INFORMED SOURCES e-Preview January 2023

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Another mixed bag for Informed Sources this month, starting with the publication by DfT of the delayed HLOS and SoFA for the new Control Period starting on 1 April 2024 – just over a year away now. While elsewhere in the magazine there is my annual rolling stock reliability review, including the performance of every fleet on the network.

Network Rail - little change in CP7 spend

Flaccid HLOS ignores current issues

Vivarail in receivership

LNER highlights structure not ownership matters

On 1 December the Department for Transport published the High Level Output Statement (HLOS) and Statement of Funds Available (SoFA) for the new five year Control Period 7 (CP7). I start the column with an analysis of the financial numbers in the SoFA, because the HLOS contains very little detail.

Under the Railways Act 2005, the Government is required to publish the HLOS and SoFA. The HLOS specifies what the Government expects from Network Rail: the SoFA how much Network Rail can spend on Operations, Support Maintenance and Renewals, plus how much subsidy will be available.

How does the funding for CP7 compare with that for the current Control Period, CP6? Ostensibly, the settlement is down by about £10bn. However, just to confuse us, the level of expenditure in the CP6 SoFA included some provision for the funding of enhancements. This was worth around £10.3 bn.

Network Rail’s projected expenditure for CP7 is £44.1bn. This covers Operations, Support, Maintenance, and Renewals for England & Wales. Funding for enhancements is allocated separately by the Treasury and has yet to be determined.

To calculate the subsidy required, DfT then subtracts Network Rail’s assumed income, from track access charges property and other third parties. These add up to £16.5bn. The difference is Network Rail’s subsidy, AKA direct support, of £27.5bn.

In the column I quote some figures on expenditure on CP6 provided by Network Rail. Network Rail says the CP7 outcome is as ‘broadly the same level as CP6, in real terms’.

For how the money will be spent we have to wait until February when Network Rail is due to publish its Strategic Business Plan (SBP)for CP7 as part of the Periodic Review Process.

With the SoFA effectively ‘same again’ it looks as though the franchised passenger operators will be bearing the brunt of cost cutting. DfT data, published in the column, gives an indication of the expected ridership and revenue recovery post-Covid.

It looks as if DfT is expecting returning revenue, plus cost control, to reduce subsidy required by the passenger operators to just over £1 billion by the start of CP7.

Bland generalisations dominate HLOS

To put the HLOS for CP7 into context, I have revisited all the previous HLOS. And in comparison, the latest one published on 1 December 2022 is not even a shadow of its predecessors.

In the column I analyse the content of these HLOS past, starting with the very first one covering CP4 (2009-2014). Published in July 2007, the focus was on cutting costs, with the SoFA falling over the five years from £4.7billion in the final year of CP3 (2008-09) to £3.27bn in 2013-14. Straight line revenue growth would make up the difference.

When the HLOS for CP5 (2014-2019) was published in July 2012 it was heralded on the front page of Modern Railways as the coalition Government’s ‘spending spree’. Under the sub-heading ‘Rolling programme of electrification’ we listed new schemes, including ‘Bedford-Oxford reopened and electrified’.

As we now know any euphoria was short-lived. When it was published in July 2017, the HLOS for the current CP6 (2019-2024) was a skimpy three pages plus a further three pages of forecasts of demand at the end of the Control Period.

As for the initial SoFA, that had no financial numbers. The final SoFA would be released in October after the Government had further assurance that the volumes and costs of operations and maintenance activity ‘are reasonable and affordable in order to fulfil its statutory role to set a SoFA’.

Announced on the same day in July was the cancellation of electrification between Cardiff and Swansea, the Midland Main Line north of Kettering and the Windermere branch.

Come October 2017, the SoFA announcement emphasised a ‘new focus on everyday services’, with ‘billions more

invested in renewing existing infrastructure to improve punctuality and reliability'. Major upgrades around the country were promised, 'delivering faster, more comfortable trains'.

But, even compared with this minimalist 'predecessor, the latest HLOS specifies no meaningful outputs. This did not daunt Transport Secretary Mark Harper.

Announcing publication of the HLOS he declared 'the high-level output specification makes it clear that the government will press ahead with rail reform, addressing the challenges facing the sector, such as fragmentation and out dated working practices, with a strong continued focus on operations, maintenance and renewal'. Well, sorry Mark, you must have shown an earlier draft.

But while the Government's inability to specify what it wants from the railway creates a policy vacuum, it equally opens opportunity for the industry to offer the Government its vision of what it can provide for the money through the Strategic Business Plan, which is due to be published in February. According to the Office of Rail & Road (ORR) the SBP is required set out, based on governments' decisions about CP7 funding and outputs, what Network Rail intends to deliver for CP7.

But since there is nothing on outputs in the HLOS, Network Rail has the opportunity to go to town, making the SBP the industry's vision of the Network for the remainder of the decade. In effect, the SBP would say 'this is what you can get for the money' and lay out what the SoFA buys for each of the Regions.

With an election coming, the industry needs to set out its stall. DfT's flaccid HLOS has provided the opportunity.

Vivarail – missed market caused collapse

When Vivarail announced its intention to appoint Administrators on 24 November, there was a collective sharp intake of breath among the Modern Railways team. Next day was the annual Golden Spanners Awards and this year I had allocated my Wild Card golden spanner to the Re-purposed category. And it was going to the Vivarail Class 484 electric multiple units on the Isle of Wight.

Might this create an embarrassing situation, we wondered? But come the day and the reaction to the receivership was a collective shrug. No-one seemed surprised at the news. One Informed Source summed up the situation: 'if you set up an organisation to make trains and don't sell enough of them you run out of money'.

Vivarail duly went into receivership on 1 December. This left the Class 230 units on the Bedford-Bletchley Marston Vale line without their Vivarail maintenance team and the service was suspended. South Western Railway was able to keep the Isle of Wight Class 484 EMUs running.

In the column I give a brief history of Vivarail and it concept of converting redundant London Underground D78 Stock to low cost Pacer replacement diesel multiple units. But by the time the new trains were ready for production, the Pacer-replacement market had been filled by new multiple units ordered under franchise replacement.

All that was left was a niche market, exemplified by the trains Vivarail has supplied for West Midlands Trains and Transport for Wales. WMT's Marston Valley Line services went through a prolonged development period, not helped by the Pandemic lockdown. The Welsh units have yet to enter service.

Meanwhile reflecting the emphasis on railway decarbonisation, Vivarail had pivoted to battery traction. The press release announcing the intention to appoint administrators airbrushed out the original proposals. It read 'Vivarail has dedicated the last nine years to investigating, trialling, developing, and testing battery technology for rail, which includes the development of its own patented Fast Charge system, able to re-charge a battery-powered train in just 10 minutes'.

That was a significant achievement. But where was the sales income to keep the company running coming from? With no new orders coming in to offset this expenditure on Research & Development, the company was dependent on continuing support from its original sole backer, who, in early 2022, cut off further funding.

Among the outstanding questions left by the receivership is what happens to the trial of a battery Class 230, with its associated fast charging system, scheduled for Great Western's Greenford branch early in 2023. Given its strategic importance ways are being sought for this to go ahead. Other operators saw this combination as a potential solution for replacing diesel traction on similar routes in electrified territory.

Ironically, having missed the Pacer replacement market, Vivarail faces going out of business just as the battery multiple unit market is on the horizon. Hopes now rest on the Administrators finding a buyer for the battery technology.

LNER revenue recovery highlights DfT dead-hand

Rail Partners, the private sector operator lobbyists, published recently the results of a study commissioned from respected consultants Oxera. The aim was to evaluate the downsides of the Government's current contractual relationship with the passenger train operators.

As this column has been pointing out, under the current situation, fares revenue is returned to the Treasury. Costs are covered by the Department for Transport.

This means that if the professional railway managers at a TOC want to run extra services or offer promotional fares to attract more passengers, the Treasury will veto the proposal because it might lose revenue in the short-term. DfT will also

reject it because of the extra cost of the more frequent or longer trains.

But, based on the Oxera study, ‘A Fork in the Tracks: Attracting customers back to the railway’, Rail Partners argues that there is an alternative to attempting to close the financial gap between the pre-pandemic fares income and present levels (currently around £2 billion) through cost savings alone. Instead, ‘we must look at both sides of the ledger – cost and revenue – together, and enable operators to focus on what they do best: attracting passengers and growing markets’.

And so say all of us. The study estimates that between £1.6 – 2.1 billion in revenue is, potentially, being lost over the next two years because of DfT’s current inflexible contractual arrangements. These were required during the pandemic, ‘but are no longer appropriate to continue to drive recovery’.

In the study Oxera compared the rate of recovery – revenue as a percentage of the 2019 level – of the 14 DfT contracted operators against the Open Access operators, Hull Trains and Grand Central, plus Mersey Rail. All three enjoy ‘commercial freedom with strong revenue incentives’. This comparison showed revenue recovery by the ‘Thrusting Three’ ahead of the ‘Frustrated fourteen’, by around 10 percentage points. The latest data was from May 2022.

But having made the point, the lobbyists can’t leave well alone. According to Rail Partners, ‘DfT’s publicly run train operators, LNER, Northern and Southeastern, are also included in this analysis but clearly do not have the same corporate financial incentives as private sector operators to respond to having stronger revenue incentives and greater commercial freedom. Only if these contracts were competed either as National Rail Contracts or as new Passenger Service Contracts would we expect the same level of revenue growth to be achieved’.

So the operators under the wing of Chief Executive Director Robin Gisby’s DfT OLR Holdings Limited (DOHL)will need an injection of private sector entrepreneurial flair to perform? Really?
LNER has been top TOC when it comes to winning back passengers, with similar ridership recovery percentages to its rival open access operators Hull Trains and Grand Central. So isn’t it likely that revenue recovery is similar?

Yes it is and I have the numbers with some analysis in the column. These show that, free from the constraints imposed by DfT on other TOCs, LNER has not only won back passengers faster than other operators, but matched this with rising revenue.

This reinforces the message from the Oxera Study. But, as this column has been saying for years now – what counts is structure not ownership. Just free the professionals in the TOCs from DfT’s current contractual straightjacket and micromanagement and let them run the railway on a commercial basis.

Roger’s blog

This is being written in the week we heard that Adrian Shooter, who had been suffering from Motor Neurone Disease, had, characteristically, taken control and died in a Swiss clinic. Adrian was one of my oldest friends in the industry, for pretty much of my time writing for Modern Railways.

Most tributes following his death have focused on his achievements with the Chiltern franchise, where he realised that the key to success in the new railway was growing ridership, not cutting costs. However, his British Rail career was equally impressive, particularly as Area Manager St Pancras, where the Adrian the engineer developed the broad management skills that made Chiltern flourish. I will include this period in the extended tribute I am writing for the February column.

Due to the vagaries of Modern Railways’ publication date, the January issue is published just before Christmas. So, after a tough year all round can I wish all subscriber a joyous Christmas and a resilient New Year.

Roger