trains a day. For those with back numbers, it's the August 1976 edition and has some interesting insights on 1970s energy policy, although I must apologise for the tables.

Two days later we celebrate InterCity's 50th birthday with a lunch at King's Cross. This is being organised by members of the former InterCity engineering team, so should be fun.

At the end of the month it's two parties in a week: first the Rail Delivery Group and two days later a mystery event organised by Hitachi.

No doubt, between now and then there will be invitations to news events and, hopefully, a rescheduled trip to see WESTCAD-E.

Meanwhile, I must get on with Part 2 of the article reporting on my visit to the Great Western Electrification Project at Swindon. In this month's magazine Part 1 covers the Overhead Line Equipment. The follow up will focus on the High Output Plant System (HOPS) and its development.

Roger