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Mr Gordon Herbert
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN

02 March 2012

Dear Mr Herbert,

**The Role of the Office of Rail Regulation / Department for Transport**

**Consultation Response from Stagecoach Group plc**

### 1. Introduction

In their recent Consultation Document, the Minister of State for Transport and Chair of the Office of Rail Regulation (the ORR) have sought views on the potential for an expanded role for the ORR in respect of new passenger rail franchises in England and Wales. Stagecoach Group plc is pleased to be given this opportunity to give its views on rail regulation. Our response is structured as follows:

- a description of Stagecoach Group;
- a response to the general principles;
- a response to the specific proposals made in the consultation document.

### 2. Stagecoach Group

Stagecoach Group is a leading international public transport group, with extensive operations in the UK, United States and Canada. The company employs 35,000 people and operates bus, coach, rail, and tram services. Stagecoach is a major rail operator in the UK and has been involved in successfully operating trains since 1996.

The Group's principal wholly owned rail businesses are South Western Trains ("SWT") and East Midlands Trains ("EMT"). SWT incorporates the South West Trains and Island Line networks. South West Trains runs around 1,700 train services a day in south west England out of London Waterloo railway station, whilst Island Line operates on the Isle of Wight. The SWT franchise is expected to run until February 2017. From 11 November 2007, we have operated the EMT franchise. The franchise comprises main line train services running to London St. Pancras, regional rail services in the East Midlands area and inter-regional services between Norwich and Liverpool. The EMT franchise is expected to run until 31 March 2015. Stagecoach also has a 49% shareholding in Virgin Rail Group, which operates the West Coast Trains rail franchise. The West Coast Trains rail franchise runs until December 2012 and Virgin Rail Group is one of four bidders shortlisted for a new 14-year franchise commencing in December 2012. The other shareholder in Virgin Rail Group is the Virgin Group of Companies.

### 2. General Principles

#### 2.1 General Principles

The NAO[1] summarised the ORR's main economic regulatory functions as the licensing of all railway asset operators; limiting track access charges; covering Network Rail's ("NR") stewardship of the rail

[1] Regulating Network Rail's Efficiency: NAO, 2011

network; and dealing access arrangements with train operating companies. These functions were established in the 1993 Railways Act, and varied by subsequent Acts of Parliament. The 1993 Act also established the Franchising Director who is responsible for the provision of passenger services, a duty now with DfT. It is clear to us from these documents that the main economic activities of the ORR should be directed at the regulation of NR, whilst the franchising authorities are responsible for the provision of passenger services.

The consultation requests views on changing the split of responsibilities between the ORR and the franchising authorities, and on the the ORR's role in holding NR to account. We believe that changes should only be considered if they meet the criteria that they would simplify the industry structure, allow the industry, of which the ORR is a part, to reduce its costs and remove duplication.

### 2.2 Holding NR to Account

Both NAO and the McNulty Value for Money review found NR to be up to 50% more expensive in cost terms than European comparators. Also, the cost of the railway to taxpayers has increased from £2.3bn in 1993/94 to £5.2bn in 2008/09. McNulty also made two further observations:

- UK train operators are 5% more efficient than their European comparators;
- any reductions in cost are likely to require whole-industry involvement and solutions.

We are therefore of the view that the main focus of the ORR should continue to be on the economic regulation of NR. NR is responsible for the largest proportion of industry cost and McNulty highlighted this as the area where efforts towards efficiency will bear the most benefit. Until infrastructure costs are brought in line with those previously experienced in the UK and elsewhere in Europe, diverting resources onto the regulation of railway service providers will not bring about the cost savings required.

Our long term position on the involvement of operators in the management of infrastructure is clear, and aligns with the McNulty findings. Since the publication of "A Platform for Change" in 2001, Stagecoach, as a train operator, has been keen to be involved in infrastructure management. Only by internalising the contractual linkages between train operator and infrastructure manager, through vertical integration, can market incentives be aligned and maximum efficiency in all parts of the railway industry be obtained. In this way, operators can deliver improved passenger benefits over a greater proportion of the railway. That is why we have been happy to progress the alliance between NR and SWT.

We are therefore keen to see the ORR encourage NR to progress towards meeting other recommendations of McNulty concerning cost reduction. Whilst NR has commenced the devolution of responsibility to route level, we would like to see more progress towards the introduction of competition such as concessioning, and ultimately in the development of vertically integrated franchises, such as Greater Anglia, as proposed by McNulty.

### 2.3 Developments with Franchising

McNulty also set out ideas of how train operators could reduce their costs if changes were made in the franchising system. We would like to see more progress being made with franchise reform. Of the recommendations made by ATOC in October 2010, there has been little movement other than extending the term of franchises. The 'more flexible franchises' (para 2.13 of the Consultation Document) have not materialised. In fact, when current proposals are reviewed in detail, we find that, far from elements of the previous franchise contracts vanishing entirely (para 2.16 of the Consultation Document), more requirements are proposed such as the need to contractualise cost savings, more financial constraints and the need for more committed obligations in franchise agreements. These changes do not allow TOCs the flexibility to contribute to the reduction of industry costs. We also do not see action being taken to align incentives between NR and train operators.

We remain concerned that the interests of railway service providers are not well served by the proposed transfer of responsibilities. Functions within DfT will be duplicated within the ORR. The NAO pointed out that any substantial change to the ORR's role could present resource challenges and would require a capability review. This can only mean an increase in the ORR costs. It would also lead to an increase in TOC costs because of the need to report to DfT under a franchise agreement and the ORR under increased licence provisions.

An increase in regulation of franchised operators by the ORR will, in our view, drive up industry costs and so does not pass the criteria for such a move. It is widely recognised that increased regulation leads to increased costs. We are ..also concerned at the apparent prioritisation the ORR gives towards passengers over taxpayers, as evidenced by the recent consultation paper on competition. Many of the proposals in that paper, whilst leading to decreased fares, involved increased costs to the taxpayer. Finally we are concerned at the 'double jeopardy' to which a franchised operator will be subjected, with commitments under a franchise agreement and possibly different requirements under a license.

**3. Specific Proposals**

In the consultation document, two specific changes are proposed to complaints handling and disabled people's protection policies. Both issues used to be dealt with by the ORR prior to the establishment of the SRA. We do not believe that the changes proposed will reduce industry costs although we have no preference for them being a licence condition or a requirement of the franchise agreement. They are more compliance issues than a differentiator between operators. However, if this change were to be progressed, all complaints and DPP activities, both in current and future franchises, should be with one party, and not run in parallel by two organisations (DfT and the ORR) whilst franchises are relet over the next 5 years or so.

The proposals concerning the transfer of the monitoring of train service performance and service quality standards to the ORR are at odds with the current franchising system. Both matters are areas where operators can differentiate themselves in their franchise proposals at tender stage and are used by DfT to evaluate and rank proposals. Were they to become the subject of licences, they would be removed from franchise competitions and become matters of compliance. This would be a backward step in our view, decrease competitive forces and not deliver benefits to passengers.

**4. Conclusion**

Whilst welcoming this opportunity to comment on the regulation of the UK rail industry, we consider the proposals are a missed opportunity. They simply tinker at the edges of an industry in need of reform. The increased transfer of commercial freedoms and responsibilities to the private sector, as envisaged at the time of privatisation, should be encouraged so that cost efficiency can be improved. These proposals add little to such a transfer.

Yours sincerely,

pp S Smith

**Graeme Hampshire**
**Director – Business Development**
**Stagecoach Rail**