STRATEGIC RAIL AUTHORITY

Fares Review Conclusions 2003

Britain's Railway, properly delivered

Contents

Foreword

Last July the SRA launched its first fundamental review of fares policy by publishing a consultation document. The consultation asked the following questions:

- Which fares should be regulated?
- By how much should regulated fares increase each year?
- Should there continue to be an automatic link between fares and performance?
- What mechanisms should be used to regulate fares?

The review has now reached its conclusions. Fares regulation will continue. The main changes to be made to fares policy are:

- a change in the annual rate of increase for regulated fares to RPI+1% for three years (since 1999, the annual change has been limited to RPI-1%);
- the removal of the ineffective link between fares and performance from January 2004;
- simplification of the mechanism used to regulate fares from January 2004;
- the review has identified a number of problems with the regulation of Saver fares (off-peak fares for leisure travel of about 50 miles and over). The SRA will address these with a view to changing the regime by 2006.

These changes meet the original imperatives driving the fares review. The change to RPI+1% helps to redress the balance between taxpayer and passenger in meeting the industry's rising costs. Most respondents to the consultation agreed that RPI-1% was unsustainable. Commuter fares will continue to be regulated to protect passengers where operators have market power. Simplification of fares baskets will reduce the administrative burden on operators and the automatic link between fares and performance has not worked well, so it will be abolished.

In terms of the future, we have looked at the possibility of introducing a national railcard product. More work needs to be done on a national railcard scheme, but we believe it may be possible to devise a product that encourages new journeys without increasing the funding burden to the taxpayer.

Fares – their structure and pricing – play a vital role in funding Britain's railway. This policy simplifies the current regulatory regime and offers the possibility of further customer-focused innovation whilst ensuring that a fair balance is struck between the contributions of the farepayer and the taxpayer.

Richard Bowker
Chairman and Chief Executive
Strategic Rail Authority
June 2003

1. Introduction

In July 2002, the SRA launched its review of fares policy with the publication of a consultation paper 'Future fares policy – seeking your views'. A copy of the consultation document can be found at www.sra.gov.uk/sra/publications. The review has now been completed and this document sets out its conclusions on future fares policy as agreed with the Secretary of State. These conclusions take into account both responses to the consultation document and additional research and modelling work undertaken by the SRA. The SRA will work with train operators during the summer and autumn this year to implement the new policy from January 2004. The new policy will apply to all rail franchises except for ScotRail, for which fares policy will be agreed separately with the Scottish Executive.

1.1 Objectives

The consultation document set out the SRA's duties and objectives relevant to fares policy, each of which was taken into account in the review. The SRA also defined a set of specific objectives for its new fares policy:

- to protect passengers in markets where train operators have a significant degree of market power, for example on urban commuter routes;
- to redress the balance between taxpayer and passenger, as increasing industry costs have so far been borne almost entirely by the taxpayer;
- to allow more scope for innovation in fares and ticket types, allowing train operators to make better use of the capacity that is available;
- to minimise the administrative burden on train operators by simplifying the processes and mechanisms used to regulate fares.

1.2 Approach to the review

In reaching recommendations it was necessary to balance the need to protect passengers whilst imposing the minimum regulation on train operators. To inform its decisions, the SRA:

- considered the 1,800 responses received from the consultation process;
- reviewed existing rail industry research;
- undertook additional research, including in particular passengers' ability to switch between different modes of transport;
- assessed operators' pricing policies and their interaction with fares regulation;
- built an economic model that tested different fares policy options and their likely effect on passenger demand, overcrowding, revenue and subsidy.

It is the SRA's intention to publish a technical annex in due course, containing a more detailed account of the analysis behind its conclusions.

1.3 The structure of this document

The next section of this document is an executive summary. Sections 3 to 7 consider the main aspects of fares regulation and the reasons behind the various conclusions. This includes the scope of regulation, the level at which regulated fares should be set, the link between fares and train performance, and the way fares are regulated. Section 8 describes how the new policy will be implemented. Appendix A lists the review's main conclusions. Appendices B and C explain how fares regulation will work from January 2004. The terms and abbreviations used in this document are explained in Appendix D.

2. Executive summary

2.1 The scope of regulation

The fares that are regulated at present are Saver fares, standard return fares where there was no Saver in 1995, standard class weekly season tickets and most commuter fares in and around London. In future, standard class weekly season fares and most commuter fares in and around London will continue to be regulated. This will provide continued protection to passengers in situations where they have little choice about using rail services.

The regulation of Saver fares (off-peak for leisure travel of about 50 miles and over) has constrained new and innovative, customer-focused tickets and has led to significant over-crowding on some routes. Indeed crowding has sometimes been higher in the 'off-peak' than the 'peak' due to the distortions introduced by Saver regulation. Train operators generally face a competitive market for this type of travel because passengers can normally choose alternative forms of travel if operators do not offer attractive and affordable fares. The SRA will be working with the relevant train operators to develop proposals to address these problems, with a view to replacing the existing regime by 2006 with one more suited to passenger needs. It may be possible to introduce a new regime earlier than this, subject to any proposal demonstrating benefits for passengers and taxpayers.

2.2 The level of regulated fares

The cost of maintaining and improving Britain's railway has increased since privatisation, and this increase has so far been borne almost entirely by taxpayers. At present, the cap on regulated fares is changed by 1% less than the Retail Price Index (RPI-1%) each year. As a result, passengers using regulated fares have benefited from real reductions in regulated rail fares of around 6.6% since privatisation. The majority of rail industry stakeholders who responded to the consultation exercise accepted that RPI-1% was unsustainable. It has therefore been decided that the annual increase in regulated fares will be changed from RPI-1% to RPI+1% in January 2004 for three years. Even after this change, passengers will continue to pay less for regulated fares than they paid at privatisation for the next few years.

2.3 The link between fares and performance

There is currently an automatic link between fares and performance for regulated fares in London and the South East.[1] However it has not worked well and will be removed from January 2004. Long time lags between performance and fare changes have led to confusion. And – as an incentive for better performance – the policy is redundant because train operators are already held to account under their franchise agreements. Most responses to the consultation document were in favour of removing the automatic link.

[1] The link is called the 'Fares Incentive Adjustment Payment' regime (FIAP)

2.4 Mechanism for fares regulation

Commuter fares around London, Edinburgh and Cardiff are currently regulated by means of 'fares baskets', where a 'cap' is placed on the total value of a weighted 'basket' of fares. Other regulated fares are at present regulated individually. A fares basket allows operators to make changes to individual fares as long as the total value of the basket remains within the 'cap'. This flexibility allows operators to respond better to changing market needs and to reduce fares where there is spare capacity. In future, all regulated fares will be regulated by means of fares baskets. Baskets will be made as simple, flexible and transparent as possible, reducing the administrative burden on operators. Simplification of existing baskets and the creation of new baskets in areas where fares were previously regulated individually will start in January 2004.

2.5 National Railcard

Many people who responded to the consultation paper called for the introduction of a National Railcard. The SRA is interested in developing a well-targeted National Railcard, with the objective of encouraging car users to switch from road to rail. Such a railcard would need to be carefully designed so that it avoids adding passengers to already overcrowded trains or reducing operators' revenue. Further work is needed, however, and over the next year the SRA will work closely with the Association of Train Operating Companies (ATOC), train operators and passenger groups to explore potential options.

2.6 Other areas

Over the next year the SRA will be working with operators to improve the information available to passengers to ensure they can easily understand the new fares structure and buy the ticket that best fits their needs.

2.7 Implementation

Each operator's franchise agreement allows the SRA to change fares regulation at any time after January 2003, as long as an adjustment is made to the operator's franchise payments so that it suffers no net loss and makes no net gain from the change in policy. Over the next few months, the SRA will produce the new contractual schedule and consult with operators about the financial effects of the new policy. This will be done in time for fares to be set in line with the new policy with effect from 4 January 2004.

3. The scope of regulation

The review considered whether the right fares are currently regulated. The fares that are regulated at present are Saver fares, standard return fares where there was no Saver in 1995, standard class weekly season tickets and most commuter fares in and around London and certain other cities. This section sets out the conclusions on the scope of regulation and the analysis undertaken to help inform the decision.

The consultation document asked the following questions about the scope of regulation:

Do you think the balance between fares which are regulated and fares which are not regulated is currently correct?

If you think that we should regulate a different range of fares, which fares should be regulated, and why?

If you think the range of regulated fares should be increased, which additional ticket types do you think should be regulated, and on which routes? Tell us why you think these fares should be regulated, and at what price level you think they should be set – for example, at the current prices or a particular historic price. How should the cost of increased regulation be paid for, and what benefits might justify this cost? What will be the effect on overcrowding?

If you think the range of regulated fares should be reduced, tell us which fares should cease to be regulated, and why. What are the likely effects of this reduction in regulation?

Is the regulation applied to ticket restrictions (for example, Savers) sufficient, and if not, would increasing regulation of ticket restrictions be good value for money?

3.1 Consultation responses

Perhaps not surprisingly, passenger groups, individual passengers and Passenger Transport Executives (PTEs) generally want the same or more regulation. Some passengers argue that Standard Open tickets should be regulated, highlighting large increases on some long-distance routes. A few passengers argue for regulation of first-class fares. On the other hand, train operators want less regulation and more commercial freedom. They argue that regulation is only justified for those flows where rail has a demonstrable market dominance, and that regulation should therefore be limited to commuter fares around the major urban centres. In addition, train operators suggest that as Travelcard prices provide an automatic 'cap' on the equivalent non-Travelcard fares, rail-only single, return and season fares within the Travelcard zones need not be regulated. Local authorities on balance believe the current scope of regulation to be about right.

3.2 The options considered

In the light of the consultation responses, the review considered three options in detail:

- to leave the current scope of regulation unchanged;
- to expand regulation to cover Standard Open Returns (long-distance fully-flexible tickets);
- to deregulate Saver returns (long-distance walk-up leisure tickets).

3.3 Conclusions

- Regulation of commuter fares will remain because passengers using these tickets generally have little or no alternative to rail travel.
- The regulation of Saver fares has constrained new and innovative, customer-focused tickets and has led to significant overcrowding on some routes. Train operators generally face a competitive market for this type of travel because passengers can normally choose alternative forms of travel if operators do not offer attractive and affordable fares. The SRA will be working with the relevant train operators to develop proposals to address the problems caused by Saver regulation, with a view to replacing the existing regime by 2006 with one more suited to passenger needs. It may be possible to introduce a new regime earlier than this, if a proposal can demonstrate benefits for passengers and taxpayers.
- Standard Open Singles or Returns will not be regulated (except where they are already regulated in a commuter fares basket or as a 'protected fare' for a journey where there is no Saver fare).

3.4 Commuter fares

The consultation document explained that fares regulation is only justified where it is necessary to prevent or correct 'market failure'. In the rail industry, this generally means one of two situations:

- where operators possess market power and might use this to exploit passengers and/or secure competitive advantage;
- where there are significant external costs not fully reflected in the cost of production or the price, such as reductions in congestion, pollution, energy consumption or accidents, relative to other forms of transport.

Commuter train operators around London in particular, but also other urban areas possess a significant degree of market power, as there are few practical alternatives to trains for many people's journeys to work. Table 1 shows the dominance of national rail and Underground travel to work in the Greater London area, in autumn 2000.

Table 1: Travel to work in Greater London

Area of workplace	National Rail	Car and Van	Underground	Bus and Coach	Other
Central London	39%	13%	31%	9%	7%
Inner London	12%	41%	17%	12%	17%
Outer London	4%	68%	4%	10%	13%

Source: Transport for London. Rows may not equal 100% because of rounding.

Given the dominant position occupied by rail in the travel to work market in urban areas, the scope of regulation applied to most commuter fares will be retained. However, some aspects of commuter fares regulation should be simplified, as explained in section 6 of this document.

Away from London and the big cities, there are generally more alternatives to rail and the case for regulating commuter travel becomes less compelling. Nevertheless, there are still many journeys to work where people do not have an alternative means of travel. Weekly seasons outside urban areas will therefore continue to be regulated. However, they will be regulated through a more flexible 'fares basket' mechanism, as described in section 6.

The SRA considered the suggestion from operators that Standard Day Single and Return (SDS and SDR) fares within the Travelcard zones might be deregulated, relying on Travelcard prices to act as a 'cap' and limit increases. For many journeys, these fares are indeed capped by Travelcard fares – but there are many cases where the SDS and SDR are set significantly below the price of the equivalent Travelcard. In these cases, deregulation would allow significant increases. Travelcard prices are not regulated individually, but as part of a larger basket of fares. The SRA therefore concluded that it is not sufficient to rely on Travelcard fares to regulate Standard Day Single and Return fares in London.

3.5 Long-distance 'Standard Open' fares

The SRA considered whether long-distance full-fare Standard Open Returns (SOR) should be regulated. Whilst there is a clear argument for regulating commuter fares because of the lack of practical alternatives to rail, this is not necessarily the case for long-distance fares where alternatives generally exist in the form of travel by car, coach or air. For example, an estimated 58% of journeys from London to Manchester are made by car and only 33% by rail. Of journeys from London to Glasgow 41% are made by air, only 14% by rail[2].

[2] Steer Davies Gleave, Virgin Trains market share update report, June 2002, quoted by the Association of Train Operating Companies.

In addition, a 'reasonable' and economically efficient fare should at least reflect the full or marginal cost of provision. It is difficult to allocate the costs of providing a train service to a particular type of fare, but it is clear that train operators' total revenue from fares only just meets, and in some cases does not meet, the cost of running the railway. The efficient level of fares is discussed further in section 4.5.

The price of the Standard Open fare reflects its flexibility. Standard Open Returns are typically used by business travellers. For example, on Midland Mainline and Great North Eastern Railway around 60–65% of passengers using this type of ticket are travelling on business. Equivalent fares on competing modes – for example, fully-flexible domestic airfares – show prices at a similar or higher levels.

Affordability and value for money must also be a consideration. It is clear that regulating Standard Open Return fares at a much lower level than current prices could only be done at considerable cost. Regulating the maximum price of Standard Open tickets as well as Saver fares would result in a very high degree of regulation – almost two-thirds (64%) of total rail industry revenue would become regulated, when competing modes are largely unregulated. Regulating Standard Open fares would limit all other fares, stifling innovation and leading to overcrowding on certain trains. For this reason, this is likely to be a poor use of the limited funds available.

3.6 Long-distance 'Saver' fares

Independent research undertaken for the SRA suggests that the regulation of Saver has led to overcrowding on certain trains and may have prevented operators from managing their capacity effectively. It may also have constrained the development of other more innovative types of ticket, and (for example) prevented operators from introducing the sort of pricing used so successfully by budget airlines.

Leisure passengers are generally sensitive to price and if Saver fares were deregulated, operators would still need to offer competitively priced tickets to avoid losing passengers and revenue. SRA research suggests that most passengers using Savers are willing and able to transfer to different types of ticket or different modes such as car, coach or air. The leisure market for long-distance rail travel is already moving away from the traditional approach represented by Saver tickets towards airline-style ticketing, where price is the main attraction for passengers and a seat reservation is automatically included with the ticket. Yield management systems are being improved, and a new rail industry reservation system which can work in conjunction with yield management systems is due to be introduced in late December 2004. This would allow operators to maximise both ridership and revenue, whilst offering the lowest possible fare to each passenger.

It has become clear that the market for rail travel is changing and the current regime no longer fully reflects the needs of the industry or of passengers. The SRA intends to work with the long-distance train operators to see how the regulation of long-distance fares might be revised, with a view to replacing the current arrangements by 2006. It may be possible to do this earlier than 2006, as long as any proposals can demonstrate an overall benefit.

Table 2: Impact of changing the scope of regulation

This table shows the percentage of farebox revenue that will be regulated if the scope of regulation is varied.

Proportion of revenue derived from regulated fares:	Current proportion:	As now, but with Saver fares operators deregulated:	As now, but with Standard Open fares regulated:	As now, but with Standard Opens regulated, Saver deregulated:
Total rail industry:	46%	32%	64%	50%

4. The level of regulated fares

This section sets out the conclusions about the rate at which regulated fares should be increased, and explains the analysis undertaken to help inform the decision. At present, the cap on regulated fares changes by RPI-1% each year.

The consultation document asked the following questions about the level of regulated fares:

How should the level of regulated fares be determined, and how should fares change each year with inflation?

If you think that an increase in fares should be permitted to fund investment, what circumstances might justify what scale of increase? Should an increase only be applied after the investment has taken place, or are there circumstances when it might be applied beforehand?

Should fares policy be used to ease overcrowding, and if so, how?

Should the same policy apply to all fares in all areas, or should different policies apply in different areas or to different fares to reflect capacity constraints, the need for investment, or the delivery of quality improvements?

What are the problems (if any) caused by differences in fares policy between the SRA, Transport for London and Passenger Transport Executives, and how might these be resolved?

4.1 Consultation responses

Train operators argue that regulation has kept fares too low in real terms, stifling investment and creating overcrowding. They recommend that fares should be allowed to vary according to local cost conditions and to allow more realistic investment strategies. They also think that fares regulation is too blunt an instrument to be used directly to control overcrowding, because of the timescales involved in changing it, and the limited ability to target regulation at particular routes or specific geographic areas. Train operators said that the difficulty of reconciling SRA, Transport for London (TfL) and PTE fares policies is a key issue.

Passengers, passenger groups, local authorities and PTEs do not believe that fares regulation should be used to 'price off' passengers to reduce overcrowding, and instead suggest that capacity should be increased. However, in spite of a general feeling that fares are too high, PTEs, the RPC network and many local authorities believe that a move from the present 'RPI-1%' to a more sustainable annual fares increase of 'RPI' would be acceptable. Where fares increases are used to help fund investment, passenger groups and PTEs believe that investment should happen first, before any associated fares increase is imposed.

Some local authorities expressed concern at the 'railheading' which lower fares in some PTE areas produce, where passengers will drive to a station within the PTE area instead of using their local station.

4.2 The options considered

The review considered and modelled the following options:

- Retaining the current regime.
- A range of options for increases above RPI, including a large one-off increase.
- Applying different fares caps for different areas or fare types.

4.3 Conclusions

- The regulated price cap will increase from its current level of RPI-1% to RPI+1% from January 2004 for three years.
- Rail industry costs have risen sharply, and the increase has so far been borne entirely by the taxpayer. SRA and ATOC research suggests regulated fares are below their economically efficient level. In addition passengers have enjoyed real reductions in regulated fares of around 6.6%. On this basis, significant increases in regulated fares could be justified.
- There has been significant investment in new trains and improved services. This is continuing, with the complete replacement of all 'Mark I' rolling stock due before the end of 2004.

4.4 The balance between passenger and taxpayer

The key considerations in setting the appropriate rate of change for regulated fares were the:

- need to recover rail industry costs;
- balance between fares paid by passengers and subsidy paid by taxpayers;
- changes in the absolute value of taxpayer contributions over time since privatisation;
- likely direction of future rail industry costs.

At the time of privatisation, it was assumed that more efficient private sector management would drive down costs. These gains would be shared between taxpayer and passengers, with government subsidies expected to reduce over time, and regulated fares reducing by 1% per year in real terms after 1999. In the event, these efficiency gains have not materialised. In fact total rail industry costs have gone up, not down. On the other hand, passengers have benefited from regulated fares falling in real terms. On average, regulated fares have fallen by around 6.6% in real terms since privatisation.

The total cost of providing the national train service rose from £6.1bn in 1999–2000 to an estimated £9bn in 2002–03. But this increase was not matched by equivalent growth in revenues, which only increased from £4.4bn to £4.8bn. Realistically, there are only two sources of funds for the railway – fares or freight user charges, and subsidy.

Recent increases in the total cost of providing the railway have partly been caused by increased levels of investment. Examples of increased investment include replacing all elderly 'Mark 1' trains in London and South East area, which will bring significant improvements in both safety and comfort to passengers. These costs are being borne almost entirely by the taxpayer. In addition, many operators have refurbished or upgraded their rolling stock, or provided increased capacity or train frequency. It is fair that passengers should help contribute to these improvements by a move to RPI+1%.

The SRA is determined that any increases in underlying costs are actively tackled. The SRA is reviewing rising train operator costs as part of its own strategic planning and the Rail Regulator is reviewing Network Rail's income requirement through access charges, part of which will involve a review of Network Rail's costs. The Regulator's review is due to be completed in December 2003 and implemented in April 2004. The conclusions of both reviews will bring much greater clarity to the rail industry about current and future costs.

4.5 Making sure fares send efficient price signals

Ideally fares would send a signal to passengers, suppliers and investors about the need for future investment. This would require fares to reflect 'efficient' pricing. Economically efficient pricing is where the price reflects the marginal costs of providing the service.

Estimating marginal costs for the rail industry is not straightforward, as long run marginal costs may differ significantly from their short run values. They will also differ between groups of passengers. A significant problem in calculating marginal costs for the rail industry is the high proportion of fixed, joint and common costs involved in providing a railway service. The marginal cost of carrying extra passengers is very small up to the point where all spare capacity is used up. At this point marginal costs of carrying an additional passenger can then be very large, as more track or train are needed. The SRA has concluded from its work so far that:

- fares should reflect the long run marginal cost because of the long lead times involved in investment and the limited ability of passengers to respond to price changes in the short term – for example, by changing jobs, changing travel patterns or moving house.
- it is not practical to calculate and apply long run marginal costs for each type of passenger. The relevant unit for calculating marginal costs should be either an additional train service or the next increment in capacity.

The SRA's research suggests that regulated fares may be significantly below their economically efficient level, in other words, below the long-run marginal cost. The result of this is overcrowding, seen on both commuter services and long-distance trains, and a lack of incentive for investment.

The SRA is continuing further research into the economically efficient level of fares and expects to conclude sometime later this year. The analysis will be used to help determine the level of regulated fares in the long term.

Conclusions from the SRA's analysis are supported by work carried out by ATOC on average incremental costs included in their consultation response. ATOC compared the extra revenue generated by selling an additional season ticket with the cost per seat of providing an additional train. The results are shown in table 3. ATOC's conclusions are that:

- the costs of increasing capacity (trains and infrastructure) are very large. For example, extending trains from eight to ten cars (the cheapest option for enhancing capacity) may typically cost around £400,000 per train. Lengthening platforms may cost around £0.5 to £1.5m per station.
- Fares are currently less than marginal (or incremental) costs on many services, as table 3 shows. In both cases illustrated (a local service and a longer distance commuter service) the additional costs of running the service exceed the price of the season ticket. This could imply that services might need to be filled to capacity near the start of their journey and/or the service would need to be severely overcrowded in order to pay for itself.[3]

Table 3: The cost and revenue of running an extra London commuter train

Incremental cost:	Local service (45 minute journey end to end)	Longer distance commuter service (1 hour 40 minutes end to end)
Short Term Incremental Cost	£ per place per year[4]	£ per seat per year[5]
Rolling stock capital/leasing costs	810	1,000
Maintenance	390	500
Cleaning	80	100
Driver and Conductor	210 (no conductor)	700
Track Access Charges etc	50	100
Average Incremental Costs	1,540	2,400
Incremental revenue = Annual season ticket fare (£ per passenger per year)		
Major intermediate station	480 to 560	2,200

[3] ATOC's figures exclude the large fixed costs that each operator pays for infrastructure, so the costs shown may underestimate the true costs. It is assumed that the additional trains only run at peak times because there are already sufficient trains to meet off-peak demand.

[4] It is assumed that the local service can carry standing passengers, up to the SRA standard that available places equal 135% of the number of seats.

[5] It is assumed that the longer distance service must provide a seat for each passenger.

4.6 The future level of regulated fares

Significant increases in regulated fares may therefore be justified on both cost-recovery and efficient pricing grounds to redress the balance between taxpayer and passenger and more accurately reflect the long-run marginal costs of providing the train service. More detailed analysis is needed, however, on what the efficient level of economic fares should be before any significant increases are made in the level of regulated fares.

In the meantime, considerable investment has been made in new trains and improved services, and this investment is continuing with the replacement of all 'Mark I' coaches due before the end of next year. It is appropriate, therefore, that passengers should share some of the costs of this investment. The cap on all regulated fares will therefore change from RPI-1% to RPI+1% from January 2004 for three years. This will increase revenue by approximately £32–42m each year by 2006.

It is not practicable to apply different increases in fares caps to different operators, for example to reflect slightly different levels of investment or service quality, because of the extent of interaction between fares set by different operators. This is particularly true in the London and South East area, because of the constraints imposed by the Travelcard and by the way in which fares baskets work. Travelcard prices are set for the whole of London by agreement between all operators and TfL. The maximum possible increase in non-Travelcard fares is constrained by the equivalent Travelcard fare, and even fares outside the Travelcard zones are constrained by the effect of 'railheading' if Travelcard fares inside the zone 6 boundary become much cheaper than fares from outside. Each operator's fares basket contains fares which it sets and controls itself, and fares which are set by other operators. If one operator is permitted a large increase in its fares basket, and as a result increases its own fares significantly, this will force other operators whose fares baskets contain these fares to reduce their own fares to offset this increase, unless they too are allowed a similar increase in the total value of their fares baskets. For these reasons, it is more appropriate to apply a consistent increase across all operators.

4.7 The impact on passengers

Table 4 shows the effect on passengers of a change from RPI-1% to RPI+1%. On average, passengers who buy season tickets will face an increase of £45 per annum in real terms by January 2006. The table also shows that passengers using services provided by long distance operators will face the highest increase. This reflects the longer distances travelled by these commuters.

Individual passengers may face the following types of increase. Commuters travelling between Brighton and London currently pay £68 for a weekly season ticket, and this may increase to around £70.10 in real terms in January 2006. Commuters travelling between Worcester and Birmingham currently pay £20.40 per week, which may increase to £21.10 in January 2006.

Leisure passengers travelling between York and London currently pay £63.90 for a Saver return. This may increase to £65.90 in January 2006 in real terms. Leisure passengers travelling between Bristol and Cornwall using a Saver return currently pay £53.10 and this may increase to £54.70 in January 2006.

Table 4: The effect of 'RPI+1%' on average annual season ticket prices.

	Average annual season ticket (at 2003 prices)			
	January 2003	January 2004	January 2005	January 2006
Regional operators (excluding Anglia)	£888	£897	£906	£915
London and South East operators	£1,464	£1,479	£1,493	£1,508
Long distance operators	£2,988	£3,018	£3,048	£3,079
All train operators	£1,470	£1,485	£1,500	£1,515

5. The link between fares and performance

A link between fares and train service performance called the Fares Incentive Adjustment Payment regime (FIAP) currently applies to the ten London commuter operators. Under FIAP, the basic 'RPI-1%' policy is varied by up to + or – 2% depending on whether the operator's train service performance has improved or worsened in the 12 months up to July before the January fares change date, when compared with performance in the 12 months before that.

The consultation document asked the following questions about the link between fares and performance:

Should fares continue to be linked to train service performance through the FIAP regime? If so, how should we deal with the problems this causes?

Should fares be linked to performance through an alternative regime, perhaps based on absolute levels of performance with a linkage to solve the 'cap' problem? If yes, which services and ticket types should it cover and how might it work?

Should a link between fares and performance be discontinued? If yes, how should passengers be compensated for poor performance? Are the current Passenger's Charter arrangements sufficient for this on all operators, or would these have to be improved first? How should we handle the issue of fares levels which are currently depressed by poor performance and the fares/performance link? For replaced franchises, do you think performance incentive payments need to be increased to compensate for the effect of losing this link?

5.1 Consultation responses

Train operators, the RPC network, passenger groups and PTEs almost all say that the 'FIAP' automatic link between London commuter fares and performance has not worked well and should be abolished. Most responses put forward Passenger's Charters as the preferred way of compensating passengers for poor performance, rather than creating an alternative automatic link between fares and performance to replace FIAP. Some local authorities were keen to retain some sort of fares-performance link, but agreed that the area was fraught with difficulty. Responses from individual passengers were mixed.

5.2 The options considered

The review considered the options to:

- retain FIAP as it is;
- remove FIAP and replace it with an alternative automatic link between fares and performance;
- remove FIAP and rely on Passenger's Charters to compensate passengers for poor performance.

5.3 Conclusions

- 'FIAP' has worked badly and should now be abolished.
- It is not possible to replace FIAP without retaining many of its drawbacks. In particular, there will always be a long time lag between the fares change and the period of train service performance that it reflects.
- Passengers do not realise that they are being compensated by FIAP and don't understand how it works. Therefore it would not be a good use of taxpayers' money to replace FIAP with another automatic link between fares and performance.
- FIAP has become redundant, as passengers' interests are protected through direct compensation for poor train service performance provided by each operator's Passenger's Charter. Passenger's Charter standards are currently under review.
- The removal of FIAP will have no effect on operators' incentive to improve train service performance. The FIAP mechanism was not designed as a performance incentive, and it includes an adjustment to franchise payments that offsets the revenue effect of the fares adjustment. A separate performance regime exists to incentivise train service performance.

5.4 Analysis

Studies carried out for the SRA by both AEA Technology & NERA have concluded that FIAP has not worked effectively for a number of reasons. The FIAP fares adjustment is based on the change in train performance from one year to the next, and not on the absolute level of performance achieved. A change from excellent performance to merely good performance requires a fares reduction, but a change from very poor performance to just poor performance produces a fares increase. There is a large time lag between the fares change and the performance that this reflects, and research shows that passengers do not associate the change in fares with the change in performance. It is not unusual for FIAP to produce an increase in fares in January, based on an improvement in performance over the previous two years, just as performance declines.

The FIAP fares adjustment does not affect all passengers equally. Passengers who buy Travelcards see little or no 'FIAP' effect on the price they pay, because Travelcard fares are agreed between all train operators and TfL, and the default increase is the rate of inflation. On the other hand, people who buy non-Travelcard tickets (for example, tickets only as far as the London terminals) may see a disproportionate effect because of the way the fares basket mechanism works. A combination of the basic 'RPI-1%' policy and a succession of negative 'FIAP' adjustments has made it extremely difficult for some operators to keep the total value of their fares baskets within the regulated 'cap' without large cuts in non-Travelcard fares. For example, for one London operator regulated non-Travelcard fares are now on average 17% less than in 1995, in order to balance Travelcard fares which are now about 18% higher than in 1995. FIAP also causes fares-setting problems between adjacent operators, as operators may have different 'FIAP' fares adjustments. This can place a strain on a coherent fares structure across the boundary, causing fares anomalies that are not in the interests of either operators or passengers.

Replacing FIAP with an alternative mechanism, based on the absolute level of train performance achieved by an operator, has been considered. However, this would correct only one of FIAP's drawbacks. Any automatic link between fares and performance will necessarily involve a significant time lag between the measurement of performance and the adjustment of fares, because of the time required to introduce new fares. Any automatic fares adjustment will also continue to distort fares within fares baskets, with the effect felt by some passengers more than others.

FIAP is both complex and not understood by passengers, who do not realise that they are being compensated. The time lag means that the people who suffered poor performance are not necessarily those that benefit from the reduction in fares, and in any case passengers with Travelcards see little benefit from the FIAP fares adjustment, because these fares are set in line with TfL's fares policy. Given these weaknesses, FIAP will be removed, simplifying regulation and ensuring a consistent annual average increase in each operator's regulated fares from 2004 onwards. Passengers will still be compensated directly for poor train service performance through each train operator's Passenger's Charter, and a review of Passenger's Charter standards is currently being carried out.

The removal of FIAP will have no effect on operators' incentives to improve train service performance, because it has no net financial effect on the operator. The FIAP mechanism was not designed as a performance incentive, and it includes an adjustment to franchise payments calculated to offset the revenue effect of the fares adjustment. A separate performance regime exists to incentivise train service performance.

6. The way fares are regulated

This section considers the mechanisms which the SRA uses to regulate fares. At present, some fares (for example, Saver fares and weekly season fares outside urban areas) are regulated individually, but other fares (for example, London commuter fares) are regulated by controlling the total value of a group of fares known as a 'fares basket'.

The consultation document asked the following questions about the way fares are regulated:

Should we continue to regulate fares through a mixture of fares baskets and individually protected fares, or should one or other mechanism be adopted for all regulated fares? What implications would any change have for passengers and operators?

What fares should be included in fares baskets – all fares from which the operator takes any share of the revenue (as now), or only the fares set by that operator? Should Travelcards and other multi-modal fares be excluded from fares baskets?

Should the weightings within fares baskets remain at the 1995 levels, be updated as a 'one-off', at regular intervals, or when certain circumstances arise?

Should the caps on individual fares within fares baskets be set closer to the overall basket cap to protect passengers from excessive rises in individual fares? If yes, what should the cap on individual fares within baskets be in relation to the basket cap?

6.1 Consultation responses

Train operators favour a 'fares basket' approach rather than regulating fares individually, although some operators are content with a mix of baskets and individually regulated fares. Operators suggest that Travelcards should be excluded from London fares baskets, and they recommend that the weightings given to the fares within fares baskets should be revised about every five years. The problems caused by interaction between SRA, TfL and PTE fares policies are highlighted, with operators recommending that the SRA ensures much greater consistency between its own policy and that of other organisations, particularly in the London Travelcard area. Operators also want a more transparent and practical alternative to the present computerised compliance checking system known as 'FIRM', and they suggest that they are in a better position to manage this than the SRA, if the appropriate audit processes could be put in place.

PTEs are generally happy with the current mechanisms, but some PTEs acknowledged the problems caused by the interaction between their own fares policy and that of the SRA. Some PTEs suggested removal of multi-modal fares from fares baskets and regular review of basket weightings. Another suggestion was to consider a policy for the whole 'travel to work' area around a conurbation rather than switch between fares policies at the PTE boundary.

Responses from passengers and passenger groups were mixed, with some responses content with the current arrangements, some preferring a basket approach and others recommending that all fares should be regulated individually. A number of passengers recommended a kilometric tariff approach. The need for regular revision of basket weightings, perhaps about every five years, was raised by a number of responses from RPCs, local authorities and other organisations.

6.2 The options considered

The review considered and modelled the following options:

- regulate as now, with a mix of fares baskets and individually-regulated fares;
- regulate all regulated fares by means of fares baskets;
- regulate all regulated fares individually;
- simplify fares baskets by removing Travelcards and fares set by other operators, or by including only fares which generate significant revenue.

6.3 Conclusions

- All regulated fares will be regulated by means of a fares basket.
- Each train operator will have two fares baskets. A 'Commuter Fares' basket will contain regulated urban commuter fares, in other words all those fares that are regulated in a fares basket under current fares regulation. A 'Protected Fares' basket will contain all fares that are currently individually regulated.
- Each fares basket will be simplified, and will contain only those fares which together account for around 95% of revenue from all regulated fares.
- Travelcard fares and fares set by other operators will remain included in Commuter Fares baskets, but Protected Fares baskets will only contain fares which are set by that operator.
- Increases in individual fares within fares baskets will be limited to 5% above the basic policy (ie RPI+6%) in any given year.

6.4 The advantages of more flexible regulation

SRA research confirmed that 'fares baskets' provide much greater flexibility compared with regulating fares individually, whilst still controlling the level of the fares concerned. This flexibility can be used by operators to reflect market conditions in the fares structure, promoting growth or managing capacity, and to correct anomalies or control overcrowding.

In the past, regulating some fares individually has generated significant work for both operators and the SRA, as approval is needed every time an operator wants to adjust an individual fare, even though the effect may be very small. Commuter fares in urban areas are already regulated by means of fares baskets. Fares currently regulated individually will also be regulated in a similar way.

However, research also showed that existing fares baskets can be unnecessarily complex. As a result many of the benefits of regulating fares in this way have not been realised. To resolve this fares baskets will be simplified to reduce the cost and effort required to manage fares regulation. Analysis of existing fares baskets showed that in many cases, 98-99% of regulated operator revenue comes from just 10% of regulated fares. Within each basket, there are a large number of fares with very low revenue that could be taken out of baskets without materially affecting the extent to which that operator's revenue is regulated. As an example, the table below looks at an example of a London basket. The table shows that the most important 10% of flows in that basket account for 98% of regulated revenue, and the most important 25% accounts for 99.7% of regulated revenue.

Table 5: Example analysis of flows and revenue in a fares basket

% of flows in the existing fares basket	% of basket revenue	Number of flows covered by those flows	Revenue of the smallest flow
1%	67%	80	£124,000
2%	81%	164	£49,000
5%	94%	417	£9,000
10%	98%	837	£1,700
25%	99.7%	2,099	£146
50%	99.94%	4,201	£20
75%	99.99%	6,303	£5

Source: Study on fares regulation carried out for the SRA by AEA Technology, March 2003

Fares on less popular flows would in effect remain regulated through (i) an SRA requirement for that fare to continue to exist and (ii) by the limiting effect of fares from adjacent stations being regulated. For example, if the fare on a very popular flow from A to C is regulated, and a similar fare is required to exist on a very small-revenue flow from B to C, the fare from B to C cannot logically exceed that from A to C. The fares included in a basket will need to provide a good geographical spread and care will need to be taken to ensure this when the baskets are created. However, in some cases, this simplification could reduce the number of separate fares within an operator's fares basket from over 20,000 to just 1,000. The SRA believes that this could significantly reduce the burden of regulation, allowing much simpler processes and systems to be used to maintain and manage fares regulation.

The SRA also considered whether operators' fares baskets could be simplified further by removing Travelcard fares and those fares that are set by other operators. However, this cannot be done without undermining the effect of regulating these fares. The proposed change in the annual increase from RPI-1% to RPI+1% and the elimination of the 'FIAP' fares adjustment make the inclusion of Travelcard fares within fares baskets less of a problem. The simplification of fares baskets by a reduction in the number of flows will make baskets more manageable, even though they will continue to contain fares set by other operators.

Fares baskets will be reweighted according to the revenue received by the operator from the sale of that fare in the financial year 2002–03. It has become clear that travel patterns have changed and actual revenue is now significantly different in many cases from the 1995 revenue levels currently used to weight fares within baskets. Given the work involved and the speed at which weights become out of date it is likely that basket weightings will only be reviewed at subsequent fares policy reviews.

A limit will also be placed on increases in individual fares within fares baskets, but in a simpler form. From January 2004, the maximum increase in any individual fare within a fares basket in any one year will be the permitted increase for the basket as a whole plus 5%, in other words, RPI+6%.

7. Other fares issues

The consultation document asked questions about other fares issues such as the complexity of the fares structure. Consultation responses also raised other issues, such as ideas for railcards, or zonal fares for London.

Questions on other fares issues asked in the fares policy consultation document

If you represent a train operator, how well do you think the mechanics and processes involved in fares regulation work, and how might these be improved? Is sufficient guidance provided, and how might this be improved?

Do you think that the complexity of the fares structure is a significant problem or not? Why? How might we resolve the conflict between offering passengers a wide choice of fares and making the range of fares understandable? How might we resolve the conflict between simplifying fares and preserving operators' commercial freedom? Should the SRA become involved directly, or should operators be allowed to address this issue for themselves?

7.1 Fares structure

The complexity of the fares structure emerged as a common theme in responses from passengers, passenger groups, the RPC network, PTEs and local authorities. Fares structure complexity was raised as a major issue in about two thirds of responses from individual members of the public. On the other hand, train operators believe that the advantages of offering a broad range of fares generally outweigh the disadvantages, and they are clear that they want to retain control over their product range. They see the issue of complexity as one of perception rather than reality. However, they acknowledge public concern about the complexity of the fares structure, and are committed to working with the SRA to reduce this perception.

Each train operator offers a range of different fares, designed to appeal to different types of passenger. There are many benefits to this segmentation of the market – passengers are more likely to find a ticket that suits their particular needs, and the operator can maximise their revenue and manage capacity through offering cheaper tickets at off-peak times, more expensive tickets when capacity is at a premium. If the SRA required operators to reduce the number of ticket types this would reduce passengers' choice and train operators' commercial freedom. It would disadvantage those passengers who used the fares that disappeared and would almost certainly reduce revenue, in turn requiring greater subsidy.

However, complexity also arises because different train operators address the same market segments with similar products with different product names and (in some cases) slightly different terms and conditions. This does not generally add to passenger choice, because a 'brand A' fare is only available on routes served by operator A, whilst a 'brand B' fare is only available on routes served by operator B. ATOC has already carried out some work on ticket categorisation, but the SRA believes that more can be done to make different categories of fare much easier to communicate for both passengers and retail staff. The SRA intends to work with train operators and ATOC to make sure that the terminology used to describe particular categories of tickets and (where appropriate) the terms and conditions for similar products, are properly co-ordinated between operators.

7.2 Zonal fares for London

TfL has suggested that national rail fares within the London Travelcard zones could be replaced by an integrated structure of zonal fares, consistent with fares for travel by Underground. There are some important advantages to simplifying fares in this way, and integrating them with fares for other modes. On the other hand, the creation of standardised zonal fares will remove train operator's ability to price up or down on specific routes to control overcrowding or reflect better or worse service quality on different routes. The SRA intends to develop this proposal further in conjunction with TfL and the train operators, but to longer timescales than its present fares review so that the likely effects on fares, revenue and passenger journeys can be properly quantified. The SRA is considering a trial of zonal fares on a particular part of the London area national rail network, to confirm its practicality and to see the effect of simplification on passenger numbers. If and when a London-wide zonal fares scheme is adopted, it is likely to be introduced gradually over a number of years.

7.3 National railcard

The idea of a national railcard was widely supported in consultation responses from passengers and passenger groups, who suggested that such a railcard would encourage rail travel, which it certainly would. However, a railcard that gave a discount to individual passengers is likely to be a very expensive way of generating extra passengers, and the extra subsidy required to support a national railcard is unlikely to be good value for money.

The consultation responses provided little to address the two concerns explained in our consultation document. The first concern was that the effect of a card would be to give a discount to existing regular rail users, and not to current non-users, the very people that need to be attracted to rail. For example, if a national railcard were introduced, a car user considering one rail trip would still be faced with paying the full fare, whilst only regular rail users benefited from the discount. The second concern was that if a national railcard was available to everyone, even higher income groups, it could not be targeted at those groups most likely to be price-sensitive and likely to switch to rail if offered lower fares. In effect, taxpayers would be paying for higher earners to have cheaper rail travel. A national railcard is likely to be abstractive, in other words to lose more money from giving existing passengers a discount than would be gained from additional passengers paying the reduced fare.

The SRA is interested in developing a National Railcard that is well targeted, encourages road users to switch from cars to trains, is carefully designed to avoid adding passengers to already overcrowded trains and does not reduce operators' revenue. For example a card could be targeted to make rail travel more attractive to small groups or building on existing local cards to take the benefits nationwide. Further work is needed, however, and over the next year the SRA will undertake new research and work closely with ATOC, train operators and passenger groups to explore potential options.

There are already railcards for young people, senior citizens, families and people with disabilities. The Young, Senior and Disabled Person's Railcards are all protected by the SRA.

7.4 Smartcards

The SRA has considered whether fares regulation needs to be altered to accommodate changes likely as a result of the introduction of smartcard ticketing both in London and as part of smartcard schemes around the country. It has concluded that smartcard schemes are at present insufficiently developed to make specific changes to fares regulation necessary.

This is not to say that changes will not be needed in the future, for example if smartcard ticketing allows the traditional pattern of weekly, monthly and annual season tickets to be changed. Another possibility is that smartcard ticketing may allow more effective 'peak' and 'shoulder-peak' pricing, where passengers save money if they travel on more lightly loaded trains at the shoulder of the peak, and pay slightly more on trains at the height of the peak. If this spread travel to work more evenly over a slightly longer period, this might bring lower levels of overcrowding, more efficient use of rolling stock, and therefore lower costs. The SRA intends to carry out some research into this possibility, and if appropriate carry out a trial on one part of the London rail network.

8. Implementation

Implementing the new fares policy will involve staff from both the SRA and the train operators supported by specialist technical and legal advisers. The implementation of the policy will need to be closely co-ordinated with the train operators' fares setting process leading up to the January 2004 fares change date.

8.1 Financial and contractual negotiations

Each operator's franchise agreement allows the SRA to change fares regulation from January 2003 onwards, as long as franchise payments are adjusted so that the operator makes no net gain or loss from the change in policy. The SRA expects the proposed policy to generate a net increase in revenue, particularly from the change in annual increase from RPI-1% to RPI+1%. This will reduce subsidy payments from the SRA, or in cases where an operator pays no subsidy, it will require a payment to the SRA. The SRA will discuss the contractual changes with each operator over the summer.

By the end of July 2003, the SRA expects each train operator to submit an analysis of the effect that the new fares policy will have on their income. The SRA will compare this analysis with its own detailed modelling of the effects of the new policy, and will discuss any differences with the operator concerned. The SRA expects all contractual changes to be agreed by September 2003, to allow implementation of the new fares policy in January 2004.

In the case of franchises which are currently being replaced or which are about to be replaced, the SRA will ask for bids on the basis of the new fares policy, which will be included in the new franchise agreement from the start. In cases where franchise replacement is due in the near future, implementation of some parts of the new fares policy (for example, the revision of fares baskets or the creation of fares baskets for Protected Fares) may be deferred until the start of the new franchise.

8.2 Setting up and amending fares baskets

One of the conclusions of our review is that the current 'FIRM' mechanism used for compiling and managing fares baskets is not flexible enough to meet operators' or the SRA's needs. The SRA expects that the simplification of operators' fares baskets will allow new processes to be introduced, making it easier for operators to check that their fares comply with regulation.

In parallel with the contractual negotiations, new fares baskets will be produced for each operator, using the generic definition of the new fares basket and converting this into the specific list of fares, prices and weightings which make up each basket. The baskets will be tested for geographic coverage (to make sure that small flows which are excluded from the basket are in effect regulated by the larger flows from adjacent stations that are included in the basket) and other sensitivities. The industry pricing managers will be actively involved at all stages to make sure that the baskets not only follow the legal requirements but that they also work as expected.

Some 20 new commuter baskets will need to be created, replacing the 24 existing baskets. There will also be 22 'protected fares' baskets, which will be entirely new. The table opposite shows the number and type of fares baskets for each operator.

Table 6: Number of fares baskets per operator:

	Pre-2004 Commuter fares baskets	From January 2004 Commuter fares baskets	Protected fares baskets	Remarks
Anglia Railways	1	1	n/a	Due to be replaced with Greater Anglia, April 2004
Arriva Trains Northern	1	1	n/a	Due to be replaced with Northern Rail, Sept 2004
c2c	1	1	1	
Central Trains	0	0	1	
Chiltern Railways	1	1	1	
Connex South Eastern	2	1	1	
First Great Eastern	1	1	n/a	Due to be replaced with Greater Anglia, April 2004
First Great Western	1	1	1	
First North Western	1	1	n/a	Due to be replaced with Northern Rail, Sept 2004
Gatwick Express	1	1	1	
Great North Eastern Railway	1	1	1	
Greater Anglia	n/a	1	1	From April 2004
Island Line	0	0	1	
Midland Mainline	1	1	1	
Northern Rail	n/a	Under discussion	1	From Sept 2004
ScotRail	1	Under discussion	Under discussion	
Silverlink	1	1	1	
South Central	2	1	1	
South West Trains	2	1	1	
Thames Trains	1	1	1	
Thameslink	1	1	1	
TransPennine Express	n/a	0	1	
Virgin CrossCountry	0	0	1	
Virgin West Coast	1	1	1	
Wales & Borders	1	1	1	
Wessex Trains	0	0	1	
West Anglia Great Northern	2	1	1	Due to be split in April 2004

The SRA is still discussing arrangements for the Edinburgh Commuter Fares basket with the Scottish Executive.

8.3 Implementing Fares Changes

There is a long lead-time required to produce the fares manuals and make sure that ticket machines contain the correct fares. During September and October, each train operator's pricing manager will need to prepare fares for January 2004 taking into account the new policy. This will be done in parallel with setting up the fares baskets and completing the financial and contractual negotiations.

8.4 Monitoring Future Compliance

The SRA's fares compliance team will establish the new processes necessary to monitor the new fares policy once the fares changes have been implemented. They will liaise with train operator pricing managers to resolve any teething problems. The team will also continue to work with the ATOC to make sure that fares compliance monitoring can be integrated with emerging industry fares systems.

8.5 Timescales

This is a summary of the key steps required to implement the new fares policy:

Activity:	Parties involved:	Completed by:
Operators submit evaluations of the new policy to SRA	TOCs	July 2003
Financial and contractual negotiations	SRA, TOCs, PTEs	September 2003
Setting Up and Revising Fares Baskets	SRA, TOCs, PTEs	September 2003
Implementing Fares Changes	TOCs	October 2003
New Fares Sold	TOCs	January 4 2004
Monitoring Future Compliance	SRA and TOCs	Ongoing

Appendix A: Summary of conclusions

Scope of Regulation

- Regulation of commuter fares will remain because passengers using these tickets generally have little or no alternative to rail travel.
- The regulation of Saver fares has constrained new and innovative, customer-focused tickets and has led to significant overcrowding on some routes. Train operators generally face a competitive market for this type of travel because passengers can normally choose alternative forms of travel if operators do not offer attractive and affordable fares. The SRA will be working with the relevant train operators to develop proposals to address the problems caused by Saver regulation, with a view to replacing the existing regime by 2006 with one more suited to passenger needs. It may be possible to introduce a new regime earlier than this, subject to any proposal demonstrating benefits to passengers and taxpayers.
- Standard Open Singles or Returns will not be regulated (except where they are already regulated in a commuter fares basket or as a 'protected fare' for a journey where there is no Saver).

Level of Regulated Fares

- The regulated price cap will increase from its current level of RPI-1% to RPI+1% from January 2004 for three years.
- Rail industry costs have risen sharply, and the increase has so far been borne entirely by the taxpayer.

The link between fares and performance

- 'FIAP' has worked badly and should now be abolished.
- Passengers' interests will be protected, as they will be compensated directly for poor train service performance through each train operator's Passenger's Charter. Passenger's Charter standards are currently under review.
- The removal of FIAP will have no effect on operators' incentive to improve train service performance. The FIAP mechanism was not designed as a performance incentive, and it includes an adjustment to franchise payments which offsets the revenue effect of the fares adjustment. A separate performance regime exists to incentivise train service performance.

Mechanism for regulation

- All regulated fares will be regulated by means of a fares basket.
- Each train operator will have two fares baskets. A ‘Commuter Fares’ basket will contain regulated commuter fares, in other words all those fares that are regulated in a fares basket under current fares regulation. A ‘Protected Fares’ basket will contain all fares that are currently regulated individually.
- Each fares basket will be simplified, and will contain only those fares which together account for around 95% of revenue from all regulated fares.
- Travelcard fares and fares set by other operators will remain included in Commuter Fares baskets, but Protected Fares baskets will only contain fares which are set by that operator.
- Each basket will be constructed using January 2003 fares, weighted by the revenue received by that operator from the sale of that fare in 2002–03. The SRA intends to re-weight only at subsequent fares policy reviews.
- Increases in individual fares within fares baskets will be limited to 5% above the basic policy (ie RPI+6%) in any given year.

Other areas

- **Fare structure.** The SRA will work with train operators and ATOC to make sure that the terminology used to describe particular categories of tickets and (where appropriate) the terms and conditions for similar products, are properly co-ordinated between operators.
- **Zonal fares for London.** The SRA is considering a trial of zonal fares on a particular part of the London network, to confirm its practicality and to see the effect of simplification on passenger numbers.
- **National Railcard.** The SRA will work closely with ATOC, train operators and passenger groups to explore potential options for a National Railcard that is well targeted and encourages passengers to switch from road to rail.
- **Smartcards.** The SRA intends to carry out some research into smartcards and how they may be used to help manage demand. If appropriate the SRA will carry out a trial on one part of the London network.

Appendix B: How the national fares system works

One of the SRA's tasks is to ensure that although there are 26 different train operators, our rail system remains a national network. There are conditions in every train operator's franchise agreement and passenger licence which require them to participate in National Rail Enquiries, in National Rail Conditions of Carriage, and in an agreement called the Ticketing and Settlement Agreement (TSA). The TSA sets out how rail fares will be created, set, honoured, refunded and the revenue settled between operators, and it ensures that nationwide through- and inter-available ticketing continues to exist as it did under British Rail.

Through tickets

A 'through' ticket is a ticket for a journey that involves the use of two or more operators in succession, for example, an Intercity operator followed by a regional operator. The TSA ensures that fares are set for each through journey for which British Rail had a fare in 1995. In practice, this means that through fares remain available for travel from any national rail station to any other national rail station.

A choice of operator

An 'inter-available' ticket is one that gives passengers a choice of operators over the same section of route. For example, an inter-available ticket from London to Peterborough will be equally valid on trains run by Great North Eastern Railway, WAGN or Hull Trains. Unless a ticket is specifically shown as valid only by the trains of a particular operator, it is fully inter-available, and can be used (subject to any other conditions applying to that type of ticket) on the trains of any operator over the relevant route or any section of that route. The TSA ensures that there is at least one set of inter-available fares for each journey on the national rail network. The SRA can permit exceptions to this rule where it believes that competition will bring a greater benefit to passengers, but the only exception permitted so far has been made in respect of fares between Gatwick Airport and London, and certain other journeys passing through Gatwick.

A choice of route

The TSA ensures that where alternative routes exist, passengers continue to have a choice of route with most tickets. Tickets on which the routing is shown as 'any permitted', or on which no specific route is shown, are valid for travel via any of the permitted routes listed for that journey in a document called the National Routeing Guide. Tickets valid via a particular location (for example, 'route Chesterfield') are valid on any route shown in the National Routeing Guide which passes through that location. The National Routeing Guide forms part of the TSA, and any changes to the routes it contains must be approved by the SRA.

Who sets fares?

Fares for each journey (known as a 'flow') are set by the 'lead operator' for that flow. The lead operator is normally the operator with the greatest commercial interest in that particular flow. The TSA requires other operators to honour these fares once they have been set by the lead operator.

Once the lead operator has set its inter-available fares, other operators are free to set 'dedicated' fares if they wish, for travel only on their own trains at fares lower than the inter-available ones. The lead operator can also set dedicated fares in certain circumstances, for example it can set cheap 'book ahead' fares for travel only on its own services.

Passenger Transport Executives (PTEs)
In seven urban areas outside London, local rail services are sponsored by local authority transport organisations known as Passenger Transport Authorities, through their executive arms, the Passenger Transport Executives. Two PTEs (Greater Manchester and West Yorkshire) allow the train operators to set fares in the normal way, and to receive the revenue from the sale of those fares. In the other PTE areas (West Midlands, Strathclyde, Tyne & Wear, Merseyside and South Yorkshire), rail fares are specified directly by the PTE, which receives the revenue from the sale of those fares and pays the train operator to run the trains. This may change when franchises are replaced.

Appendix C: How fares regulation will work from January 2004

Each train operator's franchise agreement with the SRA provides for the regulation of certain fares. The SRA will regulate fares in two categories, known as 'Protected Fares' and 'Commuter Fares'.

Protected Fares

- The following fares are 'Protected Fares':
  – Saver returns (an off-peak walk-up leisure fare available for most long-distance journeys) for all journeys where a saver existed in February 2003;
  – standard returns (the full-fare return ticket, valid at both peak and off-peak times), for journeys where a Saver did not exist in February 2003 (typically journeys under 50 miles, or wholly within the old Network SouthEast area), other than those which are included in a Commuter Fares basket;
  – weekly season tickets, wherever a weekly season ticket existed in February 2003, other than those which are included in a Commuter Fares basket.
- Each operator will have one Protected Fares basket, which will contain (before the simplification explained below) every Protected Fare set by that operator.
- Each fare in a Protected Fares basket will be weighted by the revenue received by that operator from the sale of that fare in the financial year to 31 March 2003. The total value of the fares basket is the sum of each fare multiplied by the weighting for that fare.
- To simplify the basket, fares with the lowest revenue weighting will be excluded from the fares basket, up to the value of 5% of the gross value of the fares basket. The basket will therefore include at least 95% of the revenue received from Protected Fares. However, all Protected Fares must continue to be made available for sale, whether or not they are in the Protected Fares basket.
- The train operator must make sure that the total value of its fares basket does not exceed the 'cap' placed on that basket. The cap is equal to the total value of the fares basket calculated using February 2003 fares, increased by RPI+1% on 1 January 2004 and each year after that for three years.
- Individual fares within fares baskets may not go up more than 5% above the basic policy (in other words, RPI+1%+5%=RPI+6%) in any one year.
- Fares regulation also protects certain conditions attached to these fares. In the case of Savers, these are required to be valid for no less than a month, and to be valid all day Saturday and Sunday and from no later than 10:30 on any other day. They need not be valid for any journey beginning between 15:00 and 19:00 on Mondays to Fridays from London area stations or (when travelling away from London) stations between London and Reading, Watford, Luton or Stevenage, inclusive.

Commuter fares

- Commuter fare regulation will apply to the following fares used by commuters in the London area:

  – season tickets (weekly, quarterly, annual) to, from and within the London Travelcard zones;

  – standard singles and returns for journeys wholly within the London Travelcard zones;

  – standard singles and standard returns to any station in the Travelcard zones from a defined London suburban area, roughly 35-50 miles from London. The boundary stations for this area are: Shoeburyness, Southend Victoria, Southminster, Marks Tey (exc. Sudbury branch), Audley End (not origin Stansted Airport), Ashwell & Morden, Arlesey, Harlington, Bletchley, (excluding Bedford branch), Aylesbury, Haddenham & Thame Parkway, Twyford (incl. Henley branch), Earley, Fleet, Alton, Whitley, Christ's Hospital, Brighton (exc. coastway), Windsor & Eton Riverside, East Grinstead, Crowborough, Wadhurst, Paddock Wood (incl. Strood-Paddock Wood) Maidstone East, Canterbury East, Margate.
- Each train operator serving London will have one Commuter Fares basket. This fares basket will contain every regulated commuter fare from which that operator takes any share of the revenue. This will include both fares for which the operator is 'lead operator' and sets the fare, and fares where another train company sets the fare, but the operator in question receives a share of the revenue.
- Each fare within a basket is weighted by the revenue received by that operator from the sale of that fare in the financial year to 31 March 2003. The total value of a fares basket is the sum of all the weighted fares which it contains.
- To simplify the basket, fares with very low revenue will be excluded. The basket will be constructed so that it includes 95% of the revenue received from Commuter Fares, with no more than 5% of the gross value of the basket excluded. However, all Commuter Fares must continue to be made available for sale, whether or not they are in the Commuter Fares basket.
- Each year, the train operator must ensure that the total value of its fares basket does not exceed the 'cap' placed on that basket. The cap is equal to the total value of that basket in February 2003, increased by RPI+1% on 1 January 2004 and each year after that for the next three years.
- Individual fares within fares baskets may not go up more than 5% above the basic policy (in other words, RPI+1%+5%=RPI+6%) in any one year.
- Commuter fares around Cardiff and Edinburgh are also subject to fares basket regulation. These baskets contain the standard singles, standard returns, and season tickets for journeys wholly within the defined commuter area. The weighting and annual increase in the cap will operate in the same way as for London area Commuter Fares baskets.

Unregulated fares

- Fares which are neither a protected fare nor included in a fares basket are unregulated, and train operators are free to determine these fares according to market forces. Unregulated fares include:

  – all first class fares;

  – all 'advance purchase' fares;

  – tickets (other than Travelcards) which include through travel to destinations served by bus services, light rail services or London Underground;

  – tickets which include a non-rail element such as entrance to a museum, theme park or other attraction;

  – Saver tickets, for journeys where there was no Saver fare in 2003;

  – Weekly season tickets, for journeys where there was no weekly season fare in 2003.
- Although a particular fare may be unregulated, in certain cases the regulated fare acts as a ceiling – for example, an unregulated Supersaver fare cannot logically exceed the price of the regulated and less restrictive Saver fare.

Fares regulation in Passenger Transport Executive (PTE) areas

- In five PTE areas (West Midlands, Strathclyde, Tyne & Wear, Merseyside and South Yorkshire) fares are currently specified directly by the PTE, and fares are not regulated (although this may change when franchises concerned are replaced). In two PTE areas (Greater Manchester and West Yorkshire), fares are set by the relevant train operator in the normal way, and key commuter fares are regulated by a version of the fares basket mechanism. All standard singles and returns for journeys wholly within the Greater Manchester and West Yorkshire PTE area are included in a fares basket, which is capped in a similar way to the fares baskets described earlier.

Important points about fares regulation

- **Individual fares within fares baskets.** Because fares regulation works by applying a 'cap' on the total value of fares baskets, there may be increases in individual fares that are greater than (or less than) the permitted increase in the basket as a whole. However, individual fares within fares baskets may not go up more than 5% above the basic policy in any one year.
- **Year-on-year increases.** The annual permitted increase in regulated fares (RPI+1%) is a cumulative increase in the 'cap' placed on fares baskets based on the value of that basket in 2003. It is not a maximum permitted increase in actual fares from one year to another. Operators do not have to increase their fares by the maximum permissible amount in any given year, and some choose not to do so, leaving the actual value of their fares basket below the maximum level permitted by the cap in that year. This gap between the actual value of the basket and the maximum permitted by regulation is usually called 'headroom'. The following year, such an operator can use up this headroom as well as taking advantage of the annual RPI+1%, and so legitimately increase the value of its fares basket from one year to the next by more than RPI+1%. The operator would comply with fares regulation because the actual value of the basket would still not exceed the maximum permitted value.

- **Fares anomalies.** Fares have not been set according to a standard fare per mile for many years. British Rail abandoned this principle in favour of a more commercial approach, setting fares for each journey according to what the market would bear. With such a large network, it is inevitable that some anomalies exist where a combination of short-distance tickets is cheaper than a through ticket covering the entire journey. It is also possible that such anomalies arise where the lead operator setting the short-distance fares is a different operator from that setting the long-distance fare. However, such anomalies do not contravene fares regulation, and passengers are entitled to benefit from them, providing that they can legitimately use that combination of tickets for the journey they are making under the terms of the National Rail Conditions of Carriage. The SRA will consider applications from operators to adjust the regulation of particular fares if this is necessary to correct an anomaly that has arisen from (for example) an error inherited from British Rail.
- **Fares increases and investment.** The SRA may allow increases above the base level (RPI+1%) in specific cases where this is needed to fund additional investment. Operators who want to use this method of financing improvements to services need to provide a robust business case to the SRA in support of their proposals.

Appendix D: Glossary

ATOC	Association of Train Operating Companies
FIAP	Fares Incentive Adjustment Payment regime
FIRM	Fares Increase Regulatory Mechanism
NERA	National Economic Research Associates
NR	Network Rail Infrastructure Limited
NRES	National Rail Enquiry Scheme
OPRAF	Office of Passenger Rail Franchising
ORR	Office of the Rail Regulator
PTE	Passenger Transport Executive
RPC	Rail Passengers Council, Rail Passengers Committee
RPI	Retail Price Index, a measure of inflation
SDR	Standard Day Return fare
SDS	Standard Day Single fare
SOR	Standard Open Return fare
SOS	Standard Open Single fare
SRA	Strategic Rail Authority
TfL	Transport for London
TOC	Train Operating Company
TSA	Ticketing and Settlement Agreement

Commuter Fares	Fares in urban areas falling within the scope of Commuter Fares regulation. This is described in Appendix C.
Fares basket	A mechanism used to regulate fares by placing a limit or 'cap' on the total weighted value of a group of fares. The group of fares is called a 'fares basket'.
Protected Fares	Fares falling within the scope of Protected Fares regulation. This is described in Appendix C.

Appendix E: Types of fare

This is a summary of some of the fare types referred to in this document.

Fare type:	Description:	Validity:
Standard Open Single, Standard Open Return	Fully-flexible fares for long distance travel	Valid one month Travel on any day, at any time without restriction
Saver return	Off-peak fares for long distance travel	Valid one month Valid at any time at weekends, but not usually valid before a certain time Mondays-Fridays. May not be valid in the Monday-Friday afternoon/ evening peak period for journeys out of London
Standard Day Single, Standard Day Return	Fully-flexible ticket for shorter distance travel	Valid for one day Valid any time without restriction
Cheap Day Return	Off-peak fares for shorter distance travel	Valid any time at weekends, but not usually valid before a certain time on Mondays to Fridays
'Book ahead' or 'advance purchase' fares	These are generic terms for long-distance tickets which need to be booked in advance, include a seat reservation, and which are sold in limited numbers on specific trains. Operators give these fares many different names, for example 'Apex', 'Superadvance', 'Value Advance'	Only valid on the trains which have been booked. Limited or no changes to travel plans, limited or no refunds available if the ticket is not used

SRA STRATEGIC RAIL AUTHORITY

55 VICTORIA STREET LONDON SW1H 0EU TELEPHONE 020 7654 6000 www.sra.gov.uk