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Dear Train Operating Companies and Network Rail Routes

CP6 Schedule 8 Recalibration: Request for approval of Network Rail Payment Rates

The purpose of this letter is to seek your approval of the finalised Schedule 8 Network Rail Payment Rates for CP6. This letter contains the following information, to support the approval process:

Annex 1: CP6 Network Rail Payment Rate results

Annex 2: A summary of TOC specific assumptions used in the recalibration of the Network Rail Payment Rates, produced by SDG

Annex 3: SDG's final methodology document

Annex 4: Vivacity Rail's independent audit report

Context

The purpose of the Schedule 8 regime is to hold train operators financially neutral to the long-term impact of fluctuations in performance for which they are not directly responsible. It does this by providing compensation to operators for future lost farebox revenues as a result of disruption that they have not caused.

The industry, through RDG, is undertaking a recalibration of the Schedule 8 Appendix 1 and 3 parameters. The recalibration will ensure that the Schedule 8 regime for CP6 is up-to-date, accurate and consistent with ORR's conclusions on the structure and policy of Schedule 8. The Schedule 8 recalibration work reports to the RDG Reform Board, with the technical recalibration work being undertaken by consultants. As in previous control periods, ORR is responsible for overall approval of the recalibrated Schedule 8 parameters to be used for CP6.

Schedule 8 recalibration

The Schedule 8 recalibration work has been split into 3 phases:

Phase	Description	Indicative timeline	Consultancy selected
Phase 1 [COMPLETE]	Recalibration of Monitoring Point Weightings and Cancellation Minutes	June 2017 – March 2018	PricewaterhouseCoopers (PwC)
Phase 2	Audit of Phase 1 work	Nov 2017 –	Steer Davies Gleave

	Recalibration of Network Rail and Train Operator Benchmarks and Payment Rates, and Sustained Poor Performance thresholds	Nov 2018	(SDG)
Phase 3	Audit of Phase 2 work	March 2018 – Nov 2018	Vivacity Rail Consulting (VRC)

Phase 1 of the recalibration is now complete, including the audit, and was formally approved by ORR on 5 March 2018.

SDG has now completed the recalibration of the Network Rail Payment Rates (the first element of Phase 2) and the report is shown in Annex 3. This work has been independently audited by VRC, and the audit report is contained in Annex 4. The final Network Rail Payment Rates are shown in Annex 1 for your consideration.

Engagement with TOCs and Network Rail Routes

RDG and SDG have sought engagement from train operators and Network Rail Routes throughout the recalibration of the Network Rail Payment Rates. This engagement included:

- Multiple discussions on the high-level methodology for setting Network Rail Payment Rates at the Schedule 8 recalibration working group – 25 Sept 2017, 23 Oct 2017, 20 Nov 2017, 18 Dec 2017 and 15 Jan 2018. The Schedule 8 recalibration working group delegated authority for the development of the methodology for setting Network Rail Payment Rates to the revenue sub-group on 15 Jan 2018. The revenue sub-group provided 2 updates to the Schedule 8 recalibration working group, on 12 Feb 2018 and 12 March 2018.
- All industry stakeholders were invited to be part of a revenue sub-group. The revenue sub-group comprised representatives from Network Rail, Govia Thameslink Railway, Great Western Railway and South Western Railway. The revenue sub-group met on 16 Oct 2017, 11 Jan 2018 and 25 Jan 2018. The revenue sub-group made a submission to ORR on the methodology for setting Network Rail Payment Rates on 2 Feb 2017, which ORR responded to on 16 Feb 2018¹.
- SDG held one-on-one engagement sessions jointly with each train operator and Network Rail Route between January and May 2018. The purpose of these sessions was to discuss the methodology used in the recalibration of the Network Rail Payment Rates and to understand any local issues that needed to be accounted for in the recalibration.
- SDG attended all Schedule 8 recalibration working groups since starting the project (Nov 2017), to provide updates on the progress of the recalibration and seek stakeholder's input into methodological issues².

¹ The industry submission to ORR is available at: <https://www.raildeliverygroup.com/about-us/governance/strategic-boards/reform-board/schedule-8-wg.html>

² Specifically, SDG drew the working group's attention to the definition of London and South East flows, and the methodology for calculating the Marginal Revenue Effect (MRE).

- SDG shared the methodology document on numerous occasions through the revenue sub group (23 Feb 2018), the recalibration working group (6 March 2018), the one-on-one engagement sessions and formal correspondence in April and May 2018 (with circulation of the initial and final drafts of the Network Rail Payment Rates).
- SDG shared two sets of draft results with train operators and Network Rail in April and May 2018. As part of this, the full model used in the recalibration was shared with train operators. We note that Network Rail Routes have been unable to review the full models using to produce the Network Rail Payment Rates unless train operators have shared these directly, due to the commercial sensitivity of the train operators' revenue data. Where Network Rail Routes have requested more detail on the modelling process (in particular, the impact of the Oxera methodology on Peak and Off-Peak Payment Rates), SDG provided a model that shows how the parameters affect the results for an indicative sample flow.
- SDG provided a Version Control and TOC-specific notes for each train operator and corresponding Network Rail Route for each version of the Network Rail Payment Rates results. This provided the TOC-specific methodology that was carried out and any other uplifts/adjustments that were made.
- Subsequent to the engagement sessions SDG had many follow-up discussions with the train operators and Network Rail Routes to work through issues that are particular to the train operator's characteristics.

We also note that SDG and Arup have discussed the methodology and assumptions on multiple occasions to ensure alignment between the national and the bespoke recalibrations.

Approval of Network Rail Payment Rates

As the key stakeholders of the Schedule 8 recalibration for CP6, RDG requests that you review the Network Rail Payment Rate results and bespoke changes (if applicable), and respond to this letter setting out:

1. Whether you give your approval of the Network Rail Payment Rates set out in Annex 1; and
2. If you do not give approval of the Network Rail Payment Rates, explain the reasons why. In this instance it will also be necessary for you to provide an alternative set of Network Rail Payment Rates with an explanation of how these were calculated and justification for why these alternative results should be used.

All responses should be sent to Caitlin Scarlett (details above) by 4pm 11 June 2018.

RDG will collate all responses and submit a final set of Network Rail Payment Rates to ORR for approval. ORR will ultimately be responsible for the approval of all Schedule 8 Appendix 1 and 3 data.

Next steps

RDG will consider the responses received to this letter, and make a submission to ORR which will include details of whether the train operator and Network Rail Routes have given their approval of the Network Rail Payment Rates and if not, will set out the reasons why.

If train operators and Network Rail Routes approve the Network Rail Payment Rates set out in Annex 1 (or do not provide a response), RDG will submit these Network Rail Payment Rates to ORR for formal sign-off for CP6.

If, however, train operators and/or Network Rail Routes do not approve the Network Rail Payment Rates in Annex 1, RDG will consolidate views and submit these to ORR, alongside the alternative Network Rail Payment Rates provided in response to this letter, for ORR's consideration.

We will communicate the outcome of ORR's review, subject to commercial confidentiality, to the Schedule 8 recalibration working group.

Yours faithfully,

Caitlin Scarlett