THE FRANCHISING OF PASSENGER RAIL SERVICES

The Main Text of a Consultation Document issued by the Department of Transport on 12 October 1992.
IMPORTANT NOTICE

The purpose of this consultation document is to elicit views from its recipients on the ways in which the franchising of passenger services may best be carried out and to gain information about the areas, geographically and in terms of specific activities, which may be of most interest to potential franchisees. In that connection the document provides preliminary information about the franchise proposals and the existing passenger businesses of British Railways Board. It does not constitute an offer or invitation for the purchase or acquisition of securities or any interest in any of the passenger businesses and is not intended to form the basis of any future investment decision.

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CONSULTATION DOCUMENT ON THE FRANCHISING OF PASSENGER RAIL SERVICES

Introduction

i) The White Paper 'New Opportunities for the Railways' (Cm 2012) published in July set out the Government's proposals for maximising private sector involvement in the operation of railway services. Central to the proposals for passenger services is the intention to franchise their operation. The purpose of this document is to explain the proposals for passenger franchising in more detail and to seek the views of prospective franchisees and other interested parties, such as financial institutions, on:

- the ways in which the franchising of passenger services might best be carried out, and

- the areas, geographically and in terms of specific activities, which would be of most interest to them.

ii) The Government wants franchising to be responsive to the market, and to ensure that it is, it needs to learn what services the private sector would be interested in operating under a franchise, and what information prospective franchisees would need in order to bid for a franchise.

iii) The White Paper made clear that there would be no universal template for a franchise contract - different passenger services have different characteristics. The Government's intention is that the private sector should assume as much responsibility as possible for delivering passenger services - employing and managing the necessary resources, taking the responsibility for the safety of their operation, assuming revenue risk and, where appropriate, promoting new investment. It should be the private sector franchisee who has the direct relationship with the rail passenger.

iv) The Government believes the key to maximising private sector involvement, and maximising the gains to passengers, is to adopt a flexible approach - to allow private sector companies as much freedom as possible in bringing their skills to bear. There will, inevitably, be some constraints.

v) Although the intention is to take full account of the interest expressed by private sector companies, it will be necessary to decide how services should be grouped for franchising and what functions individual franchisees should cover so that the private sector can be invited to compete for franchises through a competitive tendering process. Decisions on the grouping of services will need to be taken well in advance of the despatch of invitations to tender so that arrangements can be made to reorganise the current activities, and so that financial and other information on the services covered by an individual franchise can be made available to bidders. In order to ensure that adequate financial and other information can be made available to bidders on the first service groups to be franchised they will have to be identified as soon as possible.
vi) It is envisaged that the franchising of passenger services will be undertaken progressively, rather than in a single 'big-bang'. Decisions on the phasing of the programme will take account of the responses to this consultation document. The Government's intention is that a substantial proportion of passenger services should be franchised within the lifetime of the current Parliament, subject, of course, to Parliamentary approval of the necessary legislation. Competitions for the first franchises are expected to start in 1994.

vii) This document attempts to set passenger franchising in the context of the Government’s overall privatisation plans, to describe the ways in which the franchising process is expected to work in practice, and to provide an overview of the passenger rail business as currently provided by BR.

viii) BR's passenger operations are currently divided into three passenger businesses - InterCity (high speed, inter-urban services); Network SouthEast (the London commuter network plus local services in the south east of England); and Regional (urban, rural and some cross country services outside the south east). A detailed description of each of these businesses is set out in Annex B to the full published version of this document but, to give an indication of the scale of each, the turnover and ridership figures are:

<table>
<thead>
<tr>
<th></th>
<th>InterCity</th>
<th>Network SouthEast</th>
<th>Regional</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>£896.7m</td>
<td>£1044.3m</td>
<td>£312.9m</td>
</tr>
<tr>
<td>Grant</td>
<td>nil</td>
<td>£174.9m</td>
<td>£592.0m</td>
</tr>
<tr>
<td>Passenger journeys</td>
<td>77m</td>
<td>500m</td>
<td>200m</td>
</tr>
</tbody>
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*Figures for 1991/92
Source: British Railways Board*

ix) Each of the three BR passenger business is further divided into a number of profit centres - five in the case of InterCity, nine in Network SouthEast and five in Regional. These are currently the smallest accounting units within BR for which financial data can be readily produced (although these figures still rely to an extent on BR's internal allocation procedures). BR will produce separate accounts for infrastructure and service operations using current conventions from April 1993. One objective will be to structure the new accounting system so that, as far as possible, it is possible to generate financial information about the particular service groupings for which potential franchisees are most interested in bidding.
Franchising Passenger Rail Services

The purpose of this document is to describe how it is envisaged the franchising of passenger rail services will work, in such a way that potential franchisees can respond with indications of their interests, and
> with comments on the franchising process itself.

The structure of this document is based around providing answers to the following questions:

Section 1. how does the franchising of passenger services fit into the Government's overall policy for railway privatisation?

Section 2. who will be involved in franchising (who will be responsible for setting the terms upon which franchises will be granted, and with whom will a franchisee need to deal)?

Section 3. what might a franchise look like?

Section 4. what rights will a franchise contract grant to the franchisee, and what obligations might it impose?

Section 5. what resources will a franchisee need in order to take on a franchise, and how might he get them?

Section 6. what types of money flows will there be to and from the franchisee, what will a franchisee's capital requirements be, and against what opportunities and risks will they be set?

Section 7. how will franchises be awarded?

and finally

Section 8. how should you respond to this document?

Annex A sets out the steps likely to be involved in obtaining one of the first franchises.

Annex B to the full published document provides a detailed description of BR's existing passenger businesses.
Section 1

The Privatisation Proposals

- How does the franchising of passenger services fit into the Government's overall plans for railway privatisation?

1.1 The Government's proposals for privatisation of passenger rail services centre on franchising. The other key elements of the Government's railway privatisation policy are:

  - the creation of arrangements for granting access to the national track network for passenger franchisees and others seeking to run passenger or freight services, subject to their obtaining the necessary licences;
  - the establishment of a Rail Regulator to oversee those arrangements, protect the interests of rail users, issue licences to service operators, and generally promote competition and the efficient use of the railway;
  - the restructuring of BR to create a new, discrete, national track authority - Railtrack - responsible for timetabling, operating signalling systems, and track investment and maintenance;
  - the establishment of a framework of safety regulation which will guarantee that necessary safety performance is maintained and observed across the railway;
  - the involvement of the private sector in running and developing stations - either as part of franchises, or separately;
  - the outright sale of the freight and parcels businesses.

1.2 All of this is subject to the necessary legislation being approved by Parliament and receiving Royal Assent. The timescale envisaged is that a Railways Bill will be introduced at the end of 1992 and, subject to approval by Parliament, receive Royal Assent in 1993.

1.3 Following Royal Assent, the Regulator will assume his full duties in relation to the new rights of access to the British Rail network. The Government has employed consultants to advise on the principles for governing access to and charging for use of the track network. The Government plans to make known its decisions on the principles before the end of 1992, so that systems can be established for full implementation of the domestic access and charging regime from April 1994.
1.4 A Franchising Authority will also be appointed following Royal Assent, with the responsibility of franchising passenger services on the Government's behalf. It will arrange the competitions for granting franchises and monitor franchisees' performance. By the time formal Invitations to Tender for the first franchises are despatched by the Franchising Authority, the Regulator will be in place and the rules for access and charging will have been published.

1.5 BR will be restructured so that its infrastructure and services are managed separately. The objective is that Railtrack, which will own the track and other infrastructure, will become a subsidiary of BR with effect from April 1994. It will not be subsidised - subsidy being targeted directly to the provision of services - but it will be eligible for capital grants in certain circumstances. Railtrack will be expected to make a return on its assets and to charge operators for use of its track and other infrastructure. Railtrack's charges and allocation of trainpaths will be overseen by the Regulator.
Section 2

Who will be involved in franchising?

2.1 Some new organisations will be brought into being as a result of privatisation (eg the Franchising Authority); other bodies will have the same or a slightly different rôle to that which they play at present (eg the Health and Safety Executive). The section below sets out the nature and the responsibilities of some 'key players' who will be involved in franchised passenger services, and covers key aspects such as safety.

2.2 Three new players will have a significant rôle in franchising, the Franchising Authority, the Regulator and Railtrack.

The Franchising Authority

Granting franchises and paying subsidy

2.3 The Franchising Authority will have the specific task of franchising passenger services. Its head will be appointed by the Secretary of State for Transport, who will set high-level objectives on the way that franchising is to be undertaken. These will provide guidance on:

- the way that services should be grouped,
- the levels and quality of service the Franchising Authority should be seeking from franchisees,
- in what circumstances and to what extent fares might be controlled,
- how bids should be assessed, and
- the pace of the franchising programme.

Initially, these objectives will require the Franchising Authority to base the pattern of passenger services to be provided on BR's existing service levels.

2.4 The Franchising Authority will collect premiums from franchisees on profitable franchises, and be responsible for paying subsidy to franchisees where necessary, within overall budgetary constraints set by the Secretary of State. The Franchising Authority will thus be the main conduit of subsidy for passenger railway services. But local authorities will also have a continuing involvement here, particularly in the main conurbations outside London.
2.5 PTAs and PTEs are currently responsible for deciding rail service levels and paying subsidy in one Scottish and six English metropolitan areas - Strathclyde, Greater Manchester, Merseyside, Tyne & Wear, West Midlands, South Yorkshire, and West Yorkshire.

- Passenger Transport Authorities (PTAs) are joint authorities comprising councillors nominated by the various district councils covered by each Authority. They are responsible for the broad strategy of public passenger transport provision in their areas. Passenger Transport Executives (PTEs) are the professional bodies charged with administering PTA policies.

2.6 When franchising is introduced, the PTAs/PTEs will continue to be responsible for deciding appropriate service levels in their areas, and for paying for them, but the franchises will be let by the Franchising Authority. This is necessary because the sensible grouping of services for franchises will not necessarily fit within PTE boundaries.

2.7 Other local authorities will also have powers, as they do now, to pay 'top-up' grants to secure service enhancements in their areas. If, for example, a local authority wished to contribute toward the cost of providing an additional late-evening train, it is envisaged that it would approach the relevant franchisee directly. Local authorities, including PTEs, will continue to have powers to make capital grants, for infrastructure projects such as station improvements or the purchase of assets such as new rolling stock.

The Regulator

Railway regulation and licensing

2.8 The Regulator will also be appointed by the Secretary of State for Transport. He or she will have specific statutory duties, including:

- to protect rail consumers' interests;
- to promote competition; and
- to promote and maximise the efficient use of the railway network.

2.9 The Regulator will be responsible for licensing railway operators. All infrastructure and train service operating companies will need to obtain a licence from the Regulator before they can run services. The licence will be a certificate of competence to operate one or more aspects of railway activity, eg running trains, operating track and signalling, or running a station. To obtain a licence an operator will need to undergo a safety validation process (see para 2.17 below). Licences will also impose certain obligations. For example, all operators, including franchisees, will be required to have insurance cover; and operators involved in passenger services, including station operators, will be required to have regard to the needs of passengers with mobility handicaps.
2.10 In relation to franchising, the Regulator will have a specific interest in the allocation of trainpaths to franchisees and the impact that this has on track use more widely. The Regulator will therefore need to examine the contracts between the Franchising Authority and franchisees before they are signed. He might require changes to be made to the service pattern specified, for example if it clashed with the objective of maximising the efficient use of the network, or if it reduced competition. In looking at franchise contracts, the Regulator will need to have regard to passengers' interests, and to the budgetary position of the Franchising Authority.

Railtrack

The track network and BR’s rôle

2.11 Railtrack will be a subsidiary of BR. It will own and operate railway infrastructure - the tracks and signalling systems. Railtrack will be responsible for promoting efficient use of the national railway network by:

- allocating access and compiling the operating timetable (in accordance with the principles laid down by the Regulator),
- managing the day to day operation of the track and signalling and
- undertaking investment in infrastructure.

2.12 A franchisee is unlikely to be the sole user of a stretch of line. Freight services will continue to inter-run with passenger trains and other operators may wish to run new passenger services. For example, InterCity and Regional services often run over the same stretches of track, although their services may be targeted toward very different markets. It will be for Railtrack to balance the requirements of different track users and draw up the operational timetable, subject to the Regulator’s oversight.

2.13 As a subsidiary of BR, Railtrack will be subject to the same direct financial controls as other nationalised industries. In due course it may be possible for track to be sold outright to the private sector. However, once sold or leased, the track needed for passenger services will remain subject to the general right of access, and the terms for granting access and the charges levied will be subject to the Regulator’s oversight.

2.14 Railtrack will operate at arm’s length from the rest of BR. Apart from Railtrack, BR will have a continuing, but declining, rôle in operating passenger services. It is expected that franchises will be awarded in a rolling programme, and that BR will continue to operate those passenger services waiting to be franchised. BR will therefore need to be a party to any revenue sharing systems needed, for example to facilitate through ticketing between stations in one part of the country and another. BR will not, however, be allowed to compete with the private sector for franchises (although BR managers and employees will be encouraged to bid for franchises on the basis of management-employee buy-outs - see para 7.5 below).

2.15 The Secretary of State for Transport will, as now, be responsible for the financial regime of BR as a nationalised industry. He will continue to set objectives for BR - both
for Railtrack and for those passenger services that BR continues to run for the time
being.

2.16 In addition to these bodies, franchisees will also come into contact with a number
of other players in order to run services, in particular with respect to safety, and in
obtaining access to the assets and systems they will need.

Safety

Safety validation and monitoring

2.17 The Government has asked the Health and Safety Commission to arrange for a
thorough study of the safety implications of its railway privatisation proposals and to
make recommendations. Their advice will be published. It is expected that the
framework of safety controls will have three main elements:

Validation before commencing operation, new railway operators will be
required to demonstrate that their safety management systems
and day-to-day operating systems will ensure that their services
run safely. The issue of an operating licence will be conditional
upon the satisfactory completion of the safety validation process.
Operators will have to comply with specific safety standards set
or recognised by the Health and Safety Executive (HSE), which
incorporates HM Railway Inspectorate.

Certification staff who are critical to safety, including drivers and signalmen,
will be certificated to standards approved by the HSE.

Monitoring individual operators will have the primary responsibility for
ensuring the safe management of their own operations. Their
performance will be monitored to ensure that they are adhering to
the required standards.

Assets and systems

Access to operating assets and facilities and network systems

2.18 In order to provide services, franchisees will need to have access to use or
operate certain assets, such as rolling stock, maintenance facilities and stations and to
use common systems, for example to process revenue from ticket sales.
Rolling Stock

2.19 The Government expects to see rolling stock leasing and secondhand markets develop. Initially, existing BR rolling stock will be made available to franchisees, but it will be possible for franchisees to look elsewhere, for example to purchase new or refurbished stock outright, or, perhaps more likely, to enter into leasing agreements with asset leasing companies or financial institutions. The options are discussed in more detail in Section 5 below.

Rolling stock maintenance facilities

2.20 In addition to arranging for rolling stock to be provided, franchisees will need to make arrangements for the maintenance of the rolling stock they will use.

2.21 Rolling stock maintenance facilities will be sold or leased to the private sector, although some will remain in public sector ownership and operation at the outset. The need for access to maintenance facilities will be reflected in the structure of franchises.

2.22 Franchisees will have a degree of choice over which facilities they use for different levels of maintenance. BR currently classifies maintenance into four levels, short of complete refurbishment, from fuelling and visual inspection through to replacement of life-expired components. Clearly the more substantial maintenance requires more comprehensive engineering facilities.

2.23 The options for the future of existing maintenance facilities are discussed in paras 5.23 - 5.25 below. Information for each profit centre about the location of maintenance depots used by a particular profit centre and maintenance depots shared between a number of different profit centres is included in Annex B to the full published document.

Stations

2.24 The Government wishes to extend private sector involvement to the operation and development of stations. Station buildings are often underused, presenting retail and development opportunities in or near the centre of towns. It is likely that different approaches will be appropriate for different stations. Large termini in cities clearly provide different opportunities from small stations on branch lines in rural areas. The Government has indicated that it will be possible for stations (or more probably a leasehold interest) to be sold.
2.25 Franchisees may be interested in taking over the management of stations served by their trains for the duration of their franchise, in particular:

- the operational areas and ticket offices, where they will want to be responsible for the interface with passengers, and
- in order to take full advantage of the opportunities to realise income from station trading and retail activities.

A franchisee might therefore wish to operate the stations along the line of route served by his trains, whilst a developer might wish to acquire the right to develop them. There could be scope for joint ventures.

2.26 A key part of the proposals for maximising the use of stations is that the operational areas (eg the platforms and sidings) are protected for railway use, and open access to them is protected through the licensing system, in the same way as for the track itself. Station operators will therefore have to obtain a station operator's licence. Access and charging for the use of stations will be overseen by the Regulator.

Systems

2.27 Franchisees will need access to certain systems in order to run their businesses - for example telecommunications and lineside information technology. Much of that will be provided by Railtrack. Franchisees are also likely to need to develop relationships with other parties for the collection and allocation of revenue. For example, most franchisees will derive material amounts of revenue from ticket sales by other operators or by independent ticketing agencies.

2.28 As a network industry, the railway offers good opportunities for generating business from passengers who want to travel from one part of the country to another across the system. This means that it will probably be in operators' own commercial interests to cooperate in offering facilities like through tickets. There will also be cases where operators have an interest in ensuring mutual acceptance ('cross validity') of tickets issued by other operators.

2.29 In order to agree the joint working arrangements that will be needed to provide these facilities, it is envisaged that a Joint Industry Body will be created, which all franchisees and BR (whilst it runs services) will be expected to join. The Joint Industry Body will provide a forum for agreeing revenue apportionment and allocation mechanisms, so that franchisees are not forced to enter into separate negotiations with every other service operator on the network.

2.30 The Regulator will be responsible for ensuring that ticketing arrangements are not anti-competitive. He will also have powers to ensure that 'cross validity' is provided by operators in some circumstances (see para 4.7 et seq).

2.31 Paragraph 5.9 et seq below specifically address the mechanics of revenue collection and apportionment.
Section 3

What might a franchise look like?

3.1 No decisions have yet been taken on the design of franchises: the duration and geographical extent of franchises, and the functions to be carried out by franchisees. The aim will be to preserve as much flexibility as possible in these areas to take full account of the private sector’s views, including those expressed in response to this consultation document, on how it can best bring its skills to bear. There is a trade-off to be made between three elements:

- the need to package services in a way that will ultimately allow for the operation of all services by the private sector;
- the need to enhance competition whilst giving private sector operators as much freedom and flexibility as possible to meet passengers’ needs; and
- the desire to move swiftly and let franchises for a substantial volume of services within the lifetime of the current Parliament.

3.2 The quickest way to divide up the BR passenger network into separate service groups for franchising would probably be to base the service groups on the existing profit centres, but proposals for franchising other groupings or even individual services will also be entertained providing that they would not leave a residue of services that could not then be operated efficiently. It should be recognised that the greater the degree of disaggregation - down to lines or branch lines or even individual services - the more complex, and therefore time-consuming, it will be to separate out the business and to provide adequate financial information. Nevertheless, the aim is to devise a system which can reflect prospective private sector bidders’ views.

3.3 The shape of a franchise as it is currently envisaged is set out below:

- there will not be a standard duration for all franchises, the length of each franchise will be decided in the light of bidders’ responses;
- services will be grouped in a way that makes commercial and operational sense, based on the need to secure the efficient use of assets such as rolling stock; has regard to the markets to be served, in particular reflecting local and regional identity; and, as far as possible, provides scope for competition;
- the franchisee will take on the responsibility for managing all aspects of train operation, including traincrew, on-board services and service marketing. The franchisee might also invest, or make his own arrangements, for providing rolling stock and other operational assets;
the franchisee will generally be free to set fare levels and offer different ticket types subject to any restrictions imposed, where rail enjoys
significant market power or where the fares structure is specified by a
PTE.

the franchisee will bear both operating cost and revenue risk. In other
words, the franchisee will pay all the costs involved in operating the
franchise, and receive all the passenger revenue and other income (eg
where appropriate from station trading) attributable to the franchised
services, as well as any subsidy payment.

3.4 Another option which might be considered in particular circumstances would be
for the franchisee also to undertake capital investment in infrastructure, eg the
upgrading or electrification of a line, and so take on a 'vertically integrated' franchise
covering the operation of track and signalling as well as trains. In operating the track,
the franchisee would come under the Regulator's oversight in relation to access for any
other track users.

3.5 The passenger rail franchisee will be able to operate with his own brand image,
tailoring the provision of services in such a way as to minimise operating costs and
maximise revenue, whilst complying with a performance specification in the franchise
contract which will set minimum levels and standards.
Section 4
Franchisees' rights and obligations

What rights will a franchise contract grant to the franchisee and what obligations might it impose?

4.1 A franchise for passenger services will grant the franchisee certain rights, and require him to meet certain obligations.

- The franchisee will have the right to provide an identified group of services, be guaranteed the necessary track access (trainpaths) to do so, will receive passenger revenue and any other income his services generate, and, where necessary, receive subsidy.

- On the other hand, there will be obligations on the franchisee to provide at least the minimum level of services specified in his contract, and to meet at least the minimum standard specified therein, for the duration of the contract.

The process by which the specified level of services will be decided is discussed in more detail in Section 7 of this document. Specified quality standards will be set where necessary to protect passengers' interests and may cover broadly the same areas for which BR is currently set performance measures, including, for example, punctuality, reliability, train cleanliness and overcrowding.

4.2 The Franchising Authority will be responsible for monitoring the performance of the franchisee during the franchise period. If the franchisee fails to perform to the required standard he will be in breach of contract and liable to penalties including, in the last resort, the loss of the franchise. The franchisee will be expected to publish his own code of practice for dealing with passengers and providing compensation to passengers if standards of service fall below a certain level, as BR does in its Passenger's Charter.

4.3 On access to track and other infrastructure, the current assumption is that the existing national passenger timetable operated by BR will be the starting point for specifying the services which franchisees will be invited to provide, and that franchisees will be granted rights to the train paths they require to run those services. Other operators may be permitted to offer competing, as well as complementary, services.
4.4 Where the Franchising Authority has decided that a franchise should be let to provide loss-making services on the basis of subsidy being paid, the amount of subsidy required by different bidders will be a key element in deciding the outcome of the competition for that franchise. Once the subsidised franchise contract is let, only the winning franchisee will be eligible to receive subsidy for the particular services in question. In other words, the franchisee will have an exclusive claim on grant for the given service or service group specified in his franchise contract, but not an exclusive right to run all the services on any particular route. The degree of competition for passengers that a franchisee will face from other rail operators is perhaps unlikely to be high where subsidy is having to be paid.

4.5 The franchisee may wish to make minor changes or seasonal adjustments to his timetable during the franchise. He will be able to do this without the need for formal review of the franchise contract, subject, of course, to whatever constraints exist on changes to the timetable because of interdependencies and congestion on parts of the network. These constraints may mean that timetable changes are only possible at fixed, regular intervals.

4.6 In addition, it is recognised that the franchisee will wish to be able to adjust the level of services provided during the franchise in response to significant changes in demand. It is envisaged that the franchise contract will enable the franchisee to reduce services to a specified level in the event that the demand for passenger services declines by more than a specified amount during the franchise period for specified reasons outside the franchisee's control. If the demand for passenger services increases during the franchise period, the franchisee will be able to offer additional services on a purely commercial basis, subject to the availability of the required trainpaths. Formal review might, again, be warranted if increases in passenger demand cannot reasonably be catered for by the franchisee, such that he is unable to comply with his specified capacity/overcrowding target.

4.7 As noted in para 2.28, there are good commercial reasons for operators to participate voluntarily in offering opportunities to travel widely around the network. Certain safeguards will also be built in to protect passengers' interests. In overseeing the process of granting access and compilation of the timetable, the Regulator will have regard to the need to promote rail passengers' interests. He will therefore be concerned to see that interchange possibilities are maintained. On ticketing, operators will be required to participate in arrangements to provide through ticketing but, as now, the full range of ticket types may not be available from every station.

4.8 The Regulator will have powers, through the licensing system, to oversee and facilitate joint-ticketing agreements, and he will ensure that these do not operate to passengers' disbenefit in an anti-competitive manner. Franchisees will need to have certainty over the extent to which their freedom to set and collect fares will be limited by compulsion to participate in schemes providing cross validity of tickets between operators. The Regulator will therefore need to make clear his view on this at the outset of each franchise competition. Once the franchise is awarded and the contract let, the Regulator would only be able to negotiate, rather than impose, changes with the franchisee and any other relevant operators to introduce or change a cross validity scheme imposed through a licence condition.
Section 5

Resources

- What resources will a franchisee need in order to take on a franchise and how will he get them?

5.1 In order to be able to fulfil his franchise obligations, it is expected that the franchisee will need:

a) to have guaranteed rights of access to track and other infrastructure, and use of the relevant stations;

b) to receive passenger revenues, and have access to common services such as telecommunications and information systems;

c) to own or have use of the necessary operational assets - mainly rolling stock and maintenance facilities; and

d) to employ the relevant staff engaged in operations.

This section describes how the arrangements might work for each of these four areas, explaining, in particular, the transfer mechanisms that are envisaged.

a) Access to track and stations

5.2 The company taking on a franchise will need its own contract with Railtrack, covering access to track and other infrastructure. This contract will probably be to a standard form. One option would be for it to be completed to include the necessary trainpaths agreed in advance between the Franchising Authority (on behalf of the company that will take on the franchise) and Railtrack. The contract will give the franchisee guaranteed rights of access for the duration of his franchise to the track and other infrastructure he requires, and set out the terms (including the charging system) that will apply. These rights will allow Railtrack to move timings of trains within certain agreed bands where this would help maximise economic usage of the track and allow on new operators.

5.3 A franchisee may wish to provide services in addition to those specified in his franchise. Assuming that there are trainpaths available, it is expected that he will have either to bid for the additional train paths he requires (if there is competition for them) or to negotiate bilaterally with Railtrack (if no other operator wants the train paths).

5.4 No decisions have yet been taken on the rules governing the charges franchisees and others will have to pay for use of the track and other infrastructure. However, the charges may be affected by the amount of new investment in infrastructure to be undertaken by Railtrack. Railtrack will plan its investment programme in the light of its interpretation of market demand from rail service operators, since the cost of
investment will be recouped through track charges. The Government is also ready to provide direct support for infrastructure investment projects which, although not earning an adequate rate of return, provide a satisfactory cost/benefit return when wider benefits are taken into account.

5.5 Rail service operators, including franchisees, will want to be involved in planning new investment in infrastructure over the period of their franchise because:

- it may allow improved services to be offered to passengers, eg, reduced journey times;
- it will affect service scheduling, if major works are envisaged, and
- there may be an impact on track charges and rolling stock opportunities eg if electrification of a route is being proposed.

There will clearly need to be a degree of liaison between Railtrack, the Franchising Authority and franchisees on the planning of infrastructure investment.

5.6 In addition, it is envisaged that specific quality of service objectives and cost-related performance aims will be set for Railtrack. Appropriate incentives will be provided to ensure that Railtrack maximises the economic use of track and other infrastructure. The open access regime will continue to apply to infrastructure needed for passenger services that ceases to be operated by Railtrack because it has been sold outright or is being operated under a leasehold agreement.

Arrangements for use of stations

5.7 As noted in para 2.25 above, a franchisee may take on the operation of stations served by his trains. But that is just one option. Where the franchisee does not wish to own or manage a station he serves, he will need access to the relevant parts of the station, for which the station owner will impose a charge. Lease covenants and conditions in the station operator's licence will ensure that the interests of franchisees and other operators and passengers using the stations are protected.

5.8 Arrangements for the use of stations will need to be taken into account in determining who should control and staff ticket offices. Where a franchisee is the sole user of a station, the ticket office might be assigned to him. At larger stations where there are several users who are, to some extent, in competition with each other, operators might prefer to see the ticket office controlled and staffed by an independent party eg the station owner, with whom each operator would have a contractual relationship. There is also the option to have more than one ticket outlet at a station.
b) Revenue Collection

5.9 A franchisee will receive the fares for passenger journeys made on his services. At one extreme tickets can be sold on train (for example, on a short rural train), but at the other (for example a journey involving interchange between operators) the fare may be collected elsewhere on the network, or by another agent entirely, eg a travel agent. It is therefore likely that some fares revenue, in some cases a substantial proportion, will need to pass through a revenue allocation system.

5.10 At present BR tickets only rarely specify the route which is to be used, and this flexibility provides much benefit to passengers. A wide range of different individual train services are therefore available for any particular ticket. These train services may be provided by different profit centres and thus some method of allocating the revenue is required. For through tickets where there is a second, connecting train involved in the journey (eg from Tilbury to Leicester, changing in London) allocation between operators will also be necessary. The airlines use a system where claims for revenue from other operators must be accompanied by the actual tickets used and collected on their services. On the BR network this is impractical on short distance services, and would require much more complex and expensive ticketing, with separate tickets for each leg of a journey. Attributing revenue will therefore, involve negotiation and will need an agreed basis for allocation.

5.11 One option to provide this basis is survey information. However, given the size of the product range, it is a huge task to achieve a reasonable degree of accuracy. In addition, each timetable change will affect the split of demand between services on some routes, requiring frequent resurveying if the allocations are to be responsive to actual changes.

5.12 BR currently uses a mathematical model to allocate revenue. This is regarded by BR as being reasonably accurate, is responsive to actual changes in train services and is cost effective. The essential elements of this mathematical model are that it looks at the individual timetable available to the passenger between each origin and destination and then estimates how passengers would have split between trains, using surveys and market research. These surveys give general information on how passengers choose between trains, recording for example, preferences for particular times of day, the advantages of a through train rather than having to change trains, and how far passengers will shift their departure time in order to take a faster train. The model then applies these preferences on passengers' choice of train relatively quickly and easily (compared to the alternative of re-surveying) to any timetable change. Given the estimate of the train services used, revenue is allocated in proportion to the mileage travelled, which is the basis of allocation agreed by the existing BR businesses.

5.13 As more services are franchised and more operators come onto the network it is likely that different, possibly more sophisticated, systems may be developed. Advances in information technology and the advent of 'smart' tickets will clearly have an impact in helping to trace ticket revenue to a particular passenger journey. Some flexibility might be offered in respect of arrangements for apportioning revenue. For example, at the first stage in a franchise competition (set out in full in Section 7) a prospective franchisee might be invited to respond on the basis of using BR's existing revenue allocation systems or to propose alternative approaches. In practice, however, it is likely that, for early franchises, franchisees may need to sign up to using the
existing system (described in para 5.12). Membership of the Joint Industry Body will give operators a voice in deciding how the apportionment systems should be changed and how they should operate.

Other systems

5.14 BR currently uses a range of systems to facilitate management of the railway business and the safety of train operation in addition to those already described for revenue allocation. The principal areas these systems cover are:

- financial and management accounting;
- personnel administration and payroll;
- train planning and timing;
- operations control and monitoring;
- rolling stock maintenance; and
- control and safety systems.

Franchisees may wish to use such systems and it is possible that access might be made available, specifically to those systems necessary for train operations such as train planning and timing, allowing a franchisee to buy-in, on a non-discriminatory basis at appropriate charges. Participation in certain safety systems may be compulsory. Franchisees will be able to use the transmission links provided by BR Telecommunications on a commercial basis, or make alternative arrangements.

c) Major capital assets - rolling stock and its maintenance

5.15 Probably the most significant capital asset a franchisee will need to use is rolling stock. The franchisee will have the opportunity to purchase existing rolling stock and/or to lease or rent it for the period of the franchise. Information relating to each profit centre about the number and classes of rolling stock, and the average age of rolling stock by class, is included in the information on BR's existing passenger businesses at Annex B to the full published document.

5.16 The franchisee will be able to purchase rolling stock in one of two ways:

- he can purchase outright some or all of the existing rolling stock used by BR to provide the same service in the period prior to the award of the franchise;
- he can purchase rolling stock from the private sector, either by placing orders for new rolling stock, or by buying in the second hand market, once this develops.

5.17 In both cases the franchisee's decision will be influenced, not only by the class, the condition, and the remaining average life of the rolling stock concerned in relation
to the length of the franchise, but also by any special arrangements for the transfer of ownership of rolling stock at the end of the franchise period (see para 5.33 et seq) and by prices in the second hand market, once this develops. In addition, the franchisee may wish to consider the availability of alternative arrangements, such as the terms on which rolling stock can be leased.

5.18 It should be noted, in relation to the procurement of capital assets and also of works and supplies contracts by franchisees, that the provisions of the EC Utilities Directive will to apply. The Utilities Directive (90/531/EEC) comes into effect on 1 January 1993. Its purpose is to open up procurement by utilities, including the transport sector, to EC-wide competition (including EFTA states). Its provisions will apply to the purchase or hire of goods, the purchase of building and civil engineering works over a certain value, and, subject to further negotiations by member states, to the procurement of services (eg repairs and maintenance) from 1994. The procurement procedures it imposes include publicity for procurement contracts, non-discrimination, and the award of contracts on any basis other than lowest price or the most economically advantageous bid.

Rolling stock leasing

5.19 Franchisees may prefer to lease or rent rolling stock rather than purchase it outright. The franchisee will be able to lease or rent rolling stock for the period of the franchise from BR, with BR retaining ownership of the rolling stock concerned, while the franchisee pays BR a charge for its use during the period of the franchise. It is envisaged that any agreement for the use of rolling stock involving a franchisee and BR will stipulate the terms on which the rolling stock must be maintained and can be refurbished by the franchisee during the period of the franchise. Arrangements for maintenance and refurbishment involving the franchisee and private sector lessors will be a matter solely for the parties concerned. BR will wish to preserve the right to sell the rolling stock and assign the lease to a private sector lessor. The parties to the lease would then be the franchisee and the new, private sector owner of the rolling stock.

5.20 Another option would be for the franchisee to put forward proposals under which some or all of the rolling stock he requires is purchased from BR by one (or more) private sector lessors, who are prepared to lease it to the franchisee for the period of the franchise.

5.21 It is expected that, in addition to financial institutions, existing asset leasing companies will wish to become involved in providing rail rolling stock. By owning and providing a large fleet of different rolling stock types, such a lessor would spread the risks involved.

5.22 The same financing options exist for new rolling stock as for existing stock purchased from BR. Rolling stock manufacturers may wish to offer leasing and maintenance packages to franchisees in due course.
Rolling stock maintenance facilities

5.23 Major overhauls and repairs to BR's locomotives and rolling stock are carried out by British Rail Maintenance Ltd (BRML) through a network of depots offering the necessary facilities. The major BRML depots for this work are at Derby, Doncaster, Eastleigh, Glasgow and Wolverton. More routine maintenance (running from fuelling and visual inspection through to more thorough periodic servicing and replacement of life-expired components) is carried out using a network of smaller depots with more limited facilities owned directly by the BR businesses.

5.24 No decisions have yet been taken about the future of the BRML or other depots. They could be sold outright - together or separately - as a separate activity. But some franchisees might want direct management control of day-to-day maintenance, in order to retain complete control over the availability and condition of the rolling stock they are using. It should be possible to include, in the franchise, maintenance facilities which are wholly dedicated to the fleet of trains used by the franchisee.

5.25 Whilst franchisees will have some freedom to send rolling stock to different depots for major overhauls, the facilities needed for lighter day-to-day maintenance need to be on hand, readily and quickly accessible.

d) Employees

5.26 The staff which transfer with the passenger business to be franchised will bring with them the terms and conditions which applied immediately before the transfer. Details of the staff and their terms and conditions will be made available to prospective bidders at the time bids are invited. Franchisees will, of course, be free to negotiate changes during the term of the franchise. Bids would therefore need to reflect the costs of making these changes, including redundancy costs if staff are planned to be replaced or overall numbers reduced. One of the conditions of employment of BR staff is that they benefit from concessionary rail travel. This benefit will be safeguarded for existing beneficiaries on the transfer of services to the private sector.

5.27 Managers and employees in BR will be encouraged to bid for franchises. In addition, outside bidders will be invited to put forward proposals for enabling management and employees to share directly in the success of the franchised business.

5.28 Privatisation will not affect pensions already being paid from or pension rights preserved in British Rail schemes. After privatisation, employees will be entitled to preserve pension rights already accrued in these schemes. Alternatively, they will have the opportunity to transfer their accrued pension into a broadly comparable scheme in their new employment. The precise arrangements for ensuring that the rights enjoyed now by pensioners and members are not undermined by privatisation are under discussion. But it is unlikely that any present BR pensioners will become the responsibility of franchisees. The pension rights for employees recruited after the commencement of franchises will be a matter for the franchisees themselves.
Mechanics of employee and asset transfers

5.29 How will the resources needed by the franchisee to fulfil his contractual obligations be made available to him? It is envisaged that BR will form a subsidiary company (the 'operating company') for each business to be franchised. The operating company will employ the relevant train crew and other operational staff. It will either own rolling stock and other operational assets or have rights to use the assets under leasing or contractual arrangements. The operating company will also be a party to the package of contracts related to the franchise (the track access contract, agreements for the use of stations and maintenance facilities, asset leases and the franchise agreement itself), and will need to comply with the terms of an operating licence. The operating company will acquire its employees and any assets which it is to own by way of a transfer scheme. The Transfer of Undertakings (Protection of Employment) Regulations 1981 (TUPE) will be deemed to apply to all transfers of employees by transfer schemes.

5.30 On commencement of the franchise agreement, the franchisee will acquire the shares of the operating company. The franchisee will need to capitalise the operating company. The level and form of capital will be agreed between the franchisee and the Franchising Authority.

5.31 If, at the end of the franchise period, there is a change of franchise, the outgoing franchisee will continue to own the operating company together with the capital he provided to it at the outset, as augmented or reduced by the profits or losses earned from running the franchise (less any dividends paid to shareholders). If the capital is not subsequently employed for another purpose, the operating company can be wound up and the proceeds returned to shareholders.

5.32 The outgoing franchisee will have the opportunity to negotiate a price with the incoming franchisee for the sale of any rolling stock and other assets that he owns and which is in use on the franchise. In addition to such direct transfers, it is expected that active second hand and leasing markets will develop. Assets to be transferred may consist solely of rolling stock originally purchased by the franchisee from BR at the beginning of the franchise period, or they may also include rolling stock purchased by the franchisee during the franchise period.

5.33 Special arrangements may need to be put in place to cover the particular circumstances where a smooth transfer might not otherwise occur, so that continuity of service to the public can be ensured, for example where the outgoing franchisee and the incoming franchisee cannot agree terms for the transfer of rolling stock assets, or a franchisee fails in mid-franchise. In such circumstances, one option might be for the outgoing franchisee to be required to offer the rolling stock for sale to the Franchising Authority.

5.34 It would then be for the Franchising Authority to decide what rolling stock was essential for this purpose, in consultation with the incoming and outgoing franchisee, with arrangements being made under which an arbitrator would set a fair price.
Money flows and capitalisation

- What types of money flows will there be to and from the franchisee, what will a franchisee's capital requirements be, and against what opportunities and risks will they be set?

Money Flows

6.1 The franchisee will receive the passenger revenues attributable to the franchised services he operates. He will use this money to:

- pay staff and other operating costs;
- pay Railtrack for the use of track and other infrastructure;
- pay station owner(s) for access to stations (assuming that they are not operated or purchased outright by the franchisee);
- pay leasing or other financing charges for rolling stock and other assets, and meet the cost of maintenance.

6.2 Most passenger rail services would at present not be viable as stand-alone businesses. The Government has said that it will continue to pay subsidy, where necessary, for as long as it is needed in order to secure the provision of socially necessary services. Through franchising it is hoped that the financial performance of passenger services will improve, because:

- holding competitions between private sector operators for the opportunity to run franchised services, which will generally be awarded to the bidder requiring least subsidy and whose proposals provide best overall value for money, will bring downward pressure to bear on the amount of subsidy required for particular services, and
- the involvement of the private sector, with the introduction of fresh management and fresh thinking, will secure improved efficiency and lower costs, and, through targeting services more accurately to meet passengers' requirements, improve revenue earnings.

6.3 It is intended that the subsidy to be paid to a franchisee, either the amount or the formula by which it will be calculated, will be determined in advance for the whole period of his franchise, although both grant and the service specification may be subject to periodic review. There may also be adjustment factors, with agreed 'triggers' in the franchise contract terms, for example to take account of changes in costs over which the franchisee has no control. The contracts will be framed to ensure that the franchisee can benefit through achieving efficiency gains and cutting costs or enhancing revenue over the life of a franchise contract.
6.4 In some cases bids for franchises will be positive, ie franchisees will pay a fee to the Franchising Authority for the right to run specified services. Again, it is intended that the fee (amount or formula) will be determined in advance for the whole period of the franchise.

6.5 No decision has yet been taken about the timing of payments, whether in the form of grant from the Franchising Authority to the franchisee or a fee from the franchisee to the Franchising Authority. However, it is recognised that the timing of payments is likely to have significant implications for the franchisee’s working capital requirements.

Capitalisation, opportunities and risks

6.6 As noted above, franchising will give the franchisee the opportunity, through effective management of the business, to increase passenger revenue, cut costs and improve efficiency. Against that, it is envisaged that the franchisee will be asked to take on the full financial risks arising from the franchise. The main risks for the franchisee are likely to include:

- Passenger revenues during the franchise period may be lower than the franchisee expected as a result of an overall decline in demand for rail services, or because a new entrant starts to run a rival service and attracts custom away from the franchisee;

- Certain costs under the franchisee’s control (eg payroll, maintenance etc) may be higher than the franchisee expected;

- The franchisee may incur penalties (or, in extremis, lose his franchise) should he fail to perform to the standards written into the contract.

These risks are likely to vary according to size and nature of the franchised operations.

6.7 The operating company providing the services to be franchised will need to be capitalised by the franchisee at an appropriate level to reflect the financial risks arising from the franchise. It is expected that the capital will be provided by the franchisee in the form of a cash injection or, in exceptional circumstances, it may be guaranteed. The Franchising Authority will wish to satisfy itself before the franchise is awarded that sufficient capital is available throughout the period of the franchise.
Section 7

How will franchises be awarded?

7.1 It is envisaged that a series of competitions will be held following Royal Assent, with services passing over to private sector operators in a steady stream thereafter. Each competition will be organised in two main stages, broadly along the lines set out below. A step by step guide showing how a bidder will pass through the competitive process to become a franchisee is set out at Annex A. Normal competition legislation and procedures will apply to the franchising process. Franchising competitions may need to be held in accordance with certain rules imposed by EC Procurement Directives.

7.2 The first stage will be to announce the businesses to be franchised. Bona fide bidders will be invited to apply for an information memorandum about those businesses, and to complete a prequalification questionnaire by a deadline. Respondents will be actively encouraged to put forward alternative proposals to those set out in the information memorandum, if they consider that the services to be franchised could be provided in a more efficient way. They will not be required to bid at the first stage. The responses will be evaluated against a number of criteria, leading to the selection of a shortlist for each franchise on qualitative grounds. The Franchising Authority will also, at this stage, take respondents' alternative proposals into account, repackaging the service specification as necessary.

7.3 The second stage will be to invite the shortlisted bidders for each franchise to respond by a deadline to an invitation to tender, which will be accompanied by a draft franchise contract with the Franchising Authority and other contracts in draft form (eg a contract with Railtrack covering access to track and other matters). Following the issue of the invitation to tender, the shortlisted bidders will be given the opportunity to meet the existing management to see how the relevant business is run. In responding to the invitation to tender, the shortlisted bidders will be expected:

- to bid a fee (ie an amount payable to the Franchising Authority, or an amount payable by the Franchising Authority in the form of a grant) for providing the agreed level and standard of services for the franchise period; and

- to put forward proposals for capitalising the company that will take on the franchise.

7.4 Following a period of clarification and negotiations the shortlisted bidder who is considered by the Franchising Authority to provide the best overall value for money in each case will then be selected to take on the franchise, subject to completion. If none of the bids received is judged to represent adequate value for money, BR will continue to operate the relevant services for the time being.

7.5 BR as a public sector body will not be allowed to bid for franchises. However, as indicated in the White Paper, the Government wishes to encourage bids for franchises from the management and employees in BR. As with previous privatisations, assistance will be provided to meet a proportion of the expenditure on legal and financial advice incurred by unsuccessful teams. The Franchising Authority will wish to take steps to
ensure equality of information and treatment for all potential bidders at each stage of the process.

7.6 Until the franchisee assumes responsibility for the operation of the services, they will continue to be run by BR. The franchising process will need to ensure that the handover is managed as smoothly as possible. Similar considerations will apply if, for any reason, a franchisee needs to be replaced in mid-franchise.

7.7 There are a number of ways in which the renewal of franchises might be handled. One option would be for the Franchising Authority to invite the existing franchisees and others who passed a quality threshold to bid for new franchises. This would help to ensure maximum competition for new franchises. However, in certain circumstances (e.g., if an existing franchisee had performed to, or better than, the required standards and wished to continue operating the services under franchise), the Franchising Authority might decide to enter into negotiations with the franchisee without holding a new competition for the franchise. If a new franchisee cannot be located to run a franchise on acceptable terms, the Franchising Authority will have the necessary powers to arrange for continued provision of services.
Section 8

How should you respond to this document?

8.1 The purpose of this document is to elicit views from potential franchisees. The Government wants to know where your interest lies, and what information you are going to need in due course in order for you to be able to confirm your interest and make a bid. There are inevitably trade-offs on what can be provided and to what timescale. That is why we need your views.

8.2 If, having read this document, you think that you might have a potential interest in bidding for a passenger franchise, then we hope that you will respond in writing, giving an indication of the nature of your interest. We would also welcome your comments on the process of franchising as outlined in this document. It would be helpful to have your comments by 12 November: earlier responses would be welcomed. All responses will be treated as strictly confidential.

The contact for responses is: Mr A T Baker
Railways 2A
Department Of Transport
Room S 18/17
2 Marsham Street
LONDON
SW1P 3EB

Where appropriate, meetings will be arranged to clarify respondents' views.
HOW TO BECOME A FRANCHISEE

The table below summarises the steps involved in letting one of the first franchises as described in Section 7 of this document. As in the rest of the document, it is not intended to be prescriptive, but rather to help potential bidders and others frame their responses.

<table>
<thead>
<tr>
<th>Step</th>
</tr>
</thead>
<tbody>
<tr>
<td>Franchising Authority decides first group of Franchises to be let and advertises them in the National Press.</td>
</tr>
<tr>
<td>Pre-qualification Questionnaire issued by the Franchising Authority, along with information pack on the existing businesses which will form the franchise package.</td>
</tr>
<tr>
<td>Return Pre-qualification Questionnaire, with any proposed amendments to the franchise specification.</td>
</tr>
<tr>
<td>Franchising Authority holds meetings with respondents and compiles a shortlist.</td>
</tr>
<tr>
<td>Franchising Authority decides final form of franchise package on which to base the competition. One option would be for the Franchising Authority to negotiate draft contracts with Railtrack for trainpaths and with any independent station and maintenance depot owners for access rights, on behalf of the operating company to be formed by BR. (He may also make arrangements for rolling stock provision if the bidder wishes).</td>
</tr>
<tr>
<td>Invitation to Tender issued to those shortlisted, along with draft contracts.</td>
</tr>
<tr>
<td>Submit Bid. Bid will cover subsidy (or premium) bid, investment proposals and financing plans and any amendments to the draft contracts.</td>
</tr>
<tr>
<td>Discussions and Negotiations with Franchising Authority.</td>
</tr>
<tr>
<td>Selection of preferred franchisee (subject to completion).</td>
</tr>
<tr>
<td>Sign franchise contract. Acquire shares in operating company, inheriting the package of assets and contracts held by it (eg governing access to track and use of other assets, safety validation and the operating licence).</td>
</tr>
<tr>
<td>New franchisee commences provision of service.</td>
</tr>
</tbody>
</table>

* For the first franchises, safety validation will be carried out for the operating company formed by BR. The franchisee will need to ensure that any changes to the running of the services he intends to make are safety validated.