



Rail _____
Partners

Developing Passenger Service Contracts: Response to market engagement





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Introduction

The Department for Transport (DfT) began its market engagement on the future of Passenger Service Contracts (PSCs) with a market engagement day on 4 November 2021, followed by a series of bilateral meetings with prospective market participants. Rail Partners welcome this engagement and are committed to supporting the DfT in the continued development of PSCs – ensuring that the Williams-Shapps Plan for Rail’s ambition to create a vibrant competitive market is delivered.

We further welcome continued commitment from government and the Great British Railways Transition Team (GBRTT) to a future in which public and private sectors are involved in a meaningful and collaborative relationship to deliver rail reform. In our view, customers and taxpayers need this relationship to work, with each partner in a position to use their strengths and expertise to deliver what customers want, and the nation needs – a high quality product that helps accelerate revenue recovery.

Post-market engagement, our members have considered a number of areas and proposals for developing PSCs. These are detailed in this paper and aim to ensure that the envisaged collaborative relationship between Great British Railways (GBR) and train operators is effective and delivers the goals of the white paper. Crucially, in order to achieve this, we believe that creating a vibrant and competitive market is the first step, notably by:

- Ensuring a balanced risk and reward profile in PSCs;
- Developing a simpler procurement process enabling a significant reduction in the cost of bidding and one which does not simply result in a 'race to the bottom' on costs;
- Requiring significantly lower capital requirements and bonds compared with franchising that reflect the risks passed to train operators;
- Ensuring that the outcomes to be delivered by train operators are consistent with the levers and incentives they have; and
- Ensuring that the key commercial, innovation and delivery expertise of private sector owning groups and operators are harnessed to the full.

We recognise that the development of the first contract is a work in progress. However, at this stage, as presented the risk and reward profile in PSCs appears unbalanced and unattractive. Operators are willing to take back cost risk, reducing the burden on the taxpayer – and some revenue risk in the right circumstances – but to do this they must have the right levers to help to manage these costs and grow revenues. Further, in the context of seemingly punitive penalties associated with operational, service quality and customer experience regimes, it is not clear where the possibility of upside lies.



Although such regimes can be priced for, with the price reflecting the calibration and ability to control or influence the outcomes being measured, this approach is unlikely to deliver value for money. Equally, given the lack of revenue risk in the initial PSCs, we believe capital requirements and bonds should be substantially lower than under franchising and this will encourage more market participants to bid for the new contracts.

Fundamentally, the design of the procurement process needs to avoid incentivising a low-cost-bid-wins-all approach, driving a race to the bottom – resulting in unstable or even unsustainable contracts that will increase the risk of in-life variations or contract failure. In part, franchises failed due to bidders committing to undeliverable revenue lines. While PSCs will address this, the benefits of more stable contracts would be lost if they resulted in undeliverable cost lines. Inherently, this would undermine the whole rail reform process and not deliver the outcomes of the white paper.

Empowering operators to drive reform

The white paper is clear that private sector innovation should be harnessed. However, the initial market engagement process is focussed only on tightly specified concessions. It is understood that the intention is this would be the contractual model used for many contracts outside the long-distance inter-city sector, with seemingly limited levers in many areas for private sector train operators to collaborate with GBR in a flexible and dynamic relationship to deliver on the white paper commitments.

In our view, this would limit the ability to deliver the white paper's aspiration of leveraging private sector innovation in the interests of customers through a spectrum of contracts for which concessions may be the foundation, but which reflect different customer needs in different geographies or market types. If contractual flexibility will be a feature of these different markets, this needs to be clarified in greater detail if there is to be the opportunity for the sector to benefit from the experience and capabilities – gained within the UK and internationally – of owning groups.

Equally, the role envisaged for train operators within concessions makes it hard to see how either a genuine collaborative partnership with the client and the infrastructure manager can be developed; or how operators can be held to account for delivering outcomes for which they do not have the levers to control or influence.

As such, we have developed proposals in six areas, which remain consistent with the white paper, but also highlight how PSCs can get the best from the private sector operators and harness a truly collaborative relationship with GBR. These are as show on the right:

Section 1 - Developing the timetable:

The benefits of having a single organisation with control and accountability for train service specification, infrastructure delivery and capacity allocation risk not being taken advantage of to the full if GBR specifies the detailed timetable at invitation to tender (ITT) stage in isolation – particularly without meaningful input from train operators, potentially leading to a timetable that is not as high-performing and / or cost-efficient as it could be. We offer an alternative proposal that maximises timetable innovation by operators while staying in keeping with the white paper statement that GBR will set timetables.

Section 2 - Setting fares:

The white paper commitments for operators to be incentivised to grow passenger numbers, to manage capacity and to be responsible for meeting demanding targets on customer satisfaction, means operators outside of the long-distance inter-city market will need some influence over fare setting within a framework owned by GBR. We propose that a more developed role for operators would still be consistent with the white paper statement that GBR will set most fares and be consistent with the need for fares simplification.

Section 3 - Station operations and asset management:

The white paper sets out that operators are to be held accountable for passenger satisfaction, staff availability, customer information, vandalism repair, revenue protection and cleanliness targets – meaning that operators will need levers to deliver these targets for customers and thus necessitating a meaningful role at stations. In keeping with the white paper statement that GBR will own all stations, we propose roles for operators covering aspects of customer-facing, operational control and asset management.

Section 4 - Operational, customer and service metrics:

The white paper proposes getting the best from the private sector, notably around innovation, commercial drive and collaboration. However, it is unclear how the proposed operational, customer and service quality regimes will secure the intended collaboration and performance from the private sector, or how they will drive innovation and improvements for customers if operators do not have the levers available to them to influence the relevant parts of the customer experience. More detail is required in these areas.

Section 5 - Risk transfer:

The white paper seeks to create a vibrant and competitive rail market through PSCs. However, the apparent lack of positive incentives in PSCs would dilute the benefit of continued private sector involvement in rail. Greater clarity on how risk and reward would be shared fairly and sustainably, and how a balanced reward and penalty structure may operate, is needed to ensure the creation of a vibrant and growing market for these contracts by making them attractive propositions.

Section 6 - Capital bonding:

The level of capital requirement and bonding must reflect the contractual reality of the actual risks operators are bearing and able to influence, and not be set at a level which in itself reduces the attractiveness of the contracts. Addressing this is critical if the white paper is to deliver the reform envisaged through private sector involvement.

About this paper

Our members support the reforms set out in the Williams-Shapps Plan for Rail and share the ambition set out by the Secretary of State and Keith Williams to deliver a better railway for all our customers – driving recovery not just for the people and businesses that rely on rail, but for taxpayers and the wider economy. The proposals in this paper are intended to support that ambition, bringing together collective expertise and experience to focus on delivering the outcomes set out in the white paper.

The white paper's 10 key outcomes clearly and unambiguously set out how reform is intended to change the railway for the better. Owning groups are keen to play a role in delivering these outcomes by bringing their skills, capabilities and flair to addressing the challenges the railway faces, in partnership with GBR. Our members have already put forward ambitious plans to lead on reducing the industry's annual cost base – with elements of these proposals already adopted or under discussion.

These proposals are intended to assist in developing that meaningful role while keeping within the white paper commitments – defining the role private sector operators can play in collaboration with GBR. A role which maximises their strengths – innovation, an unrelenting focus on quality, great customer service, commercial and operational expertise, and contract management – to deliver the clear vision of the future at the heart of the white paper and a financially sustainable railway for the decades to come.



1.0 Developing the timetable



Summary of our view

The white paper, in making Great British Railways (GBR) accountable for the specification and tendering of contracts, management and development of infrastructure, and allocation of capacity; significantly reduces the potential for repeating the failures of the May 2018 timetable. The white paper rightly creates this structure to create clear accountability with GBR ensuring the timetable's overall deliverability and robustness.

The white paper notes that GBR will draw up and set most timetables, seeking to avoid the design of services that the infrastructure cannot support. However, we believe the benefits of this increased alignment of accountabilities would be reduced if GBR simply specifies the timetable and thus operating plan to deliver at the invitation to tender (ITT) stage. In so doing, it would significantly reduce the potential for bidders, using their knowledge and operational expertise during the bid stage, to develop a timetable that is more robust and which better meets the needs of customers and, in the interests of taxpayers, delivers it as cost-effectively as possible.

Even within the context of the white paper, and the clear accountability it sets for GBR in specifying the timetable, it would be possible to design a process that not only supports and enhances that broader accountability, but which delivers better outcomes for customers and taxpayers. That is why owning groups believe GBR should provide a higher-level of specification to the market than appears to be proposed, allowing bidders to enhance the proposition for GBR. This should be coupled with further opportunities to make in-life changes, which is particularly the case in the context of the increased flexibility which will result from the work of the Industry Timetable Process Reform (ITPR) group.

a. Proposed approach to timetable specification

In order to meet the goals of the white paper and fully leverage the embedded timetabling expertise of owning groups and train operators, we believe GBR should consult widely prior to the ITT stage of PSCs with relevant stakeholders, including government, on their aspirations for the timetable. With this knowledge, GBR should provide a higher level of specification to the market than appears to be proposed, similar to the train service requirement (TSR) approach used in rail franchises, rather than a detailed timetable, to allow bidders to develop a proposition that is both cost efficient and high performing while in keeping with GBR expectations.

We understand the rationale for GBR seeking to specify a detailed timetable given previous concerns over infrastructure capability. However, given that GBR will have control and accountability over train service specification, infrastructure delivery and capacity allocation, we agree with the white paper that previous shortcomings would be avoided by matching realistic specification within the confines of infrastructure constraints.¹ This was a critical failure of the May 2018 timetable change, whereby a separate train service specifier and infrastructure manager were inherently misaligned – leaving timetables unachievable within the parameters of existing infrastructure.

With these new and aligned accountabilities and expertise within GBR, the need to specify a detailed timetable at ITT stage is not necessary. GBR will be able to determine whether the train service specification and infrastructure capacity are aligned at a macro level and whether a robust, high performing and efficient timetable is possible to be developed – meaning that GBR will still “... specify service levels...” but with the added value of the private sector.²



b. Proposed approach to timetable specification

Delivering a detailed specification in the ITT risks being sub-optimal from a train planning and punctuality perspective. If GBR were to provide both the detailed timetable (the inputs) and the targets for punctuality, customer satisfaction and so forth (the outcomes), then operators would be limited by the operational constraints of the specifier and might consider that the inputs and required outcomes are not aligned. This could have the undesired effect of driving inefficiency in resource utilisation (crew and stock) and hence increase cost to the taxpayer and limits operational innovation.

The timetable would also inherently determine the rolling stock that must be used (because rolling stock characteristics are a critical element of a deliverable timetable), and the train plan for rolling stock diagrams and train crew rosters. This approach risks baking in significant cost given that operators will have little freedom to develop an optimised and cost efficient timetable at bid stage. There will also be a higher probability of bidders including larger risk premiums in their bids to cover possible contractual penalties if they believe that the timetable set by GBR and the outcomes to be achieved are incompatible at the outset of the contract.

c. Leveraging operational expertise to optimise the timetable

As noted above, we believe that a higher-level specification than a detailed timetable at ITT stage does not present the same risks as under franchising because GBR will have control over the train service specification, available infrastructure capacity and network access. As such, GBR can be confident in providing the market with the ability to hone and develop timetables and operating plans as part of the tender response. GBR could specify high-level outputs based on the geography, market or potential markets, and passenger type – including things such as (list not exhaustive):

- Frequency and stopping patterns
- Connectivity between key places
- End to end journey times
- Seat availability thresholds
- Opportunities for revenue generation

This would take advantage of existing expertise within operators in relation to resource planning (specifically rolling stock diagrams and train crew diagrams), efficient deployment of that resource through traincrew utilisation and rolling stock allocation (including any additional resource to support the operation of the service during disruption), delivery costs, and deliverability risk assessments. It would also enable operators

to develop timetables that are consistent with punctuality targets. This would ensure that the goals of the white paper and GBR's objectives are met through a cost-efficient and high-performing timetable, while avoiding baking in an operating model that is potentially high cost due to it being an inefficient use of assets and resources.

This approach to timetabling would also benefit PSCs where there are revenue growth incentives, allowing bidders to advise on revenue generation in the context of the market or markets being served. Ultimately, GBR would decide which timetables get implemented, consistent with the white paper statement that GBR will set timetables.

d. Importance of in-life changes to the timetable

During the life of the contract, it is understood that operators will be expected to use their knowledge and operational expertise to work collaboratively with GBR to continuously improve the timetable (whether over the short- or longer-term) and support earlier decision making on the train plan.

The move from franchising to PSCs will not alter the fact that it will continue to be operators who will be closest to customers and know when a timetable is not working efficiently for the business – placing them in prime position to best understand how to develop an efficient timetable and train plan. Therefore, in-life changes should allow operators to use that local knowledge, in the context of the increased flexibility and other benefits delivered by the ongoing work of the ITPR- the Network Rail programme led by the System Operator and, in partnership with GBR regions, to propose and initiate changes to the timetable where there is a demonstrable benefit to doing so.

As GBR will have ultimate accountability for the timetable, it would then either approve or reject these changes. For such changes to be truly responsive, this approval process would need to be as smooth as possible, and we would expect it to be undertaken centrally to address any potential boundary issues.

e. A collaborative process

The operator has a critical role in adding value to the timetabling process and the system should harness this in full. This has been demonstrated by those operating rail concessions on behalf of Transport for London, where the operator has a significant role – reviewing the timetable specification, considering how best the requirements can be met by leading on the production and implementation of the timetable, making best use of its management of staff and rolling stock available.

In recent years operators have worked in partnership with the client to support and refine timetable specifications, improving its deliverability and robustness. Operator involvement was critical as in many instances the original specification did not stand up to the challenges of real-world operations or resource efficiency even though timetables worked on paper. It is this intimate knowledge of the operating environment that places operators at the heart of successful timetable implementation.

f. Benefits to customers and taxpayers

Adopting the approach set out in this paper would benefit customers greatly, with high-level service requirements set out by GBR being enhanced by the market while remaining in keeping with the outputs and outcomes required from GBR. This would increase the likelihood of developing a product that meets customer demands at high levels of punctuality. It would also benefit taxpayers, not simply by the potential to accelerate the return of passengers to the network but also by producing an optimal train plan that would reduce industry costs.

The counter is that by the time the PSC came into effect, a timetable specified at ITT stage would already be at least two years old and have had little opportunity to be adjusted to improve its deliverability and efficiency. Any failure to deliver an optimum timetable would inherently lead to higher costs and possibly poorer train performance, with potentially prolonged reputational consequences for the operator, GBR and the industry as a whole.



2.0 Setting fares

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Summary of our view

It is crucial that decisions on fares are seen in the wider context of the industry's need to return to a financially sustainable position. Before the Omicron variant of COVID-19 emerged and restrictions tightened, industry figures indicated that leisure travel had returned almost to pre-pandemic levels, while commuting and business travel remained suppressed – with industry revenues still only around two-thirds of 2019 levels (approx. £3bn down).

The white paper commits to a simplification of fares, noting that Great British Railways (GBR) will be accountable for setting most fares, an approach similar to that taken by Transport for London (TfL) on the Overground network. GBR will also work with local leaders to integrate ticketing and fares with other transport services. While long distance inter-city operators will have a greater role in setting fares when compared to other operators. In those long-distance inter-city markets it is assumed that GBR will set the maximum walk-up fare and then, through the Passenger Service Contract (PSC), enable operators to set advance and other pricing differentials to grow revenue and meet market demand.

However, the need to innovate and grow revenue exists more than ever in commuter and regional markets post pandemic, and private sector operators' proven ability to grow revenues should be fully harnessed. For this reason, independent owning groups believe that commuter and regional operators should have some degree of fare flexibility within a fares framework set by GBR – while recognising that this will not be to the same extent as inter-city operators. This could mean providing input and advice to GBR on fares changes and promotions to generate revenue and manage demand in some markets while setting advance fares in all markets (not just inter-city markets). We believe this would still be consistent with the white paper statement that GBR will set most fares, while enabling operators to have the levers they need to manage demand and grow revenue as also envisaged in the white paper.

a. The benefits of some commercial freedom

It is recognised that "[GBR]...will set most fares"³ within the financial parameters set by government, marking a significant shift from today's fares framework. Currently, the lead operator sets the inter-available walk-up fare, but this will be GBR in the future – with GBR also setting the limits for regulated fares. Within this context, the white paper and the market engagement day suggested that long distance inter-city operators would have greater degrees of fares flexibility which we support, although more detail is needed about what this means in practice. However, our members believe where commuter and regional operators have been earmarked for not having control over fares, there are significant benefits to them having the ability to provide input and advice into GBR to deliver fares that meet the needs of customers and secure additional revenue. This is particularly important given that the white paper envisages revenue growth incentives in contracts.

With the right structure between operator and GBR, fares could be presented to GBR for approval and implemented at pace to make the best use of assets and drive revenue growth as well as customer satisfaction. GBR would make sure that the fares do not create new anomalies and adhere to the conditions within the framework. In addition, in instances where non-intercity operators have some form of revenue growth incentive mechanism, it is important they have control over advance fares – given that this is a key tool to drive both revenue and passenger satisfaction while managing demand within the capacity available.

³ Williams-Shapps Plan for Rail 2021, "It [GBR] will procure passenger services and set most fares and timetables." p10



b. Application of the London Overground fares model

The London Overground multi-modal zonal fares model, with TfL setting all fares, has worked well in London and would be applicable to other large city conurbations. Even then, there is a case for a degree of flexibility for operators within the overall fares structure in order to accelerate the recovery of revenues, particularly on underused routes. The risk of applying a London Overground fares model to all commuter and regional operators is its failure to account for the differing conditions in place in different geographies and different markets.

Post-pandemic and given the need to respond to different market conditions and urgently repair the industry's finances, the application of the TfL Overground fares model to all commuter and regional operators could build in a rigidity that hinders recovery. It would risk not harnessing the commercial expertise of private sector operators and knowledge of their local markets. Applying the conditions in London to the railway in Norfolk or Cumbria or Cornwall would not support the wider financial objective of reform. As such, to increase revenue and drive passengers back to the network, operators will need opportunities to adjust some fares and offer promotions within the framework provided by GBR.

c. Addressing the issue of revenue risk

We recognise that the white paper is clear that it will be GBR that will take revenue risk, and therefore would need to be protected from any potential downside from adjustments to fares and fares promotions made by operators.

With the right internal structures and capability in place, GBR would be in a position to determine whether or not any such adjustments would be abstractive across the whole system and, if so, should not be pursued. However, we would envisage the majority of any adjustments to be self-contained offers and deals designed to grow revenue. The operator should be incentivised to identify the demand based on their local knowledge and propose this to GBR, with a presumption towards proceeding if GBR were satisfied the proposal was not overall abstractive.

Where we suggest that operators in non-inter-city markets that have advance fares should have the ability to set those fares, a strong revenue growth incentive would provide the mechanism to increase the likelihood of revenue generation. Operators could even propose putting in their own capital – for example, to spend on marketing or testing new approaches – where a reasonable reward mechanism for doing so existed.

d. Benefits to customers and taxpayers

The case for giving commuter-style operators the ability to suggest fares to GBR is made more pertinent by the pandemic. Currently, commuter-style operators are likely to have higher patronage Tuesday to Thursday, compared with lower patronage on Monday and Friday – due to increased working from home. If operators were incentivised and had the mechanism to recommend a Monday fare promotion, for example, to drive increased patronage, this would increase revenue for GBR.

Having this ability is also pertinent for medium distance journeys – particularly those ending outside major urban centres – where competition exists from car, or people have the option of not making the journey at all. A model by which all fares are set centrally by GBR, with no input or control from operators outside of long-distance intercity operators, including over advance fares, would remove the capability for successful day to day yield management that occurs today. This a key tool in an operator's toolbox to manage demand and capacity, and increase revenue, as envisaged in the white paper.



3.0 Station operations and asset management

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Summary of our view

It is clear from the white paper and market engagement day, Great British Railways (GBR) will own the stations and set the long-term strategic objectives and standards. These should be linked to customer outcomes, as noted within the performance, customer and service quality regimes, and also to wider policy priorities such as carbon emission reduction, accessibility, multi-modal travel and so forth.

Owning groups believe the delivery of these strategic objectives, in many instances, should be carried out by the operator. This would provide the necessary levers and controls to enable operators to meet their contractual responsibilities and

allow them to leverage their local knowledge and understanding of the customers and communities they serve. However, it is recognised that in locations where there are currently multiple operators running stations, duplication should be avoided through 'one team' style arrangements.

There is already a recognition of the key role that operators play in the provision of customer service and delivery at stations. Under a new model, there can be greater clarity of accountability, reduced interfaces, greater use of the one team approach, and a more agile and efficient delivery response. With operators as delivery partners in customer facing roles, commercial development and asset management; better outcomes for customers, communities, and taxpayers can be achieved.

a. Ownership, strategic vision setting and branding

Ownership, vision setting and branding		
	Station estate today	New proposed model
Owned by	Network Rail	GBR
Strategic Vision and Objectives	Varies	GBR
Branding	Varies	GBR-led, with regional/local sub-brands where appropriate

In keeping with the white paper, GBR national and regional teams should take the lead in setting the long-term strategic vision and objectives for stations, alongside setting standards and masterplan development. These objectives should be linked to customer outcomes and wider national policy priorities such as emission reduction, multi-modal travel, accessibility and so on.

It is assumed that GBR centre will set national station objectives in collaboration with the five GBR Regional Station Management Teams. These teams would then identify strategic opportunities (i.e., community partnerships will be important in areas with a greater number of rural, unstaffed stations like East Anglia, the West Country and the North West) and establish partnerships between GBR, operators, devolved bodies, local authorities and community rail leads to align delivery around common goals.

Overall station branding would be led by GBR, supporting the delivery of a national identity for the railways, with regional and local sub-brands in place where appropriate.

b. Station operations, maintenance, and customer service

Station operations, maintenance, and customer service		
	Station estate today	New proposed model
Operated by	Operator (Network Rail for Managed Stations)	Operator (potential for other third parties)
Train dispatch	Operator	Operator
Ticket retail (ex. TVMs)	Operator	GBR-led, operator delivery
Station Retail	Network Rail/Operator	GBR-led, third party or operator delivery
Clean, inspect and maintain	Varies, mainly operator	Operator
Repair	Varies	Operator (potential for other third parties)
Renew	Varies, mainly Network Rail	Operator (potential for other third parties)

A customer's journey starts and ends at the station, stations therefore play a significant role in determining overall customer experience. Under their new contracts, the white paper and market engagement day outlines that operators will be held accountable for delivering targets on passenger satisfaction, staff availability, customer information, vandalism repair, revenue protection and cleanliness.

If operators are to be held accountable for these targets, they need to have the controls and levers in place to deliver against them. Which necessitates a meaningful role at stations potentially covering aspects of operational control, customer-facing roles and asset management.

Therefore, we believe operators should have responsibility for train dispatch at stations if they are to be held accountable for train performance, although efficiencies can be gained through more of a one team approach. Notably, if operators are to be measured against stringent customer experience metrics, they need to have a role alongside GBR in ticket retailing and wayfinding to meaningfully shape

the customer experience. In addition, operators will need the autonomy to manage the staff and contractors that clean, inspect and maintain the station if they are to be held accountable and face penalties under service quality regimes.

When it comes to repairing and renewing facilities at stations, local operators could be incentivised through their contracts to deliver improvements more efficiently and quicker, either themselves or through third parties. Today there are too many stations with split responsibilities (between Network Rail and operators) in this area and there needs to be far greater accountability with one single delivery agent. Operators could work with local suppliers to maintain and renew facilities, reduce costs and better meet the needs of customers. This already occurs on a number of rail franchises, where the operator has sole responsibility for delivery. This has demonstrated that the industry has the capability to deliver this and to do so more efficiently and cost effectively.

c. Infrastructure enhancement and commercial development

Infrastructure enhancement and commercial development		
	Station estate today	New model
Rail network enhancements, e.g. capacity etc.	Network Rail	GBR
Commercial development	Varies	GBR-led, operator delivery
Asset Protection	Network Rail	GBR

GBR would retain control of the network (track and signalling) and responsibility for asset protection and network-related enhancements around stations. Major commercial development and long-term planning at stations should involve a framework between GBR, operator and local community in a partnership model. GBR would specify the stations national and regional objectives and operators would use their commercial expertise to deliver on those objectives.

Operators would be closely integrated with GBR's regional divisions (and other local partners such as devolved bodies, local authorities, and community rail groups), ensuring that decision-making is kept as close as possible to the customer and local communities. Crucially, operators would be responsible for those areas for which they will be assessed i.e. customer service, service quality regime and performance.

This model keeps relationships and contracts local wherever possible. It would be more efficient and drive better outcomes for the customer than a nationally/regionally centralised and distant model. Operators could be incentivised within the PSCs to encourage

greater third-party suppliers and greater third-party investment.

This model would respond to a range of problems identified by the white paper, including:

- Keeping delivery close to the customer;
- Streamlined accountability and removing duplication;
- Improved maintenance and renewal cost efficiencies; and
- Improved local partnerships and encouraging innovation through access to third party investment.

To split the relationship with the local community between the train service provider (operator) and station facilities provider (GBR) would add an interface where the white paper is seeking greater simplification.



4.0 Operational and customer metrics

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Summary of our view

Many of the operational, customer and service quality regimes appear only to focus on penalties – rather than driving the innovation and collaboration that is envisaged in the white paper. The limited levers available to operators in contracts will inherently affect their ability to improve the customer experience and therefore the effectiveness of targets related to customer service and perception – particularly over elements such as timetabling, fares and stations – as set out in previous sections.

Therefore, there is a greater question around whether Great British Railways (GBR) will get both the collaboration and performance it desires using these measures and, in turn, the very best from the private sector. Moreover, it is unclear how these measures will meaningfully drive innovation and improvements for customers. While operators do not oppose the operational, customer and service quality regimes, we believe that, at a fundamental level, operators can only be measured for the things they have control over and that by offering appropriate input to operators, better outcomes can be delivered.

a. Service quality regime (SQR)

The service quality regime (SQR) rightly seeks to ensure that core quality standards are met, stations and trains are well-kept, and that facilities are working and in good condition. The market engagement day suggested that these operator activities would centre on cleanliness, information, asset availability/presentation, and reporting faults to GBR where they are the asset maintainer.

This would then be independently audited by an organisation appointed by GBR and deductions taken from the periodic concession payment when assets are not maintained, or faults not rectified/reported. Broadly, we support the use and principles of the SQR to ensure operators provide the best quality of services to customers in a range of functions. However, the SQR in its proposed form has several limitations that may drive up costs for minor benefits and not deliver the best outcomes for customers, taxpayers and intended collaboration between operators and GBR.

At present, the metrics proposed appear somewhat punitive, seeking only to focus on penalties rather than rewards for innovation or improved service quality. If operators are to be penalised, they will inherently need full control over the measure they are being penalised against to take remedial action. For example, an SQR will need to fully disaggregate where one operator may run a station, but another operator runs the service – otherwise penalties could be unfairly levelled on an operator. This challenge will also exist in 'one team' locations where currently Network Rail and operators deliver joint operations.

The SQR envisaged, by only focusing on faults by operators (i.e., not achieving 100% in a given area), risks importing significant cost as operators seek to meet those targets – without any margin for error. Without appropriate benchmarks, the regime will become expensive to implement as operators seek to manage out any potential failure, particularly if penalties are too harsh over small faults. The costs of managing out any potential failure will become priced into contracts and could outweigh the actual impact of failure.

Ultimately, if an SQR is focused solely on penalising Passenger Service Contract (PSC) holders it will simply encourage an inward focus on SQR measures rather than a collaborative and innovative relationship between GBR and operator. A refined system which in addition to penalties, provides benchmarks for operators to reach and be rewarded would likely create the culture of collaboration envisaged in the white paper and promoted on market engagement day. Such an approach would also likely be cheaper for taxpayers and would drive better customer outcomes.



b. Customer service regime (CSR) and customer perception regime (CPR)

The customer service regime (CSR) seeks to ensure customers receive a helpful and personable service from all staff during their journey. The market engagement day suggested that the CSR will assess how well employees are meeting the needs of customers at each stage of the customer journey – with questions weighted to reflect specific requirements between contracts. An independent organisation appointed by GBR will carry out mystery shopper surveys – with operators required to meet periodic targets (baselined for each competition) and deductions made when targets not met from the periodic concession payment.

The customer perception regime (CPR) seeks to evaluate how customers will perceive their experiences. The market engagement day suggested that Wavelength may play a key role and would allow GBR and Train Operating Company's (TOCs) to gather more holistic information to drive better decision making, with a small number of annual customer perception targets, jointly agreed, and a financial reward for achieving targets.

Gathering detailed information on how customers perceive their experiences using the railways is key to the continuous improvement of services and we support the use of tools such as Wavelength and a mystery shopper to measure the CSR and CPR. However, to really drive customer experience and perception, once again, operators can only be measured on the things they have full control over.

For example, if operators do not have control over the core product (i.e., timetable and fares) and there is an issue of overcrowding at a particular time of the day, it is only GBR that can adjust fares and make timetable amendments to manage the customer experience, and thus it would appear unfair to penalise an operator for such an issue. Similarly, if GBR are going to run stations and there are accessibility shortcomings (e.g. a toilet/lift is broken), while an operator could report this issue, such a fault would need disaggregating from an overall perception score.

As such, when it comes to the CSR and CPR, operators can only be held to account and penalised and rewarded for the things they have the power to change. There also needs to be flexibility so that the highest priority customer issues are the ones being assessed – for example health and COVID-19 mitigations during the pandemic – ensuring the new approach is agile to respond to change. This links back to recommendations made within the timetabling and fares section of this paper – notably that for operators to meaningfully develop, enhance and drive the customer experience they need levers to influence the core product. Without these levers, the extent to which operators can truly be measured within the CSR and CPR appears limited.

c. Operational performance measures

The new regime seeks to incentivise operators to improve performance through innovation and continuous improvement, in collaboration with GBR. The market engagement day suggests that the operator performance regime will centre around benchmarks set in the contract – where performance is better than the benchmark the operator will receive a bonus and if the performance is worse the operator will pay a penalty. Bidders may bid above the benchmarks to receive associated bonus payments, but they will not be able to propose lower benchmarks.

The key measure suggested is average passenger lateness (APL) – a whole industry measure to incentivise parties to work together to identify interventions and investments to improve performance and solve issues quickly. Potentially comprising of half expected bonuses and penalties, with rewards and penalties informed by the revenue impact of delays and cancellations. A TOC-on-self measure was also presented which was suggested as being passenger weighted, with KPIs such as incremental penalties for failing to reach benchmarks for cancellations (due to train crew or fleet and short-form service) and depot right-time starts, station dwell time and right-time at key junctions.

Where revenue risk is removed from operators there is a greater emphasis on incentivising operators to maintain high levels of operational performance through appropriate incentive regimes. However, the metrics used under these regimes must be agile and wide in scope to provide flexibility and reward operators to develop innovative methods to improve operational performance, while maintaining high operational standards – as noted in the white paper.⁵

Under a broad metric such as the proposed APL measure it is typically hard to make relevant to customers and staff. Under the National Rail Contracts (NRCs), operational measures are easy to explain to passengers and staff alike. Operators can provide targets to managers in frontline teams related to cancellations, short forms and delay minutes. As such, there is a risk that APL is confusing both for staff and customers and even harder for those in control needing to make quick decisions to recover delays.

In terms of disaggregating causes under APL, understanding these variables is important given that infrastructure can contribute significantly to poor operator performance, delays, or disruption (approximately 58.3% in period 8). Operational performance will need to consider the role of the infrastructure manager – in this instance GBR. Like operators, this measure (and others) must equally hold GBR to account for events it causes while incentivising infrastructure performance. While we support the principles underpinning the operational performance proposals outlined at the PSC engagement day, more details from DfT and Great British Railways Transition Team (GBRTT) are required to fully evaluate the new system and ensure that protections for things outside of an operator's control are in place.

⁵ Williams-Shapps Plan for Rail 2021, "Some targets will be adaptable during a contract, so that operators can respond to changing passenger needs, government priorities and economic conditions." p55



5.0 Risk transfer

5

Summary of our view

A key component of an attractive and biddable contract proposition is to establish a fair balance of risk and reward. Accepting that the commercial model underpinning the Passenger Service Contracts (PSC) is still in development and will be revised as part of the ongoing market engagement phase, overall, the risk profiles do not yet appear to be a compelling proposition. The lack of potential financial upside makes managing cost risk challenging without appropriate protection, and the procurement process could drive a low-cost-bid-wins-all approach without careful design.

The government rightly wants a vibrant market for PSCs, with the aspiration set out in the white paper to reduce the barriers to entry for bidders and reinvigorate the competitive market for rail. However, a key dependency is providing greater clarity and certainty to the market on the projected cost of bidding, as well as the risk profile for the contract, and levers operators will have to manage risk and deliver on their obligations.

Independent owning groups suggest that sufficient contractual protection against unintended consequences affecting the cost base are clarified, and operators held harmless in areas where they have no or limited control or influence. In addition, the current procurement approach risks driving a race to the bottom on cost that fundamentally fails to deliver reform – and leads to a process of refined in-life changes as the operator does not have the required levers for change. In part, franchises failed due to bidders committing to undeliverable revenue lines. While PSCs will address this, the benefits of more stable contracts would be lost if they resulted in undeliverable cost lines. Inherently, this would undermine the goals of the white paper and wider reform.

a. Removing financial upside limits operators' ability to respond to change

The white paper sets out that the delivery of passenger services will move away from the existing rail franchise delivery model, which at its core was the transfer of revenue risk to the operator. It states that "...in most contracts fare revenue will go to GBR ... Operators will take cost risk ...".⁶ Operators accept that, in the main, revenue risk will not be shared at this time but welcome it in some circumstances in the future. However, without the ability to earn more either through revenue incentives or customer/performance regimes, operators will lack the capacity to mitigate cost risk via financial upside and thus will need protection from costs not within their partial or complete control.

Our members are concerned that the current commercial proposition infers substantial cost risk transfer without clear protection mechanisms to limit operators from pricing uncontrollable downside risk into the bid. Therefore, given that PSCs are expected to be the length of a traditional rail franchise (i.e. 7-10 years) and thus exposed to increased cost variability overtime, the market would need protection from non-controllable costs such as inflation, energy costs and industrial relations impact costs (See Table 4).

⁶ Williams-Shapps Plan for Rail 2021, "In most contracts, fare revenue will go to Great British Railways, with operators delivering to the specification and managing their costs in doing so. Operators will take cost risk but will need to balance that with service quality, in order to be efficient while also meeting the needs of passengers." p54

Table 4: Risk areas requiring some or complete protection

Area	Risk	Recommendation
Customer experience	Operator unable to respond to changing customer needs or demands due to tight specification. Limiting the ability of an operator to respond promptly to meet customer service and perception regimes.	Make provision for operators and GBR to make in life changes to respond to changing customer expectations. Alongside provisions for investment in customer facing benefits by setting a predetermined annual investment levels.
Industrial relations	Industrial relations risk could be significant, particularly given the change projects proposed.	Operators are resourced and experienced at dealing with industrial relations issues. With only cost risk in most future contracts, additional incentives and protections will be needed to encourage operators to deliver people related reforms. Effective cost and committed obligation delivery relief mechanisms will be needed if driven by an IR response to delivering change.
Pension risk	Uncontrollable pension risk could be passed to the operators.	A risk sharing mechanism on the costs over which operators have limited control, with an absolute cap on liability on contribution increases
Collaboration	A true collaborative relationship may not be established and is used as a proxy by GBR to force operator 'change events', leaving operators exposed.	There needs to be clear and established parameters for a mature collaborative relationship to evolve, alongside unambiguous guidelines for what is considered a 'change event'
Innovation	GBR may expect operators to deliver or provide innovations that are outside of their cost base, or may make system changes that lead to unbudgeted costs for operators.	To harness the private sector entrepreneurial spirit operators will need to be incentivised to deliver innovations, including on revenue opportunities and things such as digitalisation to enable predictive rolling stock maintenance. To avoid a top-down approach, bidders need to understand how innovation is rewarded at the bid evaluation stage.
Inflation	Inflationary pressure on costs will need to be mitigated given limited revenue levers to offset any cost changes	Provide protection to operators against any inflationary cost changes during the contract term.
Energy costs	Operators will not have levers to counteract changes in fuel and energy unit costs.	Protection needed from changes in energy unit costs if revenue levers not available. Operators have managed this risk to date saving the industry over half a billion pounds between 2021 and 2023, through the electric current for traction (EC4T) scheme arrangements.

b. Positive incentives are needed to unlock private sector involvement

A sustainable and fair balance of risk and reward between private sector operators and Department for Transport (DfT) will be critical in delivering the desired outcomes set out in the white paper. However, our members understood that only punitive regimes rather than positive incentives were set out during the market engagement day. With a lack of meaningful incentives, it seems unlikely that the aims set out in the white paper would be achieved, limiting the private sector's involvement and access to their capital.

The white paper states that "Revenue incentives will be built into contracts to grow passenger numbers..."⁷ – giving a more meaningful role to operators to drive the financial recovery of the railway so long as they have the necessary levers. Appropriate incentives, with appropriate levers to respond, will be key to delivering a market proposition that enables operators to respond to customer requirements in a timely way. Ultimately, an incentive regime that seeks to drive outcomes and performance via penalties, will drive operators to comply but not thrive – focusing on decisions to avoid sanctions rather than improving the customer experience. The principle of rewarding those nearest the customer, namely the operator, to respond within a framework set by GBR, will drive the goals of the white paper.

Revenue growth features are in place in National Rail Contracts (NRCs) but are currently dormant; in some circumstances we would advocate that consideration is given to switching these on prior to the end of the NRC term, to support the introduction of PSCs.

c. Providing further clarity on the underlying cost model and the procurement process to inform expected bid costs

Our members are seeking a greater level of maturity regarding the cost model that will underpin PSCs. The procurement exercise cannot be a race to the bottom with winning bids being based on an unrefined cost model, which are then resolved through in-life change or which result in contract failure. We recommend that the procurement process is designed to prevent this risk from being realised; for example, by setting out clearly the risk profile of the proposition and articulating the level of quality the client is seeking to buy, among other things.

The procurement requirements need additional clarity so that realistic bidding budgets can be developed. To date the only costs that appear to have been removed from the bidding process by DfT are those associated with the revenue model;

this will not remove significant bidding costs, which were previously between £7m to £10m per bidder for a competitive rail franchise bid (based on average costs in 2018/19).

Setting out these requirements at an early point in the procurement process will enable the market and new entrants to make an informed decision and drive a more vibrant market.

d. Cost risk transfer recommendations

PSCs are going to be launched during a period of significant uncertainty for the railway. As part of the broader reform package, it is anticipated that many of the current practices and processes will change, particularly those concerning the overall contractual architecture of the industry. Therefore, PSCs will require sufficient flexibility to be able to adapt to a highly volatile environment as other rail reforms are implemented concurrently with PSC introduction. We would recommend that operators have sufficient contractual protection against unintended consequences that affect the cost base of the business – to be held harmless in those areas where the operator has no control, and risk being appropriately shared where the operator has some influence.

The government rightly wants a vibrant market for PSCs, with the aspiration set out in the white paper to reduce the barriers to entry for bidders, but a key dependency is providing clarity and certainty to the market on the risk profile for the contract and levers the operators will have to manage the risk. Therefore, we recommend that the DfT sets out clearly to the market the risk profile for the first competitively let PSC by the end of January 2022, broader profiles for other market segments by April 2022, while ensuring that the procurement process is designed in a way that does not drive a low-cost-bid-wins-all approach.

⁷ Williams-Shapps Plan for Rail 2021, "Revenue incentives will be built into contracts to grow passenger numbers, foster a culture of innovation and introduce efficiencies that deliver real benefits for passengers." p55



6.0 Capital bonding

6

Summary of our view

The capital requirements for Passenger Service Contracts (PSCs) must reflect the risk allocation in contracts and, given that the initial contracts will not involve operators taking any revenue risk, the overall capital requirements should be of a significantly lower magnitude than the level under the previous rail franchising system. The overall capital at risk for bidders should be between £10 million and £40 million, at the lower end of the range set out by Department for Transport (DfT) at the market engagement day. Otherwise, the white paper aspiration to create a healthy, sustainable commercial market will be unmet.

a. Appropriate capital bonding requirements

The white paper states that operators will be held accountable and risk termination of their contracts if they are not delivering punctual, efficient, and high-quality services. We support this. However, the level of capital requirement and bonding must reflect the reality of this contract and the actual risks operators are taking and are able to influence.

Previously, financial exposure to losses was effectively capped at the level of the contracted Parent Company Support, Performance Bond and, in some limited scenarios, their Agreed Funding Commitment from the parent company. We welcome the suggestion that the performance bond will be benchmarked near the level for National Rail Contracts (NRCs) rather than the level in rail franchises. We further support the full removal of the requirement to hold a season ticket bond, a policy already being adopted under the current NRCs.

PSCs should be structured in a way that incentivises train operators to use their extensive commercial and delivery expertise to support Great British Railways (GBR) in delivering the white paper outcomes, exceeding revenue growth and cost efficiency targets. Historically, Parent Company Support represented a funding source that could be drawn down to cover operator's revenue shortfalls, a risk that, as discussed earlier in this paper, is not due to be present in most PSCs. Any overall capital requirement that is more than the average level in NRCs, with an equivalent cost reduction ambition, would need to be justified.

The other role Parent Company Support has played in the past has attempted to protect the client from receiving bids from bidders that would be undeliverable financially. Further clarity is sought to understand how the procurement approach described will not simply result in the lowest cost bid winning (as discussed in section 5), and then through the invocation of change processes refine the cost base when the operating context changes for the operator for which the requisite levers are not available.

There is also a need to set out further information on what the contingent capital is protecting. Currently, the projected sum of Parent Company Support, the performance bond, plus any working capital required by the business, and bidding costs

could feasibly be higher than the expected average returns for the overall contract; particularly when the projected margins associated with concession contracts are relatively smaller and there is limited ability to earn additional rewards from the contract.

Creating a vibrant and thriving market focussed on how to deliver not only a great customer experience but also value for money for taxpayers is essential, and government's role in designing PSCs with proportionate capital requirements is vitally important in creating that market and promoting greater competition. Such a market would allow the private sector to make fair returns commensurate with the risks it is willing to bear and its success in delivery, as is the case in any contractual agreements between the public and private sectors. All successful markets are based on creating a sensible return for a sensible level of risk.

To support strong market participation, both from the incumbent market and new entrants we would welcome early sight in the procurement process of the anticipated level of fixed Parent Company Support, variable Parent Company Support, penalties in the contract, cost risk transfer proposed, the change mechanism, and the quality/price weighting to be used in bid evaluation.

The overall capital at risk should be proportionate to the risks being borne by the operator. While we are not advocating a cap for fixed Parent Company Support, we would suggest that the overall capital at risk for bidders should be between £10 and £40 million, at the lower end of the range set out by DfT at the market engagement day.



Conclusion

To collectively achieve a financially sustainable rail sector in the future it is critical to leverage the expertise and capital of the private sector.

Passenger Service Contracts have the potential to support the transformation of the railway for customers, communities and the taxpayer – and to achieve the outcomes set out in the white paper. The proposition needs to be compelling to enable the private sector to be a successful delivery partner with Great British Railways.

The current approach to PSCs outlined through initial market engagement provides limited scope for genuine innovation from the private sector and little opportunity to utilise the expertise within owning groups to drive change. Operators must be given the right levers to foster and implement a genuine collaborative partnership between the public and private sector.

The financial benefit of private operators' involvement in delivering rail services is significant, with owning groups already delivering ambitious proposals to reduce the industry's annual cost base prior to the introduction of PSCs. There is an opportunity to deliver overall annual cost savings beyond this level through PSCs, coupled with a drive to return to pre-pandemic fare box revenue, if the private sector is appropriately incentivised and given the right levers – accelerating revenue recovery, supporting a greener recovery and re-balancing the industry's finances.

We recognise the challenging financial operating environment and the enormous complexity of reform, but we believe that the proposals in this paper will deliver on the white paper and support a transformation in the customer experience, with a more punctual railway and easier to use retail and fares system.

Owning groups have a wealth of international expertise to bring to the GB market. If PSCs provide a positive proposition to operators through a flexible and dynamic approach with a fair balance of risk and reward, this will attract high performing international players – ensuring the best outcomes for customers, taxpayers and GBR.

Finally, a whole system approach needs to be taken in this reform process. PSCs need to be considered alongside the broader reform activity including the culture of GBR and how it is properly held to account, its relationship with government, the regulator, and other stakeholders. This will ensure PSCs deliver on the aims of the white paper and help the railways grow and thrive.

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