Annex 1

southeastern.

Fares brief

No one likes paying more and particularly in the current economic climate the forthcoming and recent fare increases will be unpopular. Accordingly, we would like to go into some detail to the historical background of fare increases on the Southeastern network and the economic and other considerations that have resulted in the average 8% increase to be levied from January next year.

1. Background

Historically, the former British Rail (BR) charged on a "per mile" basis moving to demand-led pricing in the 1960's. BR was able to set fares as it wished, regional managers had a considerable degree of autonomy when setting local fares and on privatisation we and other operators inherited a patchwork of fares that did not necessarily reflect passenger volumes from individual stations or market conditions.

2. The position today

Unlike BR, today's train operating companies (TOCs) are not free to set fares as they wish. This is because what are known as regulated fares, (season tickets and peak singles and returns) are controlled by Government and the level of increase in regulated fares is dictated by the policies set by this and the previous administration. 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, cheap day returns.

3. Why have your fares gone up so much over the last few years?

When the rail network was privatised in 1995/1996, to guard against excessive profiteering, the Government capped 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, under the Customer's Charter initiatives in vogue at that time, 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. This was hard-wired into franchise agreements as the Passengers Charter. 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.

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* www.dft.gov.uk/pgr/rail/whitepapercm7176/

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.

Fare increases are also predicated on the level of Government subsidy, and the amount given to Southeastern started at £139.9M, in year one of our franchise in 2006 and will decline to £24.7M in year seven. In year eight, (2014) we will be expected to pay a premium of £9.3M to the DfT to operate the franchise. This is in accordance with Government policy outlined above of moving the balance of paying for rail services and infrastructure investment, such as Crossrail, the Thameslink programme and new rolling stock, from the taxpayer to the passenger.

4. Why did your fares go up by RPI + 3% rather than the RPI+1% increase that applied to other train operators' fares?

The explanation given by the last Government for imposing RPI + 3% for the Southeastern franchise was because from 2000 onwards, the railways in Southeast England had benefited from disproportionately more investment in infrastructure and new rolling stock including Class 375 rolling stock (which replaced the old 'slam door' trains) and power supply upgrades than other parts of the UK, which needed to be paid for.

5. **But why have some fares from some stations gone up by more than RPI + 3%?**

A combination of local, arbitrarily set fares in the BR era and RPI – 1% increases and performance-related season ticket discounts between 1995 – 2006 meant that many Southeastern fares were historically low and did not reflect market conditions.

To correct this and bring fares in line with those elsewhere in the Southeast the Department for Transport authorises us through our franchise agreement to levy an increase of RPI + 3% +5%, provided that the average increase across the network is kept to RPI + 3%. This is known as the flex system.

Theresa Villiers MP, the rail minister, has ruled out scrapping the flex system, which had been dropped in the final year of the Labour government.

She said:

"The scale of the deficit means that the government has had to take some very difficult decisions on future rail fares, but the long-term solution is to get the cost of running the railways down. That way we can get a better deal for passengers and taxpayers. We are determined to do this and if we succeed, we hope to see the end of above-inflation rises in regulated fares."

(Source: Guardian 14 August 2011)

Southeastern is also in receipt of revenue support from the Government. This, requires us to minimise the fiscal burden on the Treasury by ensuring, so far as is possible, that the balance of the costs of paying for rail services moves away from Government and towards the passenger. Therefore any additional income raised goes back to the Treasury and not to Southeastern

6. Wasn't your fare increase supposed to have gone down to RPI + 1% in 2012?

Under the terms of our franchise agreement, 2010/2011 was to have been the last year that Government determined the RPI + 3% increase. For the remainder of our franchise, fare increases in 2012, 2013, and 2014, would be RPI + 1%. However, as a result of the Chancellor's announcement in the Comprehensive Spending Review last autumn, the RPI + 3% formula will now apply for the remainder of our franchise. The Secretary of State in a statement to Parliament last year said:

'More investment is clearly needed. That is why I argued for additional rail investment in the Spending Review, and it is also why I have taken the difficult decision to allow regulated fares to rise by 3 per cent above inflation for the 3 years from 2012 – to help pay for these investments'.

(Source: Hansard 25 November 2010

Southeastern's franchise agreement assumed that RPI+3 would be in place for the first five years of the franchise. The Secretary of State's recent announcement means that it will stay in place until the end of the franchise in 2014. The additional revenue from this decision will therefore be recovered by DfT from us through existing mechanisms in our franchise agreement. Therefore RPI+3% in Kent will go directly to Government to pay for rail investment and not to Southeastern.

7. So what is the fare increase for 2012 from my station likely to be?

The RPI figure used when setting rail fares is that for July in the previous year and as the RPI figure for July this year was 5.0%, the average Southeastern regulated fare will increase by 8.0% in January 2012. This is an average increase, so some fares will rise by more and others by less.

The figure for each station on our network is currently being worked on by our commercial team and decisions will be made by November.

8. I've noticed that that the percentage increase from your stations in Greater London tends to be slightly lower than from stations in Kent and east Sussex. Why is this?

The increase for what are known as our Metro stations (and this applies to all train operators serving Greater London) is predicated on the percentage increase levied by Transport for London (TfL) on the Travel Card. If, as has been the case since Southeastern took over the franchise in 2006, TfL's Travel Card increase is less than RPI + 3%, this means that to maintain the RPI + 3% increase across our network, that some percentage fare increases from stations in Kent and East Sussex may be higher than those in Greater London.

9. But aren't you making excessive profits?

No, and the figures below may be useful.

9.1. The cost of running the railway

For every pound taken in fares by a train operating company, nearly half will go back to Network Rail in access and other charges. Staffing, traction (power supply) and train leasing costs account for much of the remainder.

• Network Rail	48%
• Staff costs	17%
• Misc (office rental, British Transport Police etc)	17%
• Train leasing costs	11%
• Traction costs	4%
• TOC profit	3%p

Source: Association of Train Operating Companies

9.2 Average train operating company profit on a single fare train ticket

• National Rail	16p
• Long distance	63p
• London & Southeast	11p
• Regional routes	10p

Source: Association of Train Operating companies

9.3 Profit comparisons

Company	Sector	Operating Margin
Barclays	Financial	19.13%
Trinity Mirror	media	18.12%
Whitbread	hospitality	17.53%

Pearson	Media	13.12%
Daily Mail	Media	11.53%
BT Group	Communications	10.37%
S& S Energy	Utilities	8.93%
Tesco	Retail	6.07%
Morrisons	Retail	5.89%
Stagecoach (Rail)	Transport	4.10%
Go Ahead (Rail)	Transport	2.40%

Source: Company annual reports. For Go Ahead, Southeastern's owning group, go to www.go-ahead.com

10. But shouldn't the rail industry be reducing its costs in order to keep fares rises down?

Southeastern has worked hard to reduce its operating costs. Since we took over the franchise in 2006, over 200 middle management and back office posts have been cut and all departments have been restructured in order to reduce costs and improve operating efficiency. All external contracts have been scrutinsed to ensure value for money and changed or re-negotiated where necessary. However as the figures in 9.1 shows, most of our costs are outside our direct control.

Government is very aware of the need to reduce the industry's costs in order to both keep fares down and lessen the burden on the taxpayer. The Secretary of State commissioned former Civil Aviation Authority Chairman, Sir, Roy McNulty, to lead a review into rail industry costs and his report which can be found on the DfT's website www.dft.gov.uk › Publications makes a number of recommendations including Network Rail efficiencies, changes to ticket offices and a review of the franchise system, designed to reduce unit costs by 30% by 2018/19. The report is a recommendation to Government which will produce its own White Paper later this year.

11. It would be cheaper for me to drive to work in London!

When compared against the costs of driving to London, rail works out cheaper,

- Average cost of owning and running a new car (includes depreciation, road tax, insurance and fuel) £5,869.
- Annual cost of fuel alone £1,300
- Average car travel costs = £112.87 a week or 48.91 pence a mile
- Rail travel costs on average 19 pence a mile

These figures exclude car parking and the central London congestion charge.

Source: RAC Cost of Motoring Index 2010

12. So what am I getting for my money?

Since we took over the franchise in 2006 we hope you have noticed some improvements

- High speed services to London and journey timers slashed from Ashford, Gravesend, Folkestone and Canterbury
- 200 additional peak and shoulder peak trains
- Stations re-painted and re-signed.
- Best performance since records begin
- 50% of stations with secure station accreditation

Within the financial constraints we and other train companies operate are working hard to improve services and while we are only as good as our last journey, customer satisfaction, as measured by the independent Passenger Focus National Passenger Survey currently stands at 82%, the best achieved by any holder of the Southeastern franchise. Given the current economic climate the coalition Government has had to take tough decisions on rail fares and we're doing our best to ensure that passengers receive value for money.

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