

GREATER MANCHESTER INTEGRATED TRANSPORT AUTHORITY**REPORT FOR INFORMATION/RESOLUTION**

COMMITTEE: Policy and Resources
DATE: 19th March 2010
SUBJECT: Publication of 'The Future of Franchising Policy'
REPORT OF: Clerk to the Authority

PURPOSE OF REPORT

To inform Members of the DfT's new rail franchising policy.

RECOMMENDATIONS

Members are requested to:

1. note the report and comment as appropriate ; and
2. authorise a response to the Department based on the comments contained within, to be approved by the Clerk and Chief Executive in consultation with the Chair and Vice Chair

BACKGROUND DOCUMENTS

Previous reports held on file in the GMITA Policy Unit's office

CONTACT OFFICERS

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1. Background

1.1. The DfT has published its new franchising policy “The Future of Rail Franchising”, which is intended to encourage investment during the lifetime of a franchise whilst ensuring that passengers’ interests are safeguarded. This report sets out, and comments on, the main points of the new policy.

2. Franchise Length

2.1. In future franchises will be let for a minimum of 10 years. However operators will be free to suggest a longer contract of up to 22 years in return for additional investment. The franchise winner will be chosen on the basis of their 10-year proposal and the Department will then consider any additional proposals for a longer term. These proposals should include plans for additional investment that offers value for money and helps meet the DfT’s wider transport objectives.

Comment: This could lead to a sub optimal situation whereby an applicant wins a franchise with a particularly strong 10-year submission, but fails to submit proposals for further investment in return for a longer franchise, or submits proposals which are not considered good value for money. It may therefore be preferable for DfT to produce a ‘short list’ of 10-year bids, and then to consider these as well as any options for franchise-extension so as to ensure the best value for money bid is chosen.

2.2. The Department also retains the right to award shorter franchises where major infrastructure projects are likely to have a major impact on the franchisee’s business.

2.3. The current franchise system gives the Department the right to cancel franchises early if it is not meeting its commitments on measures such as cancellations, delays, and capacity. Longer franchises require such ‘performance beaks’ to be stronger so as to ensure that the franchisee offers the level of service expected by the passenger. As a result the Department is considering adding service quality measures to the criteria used to assess performance.

Comment: This should be welcomed; train performance is generally good and the National Passenger Survey conducted by Passenger Focus shows that passengers are now placing an increasing value on service quality, both in terms of customer care, station facilities and train standards.

3. Specification and Delivery

3.1. The franchising process involves the setting of minimum outputs which must be delivered as part of the franchise (called specifications), these often include minimum journey times, frequencies and stopping patterns for services, but recently let franchises have included standards on access to the network (i.e. cycle and car parking, transport interchange), passenger satisfaction targets, revenue protection and environmental impacts. Many of these do not offer a commercial return and would not otherwise be implemented by the operator and so are in effect paid for by the Department by being included in the specification. Whilst the Government will continue to set these requirements it will review the way they are set out so as to incentivise bidders to propose innovative methods of delivery.

3.2. The Department recognises that in a franchise system, competition is most intense during the bidding stage. This means that there is a risk that with longer franchises there is less opportunity for competition and a risk that benefits to passengers will be reduced. Under the current system there is a weak incentive for bidders to propose service standards in excess of the set specification (known as enhancements), or to make its own suggestions (known as bidder-generated option – which will from now on include longer contract proposals). The Department therefore proposes to make alterations to the way franchises are assessed by giving greater weight to innovative proposals when scoring bids. The table below sets out how the specification and additional options will be considered.

Table 4.1 Proposed Franchise Bid Structure				
	Mandatory	Scored as part of delivery plans	Included within financial evaluation	Included within franchise contract
Minimum output specification	Yes	Yes	Yes	Yes
Additional elements and enhancement package	Yes	Yes	Yes – but only a proportion of package costs	Possibly depending on Ministerial decisions and Affordability
Bidder specified enhancements and innovations* <small>*including longer contract options</small>	No – but DfT will set maximum number of plans.	Yes	No	Possibly depending on Ministerial decisions and Affordability. May require subsequent public consultation

3.3. The Department will also look again at how it supports franchisees to make additional investment late into their franchise so that, once the franchise ends, they can receive some of the residual value of their investment back when it is passed onto the next franchisee.

3.4. The new policy takes into account the recommendations of the Better Rail Stations report by considering the possibility of providing taxpayer funding for better stations by directly specifying improvements in new franchise competitions.

Comment: This is a matter which warrants further consideration, whilst for some of the least frequently used stations investment will never deliver a return on investment for the operator, longer franchises should require operators so make a greater investment in all aspects of their infrastructure, including stations, which can have a significant impact on encouraging passenger growth.

4. Changes During the Lifetime of the Franchise

4.1. It is likely that during the lifetime of a franchise, some form of change will need to be accommodated, this may be due to infrastructure enhancements, new or additional rolling stock, or changes to ticketing. With longer franchises it is more important that changes can be accommodated and that contracts are flexible enough for this to happen in a way which still gives good value for money from the taxpayer. The Department will therefore strengthen its requirements for financial modelling as part of the bid process so this can be used to cost the impacts of changes, and to require bidders to demonstrate how changes will be accommodated during the lifetime of the contract.

4.2. It is also proposed to give operators greater incentives to reduce costs to reflect levels of patronage on particular services. Under the current arrangements there is no incentive for operators to make changes to services which are no longer justified, since any savings would be retained by the Government only. In future operators will be entitled to a share of any savings made.

Comment: Given this ITAs will want to be able to satisfy themselves that passengers will not lose out as a result of these changes, and it is suggested that in any response to the DfT, the ITA requests to be consulted on any service reduction which would affect its area. It should also be easier for ITA to bring about change in its area, and it cannot be acceptable that Authority involvement is limited only to times of re-franchising.

5. Managing Risk

5.1. It is proposed to strengthen safeguards to ensure that operators remain solvent and cannot walk away from a franchise without monetary penalty. Franchisees are already required to provide a deposit – known as a performance bond – which is retained if the franchise is cancelled. In future the level of this bond will be increased.

The Government will also make it a requirement of parent companies to stand behind any losses made by the franchise; this is in direct response to the circumstances surrounding the East Coast franchise, whereby National Express returned the contract to the DfT but avoided the loss of its other operation under a cross-default arrangement as the franchise was managed by a separate subsidiary company established prevented walking away from a franchise when it fails to deliver growth as expected.

5.2. Under the current franchise system, if an operators revenues fall below a certain level, they can receive up to 80% of the shortfall from Government. Likewise, if they are above a projected level they can be required to pay the Government up to 80% of the excess. This so called 'cap and collar' arrangement kicks in after the franchise has been operational for 4 years and is designed to recognise that a significant amount of revenue growth or decline is not within the control of the franchisee but may be linked to national economic performance or changes in employment patterns. However, when an operator is receiving high levels of revenue support or making large revenue payments the incentives to improve performance are weak because year-on-year changes are unlikely to be significant given the amount of time before the franchise expires.

5.3. The Department is therefore considering changes to these arrangements which would factor forecast changes in GDP and employment levels into the calculation of franchise payments. This would incubate operators from wider economic changes and focus them entirely on actions which can have an impact on revenue – including marketing, service improvements and revenue protection. **Comment:** Such forecasts cannot be made with certainty and there is a risk that some operators will be under or over compensated and may have potentially perverse implications on operator behaviour, it may also lead to unnecessarily high taxpayer cost or operator profits or conversely increase the possibility of franchise failure.

6. Next Steps

6.1. The Department is not consulting formally on these proposals as they are considered of technical interest; however, comments are welcome by the end of April. A further report taking account of views received will be published in the summer.

6.2. Later this month the Department will begin consultation on the East Coast franchise as well as Greater Anglia and Essex Thameside, and the associated Invitations To Tender will include revisions proposed under this new policy.

7. Conclusions

7.1. The new policy attempts to walk a fine line between providing additional incentive to operators to invest and innovate by increasing the duration of the franchises from around 8 to between 10 to 22 years and improving the way that enhancements to services are scored on the one hand, and ensuring that the passengers interests are safeguarded by strengthening the performance monitoring regime and financial penalties incurred by parent companies if franchisees cannot meet their commitments on the other. The provisions contained within it represent a further sharing or risk between the public and private sectors, and the detailed proposals must be scrutinised more closely to ensure that passenger interests are safeguarded against those of the operator.

7.2. The Authority's main focus should remain on the franchise specifications themselves rather than the methods the DfT uses to procure these services. None the less it is intended to submit a response based on the narrative in this report and any Member comments. Further than that, future activity on the issue will be co-ordinated with PTEG.

8. Recommendations

See front sheet for recommendations.

Sir Howard Bernstein
Clerk to the Authority