

# **Rail Passenger Franchises**

**Research Paper 96/21**

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This Research Paper updates the sections on the franchising of the passenger train operations in *Rail Privatisation: a Progress Report* (Research Paper 95/96). It describes the background to the sales and what is happening in each case.

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## Summary

The first passenger train franchises, South West Trains, Great Western and LTS Rail were awarded on 19 and 20 December 1995 and the first two privatised services started operating on Sunday 4 February 1996. Others are expected to follow soon.

The regulatory background to the franchising of the passenger train operating companies is set out in Part I of the paper. The *Railways Act 1993* provides the legal framework and separated responsibility for the track and the train services. The Franchising Director is responsible for securing the provision of railway passenger services by entering into franchise agreements. Each of the 25 train operating companies is gradually being offered for sale as a separate franchise. The Rail Regulator also has a significant role to play in deciding the legal and economic background in which a franchisee will operate. He licenses the operators, decides the track access charges and determines the competitive background.

A franchise is the right to run specified services within a specified area for a specified period of time, in return for the right to charge fares and, where appropriate, to receive support from the Franchising Director. The rights and obligations are specified in a franchise agreement between the Franchising Director and the train operator. Each franchise will be negotiated individually with the Franchising Director. Franchisees will earn revenue primarily from fares and from subsidy.

Part II of the paper sets out chronologically what has happened to the franchising process from the announcement in December 1994 of the pre-qualification bids for the first eight companies to the award of the first three franchises in December 1995.

The last section gives details of the individual companies and the various stages which they have reached in the franchising process.

## **Abbreviations**

<b>ATOC</b>	Association of Train Operating Companies
<b>BR</b>	British Rail
<b>BRIS</b>	British Rail Infrastructure Services
<b>CRUCC</b>	Central Rail Users' Consultative Committee
<b>EPS</b>	European Passenger Services Ltd
<b>EU</b>	European Union
<b>HSE</b>	Health and Safety Executive
<b>ITT</b>	Invitation to Tender
<b>MDC</b>	Metropolitan District Council
<b>MEBO</b>	Management and Employee Buyout
<b>MBO</b>	Management Buyout
<b>MRG</b>	Metropolitan Railway Grant
<b>OPRAF</b>	Office of Passenger Rail Franchising
<b>PQD</b>	Pre-qualification document
<b>PSR</b>	Passenger Service Requirement
<b>PTA</b>	Passenger Transport Authority
<b>PTE</b>	Passenger Transport Executive
<b>PSO</b>	Public Service Obligation
<b>ROSCO</b>	Rolling Stock Leasing Company
<b>RSC</b>	Railway Safety Case
<b>RSG</b>	Revenue Support Grant
<b>RUCC</b>	Rail Users' Consultative Committee
<b>TOC</b>	Train Operating Company
<b>TOU</b>	Train Operating Unit

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# **I Franchising the Passenger Operations**

## **A. Background**

The *Railways Act 1993* provided the legal framework for the privatisation of British Rail. The first franchises, South West Trains, Great Western and LTS Rail were awarded on 19 and 20 December 1995 and the first two privatised services started operating on Sunday 4 February 1996.

### **1. Railway Privatisation**

The legislation to privatise the railways radically changed the structure of the railway industry by separating the responsibility for infrastructure and passenger service operations. The Government's intention was that all passenger services should eventually be provided by private sector operators either acting as franchisees or as independent train operators. The railway network would be divided into a number of franchises, which would provide the bulk of passenger services. Government subsidy would be payable via the Franchising Director to franchisees in respect of socially necessary services that might not otherwise be provided. Competition in the provision of passenger services would be facilitated by allowing independent train operators (ie non franchisee and not in receipt of subsidy) who could meet the necessary operational and safety standards, to have a right of access to the railway network.

The passenger railway has now been restructured so that domestic passenger train services can be offered to the private sector to run on a franchised basis. Since 1993 the Office of Passenger Rail Franchising has worked in conjunction with BR, the Train Operating Units (TOUs), the Department of Transport, Railtrack and the Regulator on the preparation of BR's passenger services for franchising. Since 1 April 1994 British Rail has reorganised its passenger services into 25 different TOUs. These TOUs have gradually been incorporated as subsidiaries of British Rail and have been run as separate "shadow" businesses within British Rail. They pay access charges for the use of track and infrastructure, and rentals for stations and rolling stock, on the same basis as the franchisees will do after franchising. Each now operates under its own licence (granted by the Rail Regulator), its Railway Safety Case (approved by the Health and Safety Executive) and a track access agreement with Railtrack (approved by the Regulator). A wide range of station and depot access agreements (also approved by the Regulator), property leases and other contracts are also required by each train operating business. The objective is to provide financial and operational information and experience of how the business will operate under the new arrangements. It will also give potential franchisees financial and management information to assist them in tendering for the franchises.

Each of the 25 train operating companies is being offered for sale as a separate franchise. Private sector companies, management employee buy-outs and, if the Franchising Director

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agrees, British Rail can bid for the franchises through a bidding process overseen by the Franchising Director. The successful bidder acquires the TOC outright for a fixed number of years.

### 2. The Franchising Director

The franchises are awarded by the Director of Passenger Rail Franchising. The first Franchising Director, Mr. Roger Salmon, was appointed by the Secretary of State for Transport on 8 November 1993 for a term of 5 years. OPRAF has been constituted as a non-ministerial Government Department since that date and now employs about 70 people. The Franchising Director is responsible for securing the provision of railway passenger services by entering into franchise agreements, with franchisees being selected through a competitive tendering process. His main functions as laid down in the 1993 Act are:

- to designate passenger rail services or groups of such services eligible for provision under franchise agreements;
- to invite tenders from prospective franchisees for the provision of services and to enter into franchise agreements;
- to consider whether provisions are necessary to ensure that the fares to be charged by franchisees are reasonable, and to secure the participation by franchisees in approved discount fare schemes;
- to form a view on proposed closures of passenger services and to initiate the formal closure procedures or, if his view is that a closure should not be permitted to take effect, to secure the continuation of the service;
- to enter into contracts with BR for the provision of non-franchised passenger services prior to these being franchised;
- to encourage railway investment;
- to promote the provision of staff concessionary travel;
- to provide support for those passenger services which BR provide under the European Community regulations governing the public service obligations which may be imposed on operators of passenger rail services.

The Act requires the Franchising Director to exercise his statutory functions so as to fulfil objectives given to him by the Secretary of State and to ensure that his expenditure represents



value for money in achieving these objectives. In March 1994 the Secretary of State set the Franchising Director the following principal objectives:<sup>1</sup>

- to secure that railway passenger services in Great Britain, other than exempted services, are provided under franchise agreements as soon as reasonably practicable; and
- to secure an overall improvement in the quality of railway passenger and station services available to railway passengers.

Other objectives set by the Secretary of State were:

- to encourage efficiency and economy in the provision of railway services;
- to promote the use and cost-effective development of the railway network;
- to promote the award of franchise agreements to companies in which qualifying railway employees have a substantial interest.

These objectives can be varied by the Government. On 11 December 1995 they were amplified in relation to risk sharing, the funding of the services of Passenger Transport Executive areas, and the provision of concessionary travel for railway employees<sup>2</sup> and on the 18 December the Secretary of State announced further changes as a result of the court case by Save Our Railways.

The Objectives, Instructions and Guidance are set out in full in the Franchising Director's annual report. The guidance given on the specification of the franchise is reproduced below as this is the section which gave rise to the court case against the Franchising Director:

**Franchise specification**

*Length of franchise*

15. You should determine the length of franchises case by case in the light of market conditions and after consultation with me.

*Scope of franchise*

16. Subject to Railtrack's agreement, franchises should normally include the management of stations, with the management of other infrastructure (track and signalling) remaining with Railtrack. Exceptionally, where, for example, franchised services operate over network where no other franchises will be operating, and there seems very little prospect of other rail operators wishing to use that network, you may consider that you would secure better

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<sup>1</sup> Department of Transport *Objectives, Instructions and Guidance to the Franchising Director from the Secretary of State for Transport* 22.3.94

<sup>2</sup> PQ HC Deb 11.12.95 c. 460W; Deposited Paper 2496 (3S)

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value for money if you proposed a degree of vertical integration, ie partial operation of the network as well as trains by the franchisees. Any such proposals will be subject to Railtrack's agreement. *You are to consult me and obtain my approval before offering vertically integrated franchisees.*

17. Franchisees may wish to operate charter services, which may, for example, involve the operation of heritage rolling stock. *Charter services are purely commercial ventures and must not, therefore, form any part of your franchise specifications.*

### *Quality of service*

18. *For the initial letting of franchisees, your specification of minimum service levels for railway passenger services is to be based on that being provided by BR immediately prior to franchising, taking into account the existence of and justification for variations in service schedules.*
19. The detail of your specifications should depend on the nature of the service to which they relate. Service levels may be specified in terms of the following:
- service frequency and capacity;
  - service availability (for example, the need for evening and weekend services);
  - provision of through services by fast trains
  - intermediate stations served; and
  - journey time.
20. Service quality for railway passenger services and station services operated by franchisees should be specified in the degree of detail that is appropriate for the particular franchise. For some franchisees, particularly those conferring monopoly power, you should ensure that the franchise agreement provides an effective substitute for market pressures. For other franchisees, where market pressures are present to a greater extent, you should impose such service quality requirements as are necessary to ensure that the taxpayer obtains good value for money.
21. When you are specifying the quality of service to be provided:
- i) the performance standards which you set for franchisees should have the effect of maintaining or improving standards;
  - ii) your specification of the quality of service to be provided by franchisees, should, as far as possible, be in terms of the desired outputs, so leaving operators as much freedom as possible for responding innovatively to passengers' demands;
  - iii) *you must require each franchisee to publish their own Passenger's Charter.* This should include the franchisee's own code of conduct for dealing with passengers, publishing performance information, handling complaints, and payment of compensation to passengers in the event of poor performance.
22. Whatever the length of the franchise, it will be important to ensure that service patterns do not ossify, and that operators are able to adjust services to match demand. You should, therefore, conclude franchise agreements that permit flexibility in service provision within a framework you have agreed.

23. Although service specifications set for the initial franchises must be based on the timetable being operated by BR immediately prior to franchising, you should aim, over time, to tailor the provision of franchised services more closely to demand. In large part this tailoring should be driven by franchisees responding on a commercial basis to passenger demand: that is why I want you to leave maximum scope for the initiative of franchisees in your franchise specifications as noted in paragraph 4 above. Any changes from the existing pattern of services should be made gradually.
24. In order for you to decide appropriate service specifications for loss-making services you will need to develop criteria which will enable you to evaluate the benefits to be obtained from their provision. *Such criteria must be submitted to me for approval.*

On 24 November the pressure group Save Our Railways, an anti-privatisation group backed by 20 local authorities, the three main rail unions and several MPs, obtained a judicial review into "unlawful decisions" by Roger Salmon, the Franchising Director, to cut services. It challenged the legality of the franchising proposals put forward on the grounds that he had failed to base the minimum passenger service levels on the current BR timetable as instructed by the former Transport Secretary, John MacGregor. Mr. Salmon had set standards in some cases well below the present timetable on the grounds that private franchisees would have a strong commercial incentive to run more trains. On 7 December the High Court ruled that Roger Salmon had not set the future minimum passenger services too low but on 15 December the Court of Appeal overturned the ruling in relation to the second group of franchises.<sup>3</sup> The key section in the ruling said that:

"'Based on' is not...an exact term. It is obvious that every train timetabled by BR need not continue to run. There may be changes...but there is a limit. The changes must in our view be marginal, not significant or substantial."

The judges said they would not intervene in the Great Western minimum service level, set at 86 per cent of the current timetable, or in South West Trains with a level set at 86 to 89 per cent. But LTS Rail with a level of 69 per cent, InterCity East Coast with 71 per cent and Gatwick with 45 per cent, were found to be unacceptable. However the LTS Rail franchise sale could proceed as there had been an "undue delay in launching the attempt to block it."

Rewriting the minimum service requirements would have been time consuming and costly and the Government instead rephrased its instructions to the Franchising Director. Sir George Young said in the House of Commons:<sup>4</sup>

We have, of course, given careful consideration to the implications of the court's judgment. I confirm that, as planned, the franchising director hopes to announce the award of the first three franchises later this week, and I welcome the court's agreement that he should go ahead with them.

The court has been concerned with the consistency between the franchising director's instructions and guidance and the PSRs. It is, in the

court's words, a "limited legal problem". The court has not questioned the Government's policy. Indeed, the judgment describes the franchising director's approach to developing PSRs as

"intelligible and in no way irrational".

The franchising director has prepared his PSRs in a manner which my predecessors and I have consistently approved. We believed them to be consistent with the formal instructions and guidance

<sup>3</sup> *Times* 18.12.95 "Regina v Director of Passenger Rail Franchising, ex parte Save our Railways and others"

<sup>4</sup> HC Deb 18.12.95 cc 1236-1246

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that were given to him. The Court of Appeal has now examined the meaning of the existing instructions and guidance and concluded that the existing PSRs are not consistent with them.

I have decided, therefore, to clarify the instructions and guidance to the franchising director to ensure that they reflect beyond doubt the policy that we have always followed. Franchisees should have flexibility to adjust commercial services but the franchise agreement should ensure that a core service level is protected so that service levels operated by franchisees are broadly similar to those operated immediately prior to franchising. My intention is to ensure that the work done in developing the PSRs so far can be relied on in the continuing franchising process.

I am pleased to tell the House that, while clarifying the franchising director's instructions, I intend to go beyond the requirements of the Court of Appeal judgment. I shall instruct him, when considering the award of future franchises, to take account of bidders' contractual commitments to, and future plans for, providing services over and above the PSR. In practice, bidders for the first franchises are offering significant commitments in addition to the minima required by the invitations to tender, and they have been taken into account by the franchising director when evaluating bids, but I have judged it right to require him formally to do so for the future to ensure the continuation of that policy.

Paragraphs 18 to 24 of the Franchising Director's Guidance were amended. The change has the effect of codifying the Franchising Director's existing practice and is designed to resolve any apparent conflict between the former wording of the instructions and the Government's intentions. Paragraph 18 contains the most important rewording:<sup>5</sup>

When setting minimum service levels for services being franchised for the first time, you should take as your starting point the service being provided by BR at the time when you draw up the specification, taking into account the existence of and justification for seasonal variations in service schedules. You should take particular account of the nature of the services concerned. Each service should be considered individually, taking account of all surrounding circumstances. For example, where you judge that services are essential but where they are unprofitable to run, you should set the minimum close to or at the current level of service. Conversely where service levels have been set by BR on a commercial basis, as with most of the former InterCity routes and with off-peak services on commuter routes, you should leave maximum flexibility for franchisees while safeguarding what you believe to be a reasonable core service level. On any route, where you judge that a train is exceptionally lightly used and is not an essential service you should omit it from the minimum specification if you consider that to include it would not provide value for money. You should use load factor regulation where you believe it to be appropriate in order to ensure that peak commuter service levels are kept in line with changes in passenger demand.

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5 Department of Transport 15.1.96; Deposited Paper 2614 (3S)

### 3. The Rail Regulator

Although the Franchising Director has the direct input in the awarding of franchises, the Rail Regulator has a significant role in deciding the legal and economic background in which a franchisee will operate. The Secretary of State appoints the Regulator for a five year period and once appointed he cannot be removed except for "incapacity or misbehaviour." John Swift was appointed in December 1993. Until 31 December 1996 he has a duty to take account of any guidance from the Secretary of State.

The Regulator is responsible for issuing licences to railway operators. In general all companies operating railway assets will need to be licensed and the Regulator is responsible for enforcing licence conditions concerning such matters as policing, the environment, insurance requirements and through ticketing. No track, train, station or depot may be operated without a licence.

He also approves access agreements between Railtrack and the train operators by which the latter acquire the right to use the track, stations and light maintenance depots, and he may modify them. About half the income of the passenger train operators will go to Railtrack to pay for access to the track so the level of these charges is of importance to the companies. Initially the Government demanded that Railtrack earn an annual return of 5.1 per cent, rising to 8 per cent after four years. The level of track access charges which would have been necessary to meet those charges would have meant that almost all the passenger services would be loss making and so reliant on subsidy. In February 1994, it was estimated that the rail passenger operators could expect to pay about £2.2bn in charges to run their trains.

The Regulator concluded that charges should be rebased in 1995-96 with an overall reduction in access charges for franchised passenger services of 8% in real terms compared with 1994-95. Individual track access charges for franchised passenger services should fall by 2% a year in real terms from 1996-97 onwards, broadly in line with the reduction in Railtrack's overall costs. There should be a further review of access charges in 2000 with the conclusions to be reflected in all access agreements for franchised passenger services from 1 April 2001. Additional charges will be levied for the use of stations and to fund specific new investment projects. A system of performance-related payments will also be used to reflect achievement of quality of service objectives, for example the punctuality of trains.

The Regulator is also instrumental in deciding the level of competition. In July 1994 he published a consultation paper on competition in railway passenger services and in December he published his policy statement on the subject.<sup>6</sup> The Regulator accepted that competition would have to be moderated to an extent in order to secure a successful transfer of passenger operations to the private sector through franchising. Although he said he remained convinced that there were substantial benefits to both the train operators and the passengers through increased competition, he concluded that for an initial period competition between operators should be restricted. Only companies that take up train operating franchises will be allowed to offer passenger services during the first four years of privatisation and severe restrictions will be imposed on new entrants for three years thereafter.

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<sup>6</sup> Office of the Rail Regulator *Competition for Railway Passenger Services* December 1994

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The Regulator's functions under the *Railways Act* also enable him to concern himself with a wide range of consumer interests. Even in cases where he does not have a statutory function, he frequently has a formal right to be consulted. The Regulator recognises that the benefits that an integrated network can provide may need protecting and he expects to secure many of these benefits through conditions in operators' licences. These will require operators to participate in industry-wide arrangements covering:

- through ticketing and ticket retailing
- telephone enquiry bureaux
- publication of the national timetable and the sharing of operating information between licence holders
- insurance
- claims handling

Ticketing has been a controversial subject over the past year. It is recognised that it is important that both through ticketing and inter-availability are available to passengers. "Through" journeys refer to journeys involving more than one passenger train operator and inter-available tickets mean that tickets issued by one train operating company are available for the same journey on other operators' trains.

The *Railways Act* made provision for through ticketing to be a condition of a passenger service operator's licence. The idea originally was that the use of British Rail's existing ticketing and revenue allocation systems would mean that operators would be able to offer through tickets on much the same basis as did BR. Through tickets would therefore continue to be available from a range of outlets and in a range of ticket and fare types.<sup>7</sup>

In his consultation paper on the retailing of tickets, the Rail Regulator commented that there was no reason to follow BR's practice unless there was a good reason for it. Interested parties were asked to consider the possibility of a new type of system based on what was called core products - a wide range of tickets which must be offered for sale - and core stations - those required to sell the core products. The proposals in the paper would have resulted in only 294 stations being designated core stations. The document produced considerable adverse reaction and when the Regulator published his conclusions he decided that operators should be obliged to maintain the service currently provided although there would be a procedure to allow for changes in the system provided they could be shown to improve the system for the customer.<sup>8</sup>

For most journeys, including through journeys, passengers will be able to buy both full and discounted inter-available tickets, the fares for which will be set by the main operator on a route. The provision of inter-available tickets will be obligatory except in those cases where the Franchising Director considers the benefits of price competition outweigh those of inter-availability. Competing operators may introduce additional non-inter-available fares which allow passengers to trade flexibility in return for a lower price.

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<sup>7</sup> Department of Transport press notice 2.2.93

<sup>8</sup> Office of the Rail Regulator *Ticket Retailing: A Policy Statement* April 1995

New routing rules are also being considered. The present British Rail rule of tickets being sold for travel between two stations by "any reasonable route" is apparently to be replaced by the more restrictive "any permitted route." The change was proposed because the degree of freedom passengers now have would make it difficult to allocate ticket revenues between the 25 privatised train operators. An official list of permitted routes would, it was hoped, avoid disputes between passengers and ticket inspectors. At present inspectors have a great deal of discretion over whether a passenger is taking a reasonable route but this frequently leads to complaints. In future passengers will know at the start of their journey which routes they are permitted to take. Details are still being worked out.

#### 4. Disputes Committees

The Government announced on 14 January 1996 that it would set up two committees to resolve disputes between the privatised companies in the hope of avoiding costly and time consuming legal actions.<sup>9</sup> One committee is intended to resolve disputes about track access charges and timetables between train operators and Railtrack while the second will consider all other issues including liability for claims. In the past such disputes would have been resolved internally within British Rail but now there are 25 passenger train operating companies among a total of more than 80 companies providing rail services.

#### 5. Competition

The Government believed the absence of competition in the railway industry was a major problem. It wanted competing train companies out bidding each other to provide quicker and cheaper services. In fact franchisees have been assured by the Regulator that new operators will not be allowed to compete in the first four years and there will be restrictions until 2002. The Regulator will review the competitive regime in 2001.

The bus industry is now dominated by relatively few large companies and it is possible that in future years the railways could be the same with perhaps 10 passenger operating companies rather than the present 25. Any competition issues raised by a rail franchise bid are for the Franchising Director, the Rail Regulator and the Director General of Fair Trading. The *Railways Act 1993* confers on the Rail Regulator the functions of the Director General of Fair Trading with respect to monopoly situations or anti-competitive practices relating to the supply of rail services. Qualifying mergers would be investigated by the OFT under the *Fair Trading Act 1973*.

The Rail Regulator is also required to approve any change of control of a licence holder.

Some consider that it is not the competition between train companies which is so important but the competition with road services. Brian Wilson MP has already said that if it wins the next election, the Labour Party will consider referring Stagecoach to the OFT to investigate the monopoly implications of the company acting as both bus and train operator in the same area.<sup>10</sup>

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<sup>9</sup> *Financial Times* 15.1.96

<sup>10</sup> *Guardian* 12.12.95

### **B. The Franchising Process**

A franchise is the right to run specified services within a specified area for a specified period of time, in return for the right to charge fares and, where appropriate, to receive support from the Franchising Director. Service standards will be monitored by the Franchising Director throughout the duration of the franchise. Franchisees will earn revenue primarily from fares and from subsidy. They will generally lease stations from Railtrack and earn rental income by sub-letting parts of them, for example to retailers. The rights and obligations are to be specified in a franchise agreement between the Franchising Director and the train operator. Each franchise will be negotiated individually with the Franchising Director. Franchisees will have to co-operate in certain central arrangements such as those necessary to provide through-ticketing and revenue settlement between train operators.

Franchisees' main costs will be the track access charges they pay to Railtrack, the costs of leasing stations and rolling stock and of employing staff. Franchisees may do light maintenance work on rolling stock themselves or contract it out to private sector companies. Heavy maintenance will normally be procured for them by the rolling stock leasing companies (ROSCOs) according to the contracts between them.

Franchises will operate as commercial businesses. Prospective franchisees will include within their bids either the premium they are prepared to pay for the right to operate services, or the level of support they estimate they will require. Tenders may also include proposals for new services or improved facilities.

The principal factors the Franchising Director will consider when awarding franchises will include the level of support bid for, the service commitments offered and the degree of risk accepted by the prospective franchisee. The Franchising Director has stated that, in negotiating franchises, he wishes to give franchisees as much scope as possible to maximise their return on the operation of passenger services, consistent with a high quality railway system, a good service for passengers and value for money for the taxpayer. On the expiry of the franchises, new franchises will be offered for tender.

#### **1. The Stages of a Franchise**

The sale of a franchise has five stages:

- pre-qualification;
- invitation to tender;
- due diligence by potential bidders;
- submission of tenders;
- assessment of tenders and award of the franchise.

Pre-qualification is a statutory requirement. Under section 26(3) of the *Railways Act 1993* the Franchising Director is required to be satisfied before issuing an invitation to tender (ITT) that



the bidder will have an appropriate financial position, managerial competence and is otherwise suitable to run a franchise. According to the OPRAF pre-qualification document,<sup>11</sup> the Franchising Director reserves the right to refuse pre-qualification and is not obliged to give any reason for such a refusal. Prospective franchisees who meet the pre-qualification criteria are sent the formal Invitation to Tender (ITT) and associated Information Memorandum. Potential bidders who pre-qualify may participate in a "due diligence" programme including visits to the TOC, meetings with the management and access to data. A shortlist is drawn up by the Franchising Director from those companies who have responded to the ITT and these companies are invited to submit a formal bid upon which the franchise will be awarded. As with the pre-qualification bids the Franchising Director reserves the right not to accept a tender on the grounds of price or otherwise and without giving any reason for his decision. Once a successful bidder signs the franchise agreement, there are certain legal formalities to be completed and the franchisee's safety case to be approved before the first train can run.

Section 26(1) of the *Railways Act* gives the Secretary of State the right to overrule the Franchise Director in the choice of franchisee.

Section 26 states:

26.--(1) Unless the Secretary of State otherwise directs, the person who is to be the franchisee under any franchise agreement shall be selected by the Franchising Director from among those who submit tenders in response to an invitation to tender under this section for the right to provide, or to secure that a wholly owned subsidiary provides, services for the carriage of passengers by railway under that franchise agreement.

(2) The Franchising Director shall prepare any such invitation to tender and shall issue that invitation to such persons as he may, after consultation with the Regulator, think fit.

(3) The Franchising Director shall not issue an invitation to tender under this section to (or entertain such a tender from) any person unless he is of the opinion that the person has, or is likely by the commencement of the franchise term to have, an appropriate financial position and managerial competence, and is otherwise a suitable person, to be the franchisee.

The contracts are between the Office of Passenger Rail Franchising and the franchisee. Each franchise will have a separate contract. The Government in its instructions to the Franchising Director said "you are not expected to negotiate uniform franchise agreements."<sup>12</sup> Each franchise contract will be a legal document and if either side breaks the terms of this contract it will be liable to legal proceedings. The contract could only be terminated with the agreement of both parties and if one side withdrew, it would be likely to lead to damages. Even legislation could be a problem and would involve substantial compensation.

The franchises were expected to be for seven years but participants in the franchising process have criticised the length of the franchises offered as being too short to make any investment worthwhile. The Franchising Director does now seem to be prepared to consider longer agreements. At the end of the franchise period the service will be available for the Franchising Director to pass to another body, either a private company, to British Rail or to a new publicly owned company. There may be some assets belonging to the former franchisee to be

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<sup>11</sup> OPRAF *Passenger Rail Franchising:Pre-qualification Document* December 1994

<sup>12</sup> Op cit

negotiated but the franchise companies own very little other than the right to run a passenger service over a particular line.

Roger Salmon announced on 14 December 1994 that "Passengers can be assured that I will be building in safeguards for all existing routes and stations, to maintain network benefits, to regulate fares for commuters, and to assume that franchise operators meet the needs of passengers." He described these safeguards as follows:<sup>13</sup>

**Required Services** - a Passenger Service Requirement (PSR) on operators to provide a defined level of services. This will cover frequency of trains, stations served, journey times, first and last trains, weekend services and, where necessary to prevent overcrowding, capacity standards. Every route and station will be included in the PSR. Operators will be free to run services above those required by the Franchising Director.

**Through Tickets** - through tickets will continue to be available for all journeys. As now, passengers will be able to buy an inter-available ticket on most routes. This extends across a range of fares including full price and discount tickets. In future, the Franchising Director will only remove the inter-availability requirement where he considers that there are likely to be greater benefits for passengers, such as more choice or lower fares.

**Railcards** - Young, Senior and Disabled Person Railcards will be mandatory, as will the London Travelcard. Operators have agreed voluntary arrangements to enable them to continue to provide other Railcards (e.g. Family and Network).

**Fares Regulation** - the Franchising Director will regulate fares for commuter journeys into London and for some other routes. Permitted fare increases will be linked to the quality of service provided. PTEs will regulate fares in their own areas.

**Ensuring Franchise Performance** - there will be financial incentives for operators to deliver good quality service. Regular customer satisfaction surveys, independently audited, will be carried out on issues important to passengers. Franchise operators will be required to produce a Passenger's Charter with, as now, published standards of performance and compensation arrangements".

## 2. Passenger Service Requirements

The Passenger Service Requirement sets out the minimum service levels for train services and is produced by the Franchising Director. Each PSR is specific to the franchise. The draft PSR is for consultation only and appears at about the same time as the pre-qualifying bids are invited. The final PSR is the one on which the prospective franchisees will base their bids.

In January 1995 Dr. Mawhinney, then Secretary of State, explained how the PSR would work. He spoke of the two different requirements of the rail services: one to vary and develop existing services in response to demand and the other to offer reassurance to passengers

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<sup>13</sup> OPRAF news release 14.12.94 p.2

through a guaranteed service.<sup>14</sup> Without the first, the benefits and opportunities offered by the introduction of private ownership, management and finance would be foregone. The second requirement is needed to ensure the Franchising Director can purchase, on behalf of passengers and the taxpayer, the appropriate level of service he judges to be necessary. These two objectives are reconciled through the PSR. At the time he stressed that the PSRs were not future timetables. These would be for the operators and Railtrack to develop. The PSR provided the guaranteed minimum safeguard. Where a service was not commercially attractive, the PSR was likely to provide for broadly the existing level of service but where the service was commercially attractive, the PSR was likely to be below the existing level to give the operator the opportunity to develop new and varied services within an assured framework.

The Franchising Director sets out a level of services in the PSR which the franchisee must operate. It in effect provides the level of service which the Franchising Director is buying and for which he will make support payments, if necessary, under the Franchise Agreement. A distinction is made between the uneconomic services for which the PSR will be very similar to the existing timetable and the commercial routes such as the successful intercity routes. In these cases the Franchising Director does not consider that he should be subsidising profitable routes and the PSR is likely to include only a token reference. Franchisees can run extra services according to their commercial judgment and are given the flexibility to determine detailed timetables in conjunction with Railtrack.

The Franchising Director's publication in January 1995 of his consultation paper on the PSRs for the first four services to be let to the public sector caused a considerable furore as the minimum requirements were considerably below the service levels currently provided.<sup>15</sup>

Operators must submit to the Franchising Director details of their proposed timetable. The Franchising Director will ensure these are compliant with the PSR and will monitor the actual services run. The PSR is included as part of the franchise agreement. If operators do not deliver the proper timetable, the Franchising Director may impose penalties or, as a last resort, terminate the franchise agreement.

### **3. Income**

A franchisee's main sources of income are the subsidy it receives from the Government and the money it raises from fares.

#### **Subsidies**

In July 1995 the Transport Committee published a report which concluded that privatisation would cost the taxpayer an additional £500-£700 million p.a. simply to maintain services at the existing levels.<sup>16</sup> In its response the Government said the increased financial support would be systematically reduced through private sector efficiency.<sup>17</sup>

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<sup>14</sup> Department of Transport press notice 27.1.95 Speech by Dr. Mawhinney

<sup>15</sup> OPRAF news release 30.1.95; PQ HC Deb 7.2.95 cc 202-250

<sup>16</sup> Transport Committee *Railway Finances* Fourth Report 1994-95, 5 July 1995 HC 206 1994-95

<sup>17</sup> Transport Committee *Government Observations on the Fourth Report*, First Special Report 1995-96, 29 November 1995 - HC 71 1995-96

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"The Government does not believe that the situation assumed by the committee, in which there is no growth in revenue or reductions in costs, is realistic. The improvements in efficiency and choice that will flow from privatisation ... will benefit customers through improved services and taxpayers through better value for money."

Subsidy payments for rail services are paid out of sums allocated by the Secretary of State for that purpose. Since 1 April 1994 OPRAF has been responsible for making those payments on behalf of central government.

The Department of Transport's consultation document on franchising stated that the subsidy paid to a franchisee, either an amount or the formula by which it is to be calculated, would be determined in advance for the whole period of the franchise but both grant and service agreement may be subject to periodic review.<sup>18</sup> There may also be adjustment factors with agreed 'triggers' in the franchise contract terms, for example to take account of changes in costs over which the franchisee has no control.

The intervals at which payments are made from Franchising Authority to franchisee or vice versa will be laid down in the individual franchise contracts (section 29(1) of the *Railways Act 1993*).

The present Government has stated that it will continue to pay subsidy, where necessary, for as long as it is needed to secure the provision of socially necessary services. This promise is not binding on a new government. A new government could theoretically reduce the total amount of money it gives OPRAF to support the railways as this is part of its public expenditure decision and is not set out in the *Railways Act*. However, the Franchising Director may not pay out in excess of the Secretary of State's allocation and if he could no longer pay the subsidies agreed under contract with the franchisees, the contracts and PSRs would have to be renegotiated to reflect the reduced amount of money available. This would not effect the lease agreements for rolling stock and the Railtrack charges which would continue at the old rate.

Section 29(7) of the *Railways Act 1993* makes the Secretary of State ultimately responsible:

"Any sums required by the Franchising Director for the payment of any grant, or for the making of any other payment, in consequence of any condition or other provision of a franchise agreement shall be paid by the Secretary of State out of money provided by Parliament"

This point was raised in the evidence given by the Mr. Salmon, the Franchising Director, to the Transport Committee during its hearing on railway finances:<sup>19</sup>

### Mr Hill

293. You expect, Mr. Salmon, to let the first franchise bid at the end of 1995. The working assumption is that this will be a 7-year franchise. You know your budget for 1995 is £1.61 billion, and you expect your budget to be of that order for the next two years. What assumptions do you make

for the budget for the three, four or five years after that, up to the end of the franchise period?

(*Mr. Salmon*) I will be entering into franchise agreements which will be long-term commitments of the Government. Those commitments will be based on passenger service requirements which are also designed for the long-term. They are being

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<sup>18</sup> Department of Transport *The Franchising of Passenger Rail Services* October 1992

<sup>19</sup> Op cit Volume II pp 126-7

prepared on the basis of instructions from the Secretary of State that he wishes me to base those PSRs on the existing timetable being run by British Rail. It is for the Government to provide me with funding to allow me to discharge those obligations. There are many precedents for the fact that when the Government enters into contracts it will be for them to find the money to honour those obligations that it enters into.

294. The fact that we are into a contract situation with these railway services is the great distinguishing factor from past experience where, of course, we know— indeed you were kind enough to concede this yourself in December 1993 when you first appeared before us— in fact, the experience of British Rail is that funding is highly variable and can change not merely from a 3-year period in the PES round, but it can actually change at 12 months' notice. But you are absolutely confident that the funding will be available, at the agreed level, for the entire duration of the franchising contracts?

*(Mr Salmon)* As far as I am aware the British Government has always honoured its contractual obligations.

295. So you are absolutely confident that the potential private operator will have the money that they expect to have over the period of the franchise?

*(Mr Salmon)* Yes, the Railways Act provides specifically that obligations of the Franchising Director under franchise agreements are to be met by the Secretary of State out of money voted by Parliament.

## Fares

Fares are the other main source of income. Directions issued by the Secretary of State to the Franchising Director require him to control fares where he considers it necessary to avoid abuse of market power and to ensure that fares are reasonable. Overall his view is that where effective competition is provided by other forms of transport, market forces are more efficient than regulation in keeping fares at a reasonable level. Where he does decide to regulate, the provisions are contained in the franchise agreement. He will specify the maximum rate of fare rise which may take place, during the term of the franchise, in the average of a "basket" of fares.

A joint announcement was made by the Secretary of State, Dr. Mawhinney, and the Franchising Director on 15 May 1995 giving details of the policy on fares regulation. From 1 January 1996, increases in capped fares will not be permitted to be more than the RPI from the 1995 base price. For the four years from 1 January 1999, the price cap will be RPI minus one. Unless the Franchising Director decides otherwise, the price cap from 1 January 2003 will continue to be RPI minus one.

Franchisees may not change the terms and conditions of the statutorily protected Young Person's, Saver and Disabled Person's Railcards. The Family Railcard and Network Card will continue. Operators cannot withdraw from the latter two schemes without the agreement of at least one third of the franchisees.

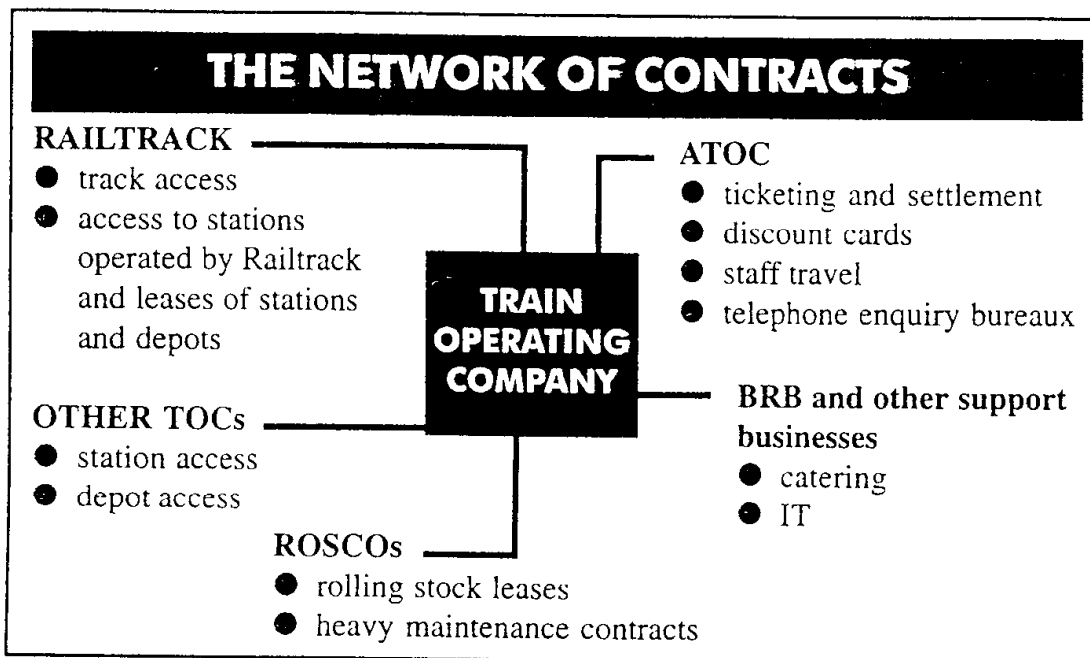
### 4. Contractual Arrangements

The key feature of the restructured railway industry is that it no longer has a vertically integrated structure as was the case prior to 1 April 1994. Many of the elements which make up a passenger service - rolling stock, track, stations, train operation and a range of other services, from catering to car parking for commuters - will involve commercially negotiated contracts. The former "commercial" structure of BR has been replaced by a "contractual" structure.

Each train operating company will rely on a number of contracts with suppliers of various services within the privatised rail industry including:

- The track access agreement with Railtrack gives a TOC the right to run trains on Railtrack's track within the agreed timetable. The track access agreement incorporates a performing regime which provides incentives to Railtrack to encourage punctuality and reliability of services. It also provides for compensation to be paid to TOCs in some circumstances for the effects of poor performance by Railtrack.
- Where a TOC has day-to-day responsibility for operating a station (a "Station Facility Owner"), there will be a lease from Railtrack, which owns all stations.
- A TOC will also require access agreements to allow its trains to stop at stations operated by other TOCs. When such a station access agreement is granted, the operator also enters into a collateral agreement with Railtrack. This enables Railtrack and the operator to enforce certain rights and obligations against each other without always having to involve the Station Facility Owner.
- A small number of stations - "independent stations" - are operated directly by Railtrack, and it is Railtrack which will grant station access agreements in these cases.
- A TOC which operates a light maintenance depot will have a depot lease with Railtrack and will enter into depot access agreements with other TOCs who wish to use that depot's maintenance services. Again, a train operator obtaining access agreement will enter into a collateral agreement with Railtrack.
- Use of rolling stock is obtained through contracts with the ROSCOs. Some flexibility is provided by the fact that a proportion of the leases will be short-term, but most of them will run for the same length of time as the franchise itself. Since ROSCOs maintain ownership of the rolling stock, they are responsible for heavy maintenance. This may be performed for the ROSCOs under contracts by those TOCs which have the capacity to carry out such maintenance.
- All TOCs will participate through ATOC (the Association of TOCs) in various schemes as part of the ticketing and settlement agreement. These cover matters such as fare setting, fares distribution, through fares and inter-availability, retailing of tickets, ticket brands, discount cards, staff travel and the provision of telephone enquiry bureaux. These schemes should enable operators to offer network-wide products to passengers.

Other contracts will exist between TOCs and the British Rail Board support businesses covering, for example, on board catering, computing and software support services and railway telephone lines. These relationships can be seen diagrammatically:



### C. Opposition Parties' Policies

#### The Labour Party

The Labour Party is not against the involvement of private capital in the railways and will encourage partnerships between public enterprise and the private industry to improve the transport system. It considers, however, that a privatised railway will cost more to run, has led to decreasing investment since 1992/93 and a collapse in orders for rolling stock and will do nothing to encourage future investment.<sup>20</sup> Furthermore the break up of the network has led to a costly internal market, the erosion of through ticketing and the undermining of train connections.

The Labour Party has spelt out its commitment to a "publicly owned and publicly accountable railway." At the 1995 Labour Party Conference Tony Blair said:<sup>21</sup>

"This nation needs a proper national integrated transport system that serves the needs of the people and safeguards the environment. And we should sit down as a country and plan it. Not wait for the free-market to build it - but plan it together.

Now let me make one thing clear. I don't give blank cheques in any area of policy, including this. No matter what the pressures.

But to anyone thinking of grabbing our railways, built up over the years, so they can make a quick profit as our network is broken up and sold off I say this: There will be a publicly owned and publicly accountable railway system under a Labour government.

And we will save the hundreds of millions of pounds still being spent on selling our railways to upgrade our service and modernise our lines."

The policy regarding the franchises for the passenger services was set out recently by Brian Wilson. He said that when Labour come to office there would be no extension of franchises which have been let and the franchising process would cease at once. He wrote:<sup>22</sup>

We will not break legally binding contracts which have been entered into. Neither will we come into government waving a chequebook and offering to buy them out. That would only succeed in guaranteeing the franchisees a no-lose bet, at the expense of a substantial spending commitment. However, we will most certainly enforce the terms of the franchises in a way which the Tories will not. To facilitate this process, the Office of Passenger Rail Franchising will be abolished, since it is an unnecessary piece of bureaucracy within an integrated railway.

Until the Railways Act can be amended, the Franchising Director will remain, but under the aegis of the British Railways Board. There will be no question of franchisees coming back to him either to obtain more money or to achieve derogations on fares or the levels of service.

As we have told the potential franchisees, we will lay stress on the absolute priority of safety and on the needs of passengers and staff. Since notice is being given in advice of our detailed approach, there will of course be no question of compensation if operators fail to meet these conditions, and pull out.

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<sup>20</sup> Labour Party press release 8.1.96

<sup>21</sup> 3 October 1995

<sup>22</sup> *Guardian* 12.12.95 "Perils of riding Stagecoach"



This approach represents a sensible balance

between our political commitment to restoring an integrated railway and the realities we will inherit. If any franchisee can live with these terms, then so be it. If they cannot, then the services will revert sooner than otherwise to the main railway network.

### The Liberal Democrats

The Liberal Democrats published a policy paper, *Transporting People, Tackling Pollution*,<sup>23</sup> in which they proposed a smaller number of regional companies rather than the present 25 passenger companies. These would be responsible for all aspects of service delivery in their region including timetabling, signal control, station management and day to day track maintenance. As far as the franchises were concerned it was the influence and control which was important, not ownership. They propose to:

- *Seek to alter the scope and specification of franchises*, by legislation if necessary, to achieve our wider objectives.
- *Design franchises to secure a steady growth in the proportion of passenger and freight trips made by rail* in line with nationally agreed targets. This would encourage franchisees to invest in all aspects of the service.

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<sup>23</sup>

Liberal Democrats policy paper 15 September 1995

## II The Franchising Programme

This section of the paper sets out chronologically what has happened to the franchising process from the announcement in December 1994 of the pre-qualification bids for the first eight companies.

14 December 1994. The Franchising Director published details of the pre-qualification process for the first eight franchises to be let (rather more than the six announced the previous year):<sup>24</sup>

- Gatwick Express
- Great Western
- InterCity East Coast
- LTS Rail
- Midland Main Line
- Network SouthCentral
- ScotRail
- South West Trains

He also let it be known that he would consider letting InterCity West Coast but as there were major problems associated with the work to be done on the track, he wanted to hear first if there was any interest expressed.

31 January 1995. Draft PSRs for Gatwick Express, Great Western, South West and LTS were published for consultation, mainly with the consultative committees and the local authorities.

37 organisations applied to pre-qualify for this first group and many applicants were interested in more than one franchise, taking the total number of applications to 160. Under section 145 of the *Railways Act 1993* the identity of individual applicants are not disclosed for reasons of commercial confidentiality.<sup>25</sup> Nor is the number of pre-qualifiers for each franchise given. BR was not considered as a bidder for any company in this group.

16 May 1995. The details of the final PSRs setting out the guaranteed service levels expected were issued for Great Western, South West Trains and LTS Rail. The next day the first three Invitations to Tender (ITTs) were issued for these companies.<sup>26</sup>

At the same time draft PSRs were issued for InterCity East Coast, Midland Main Line, Gatwick Express Limited, Network SouthCentral and ScotRail.

11 September 1995. The Franchising Director notified those who had been shortlisted for Great Western, South West Trains and LTS Rail and asked for final bids by 27 October.

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<sup>24</sup> OPRAF press release, 14.12.94

<sup>25</sup> PQ HC Deb 23.3.95 c 318 w

<sup>26</sup> OPRAF press release 17.5.95

No official announcement was made but according to newspaper reports<sup>27</sup> the bidders for South West were an MBO team, Stagecoach, Sea Containers and National Express; for LTS Rail they were an MBO team, Stagecoach, Prism and GB Railways; and for Great Western the bidders were an MBO team, Stagecoach, Sea Containers and Resurgence Railways. Sea Containers apparently withdrew from the process, saying the current plans were unworkable and that longer leases were needed to justify capital investment.<sup>28</sup>

14 September 1995. Final PSRs were announced for Network SouthCentral, Midland Main Line, InterCity East Coast, Gatwick Express and ScotRail.

19 September 1995. Draft PSRs issued for:

- Chiltern
- South Eastern.

26 September 1995. ITTs issued for InterCity East Coast, Midland Main Line, Gatwick Express and Network SouthCentral. The ITT for Scotrail was to be delayed until 1996.

3 October 1995. Pre-qualification documents issued for South Eastern and Chiltern.

15 November 1995. It was announced that 16 organisations had applied to pre-qualify for the South Eastern and Chiltern passenger franchises. Some are interested in both companies resulting in a total number of applications of 25.

19 December 1995. It was announced the franchise to run **South West Trains** had been awarded to **Stagecoach Holdings PLC**.

20 December 1995. The Franchises for **Great Western** and **LTS Rail** were awarded to **Great Western Holdings Ltd** and **Enterprise Rail Ltd** respectively, both management buy-outs.

16 January 1996. The Franchising Director notified those who had been shortlisted for Intercity East Coast, Midland Main Line, Gatwick Express and Network South Central and final tenders were requested by 1 March. He also said he was prepared to consider 15 year bids if they offered good value for money. This was because of the market reaction to the Gatwick bid but he said bidders of the other three franchises would have the same opportunity to submit proposals for longer term franchises on the same value for money basis.

The newspapers report that four companies have been shortlisted for InterCity East Coast including Stagecoach, National Express, Sea Containers and Wenfordbray, a management-employee group; four groups have been shortlisted for Midland Main Line including National Express, Prism and the MBO, Genesis 125; three companies have been shortlisted for Gatwick

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<sup>27</sup> For example, *Financial Times* 5.10.95 "Ready to step into the Fat Controller's shoes"

<sup>28</sup> *Financial Times* 15.11.95 "Sea Containers out of rail franchise race"

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Express including National Express, Prism and the MBO Relair but possibly not Virgin; and bids for Network South Central include National Express and one from Stagecoach who has formed a joint venture in conjunction with the management, Capital Coach Railways.<sup>29</sup> However it should be emphasised that these are only rumours and the final bids need not be submitted until 1 March.

- |                 |   |
|-----------------|---|
| 22 January 1996 | Final PSR issued for Chiltern   |
| 30 January 1996 | ITT issued for Chiltern   |
| 30 January 1996 | Pre-qualification documents issued for: <ul style="list-style-type: none"><li>- Cardiff Railways</li><li>- South Wales and West</li></ul> |
| 3 February 1996 | Franchise for LTS Rail withdrawn from Enterprise Rail Ltd, pending an inquiry into ticketing irregularities.                              |
| 4 February 1996 | Privatised train services start running on Great Western and South West Trains.   |

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<sup>29</sup> *Daily Telegraph* 17.1.96 "Stagecoach and Virgin on rail shortlist"; *Guardian* 18.1.96 "Repeat bids for next rail routes"

### **III The Train Operating Companies**

This section gives details of the individual train operating companies and the various stages which they have reached in the franchising process.

#### **Anglia Railways**

Passenger revenue £31 million.

Vested 23.7.95.

Pre-qualification documents likely to be issued in the Spring.

#### **Cardiff Railway**

Cardiff Railway operates passenger rail services principally between Cardiff and the valleys to the north and Barry and Penarth to the south. Whilst the company is the sole provider of passenger train services in its area, it faces significant off rail competition from private car and bus travel. The majority of its rolling stock is between eight and ten years old.

The company employs 315 staff.

Passenger revenue in 1994/95 was £5.7 million.

Vested 28.5.95.

PQD issued 30.1.96.

#### **Central Trains**

Passenger revenue £70 million.

Vested 11.95

No firm franchising proposals.

#### **Chiltern Railway Company**

The company principally operates services between Marylebone and High Wycombe, Banbury and Birmingham and between Marylebone and Aylesbury. In December 1995 Chiltern was awarded a Chartermark for excellence in the provision of public services. Major investment in upgrading signalling and stations and in new rolling stock was completed in 1992. As at 24 September 1995, Chiltern's rolling stock consisted of a modern fleet of diesel multiple units, all of which were under five years old and equipped with driver only operation.

The company employs around 360 staff.

Passenger revenue for 1994/95 was £22 million.

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Vested 30.4.95.

Draft PSR issued 19.9.95; final PSR issued 22.1.96.

PQD invited 3.10.95; ITT issued 30.1.96.

### **Cross Country Trains**

Passenger revenue £112 million.

Vested 12.95

No firm franchising proposals.

### **Gatwick Express**

Gatwick Express operates a frequent, non-stop, passenger rail service on the electrified 27 mile route between London Victoria and Gatwick Airport stations. With its relatively simple operational structure, Gatwick Express is the only rail operator currently offering a non-stop daytime service at 15 minute intervals between central London and Gatwick Airport and has over 80% of the passenger rail traffic on this route. Most of Gatwick Express' customers are air travellers and prospects are therefore sensitive to Gatwick Airport volume changes.

The company employs some 320 staff.

Passenger revenue for 1994/95 was £27.2 million.

Vested 1.4.94.

Draft PSR issued 16.5.95; final PSR issued 14.9.95.

Pre-qualifying bids invited 14.12.94; ITTs issued 26.9.95.

Final bids invited 16.1.96.

### **Great Eastern**

Passenger revenue £108 million

Vested 11.95

No firm franchising proposals

### **Great Western Trains**

Great Western Trains operates passenger rail services principally between London Paddington and South Wales, Avon, the West of England and the Cotswolds. Great Western's key strengths include access to a fast corridor into London and a balanced mix of leisure and non-leisure passengers. Journeys to and from London represent the largest element of Great Western's passenger revenue.

The company employs 2,900 staff.

Total revenue in 1995/96 was budgeted to be some £227 million.

Vested 18.12.94

Draft PSR issued 31.1.95; final PSR issued 16.5.95.

Pre-qualifying bids invited 14.12.94; ITTs invited 17.5.95.

Successful bidder announced 20.12.95.

New service started 4.2.96.

The Great Western franchise has been won by Great Western Holdings Ltd. Great Western Management and employees will own 51% of the voting shares. They are backed by West Country-based bus operator FirstBus, venture capitalist 3i and mezzanine capital funds were provided by Intermediate Capital Group (ICG) and The Royal Bank of Scotland.

In addition to planning to run at least the current number of services and reducing journey times, Great Western Holdings Ltd is committed to the following service enhancements and improvements:

- \* Refurbished rolling stock;
- \* Co-ordinated links with local bus operators;
- \* An improved Passenger's Charter.

The franchise will run for 10 years subject to the operator reaching an agreement with the Franchising Director on an improvement and investment plan within two years.

This will provide additionally:

- \* Increased service frequencies including running half-hourly services to Bristol Temple Meads and Cardiff throughout the day;
- \* Investment to produce a more flexible rolling stock fleet;
- \* OPRAF grant saving of at least a further £3 million from the year 2000 compared with the seven years franchise period.

Should agreement not be reached, the franchise will run for the standard seven years.

For the standard seven year term, the Franchising Director will provide support of £53.2m in the first year, falling to £38.2m in 2002/3. This is an average subsidy requirement of £44.8m compared with support to BR of £61.8m in 1995/96 (including a budgeted profit of £14.5m) - all figures in current prices.<sup>30</sup>

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<sup>30</sup> OPRAF press notice 20.12.95

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### InterCity East Coast

InterCity East Coast operates passenger rail services between London, parts of the East Midlands and parts of East Anglia, Yorkshire, the North East of England and Scotland. It provides a fast, frequent, high quality service, offering direct centre to centre access between London and other major cities. Covering a network of 920 route miles, ICEC has a balanced mix of leisure and non-leisure travellers, with a large catchment area which includes commercial centres and tourist destinations. Substantial investment has been made over the last 10 to 15 years to acquire modern rolling stock and to electrify routes from London to Leeds and to Edinburgh and Glasgow.

One of ICEC's key strengths is the provision of services by High Speed Trains and a modern fleet of 1C225 trains. The fleet is maintained at 3 principal depots.

The company employs some 2,900 staff.

Passenger revenue for 1994/95 was £205.9 million.

Vested 1.4.95.

Draft PSR issued 16.5.95; final PSR issued 14.9.95.

Pre-qualifying bids invited 14.12.94; ITT invited 26.9.95.

Final bids invited from shortlist 16.1.96.

### InterCity West Coast

Passenger revenue £221 million.

Vested 28.4.95.

On 14 December 1994 when the Franchising Director issued the PQDs for the first eight rail franchises, he added that he was "minded" to invite tenders in 1995 for the InterCity West Coast franchise. Franchising this route has been complicated by the concurrent modernisation of the West Coast Mail Line proposed by Railtrack. The franchise therefore differs from the other franchises that are being offered in that it will be required to be comprehensively modernised during the life of the franchise. The Franchising Director therefore hoped to invite expressions of interest from potential bidders including proposals for interaction with the modernisation programme, perhaps as part of a longer franchise. Lack of response has meant the sale has been deferred for a year.<sup>31</sup>

### Island Line

The Isle of Wight Line was one of the first franchises identified by the Government. Exceptionally it will be franchised on a vertically integrated basis and its preparation therefore requires special consideration.

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<sup>31</sup> *Guardian* 24.8.95 "West Coast rail sell-off stalls"



Passenger revenue £0.9 million.

Vested 11.95.

No firm franchising proposals.

### **LTS Rail**

LTS Rail operates passenger rail services on compact and predominantly self-contained routes to the east of London. It provides a frequent service for London commuters on its routes in the morning and evening peak periods and a regular off-peak service to its dedicated London terminal at Fenchurch Street.

Approximately 75% of revenue is derived from the sale of season tickets. It also has the opportunity to benefit from a major modernisation programme of signalling equipment and related infrastructure which is nearing completion.

The company employs approximately 770 staff.

Total revenue in 1995/96 was budgeted to be some £55 million.

Vested 18.12.94.

Draft PSR issued 31.1.95; final PSR issued 16.5.95.

Pre-qualifying bids invited 14.12.95; ITTs invited 17.5.95.

Successful bidder announced 20.12.95. The franchise was suspended 3 February 1996, hours before it was due to start running services, pending an investigation into some apparent ticketing irregularities.

The LTS Rail franchise was won in December 1995 by Enterprise Rail Ltd., the management and employee buyout team, backed by 3i and Gresham Trust. The agreement was suspended on 3 February, the day before the Enterprise Rail was due to take over.

In their bid Enterprise Rail had promised to invest and intended to re-equip the business with new rolling stock not later than 2002. Subject to finalisation of procurement and agreement of certain other terms, the franchise would have been for 15 years; otherwise the franchise term would be for seven years.

In addition to investment in new rolling stock, Enterprise Rail had also committed itself to the following service enhancements:

- \* Service levels above the passenger service requirement, including tougher standards on overcrowding.
- \* An improved Passenger's Charter from the start of the franchise.
- \* The initiation of a rolling stock refurbishment programme for existing stock.
- \* The installation of a new customer information system and Help points at stations, and the implementation of a programme of station refurbishment.

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Under the agreement Enterprise Rail would have received from the Franchising Director support (in current prices) of £29.0 million in the first year declining to £23.9 million in 2002/3, representing an average of £26.1 million over the life of a seven year franchise. £32.1 million was budgeted for support to British Rail for the current financial year, including a budget profit of £4.1 million. Further reductions in support would have been achieved over a 15 year term.<sup>32</sup>

### **Merseyrail Electrics**

Passenger Revenue £21 million.

Vested 12.95.

No firm franchising proposals.

### **Midland Main Line**

Midland Mail Line provides InterCity passenger rail services on a simple and relatively self-contained network principally between South Yorkshire, the East Midlands and London St. Pancras. A large proportion of MML's passenger revenue is derived from customers whose outward journey is from South Yorkshire or the East Midlands to London St. Pancras, a complication for a franchisee as St. Pancras is to be subject to considerable building work to make it an international terminus. It serves a diverse customer base, with a significant proportion of business travellers. MML's other strengths include its fast, frequent, high quality service and its fleet of High Speed Trains.

MML employs around 1,200 staff.

Passenger revenue for 1994/95 was £58.5 million.

A further £23.8 million of revenue came from its two train maintenance depots in Derby and Leeds.

Vested 1.4.95

Draft PSR issued 16.5.95; final PSR issued 14.9.95.

Pre-qualifying bids invited 14.12.94; ITT issued 29.9.95.

Final bids invited 16.1.96.

### **Network SouthCentral**

Network SouthCentral comprises a mix of suburban and mainline routes to the south of London, with its principal markets comprising South London, Surrey and East and West Sussex. It also serves parts of Hampshire, Dorset and Kent. NSC has a diversified passenger base with significant ticket sales to each of the commuter, business and leisure markets; the area it serves has a number of commercial centres and popular tourist attractions, and it has the opportunity to grow its business using existing off-peak capacity. NSC benefits from

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<sup>32</sup> Ibid.

operational flexibility, due to its access to three London termini, and a diversified fleet mix. It also benefits from a wide range of journey opportunities through interfaces with other transport operators, including London Underground, airlines at Gatwick Airport and ferry services.

NSC employs some 3,140 staff.

Passenger revenue for 1994/95 was £157.3 million.

Vested 1.4.95

Draft PSR issued 16.5.95; final PSR issued 14.9.95

Pre-qualifying bids invited 14.12.94; ITTs invited 26.9.95

Final bids requested 16.1.96

### **North London Railways**

Passenger revenue £52 million.

Vested 12.95.

No firm franchising proposals

### **Regional Railways, North East**

Passenger revenue £62 million.

Vested 12.95.

No firm franchising proposals

### **Regional Railways, North West**

Passenger revenue £47 million.

Vested 12.95.

No firm franchising proposals

### **ScotRail**

ScotRail operates the majority of passenger services in Scotland. It also provides services around Glasgow for Strathclyde PTE. The franchise will include the Anglo-Scottish sleeping car services. Problems with Strathclyde PTE meant ScotRail's timetable dropped behind others first announced in December 1994.

Passenger revenue £90 million

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Vested 12.95.

Draft PSR issued 16.5.95; final PSR issued 14.9.95

Pre-qualifying bids invited 14.12.94.

### **South Eastern**

Passenger revenue £205 million

Vested 23.7.95.

Draft PSR issued 19.9.95.

Pre-qualifying bids invited 3.10.95.

### **South Wales & West Railway**

South Wales & West operates over a route network of 1,569 miles. Inter urban services extend out from Cardiff and Bristol to Manchester, Birmingham, Portsmouth and the west of England, with less frequent services to Liverpool, Holyhead, Brighton and London Waterloo. As well as operating across a wide geographical area, South Wales and West also operates within various passenger markets such as interurban services largely for the leisure traveller, urban services largely for commuters and rural services. Much of the company's route mileage is also used by one or more other passenger train operators and is therefore dependent on allocation factors.

Passenger revenue 1994/95 £40 million.

Company employs 1,398 staff.

Vested 23.7.95.

Pre-qualification documents issued 30.1.96.

### **South West Trains**

South West Trains Ltd. provides passenger rail services on routes to the south west of London, with its principal markets comprising south west London, Surrey, Hampshire and Dorset. It also serves parts of Berkshire, Devon, Somerset, East and West Sussex and Wiltshire. It provides a frequent peak service for London commuters to/from its terminal at Waterloo, as well as regular off-peak services.

Passenger revenue £221 million.

Vested 1.4.95.

Draft PSR issued 31.1.95; final PSR issued 16.5.95.

Pre-qualifying bids invited 14.12.94; ITTs issued 17.5.95.

Franchise awarded 19.12.95.

New service started 4.2.96

The South West Trains franchise has been let for seven years and was won by Stagecoach Holdings Plc, the bus operating group.

In addition to planning to maintain the present level of services, Stagecoach has committed to the following additional service enhancements and improvements:

- \* A substantially improved Passenger's Charter.
- \* A number of dedicated bus links to selected SWT stations.
- \* A programme of station improvements, including passenger security measures.
- \* Improved customer information on stations.

Stagecoach will receive from the Franchising Director support (in current prices) of £54.7 million in the first year declining to £40.3 million in 2002/03, representing an average of £49.0 million over the life of the franchise. £83.4 million was budgeted for support to British Rail for operating the services in 1995/96, including a budgeted profit of £19.9 million.<sup>33</sup>

### **Thames Trains**

Passenger revenue £39 million.

Vested 12.95.

PQD expected in the Spring

### **Thameslink**

Passenger revenue £61 million

Vested 11.95.

No firm franchising proposals

### **West Anglia Great Northern Railway**

Passenger revenue £103 million.

Vested 12.95.

No firm franchising proposals

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<sup>33</sup>

OPRAF press notice 19.12.95

## Research Paper 96/21

### IV Further Reading

Debates in the House of Commons since April 1992:

1. Debate on privatisation, HC Deb 11.5.92 cc 374-466
2. Debate on the white paper, HC Deb 29.10.92 cc 1162-1238
3. Debate on privatisation of the railways, HC Deb 12.1.93 cc 771-869
4. Debate on Second Reading of the Railways Bill, HC Deb 2.2.93 cc 154-279
5. Debate on through ticketing, HC Deb 18.1.95 cc 715-790
6. Debate on passenger services under rail privatisation, HC Deb 7.2.95 cc 201-253
7. Debate on the Metropolitan Railway Grant, HC Deb 18.7.95 cc 1493-1512
8. Debate on Rail Privatisation HC Deb 18.10.95 cc 358-412

Official papers and reports;

1. *New Opportunities for Railways* Cm 2102 - July 1992
2. Department of Transport *The Franchising of Passenger Rail Services - a consultation document* October 1992
3. Department of Transport *Gaining Access to the Railway Network* February 1993
4. Transport Select Committee *The Future of the Railways in the Light of the Government's White Paper Proposals*, April 1993 - HC 246 1992/93
5. Department of Transport *Britain's Railways: A New Era* March 1994
6. Railtrack *Track Access Charges* April 1994
7. Office of the Rail Regulator *Railtrack's Track Access Charges for Franchised Passenger Services: Developing the Structure of Charges* November 1994
8. Office of the Rail Regulator *Competition for Railway Passenger Services* December 1994
9. Office of the Rail Regulator *Railtrack's Access Charges for Franchised Passenger Services: The Future Level of Charges* January 1995
11. Office of the Rail Regulator *Criteria for the Approval of Passenger Track Access Agreements* 2nd edition March 1995
12. Office of the Rail Regulator *Ticket Retailing* April 1995

13. Transport Committee *Railway Finances 5.7.95* - HC 206-I,II 1994/95
14. Transport Committee *Government's Observations on the Fourth Report of the Committee 29.11.95* - HC 71, 1995/96
15. OPRAF *Passenger Rail Industry Overview* May 1995
16. Department of Transport *Annual Report 1995* p. 21
17. British Railways Board *Annual Report 1994/95*
18. OPRAF *Annual Report 1994/95*
19. Office of the Rail Regulator *Annual report 1994/95*
20. HM Railway Inspectorate *Railway Safety - the Annual Report 1993/94*
21. Central Rail Users' Consultative Committee *Annual report 1994/95*

Pamphlet and periodical articles since 1994:

1. *Economic Affairs* Feb 1994, "Rail privatisation: a platform for success"
2. Ed. Prof. Beesley *Regulation Utilities: The Way Forward*, IEA 1994 Ch 7 "The regulation of Britain's privatised railways"
3. Christopher Foster *The Economics of Rail Privatisation* Centre for the Study of Regulated Industries April 1994
4. *Modern Railways* April 1994, "Train and track costs will double BR subsidy"
5. *Rail Privatisation News* 1995
6. *Accountancy Age* 8.6.95 "Signals stay at Danger"

**Related Research Papers include:**

**Transport**

95/96	Rail Privatisation: a Progress Report	06.09.95
95/81	The Licensing of Taxis and Private Hire Vehicles	30.06.95
95/57	Deregulation of the Buses	09.05.95
95/2	Channel Tunnel Rail Link Bill [Bill 3 of 1994/95]	10.01.95