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Consultation Response

## **DfT Concessionary Travel Reimbursement Guidance**

Full Response Document

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Pedro Abrantes

**pteg** Support Unit  
Wellington House  
40-50 Wellington Street  
Leeds – LS1 2DE  
0113 251 7445  
[info@pteg.net](mailto:info@pteg.net)

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## 1. Background to pteg

- 1.1. **pteg** represents the six English Passenger Transport Executives (PTEs) in England which between them serve more than eleven million people in Tyne and Wear, West Yorkshire, South Yorkshire, Greater Manchester, Merseyside and the West Midlands. Leicester City Council, Nottingham City Council, Transport for London (TfL) and Strathclyde Partnership for Transport (SPT) are associate members of **pteg**, though this response does not represent their views. The PTEs plan, procure, provide and promote public transport in some of Britain's largest city regions.
- 1.2. One of our core responsibilities is to administer the statutory National Concessionary Travel Scheme (NCTS) on behalf of the Department for Transport (DfT). NCTS reimbursement to operators in PTE areas now represents approximately 30% of the total cost of the scheme nationally. In addition to the statutory scheme, most PTEs also operate local additional discretionary enhancements for concessionary passengers. We therefore welcome the publication of the DfT's consultation document and the opportunity to respond.

## 2. Structure of the response

- 2.1. The DfT consultation invited views on the following issues:
  1. Whether the new guidance is fit-for-purpose, including whether the advice provided on how to calculate reimbursement is clear and relevant, and whether practical implementation issues have been appropriately addressed (Q1);
  2. Whether the balance between simplicity and local flexibility is right, in the sense that the Guidance leaves scope to introduce some local variation and to take account of local circumstances in some elements of the calculations (Q2);
  3. Whether there is additional robust evidence which supports or contradicts the findings of the research and the guidance's methodological framework, in particular in terms of variation in local circumstances. (Q3 and Q4);
  4. Whether the reimbursement calculator is easy to use and where it could be improved (Q5).
  5. Whether the proposed Regulatory changes adequately support the new reimbursement framework and whether any additional changes would be helpful (Q6 and Q7)
  6. Whether more radical reform of reimbursement should be pursued and the practical implications of such changes (Q8, Q9 and Q10).
- 2.2. Points 1-4 above relate to the Reimbursement Guidance and these are addressed jointly in Section 3. We have found it useful to structure our response around the key technical elements of the proposed reimbursement method rather than according to the five questions posed in the consultation document. Point 5 is related to regulatory changes and is addressed in Section 4. Point 6 relates to more radical reimbursement options and this is addressed in Section 5.
- 2.3. This document is supplemented by five annexes supplied as separate digital documents and the official response form.

### 3. Reimbursement Guidance

#### Summary of the proposed methodology

- 3.1. The reimbursement methodology set out in the draft Guidance consists of three key steps:
- Estimation of the proportion of observed concessionary trips at free fares which would have taken place in the counterfactual – the Reimbursement Factor (RF);
  - Estimation of the average commercial fare (ACF) that would have been paid by concessionary passengers in the counterfactual;
  - Estimation of net additional costs incurred by operators in carrying the passengers generated by the scheme.

- 3.2. In simple terms the total amount of reimbursement due to an operator should be equal to:
- Observed concessionary trips at zero fare x RF x ACF +
  - Net additional costs

Where net additional costs are made up of:

- marginal costs associated to generated passengers +
  - additional capacity requirements due to generated passengers (assuming these can be provided within the pre-existing fleet) +
  - additional costs due to an increase in peak vehicle requirements –
  - any increase in revenue from non-generated passengers due to increases in capacity.
- 3.3. **pteg** fully supports the overarching methodological approach to reimbursement described above.
- 3.4. The remainder of this Section is structured around the key steps identified in paragraph 3.1, relative to which we address a number of more detailed issues and concerns. We conclude this Section by highlighting some further steps that may be required from the DfT in the future in order to improve the practical application of the Guidance over the next few years.

#### Estimating demand / the Reimbursement Factor

- 3.5. The PTEs recognise that the draft Guidance which is currently subject to consultation represents a significant advance on its predecessors in terms of the calculation of revenue forgone. The single demand curve approach removes significant complexity from the estimation process, and DfT's proposed parameter estimates are based on, by far, the most robust and comprehensive empirical study to date. These features should lead to more straightforward, transparent and fairer reimbursement arrangements, and remove much of the scope for conflict between TCAs and operators which has been so prevalent in the past.
- 3.6. However, we are very concerned by the inclusion in the draft Guidance of a facility allowing the Reimbursement Factor obtained from the single demand curve to be adjusted where underlying trends in a specific area (or for individual operators) are significantly different to the average trend observed over recent years. This has the potential to undo much of the progress that has been achieved.
- 3.7. We believe that:

- there is no conceptual rationale or empirical support for the principle and scale of this adjustment; and that
  - the practical procedures proposed to implement the adjustment are flawed and could have substantial negative impacts on both TCAs and operators.
- 3.8. We have attempted to highlight the flawed rationale behind this proposal in the position paper included as **annex A** and summarise our key points below.
- 3.9. We fully support the core reimbursement methodology proposed by DfT, which is based on the key premise that the so-called single demand curves (one for PTE areas and one for non-PTE areas) represent the best available evidence on how concessionary passenger demand varies in response to changes in fare. It therefore provides the best basis for estimating how concessionary passenger demand would diminish in the absence of the concessionary fare, all other things being equal.
- 3.10. The proposed adjustment appears to undermine the single demand curve concept by implying that the functions proposed by DfT are in fact biased in some way, and that the bias can somehow be corrected by reference to trends in non-concessionary travel demand.
- 3.11. Even if there was a well established conceptual link between the demand function used to calculate reimbursement factors and underlying trends in non-concessionary travel, the practical procedure that is proposed to estimate these trends is fraught with difficulty:
- Consistent and auditable data on non-concessionary trips and fare levels going back to 2005 is difficult to establish;
  - Estimates of both trip numbers and fare levels will be particularly vulnerable to changing patterns of use of discounted tickets;
  - Operator-specific data, as encouraged by the proposals, will be insufficient to distinguish genuine changes in patronage from service changes arising from acquisitions or disposals, de-registrations and the like;
  - TCAs will have no power to acquire equivalent data from competing operators to enable judgements to be made about such influences, and the wider context of any claims for underlying trends;
  - The proposal will inevitably lead to increases in reimbursement since only those operators who will benefit will put forward a case for change.
- 3.12. This proposal could also have the unintended consequence to significantly increase the cost to local authorities of improving the attractiveness of the bus network. Not only would local authorities need to find the money to fund those measures in the first place but, they would also have to set aside revenue funding to compensate operators for the increase in commercial passengers.
- 3.13. It is accepted that the evidence from which the single demand curve parameters have been derived may not be fully representative of all circumstances, in all areas of England. In particular, the choice of "PTE" and "non-PTE" curves may be too harsh, since many non-Metropolitan urban areas are likely to have characteristics that are more similar to PTE areas than the "non-PTE" areas in the reference data sets. TCAs should have the choice of "PTE" and "non-PTE" parameters, and flexibility about how to apply them to the characteristics of their own area.

- 3.14. TCAs also need the flexibility to acknowledge exceptional circumstances, in which it is reasonable to apply different criteria for judging a fair level of reimbursement. For example, this might include infrequent rural services and community transport services, where the impact of fare on demand is constrained by service levels. Some of these circumstances can be anticipated, and we would welcome the opportunity of working with DfT to help articulate exception criteria.
- 3.15. However, it would be disproportionate and counterproductive to retain the current proposals for a “trend adjustment”. These will undermine the cornerstone of the proposed reimbursement methodology, and confuse the principles on which fair reimbursement should be based, for practitioners working for both TCAs and operators.

#### ***Average fare***

- 3.16. In the past, reimbursement calculations have often been based on fairly simplistic estimates and assumptions relative to the “cash” fare. However, reliance on the cash fare has become increasingly unsatisfactory as operators have broadened the range of ticket products offered. On the other hand, the vast majority of TCAs have typically not had access to data to enable them to assess the scale or value of use of non-cash ticket types.
- 3.17. **pteg** therefore recognises that the Discount Factor method proposed in the draft Guidance represents a significant advance in terms of estimating the average fare that would have applied to concessionary passengers. A key advantage of this method is that it has been devised to be operable with the minimum amount of information from operators by using empirical evidence on the travel patterns of concessionary passengers from the NoWcard smartcard scheme in Lancashire.
- 3.18. However, it should be recognised that PTEs are better equipped with data than most TCAs, allowing them to use more accurate local evidence instead of relying necessarily upon the NoWcard data. In addition, PTEs may be faced with ticket system characteristics that are more complex than those for which the Discount Factor method is designed. We therefore welcome the acknowledgement in the draft Guidance that local variations relative to the default method may be warranted in some circumstances.
- 3.19. Nonetheless, concerns remain on our part with respect to some detailed technical aspects of the Discount Factor method, the absence of a clear conceptual rationale for the proposed degeneration approach and the excessive degree of complexity in the calculations involved. First of all, and although we accept the general principle of degeneration (in the counterfactual fewer trips would be made by concessionary passengers than presently at zero fare), we feel that the proposed implementation of this principle, based on increasing the trip thresholds at which discounted products become attractive, lacks a robust conceptual rationale and is unnecessarily complex. In addition we have found some inconsistencies in the way trips on discounted tickets have been degenerated in the reimbursement calculator.
- 3.20. A second issue is the fact that due to simpler fare scales for discounted products the average trip length is different between ticket products. As a result the average cash fare that would have been available to users of discounted products is typically higher than the average cash fare actually paid by passengers using cash fares. We suggest that this problem can be adequately addressed by reference to an “average equivalent single fare”.
- 3.21. These issues and our concerns are described in more detail in the position paper included as annex C. We have also made an attempt in that paper to devise a simpler alternative

approach to degeneration (the Adapted Discount Factor method), which we feel does away with much of the complexity of the current DfT proposal and makes the underlying assumptions clearer. Although our proposed approach may have its own flaws we feel that it takes the best features from the DfT proposal and implements them in a way that is much more straightforward and therefore easier for TCAs and operators to understand.

### **Additional costs**

3.22. **pteg** supports the proposed methodology for addressing additional marginal costs.

### **Additional capacity costs**

3.23. We strongly agree with the view put forward in the draft Guidance that it is up to operators to demonstrate that additional capacity costs have been incurred. However, this does not in itself solve the problem of which methodology to adopt in estimating the additional capacity requirements that would arise in a given context, where we feel the draft Guidance provides little support to TCAs. The problem is worsened by a number of inconsistencies both within the written Guidance and relative to the reimbursement calculator. It is therefore our assessment that, in this respect, the draft Guidance is not fit for purpose.

3.24. As a result we feel that the current calculation spreadsheet invites operators to put forward reimbursement claims for additional capacity costs without a cogent empirical demonstration that these have indeed occurred. We are particularly concerned that whereas the Guidance recommends that capacity costs should be estimated on a route by route basis, the reimbursement calculator calculates a rate per passenger (incorporating an implied aggregate Mohring factor) which is applied to all generated passengers. The principle that additional capacity costs do not normally occur would in fact suggest that the Mohring factor should be zero by default. It is then up to operators to demonstrate that on a proportion of their network, generated passengers do require additional capacity costs to be incurred. We therefore cannot see the justification for setting a default Mohring factor and see this as internally inconsistent with the key principle set out in paragraph 3.23.

3.25. Another key area where we feel the draft Guidance lacks a clear conceptual rationale is in the definition of the unit costs which should apply to additional capacity cost calculations. Whereas economic theory would suggest that marginal costs should be used (which ITS estimated to be in the range of 30-50p/veh-km), the draft Guidance puts forward, with little explanation, much higher values that are likely to be closer to average costs. Given that the proposed approach steers away from economic theory, we feel that the reasons for this need to be properly understood by TCAs.

3.26. With respect to the reimbursement calculator we have concerns over the estimation of revenue generation from additional capacity, where we have found that non-generated concessionary passengers are assumed not to contribute to additional revenue generation. We argue that this is clearly an incorrect assumption. We also find it very worrying that the results of the calculator seem to be excessively sensitive to small deviations from default network parameter values, many of which are difficult to audit. We call on the DfT to tighten the definition of network parameters, clearly state the provenance of default parameters provided and, possibly, to simplify the calculator in order to constrain the impact of parameters that are difficult to audit.

- 3.27. We feel that the inconsistencies highlighted above will inevitably cause conflict and misunderstandings between TCAs and operators, and may lead to significant over-reimbursement if the reimbursement calculator was to be used by many TCAs in its present form.
- 3.28. We have described our concerns in more detail in the position paper included as annex B, following which we have made an attempt at developing a local method to estimate additional capacity requirements. This method builds on the DfT methodology and is in line with the acknowledgement in the draft Guidance that local methods may be more appropriate to deal with this issue. We have then illustrated the application of our proposed method using empirical evidence from three PTEs.
- 3.29. We would call on the DfT to acknowledge the validity of our proposed approach as we consider that this could be a useful resource to both PTEs and other TCAs grappling with claims for additional capacity costs from operators.

### **Learning from appeals**

- 3.30. Looking beyond the publication of the Guidance, we feel that some further thought needs to be given on how the appeals process could be better managed in order to inform future reimbursement arrangements.
- 3.31. We understand that DfT acknowledge that the current draft Guidance, and the final version when published, will need to be subject to on-going review as DfT's recommendations are put into practice and experience is gained. We welcome the references in the Guidance to the scope for local discretion, although we also understand the double-edged nature of such flexibility. It is inevitable that operators will see such provisions as opportunities for increasing levels of reimbursement, in some instances for good reason and in others, less so.
- 3.32. Although it is to be hoped that the changes represented by the new Guidance will reduce the volume of appeals, some disputes will not be capable of being resolved locally, and will need to be determined on behalf of the Secretary of State. We urge DfT to think carefully about how the appeal process might be managed so as to establish helpful case studies on the technical areas which may be the subject of argument.
- 3.33. With this in mind, we would suggest that commercially sensitive data is indicated by operators or TCAs at the time they provide it to the Secretary of State (it is, of course, for DfT to decide whether they agree with the operator's or TCA's judgement on this point), and that a principle is established that determinations – suitably edited – are published at some agreed period after they have been provided to the parties that are directly affected.
- 3.34. Guidance cannot be definitive on all aspects of reimbursement calculations, in all circumstances. But it should be possible in this way to move swiftly to pragmatic judgements that need to be made in the areas where local judgements are encouraged. This would provide more certainty for practitioners when in local negotiations, about both good practice elsewhere, and the likely outcome of an appeal if parties fail to come to an agreement. This will be the surest way of progressively reducing the volume of appeals, which is an objective which we are sure is shared by TCAs, operators and DfT.

## **4. Regulatory changes**

- 4.1. As part of its consultation document, the DfT proposed the following key changes to the Regulations:

1. To produce either a separate set of reimbursement regulations under each of the Transport Act 1985 (which deals with discretionary concessionary travel schemes) and the Transport Act 2000 (which covers the mandatory concessionary travel scheme) or a single set of reimbursement regulations under both Acts;
2. To allow reimbursement rates to be revised both downwards as well as upwards when considering appeals from bus operators;
3. To make provisions for TCAs to be able to require the relevant data from operators for the calculation of revenue forgone;
4. To remove any unnecessary clauses which are already covered in the relevant European Regulations;
5. To clarify concepts and definitions in the light of the new Guidance;
6. To clearly restate that operators must provide the details for the ground for the application in appeals

4.2. The DfT invited responses to the following issues:

- Whether the proposed regulatory changes adequately support the new reimbursement framework set out in the guidance?
- Whether there are any other changes to the regulations which would be helpful?

### **Proposed changes to Regulations**

- 4.3. With respect to the first point in paragraph 4.1, **pteg** strongly supports the DfT's intention to provide greater clarity in this area. In particular it seems evident to us that many of the provisions in the existing 1986 Regulations are not appropriate for 2000 Act reimbursement arrangements as they relate to non compulsory local concessions schemes which are very different in terms of administration (participation notice regime etc).
- 4.4. The general usage of the 1986 Regulations to interpret completely separate legislation is not desirable and led to some argument in past 2000 Act appeals. Most, if not all, PTEs now publish two schemes, one under each Act, that together define the local scheme. Hence it would be most helpful if any new regulations were to be produced in a single document covering both Acts provided the regulations clearly distinguish which regulations apply to which regime<sup>1</sup>. Two sets of regulations operating in parallel would not, in our view, lead to an administratively efficient solution.
- 4.5. Clarity that there are different regimes for appeals [applications] under 1985 Act Schemes and that the Secretary of State has no power to consider an application or award additional payments for 1985 Act concessions unless the TCA has forced participation would be useful clarification.
- 4.6. Areas that may be common to both sets of Regulations include data provision, payment periods, additional costs and the requirement that operators are compensated in line with Regulation 1370/2007. We would also find it helpful if DfT were to explain its interpretation

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1.1. <sup>1</sup> For example, any regulations relating to participation notices/applications to cancel only apply to 1985 Act schemes, and regulations relating to appeals relate to 2000 Act reimbursement arrangements.

- 4.7. In terms of making provisions relating to 2000 Act reimbursement arrangements that allow the Secretary of State to find, on an operator appeal, that the reimbursement arrangements are over generous and require adjustment/repayment would be welcomed.
- 4.8. The other suggested amendments are also generally welcomed. However when looking at reimbursement concepts and definitions we believe the Regulations should not be over prescriptive and need say little more than that reimbursement arrangement need to be published and should aim to comply with the requirements of 1370/2007 (not over compensating). Guidance can then go into greater detail, as indeed it does for 2000 Act reimbursement. Such guidance should be less prescriptive for 1985 Act concessions, which are local concessions not the subject of appeals to the Secretary of State.

#### **Further changes to Regulations**

- 4.9. We have set out in annex E some additional amendments to the Regulations which we consider could improve the reimbursement process.

### **5. Radical reform options**

- 5.1. The DfT has invited views on future options for more radical reform of concessionary travel reimbursement, namely:
  - A. A single national reimbursement rate;
  - B. A table of reimbursement rates which vary by geography (e.g. regions) and/or trip characteristics (e.g. urban/rural)
  - C. A table of payments per passenger which vary by geography and/or trip characteristics (e.g. urban/ rural);
  - D. A flat payment per concessionary trip.
- 5.2. The consultation document states that each of these options could be implemented either on the basis of a rate/payment covering both revenue reimbursement and additional costs or on the basis of revenue reimbursement only with separate negotiation maintained for additional costs payments.
- 5.3. Our understanding is that a reimbursement rate would represent a payment equivalent to a fixed proportion of the prevailing average commercial fare for a given operator per concessionary trip. By contrast, a flat payment would bear no relation to the prevailing average commercial fare and hence would be uniform across operators.
- 5.4. Although apparently commendably simple, it is difficult to see how any of these options could be regarded as satisfying the “No Better Off and No Worse Off” principle.
- 5.5. Option B is the closest to the spirit of current draft Guidance, but:
  - a fixed reimbursement rate implies a fixed reimbursement factor, which does not vary with the commercial fare charged. This is equivalent to an assumption of a zero fare elasticity at the commercial fare, which is in direct contradiction with all the evidence put forward by ITS; and
  - As a result, there would, in theory, be no difference in reimbursement rate per trip between two different operators charging different average fares but running services in the same type of setting.

- 5.6. Option A (a national reimbursement rate) is even less consistent with the proposal currently being put forward as it would imply a single reimbursement factor applying to all operators regardless of possible differences in passengers' response to free fares between areas and types of service.
- 5.7. It is therefore our view that neither of options A or B are compatible with the NBNW principle, and that they would inevitably lead to winners and losers with likely impacts on local bus market structure and, possibly, wider subsidy requirements.
- 5.8. We also see little practical advantage from a shift towards these options. This is because, on the one hand, the proposed draft Guidance takes away most of the difficulty in calculating reimbursement factors by fixing the parameters of the demand curve. On the other hand, options A and B would still leave the onus on TCAs to work out average commercial fares and, possibly, assess claims for additional capacity costs.
- 5.9. Moreover, given the linear relationship between fares and reimbursement implied by these options, our analysis suggests that they would both lead to an increase in total reimbursement over time as fares go up, relative to that which would have taken place had the single demand curve been used. It is important that this is clearly understood by the DfT and that future funding for the statutory scheme reflects the cost of reimbursement implied by whatever methodology is proposed.
- 5.10. As far as options C and D go, we consider that these would be likely to lead to a situation even further from the NBNW principle, since it would no longer be possible to reflect differences in commercial fares between operators. These options would have in their favour that they could significantly simplify the reimbursement process since there would no longer be any need to estimate average commercial fares locally. For that same reason, it could also become easier to control the overall cost of the scheme over time.
- 5.11. In summary, we feel that none of these options would lead to fairer reimbursement than the methodology proposed in the draft guidance. The least unfavourable of the options presented is, in our view, option B, but we consider this to be a backward step from the approach the Department now proposes to introduce from April 2011.

## **ANNEXES**

- A. Annotated digital version of the draft Guidance**
- B. Technical annex on the adjustment for underlying trends**
- C. Position paper on additional capacity costs**
- D. Position paper on average fares**
- E. Proposed changes to the Regulations governing concessionary travel reimbursement**