



Reimagining The Railway

Virgin Trains' submission
to the Williams Rail Review

**ALL
CHANGE!**



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Virgin Trains is the brand name under which certain train operators, in which Virgin Group is involved, have operated. The views expressed in this paper are those of Virgin Group, taking account of its experience of Virgin Trains branded businesses.

Foreword

In 1992 the rail industry was facing a difficult time. Passenger numbers were falling, and the Government of the day thought the best solution was privatisation. It was an unexpected success. Customer numbers have soared, satisfaction is higher than on the continent and we have the safest railway in Europe. Innovation and investment have seen vast improvement compared with the days of British Rail, with faster and more frequent services, better customer experience and an end to the rail industry being last in line for Government investment.

But together with the successes, there have been significant failures. Over the last few years, industrial action and the lamentable implementation of new timetables have left many struggling to make even the most basic daily journeys. All too often improvements have been delivered late, trains are overcrowded and ticket types incomprehensible. The industry's systems, fares and regulations have failed to keep pace with the modern world. And yes, whilst Virgin Trains has had significant successes, leading the industry with revolutionary rolling stock, high frequency timetables and automatic delay repay, we have had our problems too. Our Virgin Trains East Coast franchise ended early as macroeconomic events saw forecasts rendered too ambitious, and shareholders have said they deeply regret that.

None of us can be surprised that this unenviable catalogue has

resulted in the public becoming deeply unhappy with the current state of the rail industry. Something has got to change.

The Government is therefore right to be looking at a wide-ranging review of the industry, and we support that whole-heartedly.

This is a once-in-a-generation opportunity for reform; to build on the successes of the rail industry and to address its problems. It is a chance for fundamental and bold reform that will benefit passengers for decades to come.

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This submission was written before the recent Government decision to disqualify our bid for the West Coast Partnership.

However, we believe the recommendations are more pertinent than ever given this news. Keith Williams has said that franchising cannot continue as it is now, and it is clear we need systemic industry reform which is driven by principles and a whole-system redesign. Indeed, it is highly questionable whether any franchises can be let sensibly, or robustly, as things stand.

This will not be an easy fix. Every option will have downsides and there will be some difficult decisions to be made. But there should be no dogmatic fixation on models or ownership. Instead, we must develop a system which optimises the benefits for passengers, taxpayers and communities and which enables train companies to evolve as the world evolves around them. We must be both visionary and pragmatic.



Rail companies serve different markets; from commuters to holidaymakers, students to retirees, business people to day trippers. This submission is our vision of the future and proposes that these different markets could be better served by correspondingly different models. It imagines a world where private sector innovation and flexibility is embraced where there are benefits, but which uses the best of the public sector, or public-private partnerships, where there is a clear public good to be optimised.

We believe that for discretionary rail travel - predominantly long-distance customers travelling

for business or leisure - there should be more flexibility, with train operators functioning as normal companies and competing with each other. We believe the model used by airlines could be transferred effectively into the long-distance rail sector, with significant benefits for taxpayers and passengers. This could have a major positive impact on the two areas of most concern to customers according to the watchdog, Transport Focus: value for money and getting a seat.

However, where rail travel is less discretionary - typically over shorter distance commuter routes - we believe that seamless functionality is more important than cutting-edge innovation and higher-end customer experience. Some commuters may have little choice over how to get to work, and there is a clear public good in providing efficient mass public transport. We believe commuter services need to be reformed in a different way to the long-distance sector.

We will go through our thoughts in more detail over the coming pages, looking first at the long-distance sector, before turning to shorter-distance journeys, infrastructure, stations, and finally, regulation. Our submission is deliberately high-level and ideas-driven, rather than a detailed examination of the precise nature of operation. In this way we aim to spark debate and discussion, and to give the Review team food for thought.

Thank you for reading.

Patrick McCall, Virgin Trains



Long Distance

The long-distance rail sector would benefit from the simplicity and widespread understanding of an airline-style model.

By selling bundles of slots to operators, customers would benefit from more investment, simpler fares and operators could innovate and adapt to a changing market.

A reservation-only policy for the long-distance rail sector will manage capacity more effectively and increase passenger confidence in using rail.

The Challenge

Short franchises, overspecification in contracts, and a race towards revenue are some of the problems that inhibit the private sector from responding to customer needs as well as it could.

The vast majority of long-distance rail travel is discretionary. Most customers are choosing to visit family or friends, using the train for a weekend break or holiday, or visiting business contacts. They have chosen to meet face-to-face, rather than use video-conferencing or the telephone, and they have chosen to travel by train rather than road or air. Whilst all of their reasons for travel are important, they are fundamentally discretionary in nature. Virgin Trains' West Coast franchise does, of course, have some customers who use us to commute to work, but they are a small minority; fewer than 10% of our journeys are currently made by season ticket holders.

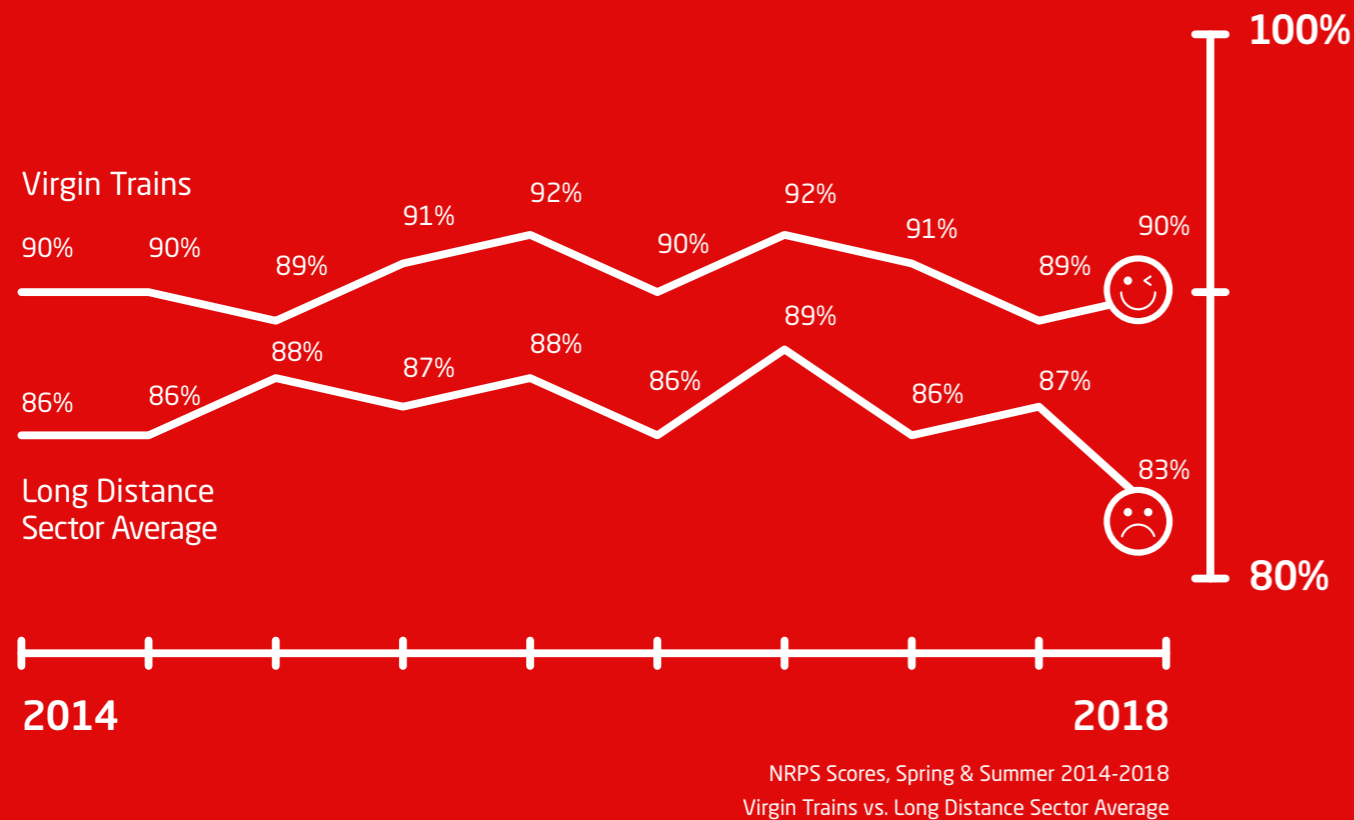
The long-distance sector has significant competition from cars, airlines and coach companies. If rail is to truly compete, companies must be allowed a level playing field with the ability and flexibility to invest for the long term. It also needs more reliable infrastructure and stations which are attractive for capital investment.

However, the current model allows little scope for train companies to invest and attract new discretionary customers. Franchises typically last a maximum of eight years – which means that unlike a normal business, train companies cannot invest for the long term as payback is generally needed within the remainder of the franchise. A relatively recent phenomenon has seen many train companies issued 'direct awards' – these are contracts without competitive tenders that might only last one or two years. Significant investment in these cases is even harder, and so in real terms the industry goes backwards, starved of investment, versus the competition. For Virgin Trains' West Coast franchise, the benefits of consistent leadership, culture and vision over two decades have seen us consistently top the independent customer satisfaction surveys for long distance franchises, despite being hamstrung by repeated short-term contracts over recent years.

In addition to short timescales, franchisees also operate in something of a straight-jacket, with their operation specified in minute detail by the franchise agreement – for example, the number of ticket machines at a particular station.



We've consistently topped the independent customer satisfaction surveys for long distance franchises



This reduces the ability to respond to events, changing customer demand, stakeholder feedback or technology, whilst imposing rigid costs and restrictions.

The nature of franchise competitions means that it is difficult for the Government not to simply accept whoever bids the most money to run a franchise. On being awarded the contract, the company then has little choice but to maximise its revenue in order to pay the promised premia to taxpayers. Of course, in some cases economic events result in it proving impossible to pay these bills, leaving an expensive headache for Government and shareholders.

The current franchise model makes it hard, if not impossible, for the Government to extract maximum value from a train company for the taxpayer, without pushing so hard that the franchise fails. The harder the contract is sweated for the benefit of the taxpayer, the greater the risks to the franchise from threats such as changes to the economic environment. On the other hand, including a buffer against existential threats means the taxpayer does not get maximum benefit.

There are also significant problems with congestion and ticket complexity. Train companies are often obliged, by regulation, to accept 'walk-up' fares which means they have no control over the number of people getting on a particular train (unless it is physically unsafe). These walk-up fares are regulated by the Department for Transport (DfT) at a set price that cannot be varied by train; inevitably they are too cheap for some services and too expensive for others. This results in the all-too-frequent sight of customers forced to stand on a long-distance journey. Yet, on the same day, rigid timetables force companies to shuttle around extremely heavy and mostly empty trains, pushing up costs and ticket prices. Rail travel has a strong environmental case, taking traffic off our roads and people out of planes, but this case is damaged by inefficient, supply-led, timetables.

Customers are often bewildered by the range of ticketing and fare options available and have little confidence that they have purchased the right ticket for their journey. There are too many options, with too many variables and unclear language.

Adding to these complications is the issue of 'open access' operators. These companies identify gaps in the timetable and gain permission from the Office of Rail and Road (ORR) to run their trains in those gaps. They pay lower track access charges to Network Rail and, crucially, no premia to taxpayers – which means they can charge customers less and still make proportionately higher profits whilst the taxpayer loses out.

We support competition, and there are suggestions that the presence of open access operators lowers prices and improves standards in franchised operators, but that competition needs to be on a level playing field. Franchising and open access are two fundamentally different systems being asked to operate in harmony. In addition, the more capacity that is squeezed into the system, the harder it is to maintain overall punctuality and performance.

We believe all of these problems could be addressed with a few simple, but radical, steps.



Planes & Trains

a new model for the long-distance rail sector

Imagine if airlines operated in the same way as train companies. They would be forced to accept whoever turned up at the gate, regardless of whether they had to stand in the plane's aisle. Customers with certain tickets could turn up for any flight they liked, without telling the airline. There would be little or no restrictions on baggage, and every airline would be forced to sell tickets from any airport in the world to any other airport. In short, it would be pandemonium. And yet this is how we expect our long-distance railway to operate every day.

In contrast, everyone understands what's involved in flying. It's almost impossible for customers to get on the wrong plane, and everyone accepts that they are booked on a particular flight with a particular seat – and if they miss it, they either don't travel or have to rebook at their own cost. In many respects, the railways are more complex of course: flights do not have intermediate stops; airline and airport staff check tickets multiple times so customers are naturally guided to the right plane; targeted customer communication is easier with only one destination involved; and with check-in and security shutting well before the flight leaves, the tendency for a last-minute rush is lessened, if not removed entirely.

Our major airports are comparable with the UK's rail network. There is little or no space to expand and rising demand places huge strain on the system. Airlines, however, have an advantage in managing this – they can think long term, and they can manage their planes in the best way to meet demand.

Airlines operate 'slots' which sees them take-off to a particular destination at a particular time. Crucially, they own these slots in perpetuity, so they know if they decide to buy a bigger plane for that slot because of rising demand they have time to recoup their investment through greater customer numbers. Or, if demand falls, they can reduce the size of aircraft or even give up the slot entirely.

There are also multiple operators on the main routes, for example London to New York. This provides direct competition and airlines are incentivised to continually improve their product and attract new customers away from their competitors. The long-term nature of the businesses facilitates this competition.

For customers, whilst there are some differences in tickets, in the main there is one price for a given flight. If that flight is filling up, the price goes up. If it's a quiet time of day, the price will be lower. It's simple, straightforward and customers understand it. They can see if they want to fly at the most convenient time it will likely cost more than at a less convenient time. Prices might vary across websites as online travel agents compete by cutting margins, and there might be room for greater transparency around

additional charges for extras such as baggage, but it is relatively straightforward for customers to compare one airline's offering with another's.

We believe we should import the airline model into the long-distance rail sector.

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Step One

creating train slots

Train slots could be 'auctioned' off to different operators, with the revenue generated going to the taxpayer. This would likely generate a significant one-off boost in tax receipts. For example, Virgin Trains runs three services an hour to Manchester. We might bid for, and win, services which leave London Euston at 7.00am, 8.00am, and 9.00am. Another train company might pick up services at twenty-past those hours, with other operators sharing the slots at forty minutes past the hour.

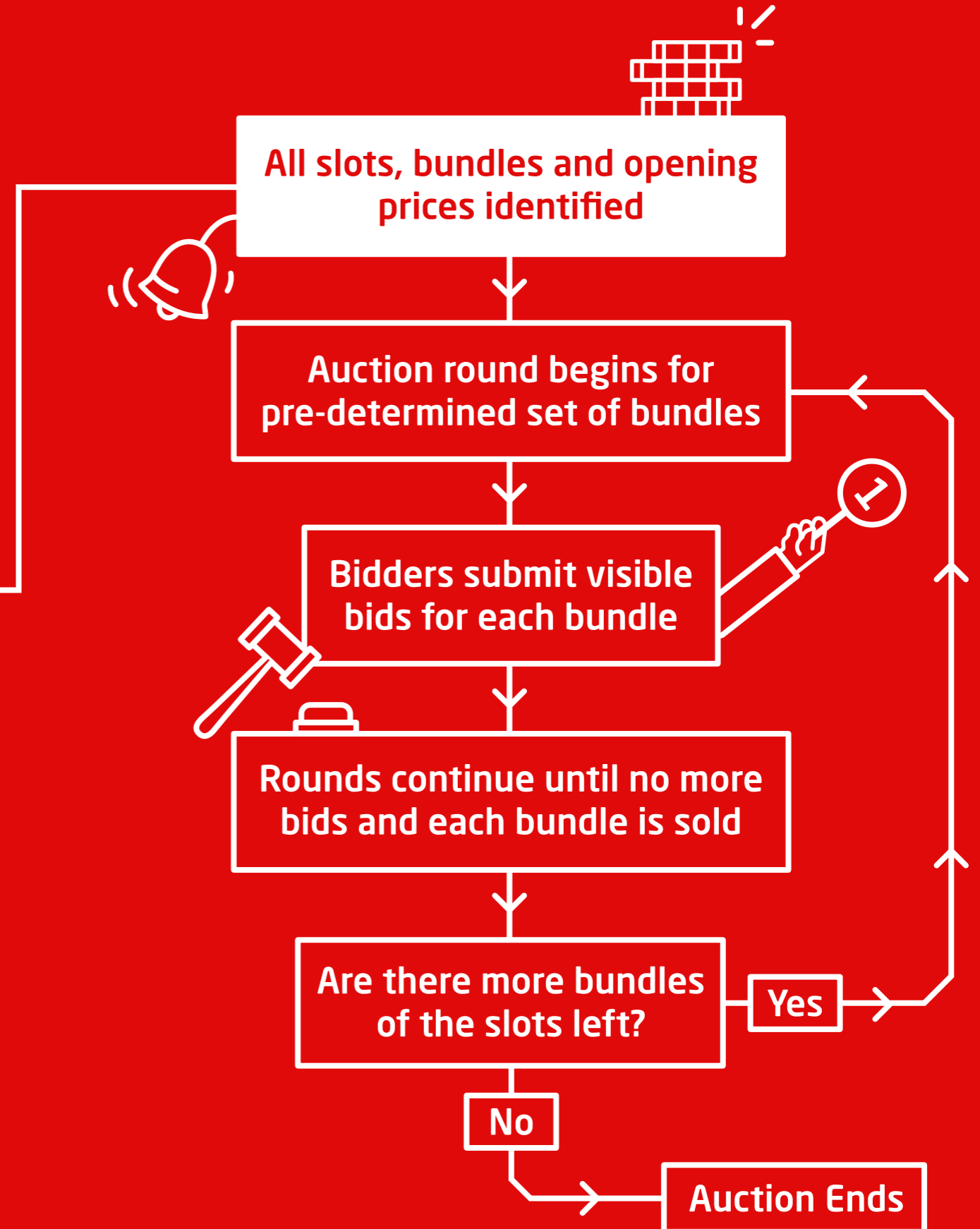
Instead of auctioning individual slots however, we believe bundles of slots should be sold - for example the three journeys above together with three corresponding returns in the evening peak. This would be similar to the auctioning of TV football packages, and there would be a limit on how many slots could be bought by a single operator. Unlike TV rights, we propose these slots are bought and owned as company assets and should not be time-limited. This is how airlines operate with 'grandfathered' slot rights at airports.

Bundling slots would be simpler than individual auctions and would also eliminate some risks for both bidders and customers. If a bidder won a single slot only, it would face considerable and disproportionate inefficiencies in managing that slot; for example, in terms of the number of trains and employees required to allow for annual leave, breakdown etc.

Unlike flights, train journeys typically stop at numerous intermediate stations. Our proposal is that the slots which are auctioned comprise the origin, destination and all intermediate stops. This allows them to form part of a co-ordinated timetable across multiple train operators, both short and long distance. There should be variety in the slots, however. For example, one long-distance service could be non-stop between the origin station and its final destination, whilst another on the same route takes in intermediate stations.

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How an auction might work



In addition to the one-off payment for the slot, operators would commit to a certain percentage of their profits from that service going to taxpayers.

In this way, a well-planned timetable could cater for the needs of smaller towns and cities along the route, as well as minimising journey time for those passengers who simply want to travel between our largest conurbations.

In addition to the one-off payment for the slot, operators would commit to a certain percentage of their profits from that service going to taxpayers. This would prevent the problems of franchise overbidding, since the payments would only be due if a profit was made and would also directly

incentivise the operator to improve profitability for the benefit of the taxpayer. In practice, it is likely that the regulator conducting the 'auction' of slots would have to fix one of the prices – either the price of the bundle of slots or the percentage of profits – leaving market forces to decide on the appropriate corresponding level of the other variable.

Competition between operators would prevent customers being squeezed in a drive for profit. If one operator did that, and provided a notably worse service as a result, customers would be free to switch to rival operators. There could also be minimum standards for customer-facing areas, enforced by the regulator. We will discuss this in more detail later in the paper.

Some slots – those in rush hour – would of course command a higher price than those late at night, with the market determining the value of the slots. If, however, a slot was unprofitable it would not be bought at auction under this model. This would prevent the current problem of almost-empty rolling stock travelling round the network with little benefit for customers, but with fixed costs that drive up all ticket prices.

Removing little-used trains would also improve overall network performance or could free up paths for more freight trains with corresponding benefits to our road network.

There could, however, be a risk to local economies and communities. Whilst they would not miss out on all rail services, since local commuter networks would still serve stations throughout the operating day, local commuter stations might see a loss of long-distance – services at certain times or locations. Often these stops have been the result of comprehensive campaigning by local stakeholders and MPs over several years, and we understand that a new approach must not endanger those services; two decades of running the West Coast mainline has shown us the transformative power rail services and investment can have.

We see two options for addressing this issue:

- The quieter routes, times and stops could be bundled with the more profitable slots and auctioned together. We would expect this to result in less money flowing to the Treasury, both through a lower auction value of the bundle, and lower overall profits for the train operator. Effectively, the taxpayer would be subsidising the loss-making route, though competition for the bundle of slots would minimise this subsidy. This has the benefit of simplicity.

- Create a public service operator to run those long-distance slots which the market believes are not commercially viable. Similar to the first option, it would mean the taxpayer is subsidising those slots, however it has the benefit that Government can directly weigh up the cost of subsidy for each slot versus the public good provided, in consultation with stakeholders. The regulator would have to ensure there was a level playing field and the state operator did not distort the market.

There are strong arguments for both of these options.



Protection Against Failure

Under the slot model, if customer demand changed, operators could respond. If demand fell, they would be free to give up a particular slot or sell it to a competitor; if demand increased, they could bid for additional slots (assuming space on the network). If an operator, or regulator, identified an additional train path that was unused, that slot could be auctioned off in the usual way.

Train companies would continue to own their slots unless they chose to sell them to a rival operator with the approval of the Competition and Markets Authority (CMA) or forfeited them through lack of use or breach of standards / regulations. Owning the slots in perpetuity would allow operators to invest more easily, without being concerned about the end of their franchises. It would encourage private sector investment and depoliticise decisions around long-distance routes. Any change in ownership of a given slot would have to be approved by the rail regulator, as well as the CMA.

A strong regulator would be given the ability to approve or deny any request by slot-owners to add or remove stops within a particular train path. There would be no obligation on the regulator to accept the request. Some inter-regional, rural journeys would likely need to be protected as they might not have sufficient coverage on local, commuter networks, but this would be accounted for by the slots having a specified

stopping pattern determined by the regulator.

Owning the slots in perpetuity and running the company as a normal (non-franchised) business would mean train companies had more levers available to respond to an adverse external environment. This could reduce the risk of failure relative to franchising. Competition would act as a brake on actions detrimental to the consumer, such as excessive cost-cutting, since customers could vote with their feet, with minimum standards enforced by the regulator.

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The most effective protection against failure however would be the structure of the industry. Having a long-term business would allow shareholders to take the

rough with the smooth, putting in place strategic plans for strong performance. The suggested model also has a percentage of profits going to taxpayers, meaning that no payment is due if the business makes a loss. This contrasts with the current situation where franchises are committed to making large premia payments to taxpayers regardless of economic circumstances, and with only a finite, and small, number of years to recoup any losses.

In addition, if a large risk materialised – for example, pensions – companies could put in place plans to manage those risks over many years, an improvement versus the finite number of years in a train franchise. Whilst this would represent an improvement in a train company's ability to withstand risk compared with franchising, it is not a panacea. Risks should still lie with those best able to control them, as recommended by the Brown review.

In the worst-case scenario of company failure, competition would insulate passengers from the effect by providing alternatives. Taxpayers would similarly be protected since the regulator would open up the forfeited slots to new companies, with a new windfall of auction proceeds.

This situation would be less likely to occur in the first place however, since each slot and piece of rolling stock would have a market value, and a train company which was struggling could sell individual slots and train sets to competitors (subject to CMA and regulatory approval). This would provide a cash boost for the under-pressure train company as well as meaning no interruption of service for passengers.

Competition between operators would drive up quality and increase choice for consumers. One operator might choose to run a First-Class only service, whilst another operated a Standard-Class only model. The regulator would need to ensure an appropriate mix, however competition would allow train companies and customers to respond – for example, if too many services were Standard Class only, then prices could fall for those seats, and/or train companies would refit some carriages as First-Class. Operators would be able to invest and change according to market needs.

It is likely that under this model a long-distance operator would want to have a strong corporate brand. This brand presence would allow a company to reinforce its offering and differentiate its

proposition within the market, aiding consumer choice in the process. In addition, once a company had established a strong brand presence it would likely want to protect it. Given that the brand would be owned for the long-term, rather than tied to a short franchise, this could act as another strong check and balance on standards to the benefit of customers.

This model offers an opportunity for successful train operators to grow their presence over time, just as normal businesses do. A very successful operator, which was popular with passengers, could buy additional slots from rivals, subject to approval from the CMA and regulator. Train companies would have control over how to run their business and both payments to taxpayers and customer satisfaction would be optimised.

Critics could fear that having multiple operators running the same route would increase complexity, but this is no different to airlines, and their customers generally manage to go to the right plane. Some complexity is inevitable if we want competition to flourish.



COMPETITION 

 WILL 

 FLOURISH

Step Two

reservations

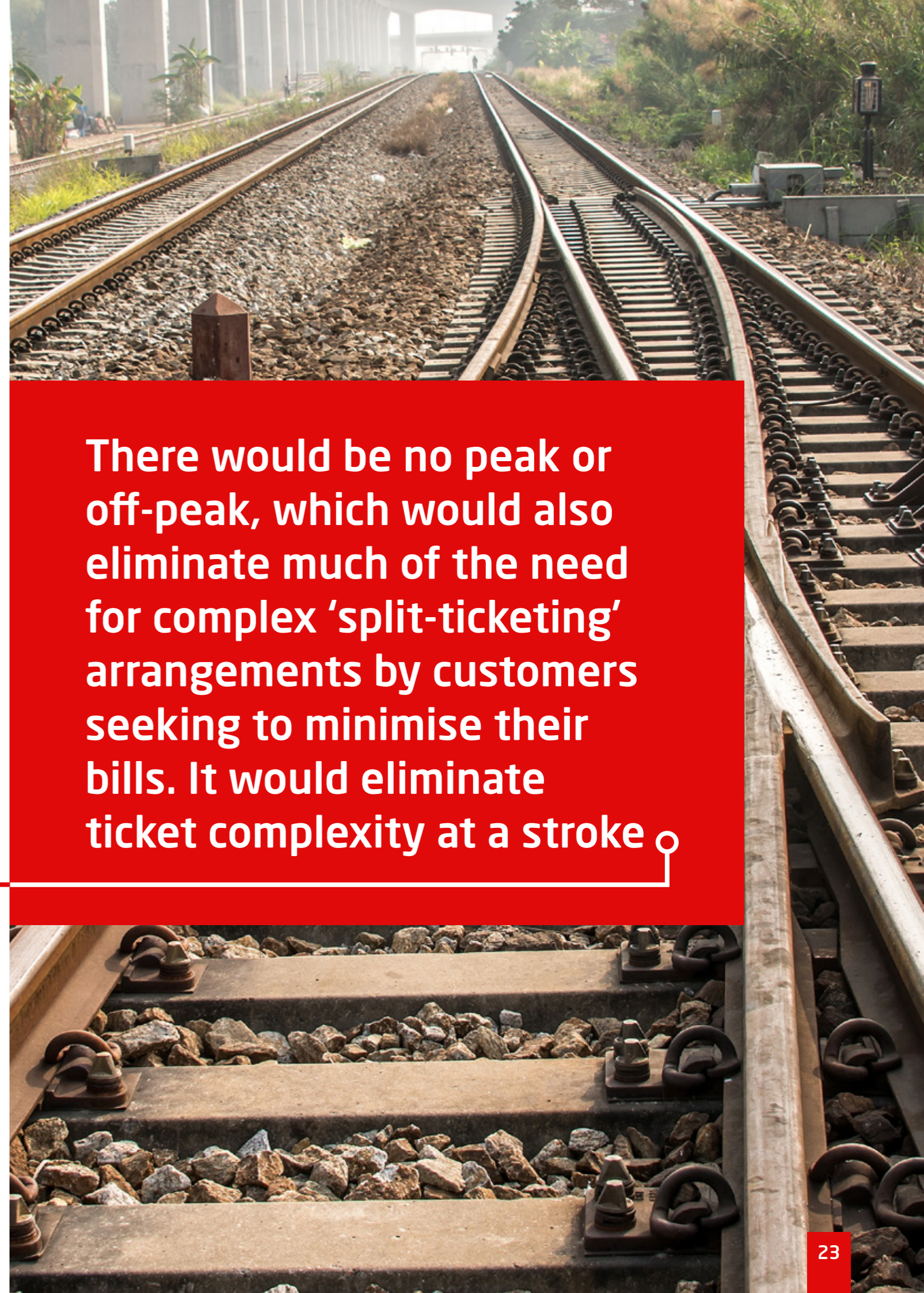
The second, vital, step to import the airline model into the long-distance sector is to have reservation-only trains. This already exists on some international services such as Eurostar. Customers would book a ticket and a seat for a particular train. The price would be based on demand so as the train filled up, the price would go up. But there would only be one price for that train at a given point in time. If we chose to allow competition between retailers then there would be some variety across websites.

Customers would be free to choose a popular train at a higher price, or a less popular train at a lower price.

Customers would be free to choose a popular train at a higher price, or a less popular train at a lower price. There would be no peak or off-peak, which would also eliminate much of the need for complex 'split-ticketing' arrangements by customers seeking to minimise their bills. It would eliminate ticket complexity at a stroke.

Just like airlines, customers could buy a flexible ticket which would allow them to change trains and make a reservation for a different service if there was space. Anyone with a season ticket would need to book a seat, and customers with 'open', fully-flexible tickets would also have to book a seat rather than simply turning up at the last minute for any train. These flexible ticket holders could of course change their reservation to another train (assuming seats were available) but could only hold one reservation at a time for a given day and journey. For example, if a long-distance operator served a commuter market as part of its route, these commuters would still be required to reserve seats if they wanted to use this long-distance service rather than local commuter services.

There would be no peak or off-peak, which would also eliminate much of the need for complex 'split-ticketing' arrangements by customers seeking to minimise their bills. It would eliminate ticket complexity at a stroke.



Once all seats were taken, no further tickets could be sold for that train or reservations made. Each operator would seek a 'market-clearing price' on average for its seats – so it sold all seats available. If an operator chose to offer faster, or more luxurious services, those would likely have fewer seats and cost more, whilst a Standard-Class only offer would see more seats and lower prices. Both services would seek the same result though – distributing demand more evenly by using fully dynamic pricing. It would end overcrowding on long distance services.

Of course, in significant disruption there would be difficult choices to be made. Either the operator would have to allow standing passengers, or those customers whose train was cancelled would need to wait for a train that had space. Our preference in this situation would be to open a limited number of 'standing reservations'. This would allow customers who preferred to stand to still travel, whilst preventing the train becoming overwhelmed. Other customers would wait for later trains, and if there were still not enough spaces for all passengers to travel that day, train companies would need

to book taxis, coaches or hotels. At the moment, train companies try in vain to carry all their passengers regardless of disruption, with inevitably unacceptable customer experience. Airlines would never even consider behaving in this way and neither should long distance train companies.

Another significant advantage of this model would be the light-touch regulation required. Long distance train companies would be overseen in a similar way to how the Civil Aviation Authority regulates airlines. Certain standards, particularly around safety and disabled access, would be safeguarded, as would the rural, inter-regional journeys not served by commuter trains and referred to above, but the operators would otherwise function as normal businesses. We envisage this as an example of the principle-based regulation which is increasingly used in other industries.

Rather than rule-based regulation, which sees the exact behaviours (inputs) specified, principle-based regulation specifies the outcome that is required and leaves the business to decide how best to achieve it. This would reduce the amount of interventionist regulation needed. Competitive forces would be used to full effect, for the good of both passengers and taxpayers.

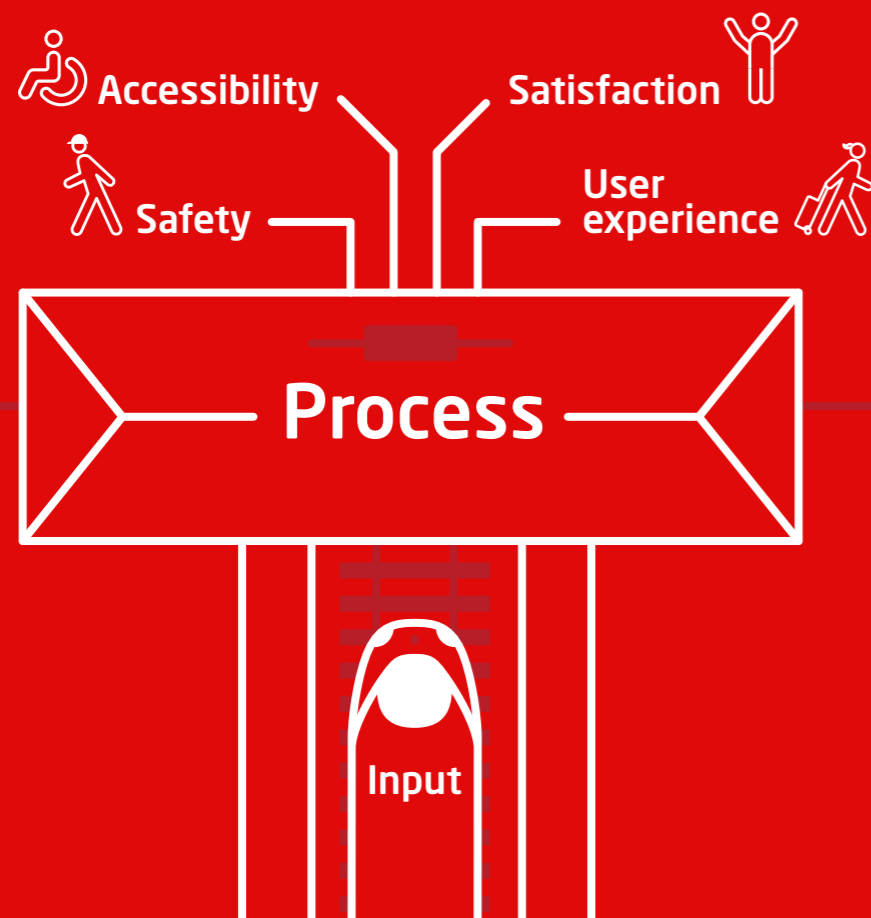
Finally, it is worth acknowledging that whilst we believe the steps we are suggesting are simple in concept, altering the system in this way is ambitious and would require a considerable amount of work. Timetables, routes, stopping patterns and franchise boundaries would all have to be redrawn before a slot auction, which would take a considerable amount of time in itself, could even take place. We make no apology for this, and strongly believe the benefits for customers and taxpayers

would be worth it. A pilot scheme might be considered, though the nature of owning slots in perpetuity could mean that a 'pilot' remained indefinitely even if it was not rolled out to the rest of the network.

There are, however, a couple of parts of the network where this could be implemented with minimum disruption: the East Coast and HS2. HS2 will be a new network, partly self-contained and partly running on the existing tracks, and there is the opportunity, should the Government wish to take it, to plan and design its operation in an entirely new way.

Of course, HS2 is some years away and we might not want to wait that long to test the model. An alternative would be long-distance services on the East Coast. These are currently run by the Government through its London North Eastern Railway (LNER) company. Without the constraints of a franchise contract, it would be possible to implement a pilot scheme in a controlled way relatively quickly.

Outcomes Led Approach



Rather than rule-based regulation, which sees the exact behaviours (inputs) specified, principle-based regulation specifies the outcome that is required and leaves the business to decide how best to achieve it.



Short Distance

Smartly regulated long-term franchises, run by devolved transport bodies, will make services work better for the communities they serve and encourage investment.

A Public Good

essential daily travel

There is undoubtedly a clear public good provided by public transport. It eases the congestion on roads, allows people to get to work in an efficient fashion and is more environmentally friendly than other modes of transport. Nowhere is this more the case than on short-distance commuter rail networks.

It is important to note that some current franchises contain both short-distance, commuter journeys and long-distance routes. In recognising that there are distinct markets, we believe it would also be necessary to redraw these franchise boundaries, so that long-distance services are properly separated from short distance ones. This would include changing the stopping pattern of long-distance slots, so they did not service short-distance commuter markets. This could potentially reduce the overall capacity available for short-distance journeys, adding to problems of overcrowding. However, with careful planning it should be possible to encourage

longer-distance passengers who use the 'commuter' services to transfer onto the long-distance operator. This would free up more local capacity and restore the balance. This would need detailed examination by the regulator.

The above 'airline' model could be put in place on commuter networks, but in reality, there would be significant challenges. Commuters are likely to value taking the next train whenever they finish work, without thinking about which operator is running that train or making a reservation. In most cases, significant numbers of passengers also stand during rush-hour, so reservation-only trains would not work. In short, it is more beneficial for short-distance commuters to be able to jump on any train they choose.

We therefore do not believe the airline-style model is appropriate for short-distance networks.

Short Distance

Or Long Distance?

Short Distance Choices

We see two alternatives which are worthy of consideration.

The first is to evolve the existing franchise model into a management one. Under this system, one train company would operate a commuter network as now and be paid a fixed management fee. This would be a departure from the franchising system, where typically an operator agrees to pay a certain amount of premia to the Government, and then, within certain constraints, takes the business's profits as its return. Under the management model the roles would be reversed, with the operator taking a fixed return and the Government taking the profits.

Most risks around revenue and costs would be borne by the Government, with the operator carrying out day-to-day operations. There would need to be some profit-sharing arrangement, or milestone payments, to incentivise the operator to over-deliver on the contract. This increases the complexity of the relationship

and the corresponding cost of managing it.

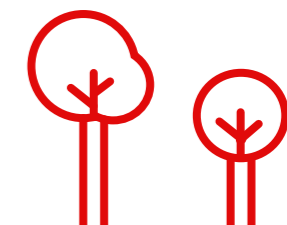
The difficulty lies in setting the management fee, and incentives, at the right level. Too high, and it results in the operator earning an easy return not commensurate with the level of risk taken. Too low, and no operators will want to run the network. With a mainly discretionary, long-distance network on-rail competition can be used to drive efficiencies and customer experience upward, and market abuses downward, but on a short distance network this important check and balance cannot be utilised.

This is therefore a half-way house solution. It utilises a public-private partnership to gain a level of innovation, whilst removing the excess risks (on both sides) that can result from franchising. However, it is complex and contains significant risks in terms of setting incentives and returns correctly.

It also fails to optimise the benefits of long-term planning and investment. Our second option, which we prefer, seeks to realise the benefits of a long-term perspective whilst also operating within the constraints and demands of a short-distance commuter market.

The need for commuters to jump on any train, almost without thinking, means on-rail competition with distinct offerings is not beneficial. In turn, a lack of on-rail competition means it would be undesirable for train companies to run the network indefinitely. However, the current franchising system, which seeks to address these points, has serious risk-share failings, is short-termist and can lead to a lack of investment.

We propose this tension is solved by utilising a long-term concession model.





Longevity of tenure tends to lead to more consistent leadership, culture and vision within an organisation, with correspondingly improved staff morale and retention

Long Term Thinking for The Short-Distance Sector

The concession could be awarded utilising supply-side competition as franchising does at the moment, with train companies submitting tenders for the right to run the network. These tenders could be partially assessed in a similar way to the idea in our long-distance suggestion above, with awards being made on the basis of percentage of profit offered.

This would avoid the current problem of franchisees bidding to pay fixed sums to Government which may turn out to be too ambitious and risk the franchise failing, or too little and risk bumper profits. If bidders were to compete based on offering the highest percentage of their profits going to taxpayers, it would still incentivise them to grow those profits, harnessing the innovation of the private sector, whilst all-but-eliminating the risk of failure, since if no profit was made there would be no payment due.

The awarded contract would last much longer than existing franchises, which are typically around seven to eight years long. We suggest a term of 20 years would be appropriate. This would allow the train company to undertake large-scale investment such as infrastructure improvements, which are difficult under shorter contracts.

The travelling public would benefit from the train company's desire to improve the reliability of the network it is operating on.

In addition, a longer-term timescale would open the door for on-board innovation. Whilst we believe this innovation is of less benefit to short-distance commuters than long-distance passengers, it would still be welcomed.

The more marginal business case for on-board investment in short-distance services would be improved, since the benefit could be reaped over the longer-term. A long-term concession award would therefore unlock a variety of new business cases for investment that are simply not possible under the current model. Private sector investment and innovation would be harnessed for the benefit of short-distance commuters.

There are additional soft-benefits in having a long-term concession model which would also apply to the 'slot' model suggested for the long-distance sector. Longevity of tenure tends to lead to more consistent leadership, culture and vision within an organisation, with correspondingly improved staff morale and retention. At the moment, rail staff potentially face having a new culture and leadership imposed on them every few years.

This proposed change to the short-distance network would need a strong and strategic regulator. There are several key reasons for this.

Firstly, with no on-rail competition to keep any drive for profits in check, the authority (whether that is the government or regulator) would need to maintain oversight through a similar system to the current 'committed obligations'. We would encourage this system to be focussed on outcomes, not inputs as it is at the moment – for example, specifying a desired level of passenger satisfaction and leaving the operator to decide how many ticket machines that meant at stations, rather than specifying the number of machines as an input. Introducing a greater focus on quality when assessing bids, as the Government is endeavouring to do, would also be desirable.

Secondly, the regulator would need to conduct a review of Network Rail's processes for infrastructure improvements. At the moment, any train company which wants to improve the network for the benefit of passengers has to employ contractors, or partners, that carry out the work in the precise way specified by Network Rail. This leads inevitably to the cost of the work being almost identical to what it would be if Network Rail had carried it out.

There is little opportunity for efficiency or innovation. The process is also slow and cumbersome, which means passengers have to wait longer than necessary to see improvements.

A regulatory review of the procurement and works processes could open up the sector to competition, with considerable benefits to passengers. Train companies could then innovate and invest in the optimum way for passengers and maximise the benefits of a long-term concession.

Finally, the regulator would also need to ensure that the overall infrastructure provider (Network Rail currently) did not alter its behaviour as a result. It is possible to imagine an infrastructure provider cutting back on local investment in the knowledge that the train company might step in.

We also believe that there could be a significant benefit in changing the way that these new franchises are procured. Instead of central government running the competition, the tender process could be managed by the local authority most closely aligned to that commuter network, or an arms-length body such as Transport for London (TfL) or Transport for Greater Manchester (TfGM). This system of procurement is already in place in Scotland.

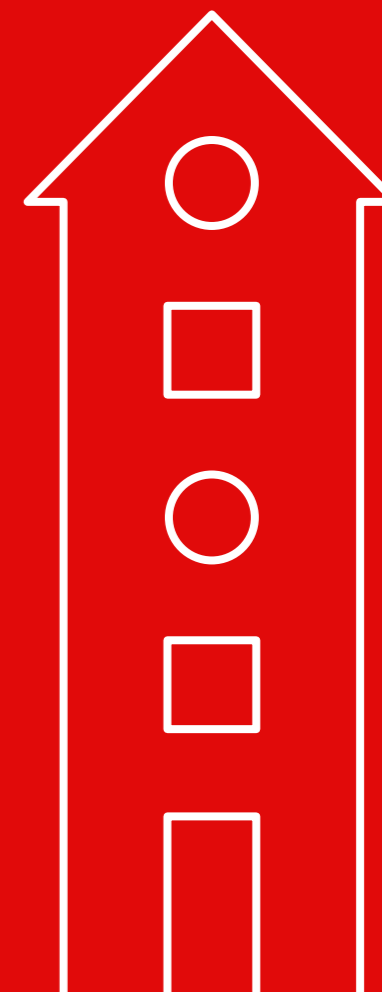
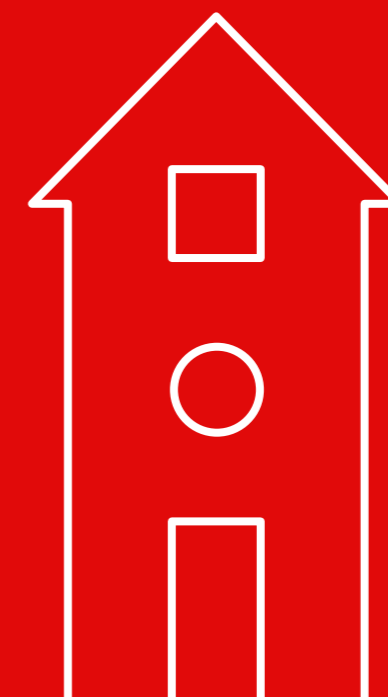
Allowing a local body to run the tender process would allow the service to be specified for the optimum benefit of the local community. It could form part of a wider local, or regional, transport plan and be fully integrated with other modes of transport more effectively.

In addition, bidders could be required to be genuinely local, with HQs and suppliers all based in the relevant region. This would build further links with the local community, increase accountability and devolution, and drive positive results.

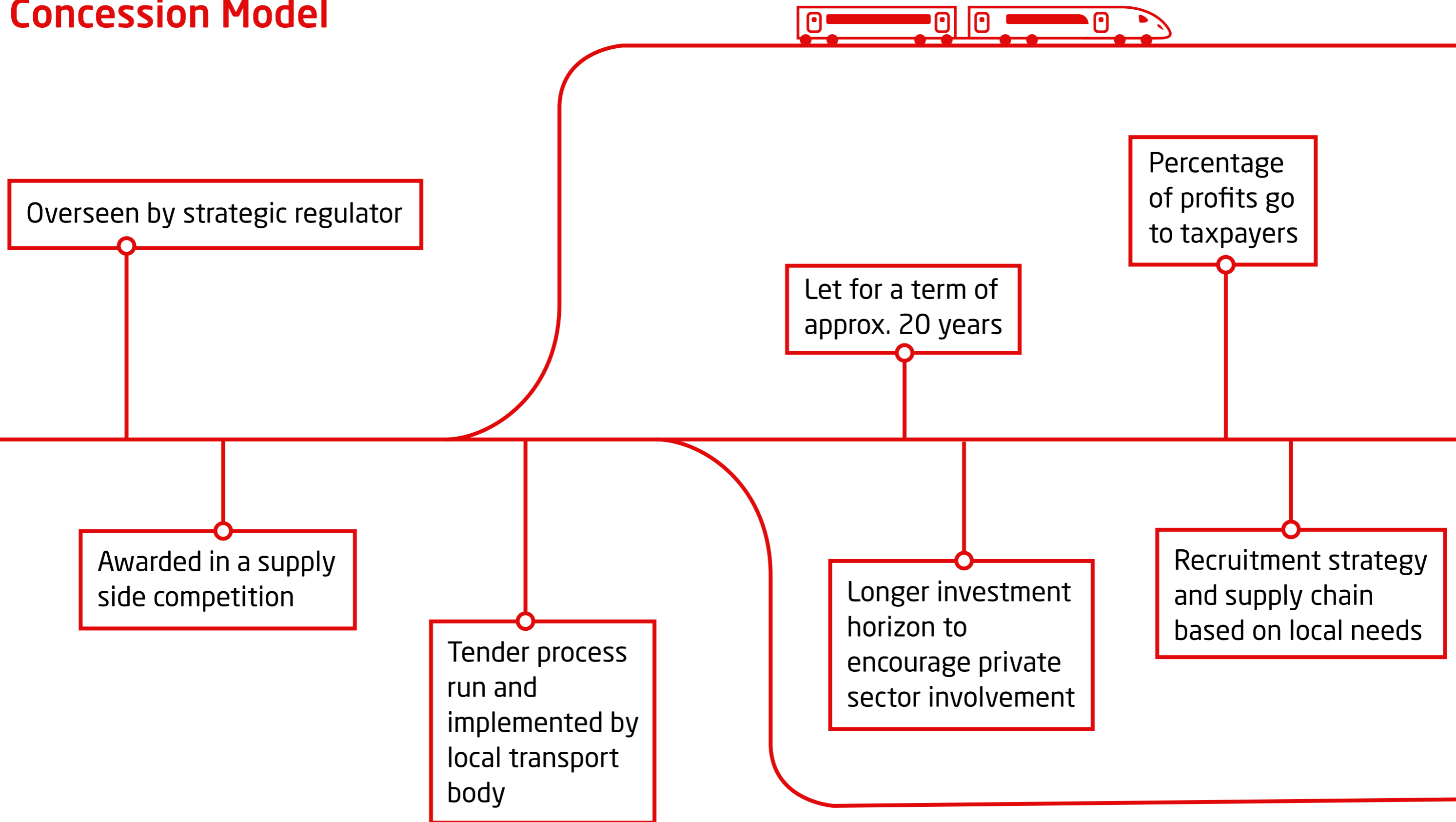
Having the franchise tendered and run locally would also lend itself to the continued devolution of Network Rail, with moves towards greater vertical integration between track and train. In addition, a long-term concession would allow that integration to be fostered and nurtured over the long-term, with alliances deepening and relationships growing. We continue this theme in the next section.



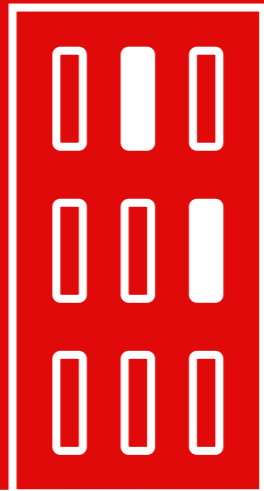
Allowing a local body to run the tender process would allow the service to be specified for the optimum benefit of the local community.



Long-Term Concession Model



London Euston



Infrastructure

Management of track should be devolved to local transport bodies.

A more relaxed planning environment for stations will encourage private sector investment and allow old stations to evolve to meet the needs of the community they serve.

The Victorian Problem

The sheer size of our rail network makes things difficult. It is almost impossible for Network Rail, which looks after our track, to be sure of the exact state of its aging assets across the country. It is also immensely expensive to operate, with budgets of a scale well beyond the experience of train operators.

Much has been written around closer integration of track and train, with the understandable desire to bring greater co-ordination to the running of Britain's railways. With aligned incentives, infrastructure maintenance and upgrades could be directed in the best way to improve the experience for passengers, and it would prevent,

or minimise, the money-merry-go-round between companies regarding compensation for delays.

However, full integration of track and train is not as straightforward as it might first appear. A private sector train operator would be reluctant to take on the risk of such a large piece of infrastructure, that is so expensive to run, without knowing exactly what the condition of the asset was and how much of it needed fixing. They would potentially demand a sizeable risk premium which could represent poor value for money for taxpayers. Infrastructure operators are also unlikely to be the best people to run customer-facing trains.

This is not to say that full vertical integration is impossible, more that there are challenges to overcome. However, there are a range of options for vertical integration, ranging from a simple partnership to a single company, and a looser arrangement might prove simpler to implement whilst still bringing significant benefits.

Between them, short-distance commuter networks encompass the entire UK rail system. These networks will also typically be the most intensive users of a given stretch of line, so the benefits of integration are likely to be most keenly felt if they are the ones integrated with the operation of the infrastructure.

Under the devolved franchising model referenced above, local authorities or arms-length bodies such as TfGM or Transport Scotland could take control of the track. They would then be in a good position to forge a 'deep alliance' between track and train, or even deeper integration, depending on their local needs. In this way, the benefits of integration and strategic planning on a local / regional basis could be maximised for those communities.

This would see Network Rail continue its process of devolution, with smaller operations based on the commuter networks. This would reduce the overall challenge of both gargantuan budgets and knowing the state of the entire network, since the smaller public bodies would be able to take greater control over their own routes.

In terms of funding, the Government could set the overall settlement level for infrastructure investment, with an independent regulator apportioning it between the different commuter networks. The regulator would also need to ensure that the infrastructure investment was spent to maximise the overall utility of rail users in aggregate, and that the integrated, commuter networks were not unduly prioritised over long-distance operators which ran through that region.

Long-distance operators would run their slots on the integrated network, paying track access charges which would help to fund its maintenance and improvement. The base level of these track access charges would be determined by the regulator at the slot-auctioning stage, with annual incremental changes also determined independently by the regulator. The regulator would be responsible for ensuring charges are distributed fairly across operators.

The regulator would have a further role to play in order to safeguard timetables and protocols during disruption, so that the aggregated good of rail users was maximised and the integrated operator's services were not prioritised over others. It would also need to ensure there are direct and clear incentives for the infrastructure operator to provide a robust service to all train companies.



Choices for Stations

At the moment stations are run by either train operators (usually the smaller stations) or Network Rail (usually the large, terminus stations). However, stations can fulfil a far greater role than simply an access point for passengers.

As well as catering for the needs of rail customers, stations also act as a vital local or regional interchange between transport modes such as buses or underground networks. They are also increasingly functioning as destinations in their own right, with high quality shopping or leisure experiences available. The rebuilt Birmingham New Street with its Grand Central area is a good example of this.

A well-functioning and coordinated transport interchange would bring clear benefits to local populations and visitors alike. Attractions such as entertainment, gyms or shopping could draw people into the area.

There would also be room to go further. Stations could provide valuable social services, such as GP surgeries or crèches, for those coming for the entertainment or transport links. They could become indispensable hubs for local communities; boosting the economy, employment and wellbeing.

The transport links give an almost guaranteed footfall which could prove valuable to traditional retailers, struggling in the face of online competition. Social services could also draw people in, providing a virtuous circle of reinforcement.

However, as things stand many stations are often difficult to invest in, either by Network Rail or train companies. Rolling stock or infrastructure will generally come first in the spending queue, leaving stations as the poor relations. Examples like Birmingham New Street are the exception rather than the rule.

An important reason for this is legacy. Stations that are in the centre of large, successful cities can be attractive for developers. They are often surrounded by other retail offerings, offices and have a very high footfall. In addition, land prices are likely to be high which means developers will be willing to make use of the space above stations by building upwards. The sale of residential units above a station can help pay for the customer-facing development.

Many stations do not occupy such prime positions. They are often on the edge of town centres, making them less attractive for developers, and are old which greatly increases the cost of any work.



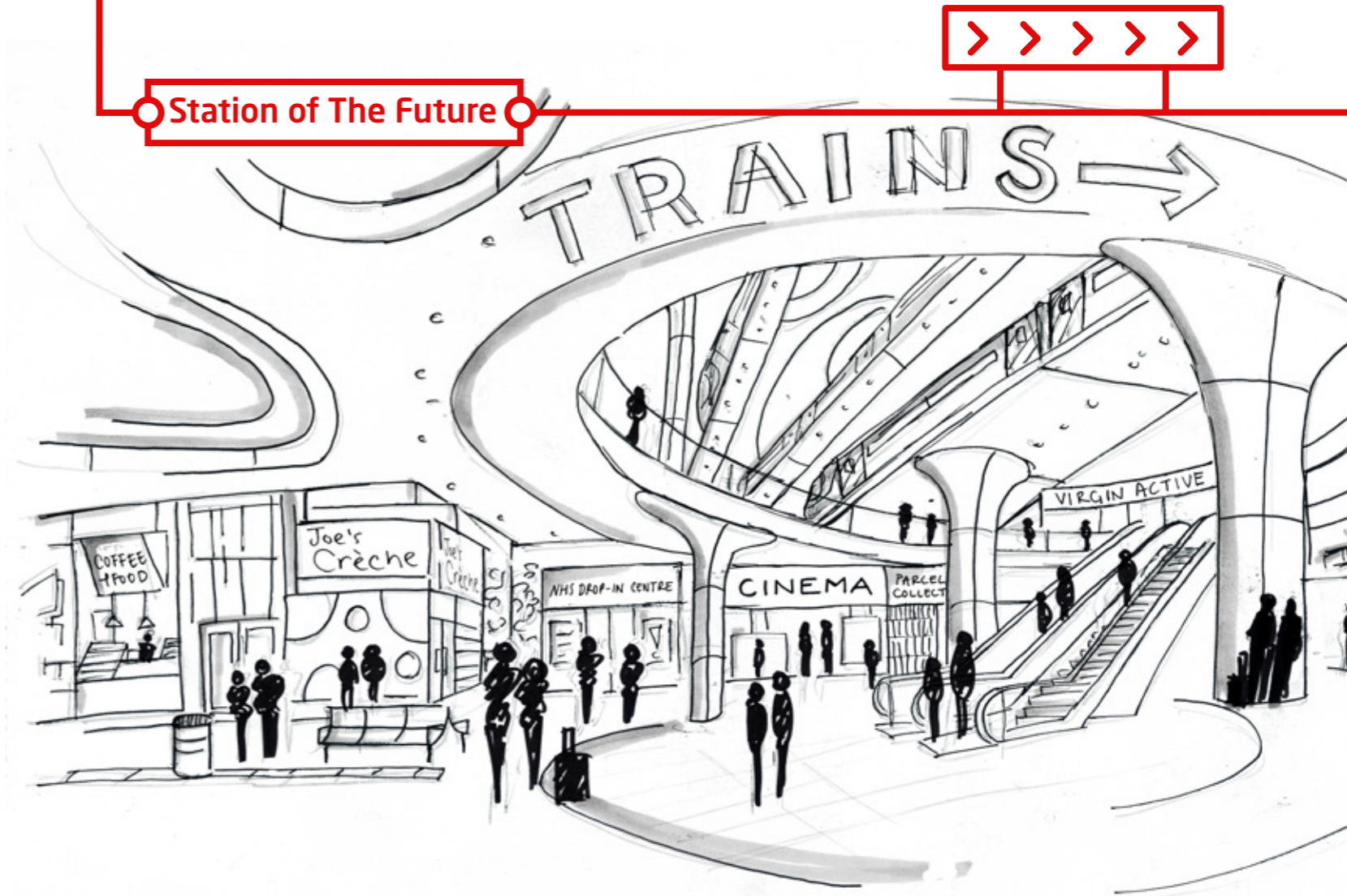
A more receptive environment for planning and redevelopment would help the situation and would dovetail well with the suggestions above around local authorities taking control of rail infrastructure and a devolved concession model. An improved regulatory environment could also assist by removing the need for regulatory approval of every change, no matter how small.

The more strategic horizon provided by a long-term concession, or airline-style slots, could also increase the incentive for train companies to invest. In partnership with commercial property investors, the local authority would also be in a position to offer or facilitate mechanics such as social bonds, with investors getting a return from the local authority if their investment, e.g. in GP surgeries, meets certain targets for benefitting the local community.

In the right regulatory environment, stations could also be targets for City Deal funding to drive local economic growth and wider social benefits.

Overall, we believe that changes to the regulatory environment, together with a longer-term focus and devolution, will improve the attractiveness of stations for development.

Station of The Future



BOOSTING

THE ECONOMY

WELLBEING

& EMPLOYMENT



Regulatory Reform

A new strategic regulator is critical to bringing all these new elements together.

Regulatory Reform

At the moment we have multiple bodies all seeking to control, or influence, the rail network. The DfT, the ORR, Transport Focus and the newly-created Ombudsman all have a role.

With the model proposed above, there would be a much-reduced need for regulation on long-distance routes compared with now, making the industry more efficient. We envisage the regulator would be mainly focussed on principles-based regulation, tackling areas such as safety and disabled provision.

Ideally it would not be regulating other areas – as these would be regulated effectively by customer experience-based competition between operators. However, we recognise that the rail industry is suffering from a collective trust-deficit which needs to be addressed. We therefore suggest that the regulator would specify a minimum standard for these types of areas. Competition should result in operators providing a service significantly better than that base level, but if this improvement failed to materialise there would be the regulatory fall-back of a minimum standard. The newly created Ombudsman service should also be retained, but have its powers extended to include Network Rail, or the devolved infrastructure provider.

On short-distance routes, a light-touch, principles-based regulation would also work, in conjunction

with the franchise specification from the local body. Political pressure from local stakeholders and passengers could take the place of market competition, with the local authority fully accountable. A similar approach to that outlined for long distance operators should therefore have merit.

There would, however, be a key role for the regulator to play in terms of directing investment to the regional infrastructure networks and ensuring that aggregate customer good was maximised, not only for investment but in terms of train paths, timetables and prioritisation during disruption.

The regulator would need to take a strategic, high-level and long-term view, without getting tied up in the minutiae of day-to-day train operations.

The regulator would also be responsible for determining the appropriate paths for freight trains, in order to strike the right balance between passenger and freight needs. It would be worth the regulator also considering whether freight companies should operate on the slot-basis to ensure they utilise their capacity effectively.

We believe that regulation should be streamlined with a single strategic body, at arms-length from Government, directing the network and investment in an independent fashion.

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Conclusions

The UK rail system has been a success, but with limits. However, radical reform could set it up for success for decades to come. An approach which seeks to ditch dogma and the one-size-fits-all approach could provide significant benefits to taxpayers, customers and the economy.

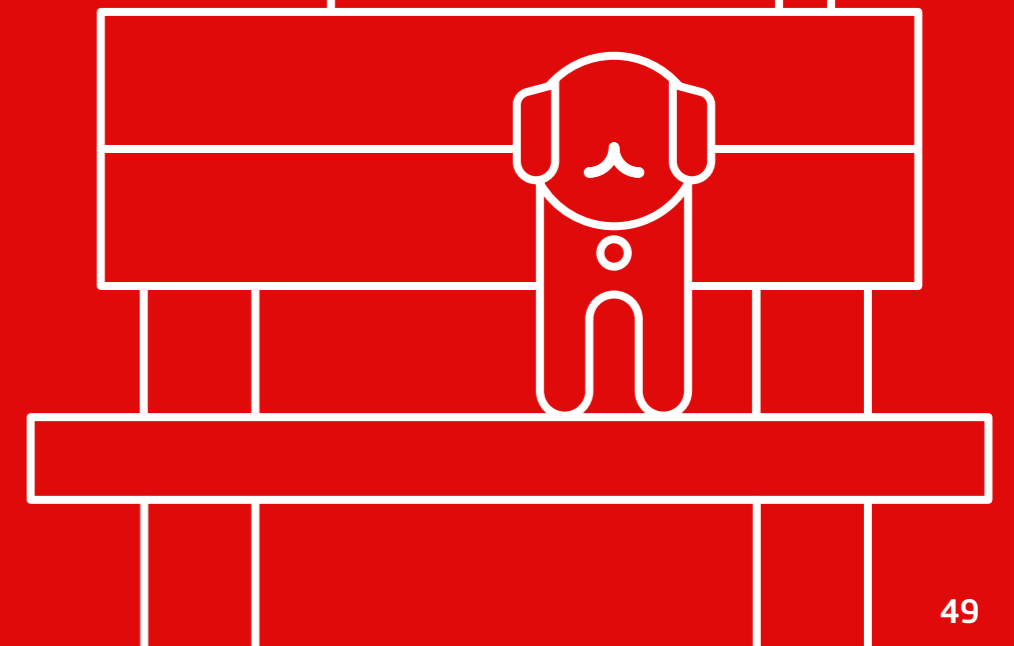
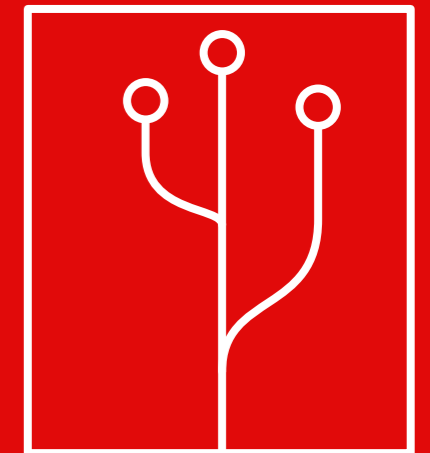
An airline style model with long-distance operators competing against each other via slots that they own indefinitely

A devolved, long-term concession model for short-distance commuter routes which would be more closely integrated with devolved infrastructure management by local governmental bodies



A more positive development environment for stations

Creation of a single independent and strategic regulator



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