Department for Transport

Reforming Rail Franchising: Government response to consultation and policy statement

January 2011

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1. Introduction and background

1.1 Between July and October 2010, the Department for Transport undertook a public consultation exercise on proposals to change its rail franchising policies. *Reforming Rail Franchising* included proposals for longer franchises; less detailed specifications; more private investment and alternative risk/ reward mechanisms.

1.2 The consultation document was accessible on the Department's website and key stakeholders were informed of its publication. Although the consultation has now closed, the document can still be viewed at:

www.dft.gov.uk/consultations/closed/2010-28/

1.3 The consultation process was complemented by a series of consultation meetings in Birmingham, London, Leeds and Bristol. At these meetings, stakeholders received a detailed presentation on the Department's reform proposals. They were also given the opportunity to ask questions and clarify issues with Departmental officials and the Minister of State for Transport, at those meetings that she was able to attend.

1.4 The Department received a total of 268 responses before the consultation closed on 18 October. These came from all parts of the rail industry; rail user groups; local authorities; charities; pressure groups and members of the public.

1.5 On 7 December the Secretary of State made an announcement about the rail industry review. This included confirmation that future franchises will be longer; specifications will be less detailed and there will be greater incentives for operators to act efficiently and invest in the improvements passengers want. The statement can be viewed in full at:

www.dft.gov.uk/press/speechesstatements/statements/hammond20101207

1.6 As part of this Review, Sir Roy McNulty is leading a Rail Value for Money study. The study is due to conclude next year but interim results were also published on 7th December, available at:

http://www.dft.gov.uk/pgr/rail/strategyfinance/vfminterimreport/

1.7 The study is assessing how the costs of running the railway can be reduced, while continuing to invest in capacity enhancement and improving passenger satisfaction. Conclusions from this work are likely to have a significant impact on the design of rail franchises in the future in order to create greater integration between Network Rail and operators. Sir Roy's interim report has found that cross-industry focus on reducing costs is the key to securing overall efficiencies, and will require closer working and alignment of incentives between train operators and Network Rail. Any such changes will have an impact on key elements of the provision of rail services and the manner in which they are procured. Further reforms to procurement and contracting of rail services, above and beyond those set out here, may therefore be needed in future.

1.8 This document is structured around the sections and headings used in the Reforming Rail Franchising document. For each element of rail franchising, it outlines the consultation proposals; summarises the responses to the various proposals and sets out some additional ideas put forward by respondents. It also provides an indication of the Government's revised policy in each area.

1.9 The consultation predicted that a single "correct" solution, applicable to all franchises would not be identified. A significant majority of respondents agreed with this view, advocating a bespoke approach for each franchise. This approach characterises much of the revised franchising policy articulated in this document.

1.10 Some of the first outputs from this review will be introduced in the new Intercity West Coast franchise in April 2012 – a consultation on this franchise is being published in parallel with this document.

1.11 This document does not represent a complete account of all of the suggestions and views that respondents included in their documents – rather it provides an overview. Many more individual ideas were put forward and were considered by the Department than can be included in this high-level summary.

2. Franchise length

Consultation proposals

2.1 The consultation proposed that the standard length of franchises should be 12-15 years. It also suggested that franchises of up to 22.5 years could be considered, but explained the requirements under procurement law that this would need to be accompanied by significant investment.

2.2 In addition, the consultation suggested that shorter franchises should not be ruled out to accommodate major planned changes to the network. The document pointed out that this approach was recently used on the South Central franchise in anticipation of the changes produced by the Thameslink project.

Consultation responses

2.3 In general, train operators advocated 15 year franchises at minimum, with some supporting the maximum option of 22.5 years. It was argued that longer franchises would allow operators to develop better relationships with their customers and suppliers, and work more innovatively. It was also argued that longer franchises would provide greater opportunities for operators to respond to economic changes and make more investment in the network. This view was supported by some user groups and members of the public.

2.4 In contrast, the majority of user groups; local authorities; members of the public and some regional transport authorities queried the benefits of longer franchises. It was pointed out that the present arrangement of 7-10 year franchises has established a highly competitive market, delivering increasing financial returns to the Government.

2.5 It was also argued that more frequent competitions have provided an efficient mechanism to recalibrate franchises. One train operator highlighted that longer franchises would not by themselves encourage investment in many of the quality and facility improvements that passengers would like, but which did not earn additional revenue. Such improvements would continue to require state funding.

2.6 There were mixed views on the consultation suggestion that shorter franchises should be used to accommodate major changes to the network. Some parts of the industry argued that a long term operator could usefully adopt a ‘client’ role during such works, with others arguing that such an approach would require the Government to undertake expensive contract re-negotiations with operators.

Additional consultation responses

2.7 A local authority proposed a ‘bespoke’ approach to franchise length. It was suggested that franchise length should be considered on a case by case basis, influence by factors such as the performance on the route; the franchise’s market and the investment required. A regional development agency suggested that bidders could be invited to propose (and justify) franchise lengths on a case by case basis.

2.8 Some operators, a user group and members of the public advocated franchise terms which would be automatically extended following the achievement of pre-specific targets. It was argued that this approach could be used to incentivise high levels of performance/ customer service and investment.

Revised Government policy

2.9 The Government accepts that significant benefits are likely to arise from moving to longer franchise contracts. Longer contracts will encourage operators to invest in projects that have a financial return over 15 years, but not over a shorter period, encouraging passenger facing enhancements. They will be able to address important issues within their own business, safe in the knowledge that they will see the benefits in future years, for example staff training in order to deliver improved passenger satisfaction. Long franchises will also allow them to develop long term relationships with some of their important stakeholders, including Network Rail and local authorities, which are more difficult to develop in the short term.

2.10 Bidders will therefore be invited to compete for franchises of between 15 and 22.5 years. The exact length of franchises will be determined on a case by case basis by the investment sought.

2.11 We do recognise that on specific occasions franchises of less than 15 years may be needed, linked to major infrastructure changes such as the opening of High Speed Two. In such instances shorter contracts may be appropriate, but we will judge an appropriate length at the time of launching each franchise competition. In these circumstances an appropriate length will need to take into account the scope for incentivising future investment, investment levels in previous franchise periods and specific challenges, such as major engineering programmes.

2.12 In order to encourage investment throughout the franchise term, we intend to make greater use of residual value mechanisms. These allow operators to make investments with a pay back period beyond the end of the contract and receive an agreed payment for these investments at the end of that period. The Department continues to develop options in relation to this mechanism.

2.13 Although we expect longer franchises to facilitate additional private sector investment, the Department also recognises it will still be necessary to specify and fund improvements which do not have a commercial case but have wider transport and economic benefits. We will consider the case for Government funding and contracting such investments on a franchise-by-franchise basis, depending on the resources available.

3. Franchise risk and reward

Consultation proposals

3.1 The consultation suggested several options for tackling the risks associated with rail franchises:

- The full transfer of risk to operators
- Government support for operators, directly affected by macroeconomic changes such as the UK's GDP and Central London Employment (CLE – for London area commuter franchises only)
- A review mechanism, activated at pre-determined points
- A review mechanism, activated by a material change in circumstances
- A change mechanism to allow the Government to alter what it is buying from operators

3.2 The consultation acknowledged that the "Cap and Collar" mechanism used on many existing franchises has produced perverse outcomes, as well as significant financial liabilities for the Government.

3.3 The consultation also acknowledged that some of the risk options outlined above would be appropriate for one type of franchise, and inappropriate for others.

Consultation responses

3.4 Operators generally opposed the proposal of full risk transfer, predicting that this would result in far more cautious bids. It was also argued that such an approach would only be viable if Government was to afford operators greater control over service levels and fares. A user group and a local authority argued that this approach would provide a powerful incentive for efficient and customer focussed operations.

3.5 The majority of operators supported the proposal to link support directly to macroeconomic changes, rather than simply to revenue levels. It was argued that this more focussed approach to risk would result in fewer franchise failures than removing all support, but would avoid the perverse incentives to cut costs below the commercial level that have been created by the existing cap and collar system.

3.6 Operators opposed any review mechanism, arguing that they would amount to a series of shorter franchises, and discourage precisely the sorts of investment that the Department is trying to encourage through the surety of longer franchise terms. Operators felt that significant break points would also reduce the value of franchises, which would be reflected in the bid price.

Additional consultation responses

3.7 Some operators suggested that mid-life changes to a franchise should be dealt with on a ‘case by case’ basis, underpinned by the principal of No Net Loss/ No Net Gain (NNL/NNG). It was suggested that the Office of Rail Regulation could provide an independent arbitration service under this model.

3.8 A regional transport authority and several user groups suggested the concession model should be used more widely. If adopted for commuter services in London and the South East, it was suggested that this approach could deliver savings of approximately £180m over 20 years.

Revised Government policy

3.9 The Government is determined that future rail franchises should offer good value for money for taxpayers and passengers. For some franchises, we may expect operators to take full risk. Where we judge risking sharing to be more appropriate, this will be linked to macroeconomic factors (such as GDP and CLE) with the level of support varying according to the franchise. We do not envisage continued use of the Cap and Collar mechanism.

3.10 The risk model applied for individual franchises will be identified on the basis of their individual characteristics and circumstances, tailored to meet their potential risks and service and fare flexibility. In some instances, we may invite bids based on a number of levels of risk and consider which represents best value for money. We may revise our risk policies further, depending on the final conclusions of the Rail Value for Money Study.

3.11 Decisions on the levels of risk transfer for each franchise will also need to be reflected in the performance bond requirements and any additional parental guarantees. A careful balance will need to be struck in order to protect the taxpayer whilst discouraging the operator from walking away from the contract.

3.12 There may be instances where an operator's profits are significantly larger than predicted at the time the franchise was awarded. This is especially likely when the contract is awarded for a longer period. Growth rates slightly larger than that forecast at bid, when compounded over a long period will have a material impact on profitability levels. A significant part of revenue growth that has occurred on past franchises has been due to macroeconomic growth rather than solely a result of good management on the part of the operator.

3.13 A 'profit share' mechanism or similar will therefore be included in all future franchises to ensure that the taxpayer benefits from unexpectedly large profits. We will determine how this mechanism will work on a franchise by franchise basis, with bidders able to offer a greater level of profit share as part of their bid proposals to Government.

3.14 We will consider inclusion of a review mechanism on a franchise by franchise basis. This could provide an important mechanism to re-set important elements of longer franchises, such as the risk and revenue assumptions. Review points would also allow for the introduction of new industry efficiency reforms, as and when they are devised.

3.15 An efficient mechanism for 'in-franchise' changes will be especially important in longer contracts, given that change is more likely to be needed over a 15 year period. We intend to retain the detailed Financial Model which has been used in recent franchises, but apply a series of reforms to improve ease of use.

3.16 We are also considering the introduction of a new independent arbiter role (which could be fulfilled by ORR), to quickly resolve any change disputes between operators and the Department.

4. Performance bonds and parental guarantees

Consultation proposals

4.1 In recognition of the increased risks to Government of longer franchises, the consultation suggested that a larger level of performance bond and/ or parental guarantee may be appropriate. It was acknowledged that such a change would have cost implications, which in turn could result in the Government receiving less competitive bids.

Consultation responses

4.2 The majority of operators queried the need for larger bonds/ guarantees, arguing that other factors (such as reputational risk and shareholder pressure) are likely to provide the necessary motivation. They also point out that the Government has a range of sanctions at its disposal to tackle poor performance, including stripping an operator of its franchise. A pressure group and regional transport authority also suggested that higher bonds/ guarantees could prevent or discourage new entrants, such as mutuals and non-UK operators.

4.3 Some parts of the industry and a regional transport authority were supportive of higher bonds and guarantees. In particular, the recent collapse of National Express East Coast was highlighted and it was suggested that consequential costs to Government would have been eliminated by higher bonds and guarantees (although these costs were in fact already strictly limited by the contract terms in place on that franchise).

Additional consultation responses

4.4 One operator proposed a relaxation of rules requiring a single large bond. It was suggested that it should be possible for bonds to be sourced from multiple providers, in order to secure better value rates. Another operator suggested that owning groups with multiple franchises should be able to pool their bonds and provide a lower headline figure.

Revised Government policy

4.5 It is important that appropriate mechanisms exist within any contract to ensure that operators cannot walk away with no financial consequences for them or their owning group. However we also recognise that performance bonds have a direct impact on both the costs of the franchise to Government and the ability of operators to invest in the network, given that they reduce the borrowing facilities available to the owning group. In an era when Government expenditure is constrained, larger bonds will increase the costs of franchises and reduce an owning group's ability to invest.

4.6 We propose that Performance Bond should reflect the likely franchise replacement costs as a minimum. We believe that for smaller franchises this minimum will be around £10m, rising to around £15m.

4.7 However we also believe that the bond should reflect the overall passenger revenue of the franchise. As a result we propose that in general the Performance Bond will be the cost of replacing the franchise contract or 6% of annual fare revenue, whichever is larger. There may be cases where the level of bond should be set differently, however. We will therefore assess the level of the performance bond on a franchise by franchise basis, taking into account the overall level of risk transfer (including revenue risk).

4.8 Where appropriate, the Department will continue to ask for parental guarantees to ensure that an owning group takes responsibility for risks taken on by a train operator, and will provide additional funding if risks materialise.

5. Specification: train services

Consultation proposals

5.1 The consultation proposed a tiered, less tightly defined service specification. This would incorporate a minimum service level, perhaps defined through frequency and station stops, with other services designed by bidders in response to output targets, and other services offered as purely commercial additions. The consultation document recognised that the extent of the minimum service level would vary according to the franchise type and prevailing commercial context.

Consultation responses

5.2 This approach was supported by the majority of operators, although some queried the need for any service specification on inter city routes, arguing that competition from other forms of transport provide sufficient commercial imperatives. Some user groups and a pressure group expressed concern that this flexibility could be manipulated and used to reduce services which are not profitable, but still provide essential social or economic benefits.

Additional consultation responses

5.3 Several operators advocated additional flexibility over contracted service levels, arguing that this would allow them to adapt to changing demands and make best use of resources. In contrast, many user groups and local authorities expressed concern that such flexibility would result in reductions to unprofitable services.

Revised Government policy

5.4 We propose to significantly simplify train service specifications, so that bidders are given greater flexibility in how they develop the service offered to passengers. However, we also recognise that on some routes (and at marginal times of day), train services would not operate unless they were specified, and subsidised. The Government therefore needs to balance operator flexibility with the requirement to protect a core level of service for passengers. Given this, the level and method of train service specification will differ by route and by franchise.

5.5 In general, we would expect to specify first and last trains, by day of week and specify an off-peak level of service, although the level will vary by route. On a commuter franchise, this level of service specification will be supplemented by a requirement for the operator to satisfy a crowding metric. This metric will ensure that peak services above and beyond the off-peak requirement are operated, and are designed to use the resources sensibly. It will also encourage operators to develop initiatives that encourage passengers to travel in periods of lower demand.

5.6 For non-commuter services, a peak requirement, framed at a high level, may be necessary. This will be applied on a case by case basis.

5.7 Bidders will be given maximum flexibility to design the most commercial service, whilst protecting the Government’s core requirements, and protecting and enhancing the value of the franchise. We will also consider options on select franchises to protect some non-profitable service enhancements. For example, we may require operators to integrate rail with local transport through local transport plans. These plans regularly deliver social, economic and carbon benefits to the local economy, but are unlikely to be directly profitable to operators.

5.8 Operators will be free to amend timetables during the life of the contract as long as the contracted train service requirements and crowding measure are met. The existing mechanisms to allow operators to amend services will be streamlined.

5.9 These are general principles, and the exact requirements and bid processes used by DfT will be bespoke for each individual franchise.

5.10 In order that operators are aware of key local concerns in any new train timetable we will require them to consult with passengers and stakeholders early enough to allow comments to be reflected in timetable development. Few meaningful changes to a timetable can be made when a consultation is carried out 3 months before it is implemented, as has been the case with some operators.

6. Crowding

Consultation proposals

6.1 The consultation suggested that a crowding outcome target should form part of new franchise agreements. This approach would provide operators with flexibility to tackle crowding in the way they considered would be the most efficient, such as reconfiguring the internal layout of their carriages or running longer trains.

Consultation responses

6.2 Several operators were supportive of these proposals. They argued that this could incentivise additional capacity for peak period commuting in a cost-optimised way, but cautioned that targets would need to anticipate planned investment and impacts of crowding.

Additional consultation responses

6.3 One operator proposed an alternative crowding measure, applicable only to London and South East commuter franchises. This would be based on a moving annual average measure of crowding using load monitoring equipment on modern trains, with the potential to encourage 'smart' deployment of rolling stock.

Revised Government policy

6.4 We propose to introduce a contractually binding requirement on some franchises that will require operators to manage crowding levels as far as possible with the resources available. The relevant resource will be based on the rolling stock committed to through the life of the franchise in an operator's bid. Bids will be assessed on the quality of the plans to manage crowding, with the expectation on intercity routes that passengers should get a seat. As today, some standing would be acceptable on commuter journeys of reasonably short length. This will give bidders who predict strong demand growth an obligation to set out how they intend to provide the capacity to carry the additional passengers over the life of the franchise. However, because bidders also need to consider overall price to the taxpayer, this measure is not an open-ended requirement to provide capacity to meet demand in all circumstances.

6.5 In some cases, the Department may include additional requirements for the operator to provide extra capacity if demand grows. We will need to consider whether these requirements are affordable for the taxpayer, and whether they represent good value for money.

6.6 The characteristics of the individual franchises will have to be taken into account when considering the appropriate approach. Firstly the scope for extra capacity will be highly relevant. On some franchises train lengthening is possible, but in other areas of the network little can be done to increase capacity without major infrastructure work. Secondly, because additional carriages do not typically cover their costs in additional fares, requirements to increase capacity will generally come at a net cost to the taxpayer, reflected in the franchise bids.

6.7 This approach will involve the reintroduction of a Passenger In Excess of Capacity Measure, or similar, especially where the measure is used as part of the Department's requirement on train services (as outlined in the section on specification of services). We will consider widening the use of such a measure to towns and cities other than London, recognising the crowding issues that exist outside the capital. We will also consider whether the current peak period definitions in London, especially the evening peak (1600-1859) remain relevant, or whether in the light of changing demand patterns these should be revised.

6.8 We will consider whether assessments of crowding can be made more frequently than today. One option would be to move to a process of continual assessment, based on a moving annual average rather than the autumn and spring assessment that occurs today. More frequent assessments will be possible by the greater use of automatic passenger counting equipment on modern trains. We will require the crowding analysis to be published, with the potential requirement for operators to provide information to passengers on which trains have high crowding levels.

6.9 These changes will mean that operators must be aware of and manage the crowding that materialises on their trains. It will incentivise them to design the timetable and deploy rolling stock to minimise crowding. It will also encourage them to develop initiatives that encourage passengers to travel on more lightly used trains at the edges of the peak period. The Department is considering further options to ensure operators do not profit unduly from crowded trains, and have stronger incentives to price in such a way that passengers are attracted to less crowded trains. These broader issues of demand management will be considered further in light of the value for money work currently being completed by Sir Roy McNulty.

6.10 We have noted the Public Accounts Committee recommendation that train operators should be required to increase capacity in response to rising demand levels. However, we remain concerned that such an obligation within a long 15 year contract would place significant financial risks on the operator. Demand growth is largely outside an operator's control and additional rolling stock does not generally cover its costs. We are therefore concerned that the PAC's recommended approach would increase the cost of franchising to the taxpayer regardless of whether the additional capacity was affordable or represented the best use of limited public funds across transport as a whole.

7. Service quality

Consultation proposals

7.1 The consultation proposed that future franchises could include an outcome based service quality measure. It was proposed this would cover factors such as the cleanliness of trains and stations; provision of travel information; provisions to purchase tickets; security and staffing. The consultation suggested that this measure could consist of a passenger opinion element and/ or a quality survey element.

Consultation responses

7.2 Operators were supportive of this proposal, predicting it would ensure rail remains attractive to passengers. However, some argued that non-achievement of these measures should only result in an improvement plan, not franchise default. Others cautioned that such a measure could be expensive to implement and would lose the long term perspective currently provided by the National Passenger Survey.

Additional consultation responses

7.3 A charity and several user groups proposed that the measure should encourage high quality service provision for specific groups, such as disabled people and the elderly. An industry group highlighted the need to make the measure robust, suggesting that assessments should be made at a variety of stations, throughout the year and at different times of the day.

Revised Government policy

7.4 It is important that our reforms to the franchising process recognise the need to protect and, potentially, improve the quality of the rail service offered to passengers. In a lightly specified contract it will be especially important to protect those elements that do not provide a commercial return for the operator, but which passengers value. However, we are aware that operators often carry out non-commercial activities, incentivised by the need to protect the reputation of their company or owning group.

7.5 Schemes that enhance the quality of service may increase the costs of running the network. Hence it will be important to ensure any enhancements are strongly supported by passenger expectations, offer good value for money and are affordable.

7.6 For Intercity services revenue incentive may be sufficient to encourage operators to continue to strive to maintain and improve service quality. However, we may ask bidders to commit to quality improvements which are within their control, such as the onboard environment; station environment; customer service and information.

7.7 For regional and commuter services, we recognise that average fare levels are small and so the revenue incentive on operators limited. In other instances, the market maybe near captive and thus reductions in service quality have only a limited impact on an operator’s revenues.

7.8 We will therefore consider including contractually binding service quality benchmarks and targets within new regional and commuter contracts. These will consist of passenger satisfaction and mystery shopping scores, focused on stations, trains and customer services and information. These targets and benchmarks will be set by operators as part of their bid. Bidders proposing more demanding targets will receive better scores as part of their bid evaluation.

7.9 Where an operator fails to meet its Service Quality Targets, the Department will seek a plan from the operator as to how the service will be improved. Performance Plan and Breach Mechanisms would be available to the Government should these targets not be met.

7.10 Where this process is introduced we would remove the requirement to carry out a separate Service Quality Management System, thereby reducing the burden on operators.

7.11 We will also consider requiring operators to publish punctuality information at a more disaggregated level. As a result, the differences between services will be far easier to identify.

8. Other government bodies

Consultation proposals

8.1 The consultation recognised the importance of close working between central and local Government to deliver high quality rail services. It made clear that mechanisms for cosignatory status and for specifying local increments and decrements will remain.

Consultation responses

8.2 This approach was broadly welcomed by local authorities; regional transport authorities and user groups, many of which argued that their roles should be enhanced for future franchises.

8.3 One operator warned against any increase in the role of local authorities and regional transport authorities, arguing this could result in greater costs and industry inefficiencies.

Additional consultation responses

8.4 All regional transport authorities argued that their local insights should be used to improve future specifications; procurement competitions and franchise management. They also advocated retention of cosignatory status, with some proposing full devolution of local rail services.

Revised Government policy

8.5 The devolution of rail services in Merseyside and London has had an extremely positive effect on patronage and levels of customer satisfaction, and we wish to see this success replicated elsewhere. A key question would be the resources local authorities would need in order to manage the significant costs and risks associated with rail franchising.

8.6 In addition, we believe that the reforms noted elsewhere in this document will increase the scope for long term relationships to be developed between train operators and local authorities. We also expect that longer franchises will strengthen the business case for local improvements that might otherwise be marginal and difficult to deliver. These reforms will be further strengthened by our plans to pass the long term management and development of most stations to operators. Our enhanced requirements for train operators to consult local authorities on their plans for timetables will also increase scope of productive dialogue between operators and local transport authorities.

8.7 We will consider options for future relationships between Integrated Transport Authorities (ITAs) and operators on a case by case basis.

9. Investment

Consultation proposals

9.1 The consultation made clear the Government's view that private sector investment should be an essential element of future rail franchises. It proposed that operators should have a greater role in infrastructure maintenance and enhancements, as well as more freedom in running and improving their stations.

9.2 The consultation also suggested that a streamlined mechanism for operators to recoup the 'residual value' of their investments should be included in new franchises. It was suggested that the combination of this mechanism with longer franchises might encourage more operators to purchase trains directly, rather than using rolling stock leasing companies (ROSCOs).

Consultation responses

9.3 There was strong support from virtually all respondents to the suggestion that operators should have greater control over the stations they manage. Stakeholders felt this would result in more station investment, delivered more quickly and efficiently. Some parts of the industry queried this approach in relation to major stations only, suggesting that Network Rail was best place to continue to manage such stations.

9.4 Several operators and a regional transport authority supported the consultation suggestion that operators should compete with Network Rail to undertake some infrastructure projects. GNER's refurbishment of Durham station was cited as a good example of an efficient operator led project.

9.5 The vast majority of respondents supported the proposed 'residual value' mechanism, agreeing this would deliver more investment in the network throughout a franchise term. Some parts of the industry emphasised the importance of careful legal drafting of these provisions to ensure the Government did not become liable to fund shortfalls.

9.6 ROSCOs challenged the suggestion that the proposed reform package would encourage more operators to purchase rolling stock directly. They argued that few operators would have the necessary funds to do this, as well as querying the lack of incentives for operators to maintain rolling stock to a high, interoperable level.

Additional consultation responses

9.7 One ROSCO suggested that future franchise agreements should place less emphasis on new trains and more emphasis on high quality refurbishments. They estimated that this could deliver savings of between £1.7bn and £2.8bn over a ten year period.

9.8 Several regional transport authorities advocated a greater role for themselves in station management, arguing this would allow for more integration with other transport modes.

9.9 Some operators; user groups and members of the public suggested that the residual value mechanism could be extended to 'non-asset' investments such as marketing; staff training and cost reductions.

Revised Government policy

9.10 One of the goals of our reforms is to incentivise operators to commit long term investment in the improvements that matter most to passengers. We believe that granting longer franchises will help achieve this. However, mechanisms will be required to encourage investment throughout the term of the contract.

9.11 We therefore propose to include a revised and enhanced residual value mechanism that will reward operators for investment with a pay back period longer than their franchise term. This will involve guaranteeing a value for those assets at the end of the franchise. It will therefore be important that such enhancements increase the value of the franchise and that they are maintained in a good condition for the next franchisee. We believe that this mechanism will encourage greater investment in passenger facing facilities. But for such reforms to succeed, processes within the Department must be efficient enough to make decisions to timescales that reflect the commercial realities of the business.

9.12 The very large stations that typically provide facilities for multiple operators are managed by Network Rail. However, the management responsibilities for most other stations are split between a franchisee and Network Rail. The Government believes that the management of stations would benefit from clear ownership by a single party. The choice of that party should be guided by how well placed they are to understand and target investment to improve the experience of passengers, as well as balancing the opportunities for long term and short term maintenance and enhancements.

10. Pre Qualification

Consultation proposals

10.1 The consultation proposed continued use of the European Foundation of Quality Management (EFQM) model for pre-qualification.

Consultation responses

10.2 A member of the public challenged continued use of the EFQM model, arguing that it prevents new entrants to the market, especially those from outside the UK.

Additional consultation responses

10.3 Some operators suggested semi permanent and automatic accreditation mechanisms. However, the Department has concluded that these suggestions raise irreconcilable issues of fairness and competitive transparency.

10.4 Other operators were broadly supportive of the current process, while expressing a preference for the required responses to be simplified.

Revised Government policy

10.5 The Government wants to simplify the franchising process and so reduce costs both to the taxpayer and the wider rail industry. We acknowledge that the current prequalification process places significant burdens on the bidders.

10.6 However, we also believe that pre-qualification is an important step in the procurement process and have therefore rejected the idea of abolishing this element. The Government believes that prequalification reduces the overall cost of a franchise replacement since it reduces the number of full bids that have to be prepared by bidders and subsequently assessed by Government. Limiting the number of bidders through prequalification will reduce overall costs. Prequalification also allows the performance of current operators to be reflected in the short listing decision for new franchises.

10.7 We propose to simplify pre-qualification by reducing the elements assessed as part of the EFQM process, focusing in the results the bidder has achieved in other transport operations. This reduces the number of EFQM questions from 32 to 8. We will continue to require bidders to set out their plans for the franchise, with these elements given greater weight within this process. Overall the size of each prequalification response will be reduced to around 50 pages (compared to 80 on the recent South Central competition).

10.8 We believe these reforms will reduce franchise bidding costs, and focus the process on the most important elements – actual results, future plans and ideas for the franchise.

11. After prequalification

Consultation proposals

11.1 The consultation document suggested that bi-lateral discussions could be held prior to the issuing of an Invitation to Tender. It was also suggested that the ‘Competitive Dialogue’ procedure could be used to inject additional bidder ideas into the franchise specification.

Consultation responses

11.2 One operator opposed any change to the Department’s existing procurement practises, arguing that these are rigorous and well understood by the bidding community. The majority of respondents opposed use of ‘Competitive Dialogue’ arguing that it was not suited to the rail franchising market.

11.3 Much of the industry and several regional passenger authorities supported the proposals of early engagement with pre-qualified bidders, prior to the issue of an ITT. It was felt that this approach would help bidders to refine their proposals, as well as encouraging closer working with Network Rail.

Revised Government policy

11.4 In future we will be more open with prequalified bidders about what our Invitation to Tender (ITT) might include. This should provide bidders with the opportunity to comment on what we are likely to require, allowing them to alert us to any areas where they believe we have got things wrong, or where our requirements run counter to their ideas. Giving proven transport operators the chance to comment on the ITT will mean that our requirements will better reflect what the railway can deliver.

11.5 We intend that after pre-qualified bidders have been announced, the Department will discuss and refine key elements of the specification with bidders during a period of at least 6 weeks.

12. Franchise award

Consultation proposals

12.1 The consultation proposed that winning bids would be selected on the basis of their compliance; subsidy/ premia and deliverability, as well as acceptable commitments in relation to crowding and customer satisfaction. It was also suggested that investment undertakings and broader economic benefits could be considered in selecting a winning bid.

Consultation responses

12.2 Several pressure groups and a regional transport authority supported the suggestion that broader economic benefits should receive credit. For example, it was suggested that proposals to reduce road transport in national parks and historic towns should be rewarded.

Revised Government policy

12.3 The Government believes it is important to clearly set out how a franchise contract will be awarded. It is imperative that each franchise competition makes clear how bids will be judged. This will ensure that the taxpayer receives good value from competitions and bidders know what they need to do to win.

12.4 The key principles for franchise award will be value for money, financial robustness, subsidy/premia and the additional quality offered by bidders (where this is above and beyond the level required by the Department as the core). The exact balance of these factors will vary, however, and the mechanisms for judging between bids will be designed to fit the individual franchise.

12.5 The procurement process will be re-balanced to provide a greater focus on the quality of bid proposals. This will be achieved by placing greater emphasis on the franchise specific proposals at prequalification and will be supplemented by changes to the bid assessment processes. The Department will change the bid RADAR scoring methodology so that more points are available for the bidder's specific approach. This will give them greater opportunities to distinguish themselves from competitors by the nature of their proposals.

12.6 For some franchises, the Department is considering a separate points system that recognises the service quality measures proposed (and committed to), by bidders. The features that can win such quality points will be made clear to bidders in the invitation to tender, and will vary for individual franchises. This new approach will separate the quality of service proposed from competence to deliver the contracted services, aspects of the bid that are currently mixed together in a single deliverability score. Competence to deliver will be assessed as a pass/ fail criteria.

12.7 Where appropriate, we will redefine points so that they are available only as a reward for additional benefits. In addition, the way in which they are used in assessment will be refined. If more than one bidder meets the wider bid criteria and is offering a good price to the taxpayer, the quality score will be decisive. A wider materiality threshold will typically be used than has been the case in previous competitions. As a result bidders will not have to be so close on price before a significant improvement in quality becomes a determining factor. Consequent changes will be made to the way in which quality and price are traded off in the decision. This will prevent a situation where the process results in DfT paying a relatively high cost for a relatively minor improvement.

13. Managing and performance

Consultation proposals

13.1 The consultation made clear Government's role in protecting the interests of passengers and the taxpayer. It proposed to achieve this through partnership working with operators, but made clear that decisive action will be taken were performance is not satisfactory.

Consultation responses

13.2 This approach was generally welcomed by respondents, with some arguing that good performance should attract financial bonuses and others suggesting poor performance should result in financial penalties.

Additional consultation responses

13.3 A user group suggested that operators could be required to publish their crowding date and performance information by route. It was suggested that this would provide extra transparency and allow passengers to hold operators to account. It was also pointed out that this information already exists and its publication would attract minimal additional costs.

Revised Government policy

13.4 We will continue to set demanding performance targets for train operators. They will be liable to contractual breach or default where these are not achieved.

13.5 We continue to consider whether better alignment can be made between the franchise agreement targets and targets set out within the JPIP process.

13.6 Sir Roy McNulty's Rail Value for Money Study is considering a variety of options to make the industry more efficient. For example, we may seek proposals for a contractually binding unit cost reduction target as part of franchise bids. We are also considering a role for the Office of Rail Regulation in relation to the protection of passengers, and this may impact on forthcoming franchises.

13.7 The number of plans that bidders are required to produce will be reviewed for each franchise – they will be kept to the minimum needed for the Department to judge bids fully and understand the potential risks and benefits for taxpayers and passengers. We expect this will see the bids reduced in length and complexity compared to recent competitions; further reducing costs to all parties. However bidding will remain a major and resource-intensive process; this is appropriate given the value, length and importance of future rail franchises. Government needs to ensure it is appointing competent operators who are able to deliver for the passenger and taxpayer.