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18th June 2013

Dear Joel,

Consultation on Schedule 8 compensation payment rates during Control Period Five

This letter sets out the views of TfL and London Overground Rail Operations Limited (LOROL) on the points raised in Network Rail's consultation on Schedule 8 compensation payment rates during Control Period Five (CP5). TfL and LOROL are content for this response to be published and shared with third parties.

TfL does not agree with Network Rail's proposition. TfL considers that the value of time weightings and elasticities proposed in version 5.1 of the Passenger Demand Forecasting Handbook (PDFH) should be used when formulating the Schedule 8 payment rates for CP5.

TfL doubts that there is a proven case against the work undertaken by MVA and ITS, both of whom are expert in this field. Network Rail needs to demonstrate a more convincing case for their argument. For example, Network Rail's backcasting analysis only includes the impact of central London employment and fares. Using these factors alone may be insufficient to generate a reliable result. Changes to economic growth and population as well as changes to endogenous factors such as journey time should also be considered.

Evidence from other sources (including the National Passenger Survey) clearly demonstrates that passengers place a high value on the provision of a reliable service. It is therefore reasonable to expect that poor performance will have a significant effect on demand and revenue as suggested by version

5.1 of the PDFH.

Network Rail argues that a reduction in the payment rate could be justified because of the lagged effect of poor performance on demand. However, franchises last for several years so operators will over the course of time feel the full revenue effect of poor performance. This argument is even more pertinent in the case of organisations such as TfL which have a perpetual interest in the demand using the system and the revenue this generates. This lessens the case for reducing the payment rate to reflect any lag effects. Indeed, where poor performance is entrenched it is likely that considerable investment in infrastructure, systems and people will be required over time to improve the situation. Higher Schedule 8 payment rates provide better incentives for this type of long term investment.

The speed with which customers react to poor performance is likely to continue to increase over time, as will the public's awareness of it due to open data policies and the opportunities for communication afforded by the internet and mobile communications technology. These factors will ensure that the public is in general more aware of poor performance on particular routes, discouraging their use. The effect of poor performance during peak periods will not necessarily be felt wholly in the peaks; it could well discourage discretionary travel during off peak periods due to the bad publicity created, to the detriment of the operators affected. Network Rail's backcasting analysis does not appear to take this into account. Flexible ticketing products will provide commuters with increased opportunities to respond to poor performance by working from home on certain days of the week (for example), to the detriment of the income received by operators.

Network Rail makes the point that operators have not claimed that payment rates were too low during Control Period 4. This is unsurprising as operators would have bid on the basis of the Schedule 8 rates that were in force at the time of refranchising and would therefore have calibrated their business models according to these rates. Operators are, of course, protected from changes to rates arising from Periodic Reviews.

Overall TfL considers that there is good evidence to suggest that performance is a key driver of rail demand. This needs to be reflected properly in Schedule 8, particularly as passengers are becoming more aware of poor performance and will increasingly be able to adjust their daily routine to minimise their exposure to it, with consequential adverse impacts on operator revenues. The impact of bad performance during the key commuting times is likely to be felt in part within other markets due to the impact of bad publicity; it is important that the performance regime takes this into account.

Yours sincerely,

**Alan Smart,
Principal Planner – Forecasting,
Rail Planning team.**