

Sent by email to:
caitlin.scarlett@networkrail.co.uk

Direct Line: 0207 944 4250
nick.bisson@dft.gsi.gov.uk

June 2013

Dear Caitlin,

Network Rail consultation on Schedule 8 compensation payment rates in Control Period 5

This letter is the Department for Transport's (DfT) response to Network Rail's consultation on schedule 8 compensation payment rates for 2014-19. Schedule 8 covers compensation arrangements between affected rail industry parties in the event of unplanned disruption and is an important incentive to generate the right behaviours around operational performance, for the benefit of passengers and freight customers. DfT welcomes the opportunity to comment and will continue to discuss these issues with Network Rail and the Office of Rail Regulation (ORR).

DfT's interest in schedule 8

Although schedule 8 provides for compensation between train operators and Network Rail, DfT has an interest for a number of reasons:

- at the level of principle, DfT has an interest in ensuring that Network Rail and train operators are appropriately incentivised to minimise disruption on the railways, for the benefit of rail users and to support economic growth;
- in relation to DfT's role in letting franchises for passenger train services, it is important that the incentive is calibrated at the right level, as the risk of under- or over-compensation could lead to risk premia being incorporated into train operators' bids. Risk premia would lead to lower revenues (or higher subsidy payments) for Government;
- excessive volatility of compensation rates could be a factor in destabilising a franchise operator, which ultimately could lead to the Department needing to fulfil its statutory duty to protect services. (Volatility can also affect Network Rail, potentially impacting on the level of subsidy required from Government); and
- the nature of franchise agreements means that DfT may be exposed to a significant proportion of any schedule 8 impacts resulting from ORR's Periodic Review 2013 changes.

DfT has covered schedule 8 in responses to previous Periodic Review 2013 consultations from the ORR. DfT agrees that schedule 8 should not undergo fundamental changes for the next control period and supports the review of payment rates to minimise the risk of under- or over-compensation. Schedule 8 payment rates are used to calculate schedule 4 (covering engineering works) and the capacity charge. This increases the importance of correct calibration.

DfT agrees that payment rates need to be increased to reflect the higher volume of passengers using the network and the inflation + 1% increase in train fares of recent years.

Response to issues raised by Network Rail consultation

Network Rail's consultation focuses on the use of methodologies from the Passenger Demand Forecasting Handbook (PDFH) on "lateness multipliers" and "generalised journey time elasticities" to help set schedule 8 payment rates. Essentially, this allows compensation to reflect the extent to which delays result in reduced demand for train services.

The Department believes that it is right to revisit these rates that were established in 2005 to ensure that they are still correct. However, DfT has concerns about the PDFH 5.1 recommendations on delay multipliers and generalised journey time presented to the PDFC community in March this year and which the ORR proposes to adopt for the calculation of schedule 8. The increases to Schedule 8 rates resulting from these changes are very significant and potentially introduce considerable volatility into Network Rail and train operators' financial positions, with consequent financial impacts for DfT.


DfT shares Network Rail's concerns that the impact of demand for commuting flows into London could be overstated by the new PDFH and notes Network Rail's findings that the impact of delays on LSE demand appears to be less even than the current 2009-14 schedule 8 rates would suggest. Network Rail sets out in the consultation its view that these issues apply only to London and South East services, given the strength of the market position for these services. DfT believes that while this may be the case, there remains a risk that PDFH values for other sectors may also be overstated as the same methodology has been used in estimating these new values.

In summary, whilst DfT acknowledges that the new PDFH studies have received some scrutiny and represent the latest evidence available, DfT still has significant concerns about the specific use of the new PDFH 5.1 values to inform higher schedule 8 payment rates. DfT would stress that it has not yet formed a final view on the changes in PDFH 5.1 and considers that the evidence base and the analyses should be peer reviewed before the new values are adopted. DfT plans to conduct an independent review concluding in November 2013, and if it decides to adopt any of the PDFH5.1 recommendations, it will do so through its WebTAG procedures for publication by June 2014. We acknowledge that this does not come in time for the final PR13 determination and that the ORR's timescales are pressing. In these circumstances, DfT's view is that the previous GJT elasticities and lateness multipliers should be used, with schedule 8 payment rates only being increased to reflect higher passenger numbers and above inflation fares.

We believe that further discussion between interested parties would be helpful to ensure that the practical application of the studies to the rail industry is understood and helps to optimise the incentives on all parties.

Notwithstanding the above, DfT notes that in the event TOCs and Network Rail mutually agree that schedule 8 rates are inappropriate, they have the opportunity to agree a

different rate, with the approval of the ORR. DfT supports these arrangements, which provide the opportunity for a practical solution to any potential mis-calibrations. DfT requests involvement in such conversations, given its financial interest described above through franchise agreements and given the importance of ensuring that any bespoke rates do not create imbalances in the incentive regime.

A handwritten signature in black ink that reads "Nick Bisson". The signature is written in a cursive style with a large, stylized 'N' and 'B'.

Nick Bisson
Director – Rail Policy
Department for Transport

