HOW MUCH COMPETITION DO YOU NEED?

(Taking stock of the GB rail situation in 2015)
How much competition do you need?
Taking stock of GB rail situation in 2015

• A little about my background
• Main changes to GB rail organisational structure from 1994 to 2014
• Railway finances today
• Network Rail – the 500lb gorilla
• Open Access – institutional conflict
• The situation in 2015: challenges and opportunities
  ➢ Planning and using network capacity
  ➢ Concessions versus franchises, and devolution
  ➢ Infrastructure
  ➢ Funding
• Some possible ways forward
Houdini Holden

He survived Railways and now surviving the unremarkable standing of
Comber. Andrew Gorman met Michael Holden who joins it for
his next trick. He can secure success with the SQA and travel at the
500-Day Anniversary South Eastern Trains.

This is what I like to call the “SQA Day franchise”...

The Mail Professional Interview
**Interview**

**Follow my train of thought**

The managing director of the only state-owned rail franchise has brought about dramatic improvements, says Ben Webster. Could the model work elsewhere?

**Michael Holden** is one of a dying breed of rail managers who have practical experience of running almost every operation on the railway.

The British Rail sponsorship 35 years ago was a prelude to a new era of private rail operators and he has spent most of his career in the sector. This year he led the bid to run the "high-performance" East Coast main line franchise. If he succeeds, it will be the final leg in his 30-year rail career.

"I've always had a lot of respect for the rail industry," he says. "It's a business that's always had a lot of problems, but it's always had a lot of potential."

Holden's experience includes running the East Coast main line franchise, which is due to start in October.

"It's a very challenging time," he says. "But I think we can make it work. We're going to need a good team, good management, and a clear plan."

Holden's career began in the 1970s when he was a trainee at British Rail. He quickly rose through the ranks, eventually becoming managing director of the East Coast main line franchise.

"I've always been passionate about rail," he says. "I think it's a fantastic industry and I'm proud to be part of it."
The key changes made since 1993

- Railways Act 1993 separated out infrastructure from train operations
- Rolling stock sold to specialist leasing companies
- Independent Rail Regulator established
- Government office established to let rail franchises
Early progress

- 1996 Railtrack seen as successful and privatised
- 1998-2002 Railtrack struggled with outsourced maintenance and renewals
- 2000-2002 Major enhancement projects overran on time and cost
- 1997-2002 A series of major rail accidents destroyed confidence
- 2002 Railtrack pushed into Administration
- 2002 “Not for profit” Network Rail created
Simplified GB rail industry structure since Railways Act 2005

- ORR safety regulation
  - Direct Agreement?
  - S54?
  - Safety Case/Certificate

- DfT
  - Premium
  - Franchise Agreement and Subsidy
  - Grants
  - Operating licence
  - Licences/SNRPs

- Passenger Operators
  - Safety Case/Certificate
  - Rolling Stock Leases

- Freight Operators
  - Access

- ROSCOs
  - Safety Case/Certificate

- Network Rail
  - Access

ORR regulates safety
Success stories of last 20 years

• Franchising has become a very competitive marketplace
• Passenger miles more than doubled
• Significant capacity increase on the network
• Major improvement in fleet capacity, reliability and passenger environment
• Passenger experience transformed and customer satisfaction grown
• Punctuality improved
• Average fare/mile has grown by less than inflation
• Freight succeeding in a very competitive marketplace
• Significant improvement in operational safety
Sources of industry income: £13.3bn

**Passengers**
- Fares: £8.2bn
- Other*: £0.8bn
  * Car parking, on-train catering and other train operator income

**Government**
- DfT: £2.6bn
- Transport Scotland: £0.8bn
- Welsh Government: £0.1bn
- TfL, PTEs and other: £0.3bn
  * Excludes net effect of taxation paid by Network Rail & Operators.

**Other sources**
- Income from property, stations retail, freight and other customers: £0.5bn

**Train operators**
- £8.9bn
  - (£6.5bn excluding NR charges)
  - Staff costs: £2.4bn
  - Rolling stock: £1.3bn
  - Other costs: £2.8bn
  - Network Rail charges: £2.4bn

**Network Rail**
- £6.2bn
  - Operating costs: £2.0bn
  - Maintenance costs: £1.0bn
  - Financing costs: £1.4bn
  - Depreciation: £1.8bn
  - Network Rail charges: £6.2bn

Receipts from government: £2.0bn
Payments to government: £1.9bn
Net: £0.1bn

Network grant: £3.7bn

Breakdown of industry expenditure: £12.7bn
Why is the cost base so high?

• Strong position of trade unions
• Lack of political will
• High labour costs become ‘baked in’
• High construction unit costs
• Working on a busier railway
• Stop/go investment cycles
• Under-developed supply chain
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Financial assessment

1. Need for improved labour productivity and/or reduced unit costs
2. Longer term infrastructure development plan with smoothed demand profile and better developed supply chain
Network Rail – the 500lb gorilla

• September 2014 reclassification onto public sector books
• £35bn debt mountain – and growing
• 5-yearly Control Periods
• Pressure to reduce public expenditure
• Insufficient incentives
• Governance changes

➢ Reducing chance of stable long term enhancement plan being sustained
Open access – institutional conflict

• Key feature of 1993 Railways Act
• Grew slowly initially but now established and approaching critical mass
• Has become profitable and popular
• Uneven playing field in charging regime
• Government is losing franchise premium
• Difficult for government to be sure of capturing benefits of route capacity/capability enhancement
The situation in 2015 – challenges and opportunities

- Planning and using network capability
- Concessions versus franchises, and devolution
- Infrastructure
- Funding
Planning and using network capacity

• New open access applications for East Coast Main Line
• Current franchisee has new fleet of trains on order and expansionist timetable proposed
• Enhanced timetable required to generate premium and ensure fleet fully deployed
• Capacity crunch – not all players requests can be met
• Thameslink specification reduces available capacity
• Network Rail trying to hold the ring on timetabling
  ➢ Institutional conflict  
  ➢ Serious consequences  
  ➢ Inertia  
  ➢ Need for changed framework
Concessions versus franchises, and devolution

• Growth in ‘gross cost’ concessions
• Client takes revenue risk, specifies service levels, fares, etc
• Working well where strong and engaged clients exist
• Everybody wins
• Fits in with movement towards devolution
Infrastructure

• Christmas 2014 engineering works shambles
• Electrification, resignalling and route modernisation programmes are revealed to be over spending and late
• Disgruntled government acts to take charge
• Review of current Control Period investment programme
• Review of how current programme came to be agreed
• Review of Network Rail’s funding and organisational model
Funding

• Comprehensive spending review underway
• Transport not ‘ring-fenced’ so expected to make substantial reductions
• Political pressure for Northern Powerhouse and HS2
• We should expect pressure on rail’s cost base to rise
Some possible ways forward

How much competition do you need?
Those problems in summary

• Government is too close to minutiae and has lost sight of the big picture
• Network Rail is too big and has too many inherent role conflicts
• The current franchising model is unsustainable
• Conflict between open access and franchising for long distance needs resolving
• Unit costs are too high. Better incentives are needed to reduce them
Some possible ways forward

10 year package of structural reforms leading to improved effectiveness and better value

➢ Government sponsorship and funding
➢ Infrastructure management and operation
➢ Train operation and the customer experience
Government sponsorship and funding

1. Central government to define vision, strategy and long term funding provision
2. New arms-length agency to manage network development and access planning, inter-urban franchises, cross industry support systems
Infrastructure management and operation

Network Rail becomes a delivery organisation

- Break up into geographically based units
- Flexible model with operation separate or combined with any/all of maintenance, renewals, enhancement delivery
- One size does not fit all – different solutions for different parts of the network
- Sale or concessioning becomes possible in places
- Vertical integration possible if desired in places
- Benchmarking possible promotes competition to drive efficiency and innovation, and enables regulation to become more effective
Train operation and the customer experience

• Devolution of client responsibilities to local/regional authorities where possible
  ➢ More concessioning of commuter operations
  ➢ Hybrid franchises with strongly incentivised quality regimes
  ➢ Rump franchises managed by rail agency
• Inter City franchises to be gradually replaced by open access
  ➢ New regulatory and charging framework to be devised
  ➢ Protection mechanism for socially required elements
  ➢ Rail agency to oversee network development and timetable planning – collects return through revenue share
Conclusions

1. Government wants to reduce rail subsidy
2. Need to solve the Network Rail problem
3. Political demand for further devolution
4. Success of concessioning and open access models

= time for a revised railway organisational model

A more appropriate level of competition will drive

- Improved value for money for government and consumers
- Greater value of railway network to communities served