ATOC

Association of Train Operating Companies

Schedule 8 compensation payment rates in Control Period 5

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Introduction

ATOC provides a national voice for Britain's passenger train companies, helping to create, inform and shape the rail environment in Great Britain. We bring together all train companies to preserve and enhance the benefits for passengers of Britain's national rail network, which jointly we do by providing the following key services:

- A central clearing house for the train operators, allowing passengers to buy tickets to travel on any part of the rail network, from any station, through the Rail Settlement Plan
- A customer service operation, giving passengers up-to-the-minute information on train times, fares, reservations and service disruption across the country, through the National Rail Enquiries (NRE)
- A range of discounted and promotional rail cards, cutting the cost of travelling by train for groups including young people, families, senior citizens and people with disabilities
- Operational and engineering expertise, promoting safety, setting standards and encouraging excellence across the sector.

ATOC's mission is to work for passenger rail operators in serving their customers and supporting a safe, reliable, attractive and prosperous railway.

Executive Summary

The Schedule 8 performance regime must remain an effective compensation and incentive mechanism. To do this requires the updating of payment rates.

ATOC Board has discussed Network Rail's proposal and does not believe it provides the appropriate way forward. Indeed handing this consultation to one industry player (Network Rail) with a clear financial interest in the result was unfortunate. We believe the answer remains to rely on the independent findings of academic experts, as expressed through the Passenger Demand Forecasting Handbook (PDFH) process. This was an exhaustive and evidence-based approach.

We believe that utilisation of such a major event as the Hatfield disaster for 'back-casting' analysis is unconvincing, because it was such an untypical occurrence. The chart produced by Network Rail does not produce any clear evidence for either of the scenarios put forward and indeed they would both appear distant from actual demand, thereby making the whole 'back-cast' analysis flawed.

The ATOC response

ATOC continues to endorse the principle that the Schedule 8 performance regime should remain "an effective compensation and incentive mechanism" for both Network Rail and TOCs. Network Rail payment rates were last updated as part of the 2005 review of Schedule 8, whereas TOC payment rates were updated as part of PR08. It is important, therefore, to update these during PR13.

Since payment rates form the basis of both bonus and compensation when Network Rail or TOCs are performing better or worse than benchmark, it is vital that they are set at appropriate levels. If set incorrectly, TOCs may not receive adequate compensation for loss of fare revenue. This, in turn, makes franchise bidding more complicated as allowance then has to be made for the revenue implications of partially compensated performance drops/increases from expectations.

We welcomed the opportunity to join the well attended workshop on 31 May 2013 and challenge Network Rail on their proposition. It is unfortunate that the process for this consultation and the workshop felt rather one-sided. Many of the discussions had already taken place with independent experts as part of the recent update of PDFH guidance and, having been evaluated, had then ultimately been discounted by the academic experts. Asking one party (Network Rail) to carry out a consultation on this point would appear to lack impartiality. We reiterate we believe that ORR will want to engage in the process and resolve the matter itself if necessary.

We note the concerns expressed by Network Rail over their payment rates for commuter services in London and the South East and indeed Network Rail made many of these points during discussions over revisions to the Passenger Demand Forecasting Handbook (PDFH) earlier in 2013. Network Rail has built their case on the need to mitigate financial risk, avoid perverse incentives and avoid industry reputational risk.

We take each of these three points in turn. First, the financial risk needs to be seen alongside that for franchise bids. The existence of a fully-compensating Schedule 8 means that franchise bids can be considerably simplified such that bidders can offer larger premia than would otherwise be the case (when they would be taking a degree of revenue risk on performance and so would need to value the risk of performance fluctuations when bidding).

Second, in terms of incentives, the industry should be able to agree a consensus on the impact of performance on revenue. The PDFH process is used to calculate the GJT elasticities used by industry parties and the conclusion that the PDFH has reached on delay multipliers was an appropriate one to achieve such a consensus. Independent experts were commissioned to review all the available evidence, their initial recommendations were subject to challenge by a steering group consisting of both Network Rail and TOC subject experts, and the final recommendations took account of the challenges from the steering group members. To reach a contrary view, within a process such as this, the burden of proof needs to be very strong.

Finally, owning groups remain totally unpersuaded about the argument Network Rail has made about reputational risk. The policy intent behind the Schedule 8 regime is for it to adequately compensate for loss of revenue as a result of poor performance as well as incentivising good performance. It is a risk protection mechanism and works both ways depending upon the agreed benchmarks between the respective companies. It is natural that the payment rates rise over time, in response to fare levels and to volume, and so the fact that substantial sums could flow back and forth between Network Rail and TOCs under Schedule 8 in CP5 would, in our submission, be more an indication that Schedule 8 is operating as it should rather being a problem.

PDFH is the industry view and it is the independent view. It generated a balanced debate and concerns raised about Lateness Multipliers did lead to them being revised downwards on more than one occasion during the recent process. No such evidence has been proposed to reduce the GJT elasticities per se.

The flawed 'back-cast'

The counter-proposal is less convincing because it has been developed by a party, Network Rail, which is not independent and which potentially stands to gain financially by it. It is based on just one 'back-cast', which does not explicitly consider all factors or lags. The Network Rail proposal does not have a much better fit to the actual demand within the 'back-cast' and this supports the view that the 'back-cast' is inadequate.

Indeed, we would question the selection of the Hatfield disaster as a suitable event to use for 'back-casting' analysis. It was of a magnitude far greater than the changes in demand / performance being evaluated and mitigated through Schedule 8. It also created very different impacts for operators north and south of the river and yet the 'back-cast' takes the whole of London and the South East as one entity. If validity was to be given to this analysis, we would require far more transparency from Network Rail on the raw data and assumptions used for the 'back-casting'. It is not clear how many long distance flows have been pulled into this analysis or the exact hours or data being termed 'commuter flows'.

More importantly, the 'back-cast' has in fact already been considered and taken into account by the independent experts (page 42 of v3.4 of the Reliability Review Technical Note). Network Rail proposes adjusting the GJT elasticities, even though the evidence base for GJT elasticities is much more robust than that for Delay Multipliers. Indeed, at the workshop on 31 May 2013, Network Rail acknowledged that they were not challenging the GJT elasticities, but were proposing to adjust them for Schedule 8 payment rate calculations solely because doing so generates what they believe to be appropriate values for the impact of performance on demand. This is clearly not an evidence-based approach.

Conclusion

All this leads us to reach a 'not proven' verdict. ATOC Board discussed this at its most recent meeting last Wednesday and owning groups firmly believe it is better to rely on the evidence based approach of the independent experts (ITS and MVA) rather than one party who is a key player with a financial interest.

The correct route where differences of opinion do exist is for there to be the possibility, within the 'star' model to agree bespoke payment rates between Network Rail and TOCs for particular service groups, an option re-stated in the ORR letter dated 14 May 13. The challenge here is the relatively short window for this as ORR have asked for revised numbers by 17 July 13.

Enquiries

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