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Sefydliad Polisi Cyhoeddus i Gymru

Not-for-Dividend Rail Service Provision

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Not-for-Dividend Rail Service Provision: PPIW Expert Workshop

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Summary

- The former Minister for Economy, Science and Transport asked the Public Policy Institute for Wales (PPIW) to provide advice on the future design of the Wales and Border franchise and, in particular, how the franchise could be designed to deliver not-for-dividend (NFD) passenger rail services. The PPIW ran an expert workshop to explore this. Participants' expressed a range of views, and this report provides our conclusions rather than seeking to represent the views of every single participant on all of the issues which the workshop explored.
- The Welsh Government is in the process of procuring the next Wales and Borders rail franchise ahead of the end of the current franchise (2018) held by Arriva Trains Wales. The Welsh Government has a long-standing aspiration to create a service run on a not-for-dividend basis. Underlying this is a desire to increase value for money and limit the potential for 'excessive' profit making.
- Participants were supportive of the Welsh Government's aims, and saw the potential benefits of a NFD model. The current legal framework requires the franchise to be let through open competition to a non-public sector body that can demonstrate management competence and an appropriate financial position. A NFD organisation that would satisfy these criteria does not currently exist; although it might be possible for a viable bidder to emerge through a partnership between a NFD organisation and an existing train operating company (TOC).
- The workshop explored options for stimulating the emergence of a suitable NFD organisation. Any Government intervention or support would need to avoid giving competitive advantage; and, by extension, there could be no guarantee that the supported organisation would win the tender in open competition. Participants also considered the possibility of running a franchising competition based on a specification that required a NFD model, as a way of trying to stimulate the market. In the discussion, potentially serious reputational risks in taking this approach were raised, and it was suggested by some participants that it may also be open to legal challenge. Nonetheless, others believed that it was a viable option.
- Whilst some participants argued strongly for a NFD model, others suggested that it was not the only way to improve the quality of services, ensure value for money and limit private sector 'rents'. More recent franchising agreements, like ScotRail, seek to deliver this through better contract design and more sophisticated monitoring arrangements. Although such an approach is unlikely to achieve the Welsh Government's aims as fully as a NFD model.

Introduction

The former Minister for Economy, Science and Transport asked the Public Policy Institute for Wales (PPIW) to provide advice on the design of the Wales and Border franchise and, in particular, how the franchise could be designed to deliver not for dividend (NFD) passenger rail services[1].

PPIW ran an expert workshop in February 2016 to explore this (see Appendix 1 for a list of participants), and what follows sets out the context before summarising the key points that arose in the discussion about how to design the next franchise agreement so as to realise the stated aims.

The Context

The Welsh Government is in the process of procuring the next Wales and Borders rail franchise ahead of the end of the current franchise (2018) held by Arriva Trains Wales (ATW). The Government has a long-standing aspiration to create a service run on a NFD basis, and has established a wholly owned subsidiary – Transport for Wales – as a not-for-profit company whose purpose is to design, let and manage the future franchise.

The interest in a NFD model primarily stems from a desire to maximise the value of Welsh Government investment in passenger rail, but a range of arguments for pursuing this model have been put forward:

- The current Wales and Borders franchise is subsidy driven and the scope for commercial / market drivers to increase profits and improve services are less obvious.
- The opportunity presented to keep investment and profit in Wales are considered to be likely to benefit people and the economy.
- Parallels have been drawn with successful models in other sectors, in particular Glas Cymru.
- Current profit levels of ATW are considerably higher than the Great Britain average.
- There are general issues with the current franchising model which is seen to create a situation where operators are focused on profit rather than investing in long term benefit.

[1] Freight is run on a different basis and was not discussed.

- Potential has been identified for higher employee engagement in mutual and cooperatives to deliver better performance.

Across these, the overarching drivers for franchise reform appear to be a desire for increased value for money and reducing ‘excess’ profits for private investors; in part this reflects a critique of the current franchise arrangements.

Current powers and the Arriva Trains Wales franchise

Rail franchising in Great Britain was created by the Railways Act 1993 and is the mechanism by which rail passenger services are secured. The 1993 Railways Act effectively ‘privatised’ the rail network in Great Britain. At present, “the UK Secretary of State designates rail passenger services to be delivered by franchises in England and Wales; prepares and issues an Invitation to Tender; and selects the franchisee from the tenders submitted. Under the Railways Act 2005 (as amended) the Secretary of State must consult the Welsh Ministers regarding franchise agreements that include a Welsh Service. The Welsh Ministers must be a joint party to any franchise that includes a Wales-only service” (Enterprise and Business Committee, 2013, p.8).

The current Wales and Borders franchise was awarded to Arriva Trains Wales (ATW) in 2003 by the Strategic Rail Authority (SRA) for a 15 year period. The Railways Act 2005 abolished the SRA and transferred its powers in relation to Welsh franchises to the Department for Transport and the Welsh Government. Since 2006, the Welsh Government has therefore been responsible for the specification and primary management of the ATW franchise, through a Joint Parties Agreement with the UK Department for Transport, but funding comes from the Department for Transport (though substantial investment has also been made by the Welsh Government) (Enterprise and Business Committee, 2013). Freight is run on a different basis.

The performance of ATW is monitored and reviewed every five years (Enterprise and Business Committee, 2013). The franchise sets out the services and service standards that ATW are expected to deliver (Welsh Government, 2013). Most rail services in Wales, with the exception of inter-city services from London (operated by Virgin, at present, to Holyhead, and the Great Western Railway to Swansea) and Cross Country services between Cardiff and Birmingham / Nottingham, are operated by ATW. The current franchise is a mix of busy suburban networks, very rural routes and major services that are ‘interregional’ in character, in some cases crossing the national border. All stations in Wales are operated by ATW under a landlord / tenant arrangement plus the franchise also manages stations at Chester, Shrewsbury and other smaller stations on ATW routes within England (Salveson, 2012). Arriva Trains Wales is ultimately owned by Deutsche Bahn, the German state-owned train operator which, alongside ATW, runs three other rail franchises and two rail contracts, including Northern, Cross Country and Chiltern Railways[2]. The network in Wales is entirely diesel operated at present though electrification of the main line from Cardiff to Swansea and some of the Valley Lines is planned.

The ATW franchise was awarded at a time when budgets were limited (Association of Train Operating Companies, 2013). Similarly, preparations for the next franchise are also being made during a time of austerity (Enterprise and Business Committee, 2013). The current franchise operation is paid for in part by income that the franchisee generates and in part from a substantial government subsidy. In 2012/13, the total income for the franchise was around £290m, of which over half comes from Welsh Government subsidy (Welsh Government, 2013). To the extent that government subsidy is needed, tight public finances will by necessity be a key factor in shaping the specification of the franchise.

The UK Government transferred funding for the ATW franchise to the Welsh Government in 2006/7 at a level sufficient to cover the baseline franchise. However, this did not provide for the growth in passenger numbers on the Welsh network. The Welsh Government has subsequently provided funding in order to the bridge the gap between the capacity provided to them in the franchise and the capacity customers require (Welsh Government, 2013).

Lessons to be learnt from the current franchise

The Welsh Assembly Enterprise and Business Committee undertook an inquiry into the future of the Wales and Borders rail franchise. According to their consultation one of the main lessons to be drawn from the current franchise was indeed the lack of forecasting and planning for growth in passenger numbers and lack of investment by the operator. There has been a significant expansion in both service capacity and passenger numbers in the Wales and Borders franchise area since 2003. Between 2003-04 and 2012-13 the ‘train kilometres’ for services provided by ATW increased by 31% and the number of ‘passenger journeys’ on these services increased by 61% over the same period (Welsh Government, 2013). The current franchise agreement specification indicated that there would be no growth in rail passenger use which has been very constricting and cost the Welsh Government dearly, because when the current franchise was awarded by the then SRA in 2003, there was not

[2] http://www.arriva.co.uk/countries/uk/arriva-uk-trains

an expectation that demand would grow significantly. The agreement requires the operator to make ‘reasonable endeavours’ to provide capacity to meet demand which in contractual terms has not been sufficient to require the operator to invest in increasing capacity. Welsh Government sought to address this, while ATW realised the benefits of the consequent growth in receipts. Consequently, ATW made larger than UK average profits.

Another lesson from the current franchise is the failure to reflect Welsh Government policies and priorities. The Welsh Government was not involved in the procurement of the current franchise therefore little consideration was given to its transport, spatial planning and environmental priorities. The limitations in the performance management regime, the age capacity and quality of the current rolling stock, poor core services standards, inadequate provision to support community rail, and the cost and complexity of fares were further criticisms for many respondents involved in the Enterprise and Business Committee’s consultation (2013) and should be taken into account when designing the next franchise.

The Challenges of Not-for-Dividend

The Welsh Government has a long standing aspiration to run the Wales and Border franchise on a NFD basis. The existing legislative framework for England and Wales prohibits a franchise being run by a publically-owned body[3], and requires that a franchise is let in fair and open competition to a body with an appropriate financial position and management experience. While this does not preclude the provision of a NFD service, it creates some significant barriers to its realisation. Principal among these is that it would require the appearance in the market of a viable NFD bidder, with sufficient financial resource and operational experience to compete with commercial rivals.

Transport Scotland explored the possibility of a NFD service when retendering the ScotRail franchise (which commenced operation in April 2015); but they ultimately chose not to pursue it because “in 2011, there were no realistic organisations that could take forward a not for dividend franchise” (National Assembly, 2013, paragraph 298). The Welsh Government’s early engagement with industry had suggested that this remained the case.

[3] The Scotland Act 2016 provides a derogation from section 25 of the 1993 Railways Act, which allows a publically-owned company to operate commercial rail services in Scotland.

The workshop explored a number of ways that Welsh Government might try to foster the appearance of a NFD bidder, while adhering to the principles of fair, open and transparent competition. In particular:

- Exploring the possibility of bids from NFD organisations in partnership with organisations with the necessary experience and financial position. During the workshop, an example was given of an organisation entering rail service provision without knowledge of rail through a relationship with Stage Coach. It is conceivable to think of a social enterprise forming an alliance with a transport operator and making an NFD bid. However, concerns were issued about the risk of such an alliance having an 'NFD front plate' and a profit-making set up.
- Providing financial support to potential bidders (as a way of helping NFD bidders overcome the costs of bidding), but this would have to be made available to all bidders so as not to incur unfair advantage.
- Running a competition based on a specification that stipulated a NFD model and using this to stimulate the market, whilst allowing a fall-back option for the Welsh Government to temporarily operate the franchise under a publicly-owned operator should the competition fail (i.e. generate insufficient or inadequate bids). Concerns were raised about this, however, as there could be a significant reputational risk in running a competition that might be expected to fail. It was also suggested by some participants that such an approach may be open to legal challenge. Nonetheless, others believed that it was a viable option.

The participants also discussed ensuring earlier access to the franchise competition 'data room' (a closed community with access to information on costs that become incumbent in the current franchise operation), careful thought about how this is put together and guidance of how to navigate this could help potential bidders in putting together their bids. Although not designed to support NFD bidders in particular, it was suggested that it could help improve the quality of the bids in general.

Alternative Approaches

The workshop participants were supportive of the Welsh Government's aims, and saw the potential benefits of a NFD model. However, it was recognised that the current legal framework creates significant barriers to delivering a NFD passenger rail service. The discussion pointed to other options for improving rail provision in Wales, although recognised that these were unlikely to achieve the Welsh Government's aims as fully as a NFD model

It was suggested that more recent franchising agreements, including ScotRail, provide a potential guide. Through better contract design and monitoring the Welsh Government could secure more efficient services, increased value for money and limit private sector ‘rents’.

One example explored was the approach Transport for London (TfL) takes with the London Overground, whereby it specifies timetables, fares, and quality factors, and procures rolling stock which it leases to the operator. In addition, with just a small share of the revenue (10%) going to the operator, TfL takes most of the ‘revenue risk’. This puts some limits on the operators ability to make ‘excessive’ profits, but also means that if operating costs exceed revenues, the majority of the resulting ‘deficit’ would fall to TfL. Discussants were not clear on the extent to which the current devolution settlement would allow Transport for Wales to take on this level of control.

Conclusion

Participants were supportive of the Welsh Government’s aims, and saw the potential benefits of a NFD model. Given the current legal framework, and the powers available to Welsh Government, delivering a NFD passenger rail service will be challenging. However, the workshop discussion suggested that alternative franchising agreements, such as ScotRail, which seek to improve the quality of services, ensure value for money and limit private sector ‘rents’ through better contract design and more sophisticated monitoring arrangements, may offer an alternative. Although it was acknowledged that such an approach is unlikely to achieve the Welsh Government’s aims as fully as a NFD model.

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Annex: Workshop Participants

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