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Dear Joel,

First Great Western response to Network Rail consultation on Schedule 8 compensation payment rates in CP5

Thank you for the opportunity to respond to your letter of 15 May. This response is made on behalf of First Great Western. We support use of PDFH 5.1 parameters, and do not agree with NR's proposed alternative.

Research Basis

Schedule 8 rates should be based on high quality objective independent research. This will ensure that they represent the best approximation of the impact of performance on revenue. The PDFH 5.1 parameters were based on such research, together with a process for industry discussion and sign-off. NR's late challenge calls into question the purpose of the industry undertaking this kind of research.

NR's proposal to use Lateness Multipliers from PDFH 5.1 and elasticities from PDFH 4.1 is at odds with the findings from the research. The consultants from ITS and MVA have pointed out that they have greater confidence in the new PDFH 5.1 elasticities than in the new Lateness Multipliers.

Backcasting analysis

NR has based its challenge on a backcasting of revenue which appears to contradict both the PDFH 4.1 and the PDFH 5.1 parameters. This either undermines the whole foundation of the research into performance impacts on revenue, or indicates that NR's analysis is not an appropriate basis on which to set Schedule 8 rates. The MVA and ITS consultants have highlighted that backcasts can mislead if they are not done properly with all elements taken into account.

NR has acknowledged that there are a number of explanations for the "gap" between its backcast and the actual revenue. There has been no in depth

work to understand these gaps, or to explore what implications the backcasting work should have for Schedule 8 rates.

The use of a backcast from a time of significant performance change is not appropriate for setting Schedule 8 rates. The deterioration in performance after Hatfield was a significant step change, and was followed by changes to the regulatory regime. By contrast, Schedule 8 rates are intended to represent the response of revenue to marginal performance changes during CP5. Big step changes in performance are not envisaged in CP5. Applying post Hatfield results to CP5 is less robust than using the research used to arrive at PDFH 5.1 parameters.

Independence

Inappropriately low rates would reduce risk for NR, but increase risk for TOCs as poor performance would not sufficiently compensate for revenue losses. It is therefore not appropriate for Schedule 8 rates to be amended due to NR analysis which has not been subject to rigorous challenge. It is vital that the process of setting the Schedule 8 parameters is clearly independent in order that the industry can retain confidence in the regime.

Summary

Schedule 8 rates should reflect the impact of performance on revenue to ensure incentives are correctly aligned. Therefore, Schedule 8 rates should be based on the latest objective expert research as discussed and agreed by the industry in PDFH 5.1. In the absence of independent, rigorous research supporting NR's argument, we do not support a move away from the industry's accepted evidence base.

Yours sincerely,

Martin Thornley
Performance Manager, First Great Western