

Tracey Crouch MP



HOUSE OF COMMONS

LONDON SW1A 0AA

Charles Horton
Managing Director
Southeastern
Friars Bridge Court
41-45 Blackfriars Road
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6 October 2010

Dear Charles

Rail Fare Increases

As a Kent MP, I represent a great many constituents who commute using Southeastern trains (to and from work) who are deeply concerned about the expected fare increases, a concern I share.

I appreciate that the level of increase in train operator's fares is determined by the terms and conditions of the franchise agreements set by the Department for Transport. As stipulated in Southeastern's franchise agreement, set by the previous Government, fares have been permitted to increase by a maximum of RPI plus 3% as significant investment in High Speed Rail in the region has been factored into the formula. This is greater than the majority of other train operators across the country who are subject to terms of RPI plus 1%; meaning commuters in my constituency have been subject to fare increases as opposed to fare reductions as a result of the previous Government's fare formula.

There are now further concerns resulting from the speculation that the basic RPI plus 1% formula could be broken following the Comprehensive Spending Review and conclusion of spending settlements. This has worrying implications for commuters using Southeastern given they already face steep fare increases. If indeed the basic formula is reconsidered, I would like to seek assurances that Southeastern fares will not be subject to the same percentage increase as those train operators subject to RPI plus 1% formula as commuters in the South East will rightly feel disproportionately penalised.

I already share the anger of Southeastern's commuters for the formula agreement under the last government. Many find it very difficult to afford and it puts a huge additional strain on their finances or simply encourages them to use their cars instead. I would be horrified if Southeastern passengers were asked to accept anything more than they are already paying.

As the formula set by the Government is a maximum figure by which fares can be increased, there is a degree of freedom available to train operators and Southeastern. I therefore urge you to take into

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consideration what is reasonable and affordable to commuters when setting Southeastern's fares in the near future.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Tracey', written in a cursive style.

TRACEY CROUCH MP

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Tracey Crouch MP
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Tuesday 12 October 2010

Dear Ms Crouch

Southeastern Fares

Your letter to Charles Horton, Southeastern MD, has been forwarded to me to respond to. Certainly we appreciate that increased rail fares will not be welcomed by your constituents. But I hope I'm able to explain why Southeastern is will use the flexibility permitted by the franchise agreement to increase regulated fares by up to the maximum allowable, to ensure that we don't increase the burden on the taxpayer.

My apologies in advance about the length of this letter but I thought it may be helpful to provide information on the:

- Background to fares setting
- Southeastern's franchise agreement in relation to fares
- Revenue support

Background to fares setting

Historically the former British Rail (BR) charged on a 'per mile' basis moving to demand-led pricing in the 1960s. BR was able to set fares as it wished and for example, to deal with excessive crowding, adopted a policy of 'pricing off' passengers by larger than average fare increases from certain stations and lines.

Unlike BR, today's Train Operating Companies (TOCs) are not free to set fares as they wish. This is because 'regulated fares' are controlled by Government. Regulated fares include season tickets and 'Anytime' tickets on routes where there is no competition to rail and where passengers have no alternative than to go by train for example commuter travel into London. For a commuter TOC like Southeastern, these comprise the majority of our fares and the bulk of our income. The only fares that can be set by TOCs are unregulated fares, for example, Off Peak (cheap day) Returns.

When the rail network was privatised in 1995/1996, to guard against excessive profiteering, the Government of the day pegged increases on regulated fares at RPI - 1% which meant in real terms, the cost of rail travel went down year on year. In addition, in order to incentivise train operating companies to improve performance and reliability, Government set a policy whereby season ticket holders would receive a discount of 5% on renewal if the operator did not meet agreed train performance targets. As you may know, previous holders of the Southeastern franchise did not meet these targets and passengers received the discount on a regular basis. Taken together, the combination of below inflation fare increases and a 5% season ticket discount meant that some of our fares were lower in 2006 than in 1996.

While good news for the passenger, the shortfall in revenue was matched by an increase in subsidy and the concomitant impact on public finances resulted in the last Government's policy of moving the balance of funding the rail network from the taxpayer to the passenger as detailed in its White Paper *Delivering a Sustainable Railway* which can be found on the Department for Transport's website www.dft.gov.uk

This shaped the cost model of subsequent rail franchises and the shift to RPI+ fare increases. For Southeastern, the increase was RPI + 3% as opposed to the RPI + 1% set by the Department for Transport (DfT) for other rail franchises granted during this period. The explanation given by the last Government for imposing RPI + 3% for the Southeastern franchise was because from 2000 onwards, the railways in Kent had benefited from disproportionately more investment in infrastructure and new rolling stock than other parts of the UK, which needed to be paid for.

Southeastern's current situation

Under the terms of our franchise agreement, 2011 is the last year that Government has determined the RPI + 3% increase. For the remainder of our franchise, fare increases in 2012, 2013, and 2014, will be RPI + 1%. When we bid for the franchise these levels of increase were assumed in our financial projections and the level of subsidy we bid for was reduced accordingly. This ensured a more cost effective franchise for the taxpayer.

The RPI figure used when setting rail fares is July of the previous year and as the RPI figure for July this year was 4.8%, it's expected that the average Southeastern regulated fare will increase by 7.8% in January 2011. It's important to note this is an average, some will be more and others less. The final figures for Kent stations will be dependent on the Travelcard fares, set with with Transport for London and other fares in the inner London boundary. Kent fares have a higher average increase as London Travelcard area fares remain in line with other parts of the Greater London area.

While this may be little consolation to passengers facing fare increases, they are also taxpayers. A useful summary of the issues surround rail fares and government subsidy can be found in recent article in the *Economist*. I enclose a copy for your interest.

Revenue Support

From April 2010 Southeastern entered Revenue Support at 80%. The DfT provides additional subsidy if TOCs find they're not meeting their predicted revenue targets from the fifth year of their franchise. Prior to this point the commercial burden is retained by the TOC. But to reduce the likelihood of franchises 'failing', which would be costly for the DfT, this mechanism is in place to support TOCs when circumstances change that cannot be foreseen at the time of bidding for the franchise.

Revenue Support is either at 50% or 80% depending on the shortfall between the revenue predicted and the revenue received. Southeastern started receiving 80% Revenue Support immediately it was eligible, as a result of slower than expected growth caused by the recession something that wasn't envisaged when the franchise was bid for back in 2004 and 2005.

Revenue Support means that if Southeastern does not increase regulated fares by the maximum permissible a greater burden would fall on the taxpayer.

Obviously, no one likes paying more and particularly in the current economic climate I appreciate that you and other Kent MPs will come under some pressure from your constituents once full details of the fare rises are announced. I hope this letter explains why it is that fares will be increasing by the amount they will.

Of course it's up to us to demonstrate that passengers are receiving value for money for their rail fares. I hope that since we took over the franchise in 2006, your constituents have noticed some improvements. I can say that performance is considerably better than that achieved by past holders of this franchise, stations are looking better and brighter and the high speed service is proving popular.

So, although we are a private sector company I hope this demonstrates that the fare increases on the Southeastern network over the past four or five years have been in accordance with the last Government's policy of moving the balance of paying for rail services from the taxpayer in the form of subsidy to the passengers by way of fare increases rather than excessive profit making on our part.

I hope this is helpful in explaining the situation. Once again, apologies for the length of this letter.

Yours sincerely



Sarah Boundy
Southeastern