

Transport Committee

Oral evidence: [Rail Franchising](#), HC 66

Monday 5 September 2016

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Watch the meeting

Members present: Mrs Louise Ellman (Chair); Mary Glendon; Karl McCartney; Mark Menzies; Huw Merriman; Graham Stringer; Martin Vickers.

Questions 1 - 69

Witnesses

I: Tony Lodge, Research Fellow, Centre for Policy Studies, Nigel Keohane, Director of Research, Social Market Foundation, and Dr Andrew Smith, Senior Lecturer, Leeds Institute of Transport Studies.

II: Dr Andrea Coscelli, Acting Chief Executive, Competition and Markets Authority, and Joanna Whittington, Chief Executive, Office of Rail and Road.

Written evidence from witnesses:

- [Nigel Keohane, Director of Research, Social Market Foundation](#)
- [Dr Andrew Smith, Senior Lecturer, Leeds Institute of Transport Studies](#)
- [Dr Andrea Coscelli, Acting Chief Executive, Competition & Markets Authority](#)
- [Joanna Whittington, Chief Executive, Office of Rail and Road](#)

Examination of witnesses

Witnesses: Tony Lodge, Nigel Keohane and Dr Andrew Smith.

Chair: Good afternoon and welcome to the Transport Select Committee. Could we have your names and organisations, please?

Nigel Keohane: I am Nigel Keohane from the Social Market Foundation.

Tony Lodge: I am Tony Lodge from the Centre for Policy Studies.

Dr Smith: I am Andrew Smith from the Institute of Transport Studies at the University of Leeds.

Q1 **Chair:** The UK rail sector has a very good record on safety; it has the safest railway in Europe. But when we look at fares, we find that during the last six years they have increased by 25%, which is twice the rate of wage increases, and we have evidence of mounting passenger dissatisfaction. Do you think the current franchise system could deliver better than that?

Nigel Keohane: Yes; I think it could deliver significantly better. We saw significant improvement in the 2000s on things like passenger satisfaction and punctuality of rail services. From a consumer point of view there was some improvement in the 2000s, but since then we have seen a tailing off of that and some dip in performance, in terms of how satisfied people are both generally with their services and with punctuality.

There is a significant issue on the passenger side. If you drill down a bit lower, you see very significant variation between the franchises. Even taking some quite similar franchises—intercity rail, or comparing within suburban or regional rail—you see some very significant variation in performance. There is real reason to be concerned about the quality of services and whether we have dipped recently.

The other area where there has been a cause of concern for some time is costs, which obviously will have an implication for fares. We have evidence on costs generally. Obviously there was the McNulty review about five years ago, which was about rail as a whole. If you look more specifically at franchising, you will see that in some European countries there have been significant efficiencies driven by competition and franchising, whereas in the UK we seem to have seen unit costs per passenger kilometre flatlining and even dipping in some areas. That is strange because there are high fixed costs in rail and you would expect the unit cost to go down as passenger numbers go up. On the costs side there are some very thorny issues that we need to confront.

I guess we will come back to those. Some of them are quite political. There is the issue of train utilisation and the issue of labour costs. There is evidence that in the UK labour costs have not gone down; in fact, they have gone up in some instances. There may be issues there. We have a



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dispute going on at the moment with Southern Rail and their franchise holder. There may be issues to do with length of contracts. The one who makes the first move may be disadvantaged. Which franchise holder is going to take on the union on a specific issue? Those are two principal factors, as well as the issue to do with Network Rail and the asset base, and the inefficiencies, especially on very busy lines. Southern would be another example where improvements are being made. There is an accountability issue because people do not know who to blame when things go wrong. There are also inefficiencies; you want those organisations working closer together than they do. My conclusion is that there is significant room for improvement, yes.

Q2 Chair: Dr Smith, what is your view of the current system? You have done some work looking at European systems. Why are our costs so much higher? Can anything be improved with the current system?

Dr Smith: Taking a slight step back, if we look at most examples around the world where competition has been introduced either in the market or for the market, you tend to see significant cost reductions following reforms. As was mentioned earlier, elsewhere in Europe—in Sweden, Germany and so on—we have seen substantial reductions in unit costs, whereas in Britain we have seen the opposite. Around the time of the McNulty study we did some work showing that unit costs per train kilometre had gone up by about 15%. That was used in the McNulty review. The view was that the costs should have come down, but in fact they have gone up.

I recently looked at that data again and the cost increase is now more like 25% if we update it to today. The cost situation is simply not in line with what we expect from competition. As for why that is, probably the dominant factor is labour. The labour costs have gone up very substantially. In the current British system, when a new franchise company wins a franchise they do not bring their own staff and rolling stock, as occurs in some cases in Sweden and Germany. They take over an existing company and therefore all the staff and rolling stock. From there they have fairly limited incentives really to tackle the staff cost base, because taking on a strong union in a relatively short franchise means a lengthy dispute, lost income and a lost opportunity to make the money they need to make out of the franchise.

Q3 Chair: What percentage of the German and Swedish rail networks are actually put out to competition?

Dr Smith: I don't know the definite number; it is certainly lower than in Britain.

Q4 Chair: Is it significantly lower?

Dr Smith: First of all, in Sweden and Germany all long-distance services are run either by the dominant incumbent state-owned operator or open access operator. They do not have franchising for long-distance services as we do in the UK. In Sweden all other regional services are tendered. I



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do not know the exact proportion in Germany, but I think maybe only about half have actually been tendered.

Q5 **Chair:** It may not be directly comparable in terms of the network as a whole.

Dr Smith: It is only not comparable in the sense that they have not done it as extensively yet as in Britain, at least in Germany. There is no reason why we could not have achieved a unit cost reduction had we perhaps adopted a different way of doing it.

Q6 **Chair:** Mr Lodge, what is your view on this? Could the current franchise system deliver better in terms of costs, ticketing and passenger satisfaction? Could it do better?

Tony Lodge: It most certainly could. You have a test case on the east coast main line at the moment, which has been in place since the early to mid-2000s, where you have the franchise holder in competition with two open access operators, Grand Central and First Hull Trains. That is quite a mature market now, though the open access operators are only 80% of that market. You see comparable fares held where the open access operator competes with the franchise holder at stations like York. Where there is no competition on that line, fares are comparatively higher; Virgin Trains East Coast can charge more without fear of competition.

The highest passenger satisfaction, according to Passenger Focus, is with the open access operators on the east coast main line, and actually the franchise also tends to do very well. I would argue that if you provide more passenger choice you find the choice rewarded by happier passengers. More routes are delivered and more people use the railway. The franchise does not have an issue at the moment with its premium, which has been rising since 2002. I think it has gone up by about 420%.

Perhaps the most important thing is that you actually lead to a situation where you have quite vibrant fare competition and, therefore, companies innovating to try to outperform each other. That does not apply out of Paddington on the great western. You do not yet have it out of Euston on the west coast main line. You do not have it out of Waterloo. I think the east coast main line is a worthy test case.

Q7 **Chair:** Is the success of the open access operators there because they are cherry-picking the routes they want to run?

Tony Lodge: I disagree with that totally. I am from West Yorkshire and I use both Virgin and the open access operators quite a lot. The important thing to understand, if I may, is that they actually decided and chose to go to routes and destinations where the franchise did not want to go. They actually took it upon themselves to grow new rail markets in what I might call a post-industrial part of the country—I'm allowed to say that, being from Yorkshire. There are some large urban towns and locations in what I call the M62 corridor where they took the risk, decided to serve and have made a success of it. They understood as railway innovators



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that there is a large catchment around places like Hull, Bradford, Sunderland and elsewhere.

Q8 **Martin Vickers:** Mr Lodge, you referred to creating new markets benefiting a greater number of passengers. You will be aware that the regulator recently refused an operator to operate services from King's Cross to my Cleethorpes constituency. Do you believe that is because the criteria within which the regulator has to operate are too restrictive? Do you think the DFT are supportive of open access operators or are doing their best to block them for fear of losing income from the main franchise?

Tony Lodge: I think you are right, Mr Vickers. There are two problems and they are both out of date. For a long time the Department for Transport—there is a plethora of written answers in this place stating this from various rail Ministers—have hidden behind the argument that more open access depletes or harms the funds available to the Secretary of State. There is no evidence to support that. The premia on the east coast main line with the franchise have been going up and up. I would argue that competition has benefited the service. It has brought more people to the railway. It has led to the operation, effectively, being more liquid.

The issue with the Office of Rail and Road is its not primarily abstractive test. I would argue again that that is out of date and is not allowing that organisation to grant the kind of services that would benefit the railway. You have the CMA here later, which, with its option one, has made a call for much more open access. We need it changed and then you will genuinely see a lot more innovation. In my opinion, there is nothing to stop an innovator serving your constituency and the rest of north Lincolnshire with various innovative ideas to split trains or have them coming north or south first—whatever tends to work. The NPA test is out of date.

Q9 **Chair:** Dr Smith, could the success of those two open access operators be replicated on a much bigger scale across the whole network, or is it something that has to be confined to particular sorts of routes?

Dr Smith: That is an interesting question. Certainly one would expect it only to be applicable for longer-distance services—intercity services. One aspect of the research that we have done is that as a transport economist you might look at open access services and believe there are benefits from competition, but a big concern is that, once you start to split up train operations on a certain route, the costs may go up and you lose what we refer to as economies of density, or scale, in the sector.

The research we did actually showed that, despite the fact that the current open access operators are small and therefore you would say at a bit of a disadvantage because they do not get the economies of size and density, they are nevertheless roughly the same unit cost as existing franchise operators. As we go forward and see expansion of open access, it would be likely that their unit costs would probably fall. In that sense,



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larger scale open access on intercity routes would probably bring benefits in competition and probably would not increase costs as much as might be feared. For that reason, I feel that the balance of evidence has moved more towards open access than it might have in the past.

Q10 Chair: The current system is often criticised as being too fragmented. Organisations like the Rail Development Group are tasked with bringing the sector together. Wouldn't a mushrooming of open access operators increase the fragmentation? Is that a problem?

Dr Smith: That is certainly a danger. We have done some international research which suggested that busier railways in particular would tend to benefit more from an integrated structure than less busy railways. That argument could probably be replicated in what you are saying—that having more operators makes integration harder to achieve. What I would probably observe is that, if we look at overall rail industry costs over the last 20 years for both Network Rail and train operating companies, it certainly does not appear that the current ways of dealing with that have been particularly successful. We need to bear that in mind.

Nigel Keohane: On the fragmentation point, we have many rail networks, not one. To that extent it is valuable to have diversity in the way that we provide the services and the way they are structured. I do not think anyone is suggesting that we would be running this sort of open access competition in all areas of the network. Some parts of the south-east might be structured well as a concession, where you integrate the rail lines with the train operator and give responsibility for a number of years to a company to do that, given the volume of traffic and the importance of alignment there. Up in the north, a devolved set of authorities are getting the ability to commission rail services themselves, or at least have significant greater input.

There is the point that, yes, it looks fragmented, but we need to make sure that in each area of the country the rail service is designed correctly for that particular area. It means that ultimately we are going to have greater diversity. That is a bit of a headache for the DFT, but there are benefits. One benefit is that we will probably test out more different approaches using that model than, let us say, if we had a totally nationalised industry or if we franchised services in exactly the same way.

Tony was referring to some of the new entrants that we have seen in Yorkshire. We may see all sorts of new entrants coming into the market. They may enter the market as providers in terms of open access competition and then they may graduate to compete for bigger contracts. There are benefits to some of that messiness and diversity. I would worry less about the fragmentation and worry more about how you design it for the unique characteristics of a regional network, an intercity network or an urban network.

Q11 Chair: Mr Lodge, you compared the railway sector with airlines. Do you



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think that is a valid comparison?

Tony Lodge: I think there are valid comparisons with long-distance, high-speed services—a very important point. The commuter railway network and what we might call the social railway, which require significant subsidy, are a different point. For the long-distance, high-speed railway there are a lot of franchising awards coming up, so that slightly muddies the water, giving people new semi long-term franchises. It will be interesting to hear what the CMA says later, but I think there is a future where you have licensed paths in the same way that aviation slots are potentially managed, where people bid for them on the long-distance, high-speed network. The opportunity is potentially one where you bring manageable competition to the network.

An important point is that there is going to be a lot of suitable rolling stock coming available in the course of the next two years as IEP comes on. You are going to see a lot of suitable and excess rolling stock, coming particularly from great western, which would be suitable for expansion in open access. These would be the kinds of locomotives that could serve Mr Vickers's area, where they would have to come off the electrified route to serve, dare I say, more remote towns and cities.

Q12 **Chair:** How can we compare the way freight runs with the way passenger services can be run? Does freight have an easier way of controlling costs? Can the two systems be compared?

Tony Lodge: We did some research on freight. The freight sector has significantly reduced costs since privatisation. It has significantly increased productivity since privatisation. There is going to be a real blip in these figures because of the events of the last 18 months. One of their biggest sectors, the coal sector, has effectively come off a cliff due to the early closure of coal-fired power stations and the carbon price floor, which has effectively made coal haulage on the railways near extinct. There is very little being moved now.

A parallel I would like to run is that the sector is now working very hard to fill the gap left by coal with inter-modal, biomass and other sectors. It is getting a lot more retail produce on to the railways, which was thought impossible some time ago. Rail freight is totally open access. It is very competitive. There are about six or seven significant companies that do it. I am not saying this is completely the same as passengers because it is not, but they have delivered choice to the customer and it is quite a vibrant sector despite the massive torpedo in the last two years from the carbon price floor.

Q13 **Chair:** When the franchise system was drawn up, it was expected that it would reduce the cost of running the railway and that franchise holders would be incentivised to invest. Neither of those things has happened. Why do you think that is the case and what needs to change in relation to the franchise system?



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Nigel Keohane: You are right. You need to give operators the ability and the incentive to invest. That seems to me the first principle. In a way, if you are not going to do that, you might as well run the services from the Government. If you are not going to give them the incentive and ability to innovate and invest, there is no point doing franchising. This is a criticism that has been around for some time that we have not properly addressed.

If you look at operators' ability to innovate and change services, they are very prescribed by someone sitting in Whitehall who is predicting what passengers will want in five or 10 years—in terms of timetabling and things like when people should be able to take bicycles on. Many aspects of the services are prescribed, so in a way you are limiting what firms can do and how they can make efficiencies.

That is a problem in its own right, but when you put it together with the fact that operators do not have much incentive to innovate and invest there is a real problem. The incentive to invest is probably dampened or reduced by two things. The first thing is when the Government reduce the risks that are passed over to the operator.

In the past, we have had this thing called cap and collar; if there is a really significant revenue increase in profits the Government take some of that, and if there are significant reductions the Government cover some of that. If you apply those sorts of approaches, you reduce the incentive for the firm to innovate and invest because they are only ever going to capture a part of the potential profit. That is an example of the issue.

If you turn to fares on the other side, there is a very good reason why the Government regulate fares. Obviously you would not have a free market in this given the monopolistic characteristics of rail. Almost half the fares are regulated. Operators used to have some discretion in terms of how they varied fares, but that discretion has been reduced. That means that if they are trying to think about how they can manage demand at, say, 9 o'clock in the morning, in a freer market or if they were given greater choice, they would be able to make sure that trains were utilised efficiently at 9.30 or 9.45 rather than trying to ram all the trains, with lower quality services and overloading the network. In both of those instances, the issue is that they do not have the ability to do what they want to be efficient or innovative or to improve the quality of the service, and they do not have the incentive.

We have spoken about moving to a measure that captures what passengers generally think about rail services. That would be something like the overall satisfaction score, which captures both whether they think the service is good value for money and whether they think they are having a reasonable experience. If you targeted that sort of measure more and said to companies, "It is up to you how you try and target this measure," over time we could try to free up some operators.



One way we thought it could be done is that if firms are performing well on core performance measures, like the satisfaction score, you give them some additional flexibility on some of the specifications that the DFT puts into the contract. It could be timetabling. It could be allowing them some flexibility on fares policy. It would be a kind of reward for good performance, but ultimately it would be a reflection of how well that company is doing in meeting the overall expectations of its passengers. If you did that, I think you would give more freedom to the operators and you would give them more incentive to think differently and to innovate.

Q14 Chair: That would all be after the event though, wouldn't it? I will come back to the specific point on how that could be followed through. What about the length of franchises? Are they too short or too long? Is that one of the issues?

Dr Smith: There has been quite a lot of debate about that. Certainly the McNulty review suggested longer franchises. One of the reasons for that was to incentivise cost reduction. I personally think that the dominant reason why costs have not come down is that in the current system there is very little incentive for operators who typically have net cost contracts—meaning they take the revenue risk and the cost risk—to tackle the staff cost base because it is simply too expensive. An industrial dispute would wipe away their margin. We see it on the Southern franchise at the moment. That is run on a management type contract where they are not taking revenue risk.

My view is that certainly for a time, to get the focus on cost, we need to move more towards these gross cost type contracts with the revenue risk taken back into Government and the firms focusing on getting the costs down, as has been used more in Germany and Sweden. There is much more prevalent use of that kind of contract elsewhere. That is certainly what is needed at the moment to tackle the cost question.

Q15 Chair: Mr Lodge, do you have a view on the length of franchises? Are they too long or too short?

Tony Lodge: They should be shorter, but fundamentally the question is about what you are attempting to deliver on a particular railway, given what that particular railway needs. A good example would be the future of the east coast main line, where there are going to have to be some significant upgrades and other deliverables. The question is, what are the ambitions of the franchise holder when it bids and if it is successful in securing it?

Obviously IEP is going to be on there quite soon, and I would hope and expect there to be significant benefits. I would like to see more allocation of responsibility in a franchise. At the moment there is no real competition, unless you know you are going to face an open access operator when you bid; that is a really important point.



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When Virgin bid for the east coast main line, they knew that Grand Central and First Hull Trains were there and that those were ambitious companies who might try to get even more capacity. In the bidding for great western at the moment or if you are looking to bid for the old midland main line/east midlands route or the west coast main line franchise—although there is going to be some open access on the west coast main line—I would like the Government to make a case for more open access so that the franchise bidder is aware that it will face some level of competition on that railway in the short to medium term if it wins. The point about that is that it will mean that there is a much more innovative franchise in the course of the franchise term. At the moment, if you get the great western franchise when it comes up, you are going to have a situation where you are the monopoly operator to the west country and south Wales for the medium term.

Chair: Southern Rail and GTR have been mentioned. Mr Merriman has some questions about that.

Q16 Huw Merriman: Southern operates in my constituency, when we are fortunate enough for that to occur. You have talked about Southern operating under a management contract. Do you believe that management contracts should be abolished and that either we work under a risk and reward transfer to the train operator or, if that is not appropriate, the Government just run those franchises themselves?

Dr Smith: First, going back to my earlier point, on that particular franchise, given the number of changes to service patterns and all the remodelling of London Bridge and so on, that was the reason why a management type contract was used.

What we are seeing played out there is in part a battle between the company and the trade union. Given that all the evidence, both international and looking back over time within Britain, is that the staff costs are particularly high, there is an argument that it may well be a battle that needs to happen. Clearly the disruption is extremely difficult to deal with, but, on the other hand, we have seen 20 years of huge cost increases from train operating companies when really we should have seen cost reductions.

Q17 Huw Merriman: Agreed, but Southern is a good example of the issue of franchise agreements as a whole. We have a situation whereby the unions do not wish to modernise and take advantage of the technology that is available and could reduce costs but, we are told, would still maintain safety. We have a situation whereby the franchise operator—Southern—has given everything it can in terms of guarantees over the life of its franchise but that does not seem to be enough. We have the Government saying, “It is not our responsibility,” and Department for Transport officials said they urged both parties to come to the table.

Yet the franchise agreement, we are led to believe, stipulated a requirement to bring in this type of reform—Government-led—and indeed



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the franchise agreement also includes a force majeure clause that effectively allows the train operator to have a holiday in terms of performance failure if it is all down to industrial action, which is very loosely defined. Taking all of that together, it is no wonder that this has taken nine months and there is no resolution. Everybody can blame each other and the passengers just suffer disruption.

There was a question in there somewhere, but I wanted to use it as a case study and as a reason why perhaps the franchise system does not work.

Chair: What does the current experience on Southern tell you about the existing system? Should it have been let on a management contract? Would a franchise competition have been better? What does that demonstrate is wrong?

Tony Lodge: I think it is too big a franchise. That is one initial problem. That point was made by some people at the time. It is a very, very big franchise and that is part of the issue. It takes you right back to the origins of railway privatisation in one sense, in that it is a trade union dispute. The trade union blames the Government, although the Government can point to the franchise holder, but after all we are dealing with a state-sponsored franchise, which is effectively what it is. I do not claim to have an easy answer to this one, Mr Merriman, because it is a trade union dispute.

Q18 **Chair:** Mr Lodge, it is more than that. It certainly is a very serious trade union dispute, but there are also other issues about major refurbishments on the line.

Tony Lodge: Absolutely, and I fully support the company's bid to get new technology, new rolling stock and new advancements on the railway. There is another issue, which is a slight side point. The bulk of that region is a commuter region, where people want to get from A to B as quickly as possible and as frequently as possible. That makes the problem much worse. I think it is too big a franchise, which has actually made the noose round the Government's head so much bigger. We do not want this franchise back under directly operated railways, which would force costs up for the taxpayer and would mean that the British Government would effectively be running one of the biggest parts of the railway network as regards foot passengers since 1992.

Q19 **Chair:** What about Transport for London? Would that be a better way to do it?

Tony Lodge: It is a significant undertaking for TfL. This is not like London Underground. This would be one of the biggest franchises in the country. TfL would have significant costs which would be passed on. I do not envy Paul Maynard, the new rail Minister, on this; it is a real problem. You say it is more than a trade union dispute and it is, because it is an attempt to try to get better trains on the route and you are facing a trade union which is determined to stop it, but as regards the viability of the



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railway that is not an issue. The viability is there and advances in railway technology are coming on. They are attempting to prevent working practices that will benefit the commuter and the passenger.

- Q20 **Huw Merriman:** I do not disagree in terms of your view with respect to the union action. It is incredibly frustrating when jobs and wages have been guaranteed. Would you not agree that perhaps there is room for another party—the Office of Rail and Road; the regulator?

At the moment if the Government set the terms on the franchise and the Government, on a management contract, are largely behind it because they absorb all the risk and reward, would it not be better for another party to determine, for example, whether the franchise operator has done everything it can to resolve the industrial relations dispute? If it is the Department for Transport that acts as that determining body, it is also a party to the franchise and it just does not make any sense at all. Do you not see more creative ways for there to be a bit more flexibility in the system to end a dispute like this?

Tony Lodge: That is a very fair call. You have a very good chairman of the Office of Rail and Road in Professor Stephen Glaister. I suggest you write to him. I think it is a very good idea.

Huw Merriman: We have the regulator coming up next. We will ask them.

- Q21 **Mary Glendon:** Going on from what has happened at Southern Rail, you mentioned the east coast and Virgin's contract there. We know that over the summer there was the possibility of industrial action because of changes that Virgin wanted to make. That has been put on hold because the parties have got round the table. Do you think that is too big a franchise, bearing in mind the fact that you have Grand Central and Hull and the possibility of First Choice and what might happen in the next year? Is the franchise system all too complicated when one big company gets it and you then realise that it is not the best way forward?

Tony Lodge: The east coast main line franchise, as it stands, is not too big. The problems come when a company overbids for it. I think Virgin may have overbid for it. National Express certainly overbid for it. We know about Sea Containers, GNER, and their issues some time ago. The east coast main line franchise is not too big. I think it requires an understanding that this is the most competitive railway we now have in Britain.

The fundamental problem with franchises, as I see them, is that they are over-specified by the Department for Transport. You then get a situation where companies like Virgin overbid, and then, when they run into certain issues, we have the ghost of them handing the keys back or not being able to pay the premia. I am not saying that that is with us now, but Virgin went into that contract knowing that they were going to face two determined open access operators. Their marketing and innovation is very impressive, in my opinion.



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I do not think it is too big. I think if you overbid and expect things to happen when they don't, that is when the DFT should be better mitigating and designing its franchise bids.

- Q22 **Martin Vickers:** Mr Lodge, taking you back a few minutes, you said that Virgin bid for the franchise knowing that there was competition from First and Grand Central. I referred earlier to whether the DFT take a hostile view of open access operators. When DFT were running the east coast they introduced a service to Newark, for example, which was seen by open access operators as a way of blocking one of the paths that they could have used. Do you think that is the case? Is there evidence that franchise holders, and indeed the DFT, conspire to block paths to prevent open access operators?

Tony Lodge: A former Conservative rail Minister, whom I will not name, said to me at an event a few months ago, "Blah, blah, blah, I like what you are doing and the stuff you have been putting out. There is a real blockage in the Department on open access. It goes back to the old BR days. There is a mentality there and it is rich within the rail civil servants." I said, "Well, there we go."

Fundamentally, that is why the CMA report in March was so important. They had four options in front of them when they concluded, and they chose option one. Option one was franchisers with significant increases of open access alongside them to drive more competition. It was not having two franchisers on a franchise route but having a franchise, with possibly even a 70/30 mix of franchise versus open access. They believe that can drive a lot of the innovation, protect premia and deliver passenger choice, more fare competition and more routes. I know they are on later.

- Q23 **Chair:** Dr Smith, do you have the same confidence in open access to resolve the competition problems?

Dr Smith: We have to bear in mind that, at its current level, open access is still relatively small in terms of the number of services. Given the capacity issues on the network, one would need to make some fairly substantial changes to the franchise to enable more open access competition to happen.

Certainly in the past I may have had some sympathy with the view that open access competition is something of a headache and that, if you are trying to adopt a franchising model, perhaps you should just have a franchising model and not play around with open access. However, the evidence increasingly suggests that franchising has not been successful enough, particularly in getting costs down. It may possibly have been successful in growing demand, but certainly on the cost side it has not been successful. I think there is increasingly a case now for more open access in the sector.

- Q24 **Chair:** Competition should be the basis of the franchise system, yet there is not all that much competition. Three quarters of the most recent



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franchises let have been direct awards with no competition at all. There are fewer companies bidding for a franchise than there were at one time. Does this mean there is something wrong with the whole model and that the whole system is failing in terms of competition?

Dr Smith: In the past, it was interesting that we actually had quite a few competitors for each franchise, maybe four or more. That was seen as quite healthy competition.

Q25 **Chair:** But that is not the case recently.

Dr Smith: No. More recently, you are correct. There were specific reasons for the direct awards, but more generally we are seeing less. That is partly because the bidding costs are very substantial. Coming back to the point that was made earlier, it may well be that some of the franchises are becoming too large. They involve a huge financial risk to companies. The DFT's attempts to mitigate overly aggressive bids by having companies put up more capital is proving quite difficult, because companies do not necessarily have the appetite for that. It is arguably the case that perhaps a move towards smaller intercity franchises alongside increased open access might be a useful way forward.

Nigel Keohane: We had a look at the 12 years up to 2015, so it is ignoring the point. We may have seen a bit of change in the last 12 months but one would not expect it to be that dramatic. Admittedly, we had some issues at the beginning of this year in terms of too few bidders or a small number of bidders, but most of the ways of understanding good competition were there. You had quite a few shortlisted bidders. You had quite a lot of churn; it was not always the incumbent who was winning the contract. We have had some new entrants in this century from abroad and from different sectors. Generally, the story has been a reasonable level of competition.

Earlier we were discussing the length of contracts. There are benefits. Going back to your question about what is going on with Southern in terms of the industrial dispute, it seems to me strange to deliberately have a relatively short-term management contract and then try to take through a very big labour change. You basically know that you are going to have an industrial dispute. That seems to me to be quite strange.

If we try to lengthen the contracts, it is going to have the implication that it makes bidding even more expensive because it will be even more risky. If our main priority is to make sure that we have a reasonable level of competition, I do not think we should be extending the contract lengths on that basis.

Q26 **Chair:** Mr Keohane, you suggested passenger satisfaction as a measure of success. How would that actually be implemented?

Nigel Keohane: At the moment we have the national rail passenger survey, which is carried out twice a year. They look at about 30 different measures. They have quite a good question: "Overall, how satisfied are



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you with your service?" That includes punctuality, quality considerations and costs. A question like that would probably be the one that you would want to try to put greater weight on. What we are suggesting is not that you strip away all the specifications or all the regulation, but that over time you try to focus more on a big question that can reflect what passengers think of a service.

The mechanisms would be quite straightforward. You would design a contract so that over time that general satisfaction measure is tracked. If the operator achieves certain scores on that measure, they are rewarded in certain ways. They could be rewarded directly with cash, like a payment by results approach, or alternatively by giving the provider greater flexibility.

Q27 **Chair:** And if they don't succeed?

Nigel Keohane: If they don't succeed, we suggest that they should have penalties. It goes back to the point about competition. You might have a contract that is for 10 years. It is different if you have competition from other providers through open access, but if you do not, you need an incentive for that operator to worry about how they are looking after their consumers and how they are driving down costs during that 10-year period, otherwise you are putting all the weight on the bidding process.

As we described earlier, typically we had a reasonable number of bidders but recently we have not had so many bidders. You want a competitive process at the beginning when you bid the contract. You want competition while the contract is going on or a competitive incentive for the operator to worry about delivering for its passengers.

We think that the measures are already there. What needs to be done is to build up the sample of people who are questioned and to speak to people who do not use the service. For instance, they could be opting out of the service because it is too expensive. If you only interview passengers, you do not capture that element of the service or fares. It seems to me perfectly achievable.

Q28 **Chair:** Let us go back to the situation on Southern Rail. I dread to think what the level of passenger satisfaction above nought might be. It would be something very much in that area. This Committee has been trying to secure information from the Department about the details of the contract—the management contract with the Department—on what needs to be achieved. We are having great difficulty getting precise information.

Dr Smith, is that something that surprises you or do you think it would apply to franchises as well as to management contracts? It is very hard to identify exactly what the contract is, what levels have been achieved and what the grounds would be to terminate a contract or move it to another operator.

Dr Smith: To be honest, I do not really know the answer to that question. My understanding of franchise agreements is that typically they



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are published in some form at least, but perhaps the key parts are redacted. I was not aware that there was anything more commercially sensitive about this agreement than any other franchise agreement.

Q29 **Chair:** This is not something you have come across in the work that you have done.

Dr Smith: No, not particularly.

Tony Lodge: Me neither. I trust you can use your former Committee colleague, the new rail Minister, to help on this one.

Chair: We are pursuing this and we will get there in the end. It is a matter of time. Thank you very much, gentlemen.

Examination of witnesses

Witnesses: Dr Andrea Coscelli and Joanna Whittington.

Q30 **Chair:** Good afternoon and welcome to the Transport Select Committee. Could we have your name and organisation, please?

Joanna Whittington: I am Joanna Whittington, Office of Rail and Road.

Dr Coscelli: Andrea Coscelli, Competition and Markets Authority.

Q31 **Chair:** What are your views about the current franchise lengths in the UK? Are they the right length to incentivise operators or should it be done differently?

Dr Coscelli: We have spent quite a bit of time looking into rail franchising lately. We published a report in March this year. It is a complex question whether the lengths are the right ones, because obviously there are a number of objectives. One of the constraints of having a longer franchise, which might have some advantages, is the need to specify the franchise. One of our recommendations, which is to try to increase direct competition on intercity routes, would be, essentially, to allow the degree of specification in the franchises to decrease. That might allow slightly longer franchises, which might have some benefits in terms of investments and cost reductions, as we heard earlier.

Q32 **Chair:** Ms Whittington, what are your views on current franchise lengths?

Joanna Whittington: As an office, we do not have particularly strong views on the duration of the franchises. I recognise the debate that took place earlier about the trade-offs over the duration of the contract and the benefits of the frequency of the competition.

Q33 **Chair:** Do you draw any lessons from the current situation on Southern Rail in relation to franchises, management contracts or the way that services are delivered?



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Joanna Whittington: Clearly the level of service that passengers on Southern Rail are currently receiving is very poor, and that must be extremely frustrating for those who have to use their services on a daily basis. As an office, I do not think we have any views on the franchise, which is obviously a contract entered into between the Department for Transport and GTR. It is the responsibility of the Department for Transport to manage and enforce that contract.

Q34 **Chair:** Do you have any views on the size of the franchise as well as its length? There is an issue there.

Joanna Whittington: It is a very large franchise. When you look at public performance measures for England and Wales right now, you see a reduction in the level of PPM that is being achieved. Overall, when you take GTR out, the numbers go up compared with last year. That indicates both the size of the problems that passengers on GTR are currently facing and the size of the franchise itself. It has a huge impact overall on the reporting of performance at the England and Wales level. The evidence would suggest that there are real problems right now, but as an office we do not have a view on the size of franchises per se.

Q35 **Chair:** Dr Coscelli, do you want to comment on that?

Dr Coscelli: Not on Southern specifically. One interesting element of our very detailed discussion with stakeholders throughout our project was that stakeholders were unanimous that competition could help on the main intercity routes. We identified three: the east coast main line, the west coast main line and great western. Stakeholders were unanimous that on commuter-type services or regional lines with substantial subsidies, probably the disbenefits from competition were greater. Southern would be outside our proposals at the moment.

Obviously if the Department implemented competition on a number of intercity routes and it proved successful, potentially the programme could be extended over time. Our view is that it should be very much a step-by-step process and should not start with a franchise like Southern.

Q36 **Chair:** What could be done to introduce more competition from potential franchise holders?

Dr Coscelli: It was quite interesting for us to look at franchising in this sector. As you know, we are a general competition authority so we look at all forms of competition and procurement for the market in a number of sectors. In many ways, when we came afresh to this, we thought that it was quite a successful programme. It is quite difficult over 10, 15 or 20 years to maintain that degree of competitive intensity.

In a number of areas—you are probably familiar with some of the other areas in terms of Government procurement—after a number of years competition peters out a bit. If people spend quite a lot of money preparing bids for complex contracts and do not win them, after a while it becomes increasingly difficult to justify to their shareholders that they



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should remain active in a particular market. In that sense, after 20 years, the fact that we still have a number of well-funded bidders putting money and effort into the competition is very positive and reflects the fact that over the years a lot of good work has gone into trying to keep this programme.

Our view is essentially to try to evolve the system and move the system as is and combine it with a bit more direct competition on some of the routes. We think a lot of the current system of franchising should be retained. If you compare it with a number of the key European countries, essentially they are moving towards a similar system, where there is competition for the market for franchises on a lot of commuter and regional lines, and then you have direct competition on the main intercity routes and often with the high-speed links in other European countries.

Q37 Chair: If there is going to be more competition introduced in rail systems across Europe, does that mean that there will be fewer companies willing or able to bid?

Dr Coscelli: No. Obviously it is a delicate balance. One of the benefits of our proposals is to increase the number of opportunities for bidders to be active in the UK rail market. If you think about the competition today for the east coast or west coast, it is a very big binary type of competition. You spend a lot of time and management effort and either you win or you lose. If you had two franchisees, which is one of our options, or you had one main franchisee and open access, you create at least two opportunities, maybe three, to win something.

That would help in terms of having a greater balance of assets for the transport companies in the UK market. It would make it easier for some of the foreign entrants to justify being and remaining in the UK market. That was one of the benefits of the proposals for us as well. Obviously it is in the interests of passengers to retain enough bidders who are serious about the UK market in the medium and long term.

Q38 Chair: We are told that the cost of bidding is between £5 million and £10 million. Is that a serious impediment to a company submitting a bid?

Dr Coscelli: Obviously it is a question for the companies more than for us. My impression is that given the size of the franchises it is probably not, per se, a barrier to coming to the market.

Q39 Chair: But the cost!

Dr Coscelli: It is a trade-off. Over the years, as you keep having these competitions, there are legal risks for the Department, as we have seen from some of the judicial reviews. There have been a number of reasons why the Department has ended up running fairly complex processes.

At the same time, as you know, there is a lot of pressure on the Department to try to control outcomes. Having detailed specifications with very detailed granular outcomes clearly adds to the process. In



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some ways you could go for a slightly simpler process, which would cost a bit less, but a number of stakeholders would be unhappy about some of the aspects. It is a balancing act for the Department.

Q40 Chair: Ms Whittington, the ORR is asked to bring about whole of industry efficiency. Do you need more powers to be able to do that?

Joanna Whittington: Our role in relation to franchising is fairly limited. We are obviously the safety regulator. We approve access to the network. Through Network Rail's access review we set charges. We also license train operators. What we include in the licence reflects what else is happening in the market. We specifically have regard to the franchising agreement and what is contained in that in deciding what we should license. As a result, we do not, for example, look at train operating company performance, but we do look at the information that they provide during disruption, and at compensation and the treatment of disabled people.

That method works very effectively, but you have to understand that the focus of the ORR is very much on Network Rail's efficiency. The Department, through the procurement of franchises, is responsible for train operating company efficiency.

Q41 Chair: The Department both lets franchises and monitors them. Is that a satisfactory arrangement?

Joanna Whittington: A franchise agreement is a commercial contract that two parties enter into. It is appropriate for those parties under contract law to enforce the terms of the contract. As a regulator we publish a lot of information.

We think that transparency can be another mechanism through which you improve passenger service. First, it gives the users of that service some sense of the quality of the product across the board and how it is changing over time. It also provides a strong reputational incentive for the service provider to improve the quality of the service. Managing the contract and enforcing the contract is part of what the Department should do. I would also look at other mechanisms that help support that, such as publication of information.

Q42 Chair: Are you in a position to insist on that information being published?

Joanna Whittington: We can publish information to the extent that it applies to the functions we have; for example, we publish quite a lot of information on performance overall because we hold Network Rail to account for some regulated outputs.

On performance, currently we publish information through our data portal on a monthly basis. We provided a quarterly stats analysis and then we provide a really detailed report every six months on Network Rail's performance overall. Through that you will see the level of performance, both PPM and CaSL, that is being provided to passengers. That is



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necessary for our regulation of Network Rail, but it is not all the information that a franchise manager would have. It is the information we have.

- Q43 **Chair:** What about the train operating companies? Perhaps I could take this back to GTR and Southern Rail again. This Committee is having difficulty securing proper information on contractual benchmarks compared with performance. We will persist and eventually we will get the information, but it should not be such a problem. Shouldn't it be available on request? You are talking about publication of information. Do you think you should be able to get hold of that information?

Joanna Whittington: It is a matter for the Department for Transport to decide what information it puts into the public domain. It clearly needs to recognise that there are elements of the contract that will be commercially confidential. As I say, as a regulator we see value in information of that sort around performance being put into the public domain; I agree.

- Q44 **Chair:** But as a regulator wouldn't it be good if you could get that information? You have told us about your role in relation to Network Rail, but equally important is the performance of the train operating companies.

Joanna Whittington: Yes, and that is the responsibility of the Department for Transport, both in letting the franchises and determining what level of performance it wants to buy from train operating companies; and then in monitoring and enforcing the company's performance. That is not our responsibility. It is a commercial contract between two parties. As I say, I see a role for transparency around that in addition, to build on the reputational incentive that that sort of information can have on service providers.

- Q45 **Chair:** Dr Coscelli, do you have any views on access to information of that sort?

Dr Coscelli: We have not really looked at that at all in our work.

- Q46 **Chair:** Is it something of any concern to you?

Dr Coscelli: Accountability sits fairly clearly with the Department for Transport, so in a sense we have—

- Q47 **Chair:** It does, but certainly I am not satisfied with the way they are exercising that responsibility. Do you think that you should have a role in being able to secure that information when there is a problem and a need to have the information?

Dr Coscelli: In an agency like ours, we have independent panels as part of the agency. In terms of institutional design you can have various options. You can have part of the Department negotiating a contract and a separate part monitoring and enforcing. You could ask a separate



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regulator to do it. There are various forms of institutional design. It is really a matter for the Government to decide.

- Q48 **Huw Merriman:** This follows from your line of questioning, Chair. On the basis that the regulator is able to regulate and have control over Network Rail, which ultimately is an agency that produces services, perhaps on behalf of the Department for Transport, I equate the Southern contract as something quite similar, in the sense that the risks and rewards stay with the Department and the operation is managed by Southern. For that reason I cannot see why there would not be a role for the regulator in a consistent manner.

Joanna Whittington: The way it currently works is that the Department for Transport is the party to that contract. It is therefore responsible for managing and enforcing that contract under contract law.

- Q49 **Huw Merriman:** I fully recognise that. I recognise it is difficult for you to say, "Yes, give me more powers and I will sort it out," albeit that is where I am going. The frustration is that the two parties seem unable to give this Committee the information that has been requested. I dare say that if there was a regulator with teeth the regulator could force that to occur, in the same way that if this Committee was struggling to get the same information from Network Rail, the rail regulator would be able to remove that blockage or take action. This may be an easier question to put to Dr Coscelli.

Dr Coscelli: I will repeat myself a bit. We have seen similar issues across a number of the sectors we look at. It is genuinely a form of institutional design in legislation in terms of who you give powers to do what. At the moment, if an agency does not have the powers to do something, you need to change the legislation to change that. It is difficult for an agency to argue for more or different powers. To be honest, you often also have independent structures within a particular Department or a particular agency, so there are various options.

- Q50 **Huw Merriman:** Do you feel that issues like that are perhaps why we do not have as much competition? It is hard to get transparency. It is hard to get the openness for this Committee. We understand that companies are not bidding for contracts and maybe companies get blamed for disputes, when in fact the Government should take more responsibility. Do you think that type of thing undermines competition in the franchise network?

Dr Coscelli: Again, there is an issue about commercial confidentiality in all of this. The current set-up is having the Department accountable for the outcomes in the sector, which is fairly clear. You can try to change that, but at the moment in many ways it makes sense from the outside. If you do not think it is delivering the right outcomes, you can discuss changes to that.

- Q51 **Huw Merriman:** Looking at competition, if in fact there is a franchise like the one with Southern, which is a management contract, is there any



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point in having a private contractor running it when there are such heavy specifications as to what the operator must do, and therefore perhaps it is unable to resolve a dispute like this, because the contract effectively stipulates that it must do one thing but it does not have the power to do anything beyond its franchise, which runs out in a few years' time?

Dr Coscelli: As you know, a number of considerations went into it. One is obviously the capacity to deliver. In many ways it is like an outsourcing agreement. The Government are outsourcing a number of services across a number of areas. There is almost a score card that you need to use for the benefits and costs of various options.

The Department must obviously have concluded that this was the best option. It is not something we looked into. Clearly it is one of the sensible ways of trying to achieve what they wanted to achieve. There were alternatives. Obviously the current outcome is not good. That is certainly something to ask the Department, but it is very difficult from the outside to try to second-guess their judgment in comparing that particular form of franchising with others.

Q52 **Huw Merriman:** Because it is like an outsourcing contract, which is not that dissimilar to Network Rail where there is a regulator with teeth, that is the very reason I put it to you that perhaps the regulator should have teeth in a train operating contract as well as Network Rail.

Joanna Whittington: That is a matter for Government policy.

Huw Merriman: Indeed.

Q53 **Chair:** Will encouraging a multiplicity of open access operators really improve the network as a whole?

Dr Coscelli: Our view is very much a step-by-step approach. The conversation we had with the Department was about piloting more open access competition on one of the intercity lines. The east coast is the next one coming up in terms of franchises. The franchise needs to be awarded by 2023. The documents need to be sent to the bidders by 2021 and a number of preliminary steps need to take place.

The ORR is leading a review of the track access charges and the introduction of a levy to try to reduce the possible hit on Government funds. We set out clearly in our report that we had detailed discussions with the Department for Transport. We think it is doable. We think a number of things need to happen over the next two or three years. Certainly given the complexity of the system it is in everyone's interests to try to do it step by step; to try to make it work on one line and then see whether it can be extended to a second and third line slightly later.

Q54 **Chair:** How do you envisage that process? How much time are you going to allow to elapse before you decide whether it is working?

Dr Coscelli: Suppose the award and mobilisation starts in 2023 with the franchisee and one open access operator, or maybe two open access



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operators competing with the east coast. We already know there is open access competition today on the east coast, so it clearly needs to be accommodated. Either that needs to be extended or it is part of the process for allocating a greater role to open access.

If it starts in 2023, our experience is that it usually takes at least three or four years of operation of a new set-up in a market to start getting a sense of the outcomes and being able to judge whether the outcomes seem to be working in the right direction or not. If you think that the franchise will be for eight or nine years, and the other franchises on the west coast and great western are around 2025 and 2026, there will be some information available to inform the next batch of franchise awards.

Q55 Chair: Ms Whittington, what is your view of this policy? Do you think it is the right way to go? How would it contribute to better services and whole industry efficiency?

Joanna Whittington: Open access already forms part of the offering available on the railways today, albeit a very small one. It is less than 1% of passenger miles. What we can point to are practical examples where competition has led to benefits for passengers. First of all, fares tend to be lower on flows where there is competition. That benefit applies not just to the people using the open access service but to anyone who is using services on that flow, because it is then fed through in a competitive response that the franchisee makes.

In addition, we have seen other product innovations. You get the new flows—the new point-to-point services—coming about as a result of open access. Grand Central was the first to introduce on-board wi-fi. First Hull Trains was the first company to introduce the first real-time operational information. The combination of fares together with product innovation is then reflected in really positive passenger growth. In addition, you see high levels of passenger satisfaction, which was something one of the previous speakers referenced, of 94% currently for Grand Central and First Hull.

Q56 Martin Vickers: Ms Whittington, when I questioned the previous panel I referred to the criteria that the ORR works to. If I recall correctly—I refer again to the application for the King's Cross to Cleethorpes service—your letter telling me that you would not be granting that service was because it was part of a bundle that also included additional services into Yorkshire and that, in effect, you had a duty to protect a main franchise holder. If I understand that correctly, it seems to be reducing competition. Would it actually benefit the potential passengers if the criteria were changed, giving you more freedom?

Joanna Whittington: When we come to take these decisions as a board we look to balance the duties that Parliament gave us. They are duties to promote the use of the network and to protect the interests of users but also to take account of the Secretary of State's funding.



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We do that by grouping our analysis into three broad areas. First of all, we look at the impact the new services will have on capacity and performance. We then look at the impact the new services will have on the costs and benefits of the alternative uses. Finally, we look at the financial impact they will have on existing operators, whether they be open access or franchise, and on the Secretary of State's funding position.

The set of decisions that we had to take in relation to east coast was obviously very difficult, not least because the applications exceeded the amount of capacity that was available. It was a process that involved a lot of modelling and the balancing of those judgments against our duties. As a result, it was unfortunate that we were not able to accommodate the Cleethorpes services in addition to what the franchising sought and the First services to Edinburgh. There will always be really difficult decisions to make where the applications we receive exceed the amount of capacity available on the network.

Dr Coscelli: Our proposed change of the rules will be to try to accommodate more of those services. At the moment, because of where we are on access charges and the inability to get a contribution from open access operators because there is no levy, in a sense the set of rules is what they are and the Office of Rail and Road has to apply its duty to the current set of rules. Our proposal is to try to increase the contribution of open access operators so that more open access operators will be allowed through, essentially applying the same combination of duties.

Q57 Chair: Ms Whittington, aren't you concerned about the possible impact of many more open access operators on competition from franchise bidders and therefore on revenues to the Department?

Joanna Whittington: There are two separate points. The reforms that we have been talking about in terms of track access charges and the possibility of a levy would address the tension that we currently see between the Secretary of State's funds on the one hand and the benefits that we think open access competition can bring to all users of the rail network.

One of the points Andrea made earlier was that actually the possibility of a bigger open access market might encourage new entrants to bid for franchises. Currently, if you do not get the franchise you are not in the market, whereas if open access was a larger part of that offering, if you did not get the franchise you would still have another opportunity to develop your business in advance of the next franchise coming up. I do not see a conflict in the way that I think was implied.

Q58 Chair: What work have you done on the levy on the public service obligation?



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Joanna Whittington: The levy, if it came into effect, would be introduced by Government. We have had initial conversations with the Department that we are hoping to take forward to consultation later this year. The work that also needs to happen in parallel is around the track charges that open access operators would pay and is part of the ongoing review we are doing into the structure of Network Rail's charges. Again, we are intending to consult on that in the autumn.

Q59 **Chair:** What will you be doing by autumn? Will you be publishing that?

Joanna Whittington: Those new arrangements cannot come into effect until the beginning of the next funding period for Network Rail, which is 1 April 2019. We are doing the preparatory work as part of that review and we will be consulting on that in autumn this year.

Q60 **Chair:** How are you addressing the issue of track access charges?

Joanna Whittington: Track access charges fall into two broad categories. There are charges designed to recover the fixed costs of the network and there are charges designed to cover the costs of the network that vary with the number of trains you run.

At present, open access operators do not make a contribution towards the fixed costs of the network; they only pay the variable charges. The question is whether, by better understanding how those fixed costs vary with the number of trains operating on it, open access should make a greater contribution towards the overall cost of running the network. That is what we are going to look at in the context of our duties overall, and we will be consulting on it in the autumn.

Q61 **Chair:** Are you comfortable with the idea of more open access operators in relation to efficiency of the whole sector? Wouldn't that introduce a lot more complexity, with a lot more operators and a lot more fragmentation in a system that we are already told is too fragmented?

Joanna Whittington: On the routes that we were talking about—the intercity services—the timetabling process and the role that Network Rail has as system operator in looking at capacity, together with our role in defining what is the efficient use of that capacity through our approvals process, would provide protections so that the overall package was still co-ordinated and provided a good service for passengers overall. I do not think it is a model that we would want to see extended into other markets at this point. It is very much something that we see focused around those three big intercity routes.

Q62 **Chair:** Dr Coscelli, what is your view in terms of competition? I know you have given some comments, but it looks as if you are underestimating the potential impact of this on current franchise operators and potential ones. Surely they will look at the potential impact on their revenues if more open access is going to be actively encouraged, as you want to do?



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Dr Coscelli: We were always very clear in our report that this is about future competition. It is clearly very important that the operators who bid and have paid money for certain franchise contracts under the current conditions should not suffer from these changes. It is really about planning a change in the rules for the future set of franchises. It will not have any impact whatsoever on the franchisees at the moment. That is why most of the franchise operators have been pretty positive about our proposed changes.

Q63 **Chair:** If a train operating company was underperforming, could they be threatened with part of that service going to an open access operator? Would you envisage that as part of the system?

Dr Coscelli: Suppose that on the east coast main line the franchisee was operating 75% of the train path and 25% was operated by competing open access operators. If the 75% franchisee was underperforming, we would be in a better place than we are today because the passengers would have much more of an active choice to walk with their feet and choose the competing operator, so that would help. In terms of extra pressure on the franchise operators, it would be very similar to what is in place today. It would come down to the contract, and enforcing the contract. Essentially, we would be where we are today plus the benefits of direct competition. As we know, where that works it is a very effective tool to deal with underperformance.

Q64 **Chair:** Would you encourage devolution of services to local authorities or regional groupings?

Dr Coscelli: We have consulted extensively with devolved authorities, both in the north and in Scotland. They are mainly focused on the type of franchises that would not be affected by these changes. Their main concern was one of the concerns that you raise—the complexity and whether it would have some negative impact on some of the more regional and commuter routes. As I said, we think that by doing it through a step-by-step process there will be a fairly limited change from what we have today. We do not think there will be an issue.

Q65 **Chair:** Ms Whittington, are there any other comments you would like to make to us about the whole franchise process and the developments now being considered?

Joanna Whittington: Franchising has been very successful overall, but there is now real opportunity for open access to play a more significant role. The benefits are there today, albeit on a very small scale. The opportunity to roll that out across more of the intercity routes would seem to be for the benefit of passengers overall.

Q66 **Chair:** What percentage of the intercity network would you envisage as being open access over the next 10 years?

Joanna Whittington: It is more about looking at what flows would be relevant in that area. As Andrea was saying earlier, we see that on east



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coast, west coast and great western. At present the passenger miles are a really tiny part of the overall offering, at less than 1%. It is more about getting the introduction on those routes and getting two or three perhaps on each of those routes potentially, in addition to the franchise.

Q67 **Chair:** Dr Coscelli, do you envisage a particular percentage of intercity networks that might be open access in 10 years' time?

Dr Coscelli: Because our report is essentially a set of recommendations for the Department, we tried to have a menu of options so that the Department could incorporate them into their various policy considerations. What we say in the report, and what we said in discussion, is 75%:25% or 80%:20%. In a sense, I am personally fairly pragmatic. I focus very much on incremental change in this type of complex situation. It would be very good to try to start with 15% or 20% allocated to open access to see how it works, and then potentially be slightly more ambitious either with the following franchise or with the following route.

Q68 **Mary Glendon:** Going back to what has happened with east coast and the changes they are having to make, if there is more open access, which will increase competition and pressure on the main franchise holder, what effect will any potential competition have on increased industrial action because of changes that would have to be made, and how would that reflect ultimately on the experience of the passenger? I am thinking of what has happened with Southern and potentially with east coast.

Joanna Whittington: When Virgin entered into that process they were aware of the possibility of open access. Indeed, open access already operated on the route, so I would have expected them to reflect that in the bid that they made to the Department for Transport. If anything, I see the market providing an additional stimulus to making sure that the service that Virgin continues to provide is of high quality because there are alternatives on some of the flows on that route.

Q69 **Mary Glendon:** There would not be a compromise; they would not make themselves more competitive by cutting back on the service they were providing.

Joanna Whittington: Obviously it depends on what is specified in the franchise agreement, but we would expect the Department to enforce the franchise agreement and, in addition, for open access to provide ongoing pressure to deliver and improve the quality of services for all operators on that route.

Mary Glendon: It is what would happen, Chair, when it means jobs, bearing in mind what has happened on Southern.

Chair: Are there any further questions? No. Thank you very much.