6th October 1999

The Strategic Rail Authority's Challenge to the British Rail Industry

To

Warburg Dillon Read 1999 Transport Conference

Savoy Hotel, London

5 October 1999

The Strategic Rail Authority 's Challenge to the British Rail Industry

Let me start by clearing out of the way the layman 's question - Why are we a "Shadow" SRA? - and then get into the interesting question - What are we Going to Do?

The SRA will be a new Statutory Corporation, thus needing a statute (that is, legislation) to establish it. It will subsume (that is, absorb into itself) several public service entities or parts of entities, namely:

- OPRAF;

- British Railways Board;

- international administrative and liaison responsibilities of DETR;

- freight responsibilities of DETR;

- consumer, i.e. passenger, benefits responsibilities of ORR.

It needs legislation to do that, but all those activities exist today; all those responsibilities are currently borne somewhere by someone. But the new factor, the mind now behind them looking forward, is the SSRA.

The Deputy Prime Minister has appointed me Chairman of the BR Board

and has requested me to establish the SRA. He has instructed the Franchising Director

to work with me and he has made it known that I will be Chairman of the SRA and Mike

Grant, the Franchsing Director, will be the Chief Executive. So we work together now as the Shadow SRA, as we will in future - and did when close colleagues in the past.

So what will we do, from here forward? First we take a strategic view of the network as a whole, both passenger and freight.

The SRA will inherit the current powers of the Franchising Director but the SRA will be different in being proactive in planning and facilitating the development of the network as a whole to provide more and better service to rail users, freight as well as passenger. That 's new; we will do it:

- with an eye to continental links and services; and

- within a framework of integration for transport in Britain - road, rail, air, public, private, etc.

And that's new too! I know civil servants who were present in the 1980s when Mrs. Thatcher physically terminated meetings when the dreaded words "integrated transport plan" were uttered. The management term "logistics chain" was completely unknown to her.

That's who we are and that 's what we are going to do. What good will it do? - and why now?

I believe there is now a window of opportunity - the first in 40 years - to invest in re-balancing our rail network and services to meet the needs of our society in the coming decade. The needs are already evident from the cries that "something must be done". The pressure on users, already almost unbearable, can only increase over the decade, but for the first time in 40 years our political masters and their master, the Treasury, may respond. Hence the window of opportunity. Transport has roared up the political agenda and is now a "must have" in voter satisfaction terms.

Several factors have pushed it up the agenda. First, Britain stopped building major roads about nine years ago - a semi-conscious decision likely to stick despite Mr. Redwood 's undeliverable pleas for the motorist 's love. Since that halt the pressure on users of our major and urban road systems has built up relentlessly.

Second, New Labour came to power believing - at John Prescott's instigation - that we must integrate our transport systems, rail, road and air.

Third, congestion on our roads has launched a modal shift of passengers and freight from road to rail. The 25% and more increase in rail use since privatisation is something much greater than any near-boom in the economy could produce. Railways are now a growth business.

Fourth, and also important, we have moved since the mid '90s into Public Private Partnerships in financing capital investment. That is just as well, as the Treasury neither could nor would come up with the necessary capital.

If I were not convinced there is a "window of opportunity" for capital investment to upgrade rail's contribution to our society, I would not have taken this job.

Perhaps I can best illustrate it by reference to my ever-amiable friends in the media. Whereas in the late 1980s I was constantly asked why on earth I wanted to invest a fortune in rail development, now I am asked why it has not already been done!

As all agree privately, it will take years not weeks. You simply do not revamp a capital intensive industry in a matter of weeks, particularly when it runs through inner cities and lovely countryside.

Having established that there is a window of opportunity, lasting at least a few years, and recognising that change requiring capital investment takes years - how do we propose to initiate, facilitate or just plain levitate enough investment commitments to upgrade rail's capacity and service levels in Britain over the coming decade?

Let me proceed from here by Question and Answer.

Q Investment commitments to what?

A Increased capacity in the network, usually meaning opening up bottlenecks; and providing better service facilities.

Q What will that involve?

A 1. Better access, and more of it, meaning:

- Information and ticketing: that doesn't just happen by wanting it

- Car parks, bus interchanges, covered walkways at stations, etc

- Security, Shelter and Shopping in whatever proportions on and

around stations

2. Better and more equipment:

- Rolling stock for more trains, longer trains, safer trains, higher capacity trains, with different answers necessary for commuters and inter-city or outer suburban travellers

- On-train and on-station equipment

3. More and better infrastructure, introducing modern technology to

improve safety, capacity and speed:

- Track quality and number of tracks through bottlenecks

- Signals and layout of signals to permit trains to pass and to cross at more appropriate intervals

- Stations, both new and extended

and so on. There are opportunities for a huge variety of suppliers and contractors in whom you may choose to invest as the players gear up to order in billions.

Q How much has happened so far?

A Some, but nowhere near enough, and not all pointed in the right direction. For example, as part of privatisation Railtrack agreed to "regenerate" most of our stations, at a cost way over £1 billion. The Tories demanded first priority use of Railtrack 's powerful balance sheet not for expansion but to put a better roof over our heads while we wait for our trains.

There has been progress. Just by way of example, I would cite 2,000 new vehicles (equals 20% of the stock at privatisation) and Railtrack 's critically important initiative to re-signal the Leeds junction and station at a cost of £160 million. But as I said, those take years not months.

Looking forward, however, Railtrack has to raise its game well above its form to date; so do the TOCs. The basic problems left by privatisation must now be put behind us.

Q What were those basic problems?

A Basically structural. Partly the cultural and organisational difficulties of settling into a new, privatised industry structure; but, more substantially, the faults in the structure of privatisation.

Q What structural faults in privatisation?

A The Tories saw themselves removing a static or declining industry from the PSBR. They provided for Railtrack to raise capital in the private sector to maintain it and renew it when necessary; and enlarge or enhance it if Railtrack perceived a profit therein.

Meanwhile the grossly mishandled sale of the rolling stock lessors, or ROSCOs, constituted a vague wave in the direction of new rolling stock investment. They could boycott it if they wished.

Then the train operators. They were the vehicles for making Railtrack and ROSCOs saleable. The Treasury more or less doubled its initial subvention to them on condition they paid fixed track access charges to Railtrack and expensive lease charges to the ROSCOs. But the Treasury was not going to continue that - each year the subsidy to TOCs has come down, until next near, from April 2001 to March 2002, it will be about equal to the pre-privatisation level. All trace of the much vaunted "doubling of subsidy" will be gone and in aggregate will have cost the Treasury less than the privatisation sale proceeds - reduced though those were by the conduct of the sales.

So the train operators were asked to cut costs (except the big ticket items: track access and equipment leases) and raise revenues, despite capped core fares. Not easy, but the Treasury was so scared it would be ripped off by these new "entrepreneurs" that it required re-auctioning the franchises every seven years in most cases.

I could go on about the structural defaults that have conditioned behaviour since 1995.

Q That's the past. We are where we are. How can the SRA take things forward to get us investment in more capacity and better services?

A 1. In concert with the Regulator is the first part of the answer. Tom Winsor is busy on the Five Yearly Review of Railtrack 's Track Access Charges for TOCs, which also affects freight companies. The new charges will come into effect in April 2001.

Tom is in a pretty public dialogue with Railtrack - broadly speaking around Railtrack's investment intentions and performance. The less Railtrack promises to deliver from its own balance sheet, the lower the need to raise its return on investment above minimum utility levels.

The SRA's role is to establish strategic targets based on users' needs and facilitate the network's development. Tom's role includes facilitating the achievement of our strategy, though his primary role is to regulate the behaviour of a monopoly towards its customers.

2. Moving on from Railtrack, we aim to develop three other parties to join a heavier and more purposeful investment programme:

- the TOCs

- structured financings in global capital markets

- the SRA, holding the railway corner of the public purse.

Q Before we get to the three newcomers, why should Railtrack sign up to this new regime?

A Because it has to. It is a fallacy to assert, as some do, that Railtrack's primary duty is to its shareholders. They bought the right to profit from a monopoly by proving highly efficient in delivering the conditions under which that monopoly is licensed to operate. The most significant condition is No. 7. Railtrack must meet the "reasonable requirements" of users (TOCs) and funders (the SRA).

I do not believe Gerald Corbett seeks to avoid this duty, though some of his team are not yet comfortable with the thought of meeting the "requirements" of others.

Gerald's current task is twofold - to obtain an incentivised return on investment and to deliver a greater volume of investment than Railtrack has yet seemed capable of. I wish him well: a crippled Railtrack is no use to any of us. I believe the company is more likely to cripple itself by poor delivery than be crippled by its terms of reference.

Q How and when will Railtrack sign up to all this?

A Over the coming months, but three important steps will be:

1. Railtrack's annual Network Management Statement (NMS) next March, of which the Regulator intends to take note in reaching his conclusions.

2. The SRA's first Strategic Plan next May, which will put into context the emerging plans of the TOCs and the NMS and point the way forward for the network. And then:

3. The Regulator's final and binding conclusions on Track Access Charges payable to Railtrack for five years from April 2001.

Q How will the four groups of investors proceed?

A 1. Railtrack, recognising Condition 7, will invest heavily itself on an expanded programme of network enhancement, over and above replacement and renewal. And Railtrack will co-invest with others. To manage this larger programme to time and cost, I imagine Railtrack will contract for project management services from independent international project management contractors. Bechtel is only one example.

2. The TOCs will invest in delivery of the commitments they make to get new, longer franchises on more satisfactory terms.

3. The City, I hope, will mobilise global capital markets to provide structured financings for projects big and small; for new equipment in construction and maintenance; and for literally thousands of rolling stock vehicles, all of which can be sure of employment beyond their first franchises. By the way, I have been pleased to see how costs of lease finance have come down in the past year as competition entered the field.

4. Finally the SRA. Its financing role will be residual, limited to essential projects where the overall benefit is high but the cash return is very slow, or too much of the return is not cash capturable by TOC, freight company or anyone else. The Treasury is definitely edgy about all this but, as I said, rail investment is currently a "must have".

Q How will new franchises mobilise TOCs?

A We have announced we hope to reach voluntary agreement to replace 18 existing franchises, with three and a half to five years ' life remaining. There will be new franchises - not necessarily 18 in number - of longer term and modified subsidy or premium trends. The intention, approved by Ministers, is to put value into the franchises - in return for which they will bind themselves to invest in specified ways in pursuit of specified objectives. No investment delivery and/or poor performance will bring early termination of new franchise.

Q Why are they called "new" franchises?

A Because, while anyone - incumbent or other - can ask for them, they have to be new agreements to replace current franchises. An incumbent may decide to sell his right to complete the last few years of his current franchise - or may pay someone to take it away - but whether the SRA's eventual negotiation is with the incumbent or someone new, our concern will be the commitments to investment and performance going forward. An incumbent performing poorly will not have high credibility for promises of future performance.

Q When will all this happen?

A It has started, but there is no deadline. Absent agreement, the existing franchises will run on to expiry and their replacements will be auctioned or negotiated with new applicants. If successful, we hope to get it done in 18-20 months.

Q Finally, what about freight?

A Good question. The venture capitalists have shot the Evangelist, Ed Burkhardt, and a long-term venture - to obtain a much bigger role for rail in British logistics - is marking time while the SRA thinks through its plans and the Regulator reviews Track Access Charges for freight. In policy terms freight is assured of priority attention. In practice we have to determine how to deliver that. Watch this space!

That's where we are headed. Bear with us when we pause for thought. We will,

however, seek to make clear what is happening; and meanwhile, a special plea.

Inter-city rail - to Manchester, Newcastle and Scotland - competes with air. As with Eurostar to Paris, inter-city rail is more punctual than air, which seldom gets more than 70% of flights within 15 minutes of already-lengthened schedules. And inter-city delivers you to your downtown doorstep - not ten to 20 miles out. Give rail a break - compare its performance with air - it's better. Airports are no nicer to sit around in than trains!

The situation for commuters is more aggravating: every day we seek to get to work on time. But compare its cost and its time with road. Luton to Central London by rail at 8 a.m. is far better and closer to a fixed timetable than road has been for years, despite the intense loading and complexity of the capital's rail network.

The task is to make rail yet better in punctuality; and less crowded. New rolling stock is on the way, but it's still all about "Investment, investment, investment" - particularly by Railtrack.