Fares and Fares Regulation on Britain's Railways

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Passenger services on Britain's railway, once run by a single nationalized organization, are now provided by a combination of 26 privatized passenger train operating companies (TOCs) owned by almost a dozen different parent companies. But in spite of the number of individual companies involved, the British railway system remains an effective, coherent, national network. Prospective passengers can pick up the phone and dial a single, memorable 24-hour number to find out about train times and fares for any journey in the UK. You can turn up at any station and buy a through ticket to just about any other station on the network, even if that journey involves several changes of train and several different operators. Tickets can normally be used on trains run by any operator over the route for which it is valid, even on trains run by 'open access' operators such as Hull Trains who have no franchise agreement with the government's Strategic Rail Authority (SRA). And national railcards for young people, older people and people with disabilities continue to exist and are accepted by all train operators. These 'network benefits' are no accident, but the result of a regulatory framework that was put in place at privatization. This article outlines this framework.

Responsibility for setting fares and marketing services has been transferred to the private sector, but there are inevitably some circumstances—for example, commuter services to London and other big cities—where rail's high market share makes it desirable to retain some control over operators' pricing. To protect consumers, the SRA therefore regulates certain fares. This article also explains how that fares regulation works, and how it will change from next year following a complete review of fares policy undertaken by the SRA in 2002–03.

In the Beginning

The arrangements for maintaining these network benefits, and in particular the arrangements for the setting, settling and regulating fares are complex, and as with most complicated things, it's best to start at the beginning. And in the beginning was the Act; the Railways Act 1993, to give it its full name, set up the framework for privatizing the national rail network. It created the Rail Regulator to issue licences and regulate the monopoly infrastructure provider, then called Railtrack, and it created the Franchising Director to let and manage franchises for running passenger services over the infrastructure. Some things have changed since then. The Transport Act 2000 created the SRA, combining the Franchising Director's franchising functions and the Rail Regulator's consumer protection functions. Privately-owned Railtrack has been replaced with not-for-profit Network Rail. But one thing which hasn't changed is that the Railways Act makes it a criminal offence to operate a railway asset—a train, station or network—without a licence. For the purposes of this article, the most important type of licence is the Passenger Licence, the licence needed by anyone who wants to operate a passenger train over any part of the national network.

Passenger Licence

A typical passenger licence is a relatively short document. It contains a requirement to have adequate third party insurance, to be party to approved arrangements for claims handling, to comply with Network Rail's Railway Group Standards, and so on. And most importantly, it contains a short but crucial paragraph entitled 'Through Tickets & Network Benefits.' Put very simply, this paragraph requires the licensee to be a party to, and to comply with, arrangements approved by the SRA for a telephone enquiry service; through ticketing; settlement of revenue received from the sale of through tickets; and conditions of carriage. From this one paragraph flow the major industry arrangements for fares, tickets, settlement and passenger information. It's important to remember that even 'open access' operators (operators who operate a purely commercial service with no franchise agreement or government subsidy—currently just Hull Trains, but other open access operators may follow) require a passenger licence and so are bound into the resulting national arrangements as much as any franchised operator.

National Rail Enquiry Scheme (NRES)

To fulfill the licence requirement for arrangements for a telephone enquiry service, the SRA has approved the National Rail Enquiry Scheme (NRES) agreement. This is an agreement between all train operators to operate a national enquiry service jointly. The agreement sets out how the scheme will be managed and paid for, the type of information that the service will provide to callers, and the quantitative and qualitative call-handling standards that the scheme will have to meet. NRES Ltd—now a limited company wholly-owned by the train operators—has a small full-time management staff, and major issues are considered by a management group and council on which train operators are represented. A regular survey determines the proportion of enquiries that relate to each operator's trains, and NRES costs are distributed amongst the train operators on this basis. NRES has been one of the great successes of privatization; it inherited 40+ small ex-British Rail call centres, each of which had its own public telephone number and opening times. Demand exceeded supply at almost all centres. NRES soon introduced a single 24-hour nationwide number, allowing calls to be switched to make best use of the available capacity, and progressively outsourced call handling. Calls are now handled by just three private suppliers at four large modern call centres, over 93% of all calls are answered and complaints about access to train information have almost disappeared. NRES handles almost 60 million calls each year, compared with about 40 million at privatization, but outsourcing has contained costs. It has also expanded to offer train information on the internet (www.nationalrail.co.uk) although there is no regulatory requirement to do so.

National Rail Conditions of Carriage

For 26 operators to act together as a network, it is important to have common conditions of carriage. To fulfill the licence requirement for arrangements for conditions of carriage, the SRA has approved the National Rail Conditions of Carriage (NRCofC), drawn up on each operator's behalf by the industry's trade association, the Association of Train Operating Companies (ATOC). The NRCofC set out the basic terms for the contract between the train operators collectively and the passenger whenever a passenger buys a ticket to travel. They set out the train operators' obligations, including minimum compensation in the event of a delay, although an operator's own Passenger's Charter may provide greater levels of compensation.

Ticketing & Settlement Agreement (TSA)

To fulfill the through tickets condition in each operator's Passenger Licence, the SRA has approved the Ticketing & Settlement Agreement (TSA). The TSA is an extensive document that defines the way train operators will set, sell, and honour fares across the network, broadly based on British Rail practice and capability before privatization. The TSA is produced by ATOC on behalf of all operators, and like the NRES agreement, it is not an agreement with the SRA, but an agreement between operators, which the SRA has approved. In most cases, changes to the TSA must also be approved by the SRA. The TSA fulfills the settlement condition in Passenger Licences by specifying the arrangement for settlement of revenue between operators using industry-wide systems. This is done by an organization called Rail Settlement Plan Ltd, wholly-owned by all the rail operators who are a party to the TSA.

Passengers watching display board at Paddington Station (T. Suga)

Who Sets Fares?

The TSA defines a flow as a combination of origin, destination and route—for example, London to Birmingham route any permitted. There are hundreds of thousands of flows in the fares system, and each flow is assigned a Lead Operator—the operator who has the right and obligation to set fares for that flow. The Lead Operator is normally the train operator with the greatest commercial interest in the flow—for example, the Lead Operator for London to Birmingham is Virgin Trains, which runs half-hourly fast services, although other operators also run slower and less frequent trains over the same route. There is a procedure for changing Lead Operator should another TOC challenge the existing Lead Operator, or if operators agree that the Lead Operator should be changed. After a Lead Operator has set fares for a flow, the TSA obliges all other operators running trains serving all or part of that route to accept those fares for travel on their services. Consequently, after Virgin Trains has set a fare for London to Birmingham route any permitted, Silverlink and Chiltern railways are both obliged to accept these tickets on their own London to Birmingham trains as are other operators serving any part of the route. The TSA also ensures that route any permitted fares like these continue to be valid on a variety of reasonable alternative routes. The permitted routes for any given journey are defined in a schedule to the TSA called the National Routeing Guide.

The Lead Operator arrangement applies equally to through fares. For example, Virgin Trains is the Lead Operator for the London to Walsall flow and sets fares for the whole journey although it only operates from London to Birmingham and passengers must use Central Trains from Birmingham to Walsall. The initial range of flows in the fares system was inherited from British Rail and flows cannot be deleted (or created) without SRA permission. In this way, the existence of inter-available through tickets is assured between every pair of stations for which British Rail offered a through ticket in 1995. In practice, this means there are through fares between just about every station on the network.

Under the terms of the TSA, a Lead Operator cannot set dedicated fares on that flow (fares that are only valid on its own services). There are some exceptions, such as where the fare is a prebooked train-specific Apex-type fare, a temporary promotion, or a special first class inclusive offer. This prevents a Lead Operator raising the inter-available fare to unreasonable levels so that passengers buy the operator's own fares instead. However, once the Lead Operator has set its inter-available fares (fares that are valid on any operator's trains), Secondary Operators (other operators serving the same route) are free to set competing fares of any type that are only valid on their services. In this way, as well as assuring the existence of flexible inter-available tickets that are valid on any operator, the TSA allows the benefits of competition to be enjoyed wherever there is more than one operator.

Selling fares

The TSA defines the opening hours at each ticket office on the rail network and the range of fares that must be sold, ensuring that inter-available and through fares not only exist but are available to passengers. In fact, British Rail did not sell every fare at every station because its capability at each station was constrained by the type of ticket issuing system installed, whether or not the office had a reservations system, and whether it held a full range of fares manuals or just a sub-set. The TSA defines the product range to be sold at each station in these terms, based on what was sold under British Rail, although there are procedures in the TSA to change this when necessary. Each ticket office is allocated to a particular operator, but the TSA requires that operator to sell fares accurately and impartially. Operators are required to carry out an annual survey to monitor accuracy and impartiality and ATOC carries out an 'undercover' survey on behalf of all operators to fulfill this obligation. However, despite early concerns over operators' impartiality, accuracy rather than impartiality has proved the bigger problem as the range and type of tickets has continued to grow.

Regulating fares

At privatization, it was recognized that some sort of price control would be necessary in certain areas, especially where rail enjoys a large market share, such as commuting into London and other cities. Therefore, each train operator's franchise agreement with the SRA provides for regulation of certain fares. The SRA has been operating two types of fares regulation, called Protected Fares and Commuter Fares since 1 January 2004. Both types employ a mechanism called a fares basket where a limit or cap is placed on the weighted total of a basket of fares. This controls overall fares levels while allowing operators some degree of freedom to adjust individual fares within the overall basket in order to resolve fares anomalies, adjust fares on different routes to control demand, or take advantage of differences in markets.

Protected Fares

The following fares are designated as Protected Fares:

- Saver returns (an off-peak walk-up leisure fare available for most long-distance journeys) for all journeys where a saver existed in February 2003
- Standard returns (full-fare return ticket valid at both peak and off-peak times) for journeys where a saver did not exist in 2003 (typically journeys under 50 miles or wholly within the old Network SouthEast area, other than those included in a Commuter Fares basket)
- Weekly season tickets wherever a weekly season ticket existed in 2003, other than those included in a Commuter Fares basket

Each operator has one Protected Fares basket, containing (before simplification) every Protected Fare set by that operator. Each fare in a Protected Fares basket is weighted by the revenue received by that operator from the sale of that fare in the financial year to 31 March 2003. The total value of the fares basket is the sum of each fare multiplied by the weighting for that fare.

To simplify the basket, fares with the lowest revenue weighting are excluded from the fares basket, up to the value of 5% of the gross value of the fares basket. The basket therefore includes at least 95% of the revenue received from Protected Fares. However, all Protected Fares must continue to be made available for sale, whether or not they are in the Protected Fares basket.

The train operator must make sure that the total value of its fares basket does not exceed the cap on that basket. The cap is equal to the total value of the fares basket calculated using fares at February 2003, increased by the retail price index (RPI) plus 1% on 1 January 2004 and each year after that. There is also a limit on individual fares within fares baskets. These may not go up more than 5% above the basic policy (in other words, RPI + 1% + 5% = RPI + 6%) in any 1 year.

Fares regulation also protects certain conditions attached to these fares. In the case of savers, these must be valid for no less than 1 month, and all day Saturday and Sunday, and from no later than 10:30 on any other day. They need not be valid for any journey beginning between 15:00 and 19:00 on Mondays to Fridays from London-area stations or (when travelling away from London) stations between London and Reading, Watford, Luton or Stevenage, inclusive. However, the SRA will consider applications from operators to apply a greater restriction to savers where it can be shown that this is necessary to reduce overcrowding.

Commuter Fares

Commuter Fare regulation applies to the following fares used by commuters in the London area:

- Season tickets (weekly, quarterly, annual) to, from, and within the London *Travelcard* zones
- Standard singles and returns for journeys wholly within the London *Travelcard* zones
- Standard singles and standard returns to any station in the *Travelcard* zones from a defined London suburban area roughly 35 to 50 miles from London

Each train operator serving London has one Commuter Fares basket containing every regulated commuter fare from which that operator takes any share of the revenue. This includes both fares for which the operator is Lead Operator and sets the fare, and fares where another train company sets the fare, but the operator in question receives a share of the revenue. Each fare within the basket is weighted by the revenue received by that operator from the sale of that fare in the financial year to 31 March 2003. The total value of the fares basket is the sum of all the weighted fares that it contains.

To simplify the basket, fares with very low revenue are excluded. The basket is constructed so that it includes 95% of the revenue received from Commuter Fares, with no more than 5% of the gross value of the basket excluded. However, all Commuter Fares must continue to be made available for sale, whether or not they are in the Commuter Fares basket.

Each year, the train operator must ensure that the total value of its fares basket does not exceed the cap on the basket. The cap is equal to the total value of the basket in February 2003 increased by RPI +1% on 1 January 2004 and each year afterwards until further notice. As with the Protected Fares basket, individual fares within fares baskets may not rise by more than 5% above the basic policy (RPI + 1% + 5% = RPI + 6%) in any 1 year.

Commuter Fares around Cardiff and Edinburgh are also subject to regulation by fares basket. These baskets contain the standard singles, standard returns, and season tickets for journeys wholly within the defined commuter area. The weighting and annual cap increase operate in the same way as for London-area Commuter Fares baskets.

Unregulated Fares

Fares, which are neither Protected Fares nor Commuter Fares are unregulated, and train operators are free to determine these fares according to market forces.

Unregulated fares include:

- All first class fares
- All advance purchase Apex-type fares
- Tickets (other than *Travelcards*) that include through travel to destinations served by buses, light rail, or London Underground
- Tickets that include a non-rail element such as entrance to a museum, theme park or other attraction
- Saver tickets for journeys where there was no Saver fare in 2003
- From 1 January 2006, any Saver fare set by Great North Eastern Railway (GNER), Virgin West Coast, Virgin CrossCountry, First Great Western, Midland Mainline
- Weekly season tickets for journeys where there was no weekly season fare in 2003

Although a particular fare may be unregulated, in certain cases a regulated fare may act as a ceiling. For example, an unregulated Supersaver fare cannot logically exceed the price of the regulated and less-restrictive Saver fare.

Fares Regulation in Passenger Transport Executive Areas

Rail services in seven regional conurbations are sponsored by Passenger Transport Authorities, through their executive arms, the Passenger Transport Executives (PTEs). In five PTE areas (West Midlands, Strathclyde, Tyne & Wear, Merseyside and South Yorkshire) fares are currently specified directly by the PTE so there is no need for fares regulation (although this may change when franchises are replaced). In two PTE areas (Greater Manchester and West Yorkshire), fares are set by the relevant train operator in the normal way and commuter fares are regulated by a version of the fares basket mechanism. All standard singles and returns for journeys wholly within the Greater Manchester and West Yorkshire PTE area are included in a fares basket that is capped in a similar way to the fares baskets described earlier.

SRA's Review of Fares Regulation

Fares regulation has been in place since the first franchises were let in 1995. However, the above-described fares regulation is the result of an extensive review of fares regulation carried out by the SRA in 2002–03. The new policy has been designed with four aims in mind:

- To protect passengers in markets where train operators have a significant degree of market power, for example on urban commuter routes
- To redress the balance between taxpayer and passenger because increasing industry costs have been borne almost entirely by taxpayers so far
- To allow more scope for innovation in fares and ticket types, allowing train operators to make better use of available capacity
- To minimize the administrative burden on train operators by simplifying the processes and mechanisms used to regulate fares

The review looked at each of the following key aspects of regulation:

- The fares that should be regulated (scope of regulation)
- The price at which those fares should be regulated (level of regulation)
- Whether or not there should be a link between fares and performance
- The mechanisms that should be used to regulate fares
- Other fares issues, including fares structure, zoned fares, smartcards and railcards

Scope of Regulation

Not surprisingly, the SRA's consultation showed that passenger groups, individual passengers and PTEs generally want the same or more regulation, while train operators want less regulation and more freedom. The SRA's own view is that fares regulation is justified only where it is necessary to prevent or correct market failure. In the railway industry, this generally means one of two situations:

- Where operators may abuse a dominant position
- Where there are significant externalities not fully reflected in the cost of production or the price, such as reductions in congestion, pollution, energy consumption or accidents relative to other forms of transport

Commuter train operators around London in particular, but also other urban areas, possess a significant level of market power because there are few practical alternatives to trains for most journeys to and from work. Table 1 shows the dominance of national rail and London Underground travel for commuters in the Greater London area in Autumn 2000.

The SRA concluded that although some aspects of the Commuter Fares regulation could be simplified, the scope of regulation applied to most commuter fares should be maintained because of rail's position in the market for commuting in urban areas. Away from the big cities, there are generally more alternatives to rail and the case for regulating commuter travel becomes less compelling. Nevertheless, there are still many journeys where people do not have an alternative means of travelling to work, and on balance it was decided to continue regulating weekly season tickets outside urban areas as well, but using a more flexible fares basket mechanism.

The SRA considered whether regulation should be extended to cover long-distance full-fare tickets (standard open singles and returns), some of which have risen significantly since privatization. However, while there is a clear argument for regulating commuter fares because of the lack of practical alternatives to rail, this is not the case for long-distance fares where there are generally alternatives, such as car, long-distance bus, or air. For example, an estimated 58% of journeys from London to Manchester are made by car and only 33% by rail, while 41% of journeys from London to Glasgow are made by air and only 14% by rail.

In the case of standard open fares, price would be expected to reflect the flexibility that these fares provide and the type of passenger at which they are targeted. Standard open returns are typically used by business travellers—consultation responses from train operators suggest that 60%–65% of Midland Mainline and GNER passengers using this type of ticket are travelling on business. Equivalent fares on competing modes, such as fully-flexible domestic airfares, are priced at similar or higher levels.

The SRA also has to consider affordability and value for money, and regulating standard open fares at a much lower level than current prices could only be done at considerable cost. Regulating the maximum price of standard open tickets as well as saver fares would result in

Table 1 Travel to Work in Greater London

Work location	Railway	Private vehicle	London Underground	Local and long-distance bus	Other
Central London	39%	13%	31%	9%	7%
Inner London	12%	41%	17%	12%	17%
Outer London	4%	68%	4%	10%	13%

Source: Transport for London (TfL)

regulation of 64% of total rail industry revenue when competing modes are largely unregulated. Regulating standard open fares would limit all other fares, stifling innovation and leading to overcrowding on some trains. For all these reasons, the SRA decided that it was undesirable to extend regulation to this type of fare.

The SRA considered the advantages and disadvantages of continuing to regulate saver fares; research suggests that regulation of saver fares has led to overcrowding on some trains and may have prevented operators from managing their capacity effectively. It may also have constrained development of other more innovative types of ticket, possibly preventing operators from introducing the sort of pricing used so successfully by budget airlines. Leisure passengers are generally very price sensitive and if saver fares were deregulated, operators would still need to offer competitively-priced tickets to avoid losing these passengers and revenue. Research suggests that most passengers are willing and able to transfer to different types of ticket and can use alternative forms of transport such as car, bus or aeroplane. The leisure market for long-distance rail travel is already moving away from the traditional approach represented by saver tickets towards airline-style ticketing where price is the main attraction for passengers and a seat reservation is included with the ticket. Yield-management schemes are being improved and a new reservation system that can work in conjunction with them is due to be introduced in late December 2004. This would allow operators to maximize both ridership and revenue while offering the lowest possible fare to each passenger.

However, some people still rely on saver tickets, and most rail passengers are not yet used to booking rail journeys in advance as they do with airlines. A new reservation system allowing dynamic airline-style pricing is not yet available, so it has been decided to continue regulation of saver fares until late 2005, but with some changes. Since 1995, each saver fare has been regulated individually, but a fares basket mechanism was introduced in January 2004, giving operators a degree of flexibility to vary the price of individual fares within the basket. The SRA will also allow changes to the maximum restriction that can be placed on saver fares on a case-by-case basis where an operator can show that the current maximum restriction needs to be relaxed to prevent overcrowding. The SRA will further review saver regulations with a view to replacing the current regime by 2006. Changes may be made earlier if train operators put forward proposals showing clear benefits to both taxpayers and passengers.

Table 2 shows the percentage of farebox revenue that would be subject to regulation if saver fares were deregulated or if standard open fares were regulated.

Table 2 Impact of Changing Scope of Regulation

Proportion of revenue from regulated fares	Current proportion	Saver fares deregulated	Standard open fares regulated	Standard open fares regulated and saver fares deregulated
Total rail industry	46%	32%	64%	50%

Level of Regulated Fares

The SRA considered a range of options for regulation levels, ranging from continuing the policy of reducing regulated fares in real terms by RPI –1% each year (used since 1999) to allowing various increases above inflation. Consultation responses showed that train operators feel regulation has kept fares too low in real terms, stifling investment and creating overcrowding. On the other hand, passengers, passenger groups, local authorities and PTEs do not believe that fares regulation should be used to price passengers off railways to reduce overcrowding, suggesting instead that capacity should be increased. However, despite a general feeling that fares are too high, PTEs, passenger representatives and many local authorities said that a move from the RPI –1% model to a more sustainable annual fares increase of RPI would be acceptable.

The SRA considered the need to recover rail industry costs and how the balance of cost recovery should be set between fares paid by passengers and subsidy provided by taxpayers. At privatization, it was assumed that more efficient private-sector management would drive costs down. The gains were to be shared between taxpayers and passengers with government subsidies expected to fall over time, and regulated fares reducing by 1% a year in real terms after 1999. In the event, efficiency gains did not materialize and rail industry costs have actually gone up rather than down.

Between 1999–2000 and 2002–03, the total cost of providing the national rail network increased from £6.1 billion to an estimated £9 billion. However, this rise in costs was not matched by growth in passenger and freight revenue, which only increased from £4.4 billion to £4.8 billion, as regulated fares have continued to decline in real terms (by an average of 6.6% between 1995 and January 2003). As a result, the taxpayer has borne most of the increase in costs. SRA research also suggested that regulated fares may be significantly below their economically efficient level, or long-run marginal cost. The result is overcrowding on both commuter services and long-distance trains, and lack of investment incentive.

The SRA concluded that an increase in regulated fares may be justified on both cost-recovery and efficient-pricing grounds to redress the balance between taxpayer and passenger and more accurately reflect the long-run marginal costs of providing rail services. It decided to change the annual permitted increase in regulated fares from RPI –1% to RPI +1% from January 2004 for the next 3 years. In the London area, the RPI +1% increase will partially reverse some of the reductions in regulated fares over the past few years, improving the consistency between SRA fares policy and the RPI policy of Transport for London (TfL).

Some consideration was given to applying different increases in caps to different operators to reflect slightly different levels of investment or service quality, etc. However, the extent of interaction between fares set by different operators made this impractical, particularly in the London and South East area. Each operator's fares basket contains fares that it sets and controls itself, and fares that are set by other operators. If one operator is permitted a large increase in its fares basket and so increases its own fares significantly, other operators whose fares baskets contain these fares would be forced to reduce their own fares to offset the increase, unless they are allowed a similar increase. In addition, commuter fares baskets include *Travelcard* fares (London-wide multi-modal rail/bus/London Underground fares) that are set for the whole of London by agreement between all operators and TfL. If different permitted increases were applied to each operator's fares basket, there would be a disproportionate effect on each operator's own non-*Travelcard* fares because these were adjusted to keep the total fares basket within the cap. Ultimately, the SRA concluded it was more appropriate to apply a consistent increase to all operators.

Many consultation responses said that fares increases above inflation could be justified to fund investment as long as the increases were applied *after* the improvements were delivered to passengers. To help fund specific investment, the SRA will continue to allow increases over and above the basic policy where agreed with operators.

Link between Fares and Performance

Since 1995–96, fares regulation has included an automatic link between London commuter fares and train service performance generally known as the Fares Incentive Adjustment Payment (FIAP) regime. Under FIAP, a small adjustment of up to ±2% was made to the basic RPI -1% annual increase in the fares basket cap for each of the ten London commuter TOCs, depending on whether a TOC's performance had improved or worsened in the preceding 12 months relative to the previous 12 months. FIAP involved a long time lag between the fares change and the related performance, and since it was based on relative performance, a performance improvement from bad to merely poor permitted a fares increase, whereas a worsening from excellent to merely good performance required a fares decrease. Almost all consultation responses from both train operators and passenger groups said that the FIAP automatic link between London commuter fares and performance has not worked well and should be abolished.

In addition, a performance-related fares adjustment will create inconsistency between SRA and TfL fares policies. FIAP has sometimes required fares baskets to be reduced by RPI –3%, when London *Travelcard* fares (which rise in line with inflation unless otherwise agreed with TfL) have been increased by RPI. *Travelcards* make up 70% of some operators' fares baskets, and these operators have had to make large reductions (over 20% in 1 year in some cases) in the non-*Travelcard* fares which they set in order to keep the total value of their fares basket within the regulatory cap. This meant that passengers using *Travelcards* saw little or no benefit from the FIAP fares adjustment while passengers using non-*Travelcard* rail-only tickets enjoyed a disproportionately large effect.

The SRA has decided to eliminate FIAP and rely on the compensation arrangements set out in each operator's Passengers Charter to compensate passengers directly for poor performance.

How Fares Are Regulated

Fares baskets provide much greater flexibility compared to regulating fares individually but still control the level of the fares concerned. This flexibility can be used by operators to reflect market conditions in the fares structure—promoting growth or managing capacity—and to correct anomalies or control overcrowding. Individually regulating some fares generated significant work for both train operators and the SRA, because approval was needed each time an operator wanted to adjust an individual fare although the effect may be very small. Commuter fares in urban areas have always been regulated by fares baskets, and each operator's Protected Fares are now regulated in this way since January 2004. However, fares baskets can be extremely complex, especially in the London area. To resolve this, since January 2004 fares baskets have been simplified to reduce the cost and effort required to manage fares regulation. In many cases, 98%–99% of an operator's revenue comes from just 10% of regulated fares, and there is a long tail of low-revenue fares in each fares basket that could be eliminated without materially affecting the extent to which that operator's revenue is regulated. As an example, Table 3 shows a typical fares

Table 3 Analysis of Flows and Revenue in Typical Fares Basket

Flows in existing fares basket	Basket revenue covered by flows	Number of flows	Revenue of smallest flow
1%	67.00%	80	£124,000
2%	81.00%	164	£49,000
5%	94.00%	417	£9,000
10%	98.00%	837	£1,700
25%	99.70%	2,099	£146
50%	99.94%	4,201	£20
75%	99.99%	6,303	£5

Source: Study on fares regulation for the SRA by AEA Technology, 2003

basket. The most important 10% of flows in the basket produce 98% of regulated revenue and the most important 25% produce 99.7% of regulated revenue.

Fares on less popular flows would in effect remain regulated through a requirement for that fare to continue to exist, and through the limiting effect of fares from adjacent stations being regulated. In some cases, this simplification could reduce the number of separate fares within an operator's fares basket from over 20,000 to just 1000, significantly reducing the burden of regulation and allowing much simpler processes to be used to maintain and manage fares regulation.

The SRA considered whether operators' fares baskets could be simplified further by removing *Travelcard* fares and those fares that are set by other operators. Although there would be advantages in this, it might undermine the effect of regulating these fares. However, the proposed change in the annual increase from RPI –1% to RPI +1% and elimination of the FIAP fares adjustment will make inclusion of *Travelcard* fares within fares baskets less problematic. The simplification of fares baskets caused by a reduction in the number of flows will also make baskets more manageable, even though they will continue to contain fares set by other operators.

In January 2004, the SRA re-weighted fares within fares baskets according to the revenue received by operators from sale of fares in 2002–03, because it is clear that travel patterns have changed and actual revenue is now significantly different in many cases from the 1995 revenue levels used to weight fares in the original baskets.

Fares Structure

The complexity of the fares structure emerged as a common theme in responses from passengers, passenger groups, PTEs and local authorities. On the other hand, train operators believe that the advantages of offering a broad range of fares generally outweigh the disadvantages and they are clear that they want to retain control over their product range.

Each train operator is free to offer a range of different fares, designed to appeal to different types of passenger. There are many benefits to this market segmentation—passengers are more likely to find a ticket that suits their particular needs—and the operator can maximize revenue and manage capacity by offering cheaper tickets at off-peak times, and more expensive tickets when capacity is at a premium. If operators were required to reduce the number of ticket types this would reduce both the passengers' choice and the train operators' commercial freedom. It would disadvantage those passengers who used fares that disappeared and would almost certainly reduce revenue, in turn requiring greater government subsidy.

However, some complexity arises because different train operators target the same market segments with similar products with different product names and (in some cases) slightly different terms and conditions. Passenger choice is not enhanced if a brand-A fare is only available on routes served by operator A, and a brand-B fare is only available on routes served by operator B. ATOC has already done some work on ticket categorization and more can be done to make different categories of fare much easier to communicate to both passengers and sales staff. The SRA intends to work with train operators and ATOC to ensure that the terminology used to describe particular categories of tickets and (where appropriate) the terms and conditions for similar products, are properly coordinated between operators.

Zoned Fares for London

TfL has suggested that national rail fares within the London *Travelcard* zones could be replaced by an integrated structure of zoned fares, consistent with London Underground fares. There may be significant advantages of simplifying fares in this way, and integrating them with fares for other modes. On the other hand, creation of standardized zoned fares will remove a train operator's ability to price fares up or down on specific routes to control overcrowding or reflect better or worse service quality on different routes. The SRA will develop this proposal further with TfL and the train operators over the next 2 years, allowing the likely impacts on fares, revenue and passenger journeys to be properly quantified.

Railcards

Currently, there are nationwide railcards for young people, senior citizens, families and people with disabilities, all of whom typically have lower incomes and for whom a discounted fare is likely to generate both more travel and more revenue. These railcards are protected by the SRA which requires TOCs to participate in these railcard schemes through their franchise agreements.

However, the idea of a national railcard available to everyone was widely supported in responses to the SRA's consultation on fares policy. Unfortunately, a railcard that gives a discount to individual passengers is likely to be an expensive way of generating extra passengers, and the extra subsidy required to support a national railcard may not be good value for money. There are two major concerns. First, that the effect of a card would be to give a discount to existing regular rail users and not to current non-users, the very people that need to be attracted to rail. For example, if a national railcard were introduced, a car user considering one rail trip would still face paying the full fare, while only regular rail users benefit from the discount. Second, if a national railcard was available to everyone including higher-income groups, it could not be targeted at the most price-sensitive groups likely to switch to rail if offered lower fares. In effect, taxpayers would be paying for cheaper tickets for higher earners. A national railcard giving discounts to individual passengers is quite likely to lose more money from giving existing passengers a discount than would be gained from new passengers paying the reduced fare.

Nevertheless, the SRA is keen to see whether it is possible to develop a national railcard that is well targeted, encourages road users to switch to trains, avoids adding to overcrowding, and does not reduce operators' revenue or require extra subsidy. For example, a railcard for small groups might make rail travel more attractive for people who currently travel together by car due to the cost saving over rail. The SRA intends to develop proposals for a national railcard in conjunction with ATOC and the train operators. If a viable proposal can be produced, a national railcard could be introduced as early as 2005.

Smartcards

Fares regulation will probably need to be altered at some point to accommodate changes resulting from the introduction of smartcard ticketing both in London and around the UK. However, smartcard schemes are insufficiently developed at present to make specific changes to fares regulation necessary. This is not to say that future changes will not be needed. For example, if smartcard ticketing allowed the traditional pattern of weekly, monthly and annual season tickets to be changed. Another possibility is that smartcard ticketing might allow more effective peak and shoulder-peak pricing, where passengers can save money by travelling on less-crowded trains at the shoulder of the peak. If this spread commuting more evenly over a slightly longer period, it might bring lower overcrowding levels, more efficient use of rolling stock, and lower costs. The SRA intends to research this possibility and carry out a trial on part of the London rail network if appropriate.

Implementing Fares Review

Each operator's franchise agreement includes provision for the SRA to review and alter fares regulation. The SRA is permitted to change fares regulation at any time after January 2003 as long as franchise payments are adjusted so that the operator makes no net gain or loss from the change. The new fares policy is expected to generate a net increase in revenue, reducing subsidy payments from the SRA. In cases where an operator pays a premium, increased payment to the SRA will be required. The amount of the adjusted franchise payments was evaluated and discussed with operators in time for the new fares policy to be implemented in January 2004. ■

Further Reading

Update report on Virgin Trains market share prepared by Steer Davis Gleave, 2002.

Fares Review Conclusions 2003, SRA, http://www.sra.gov.uk/publications/index.tt2.

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