



OFFICE OF RAIL REGULATION

Periodic Review 2013 Consultation on Schedules 4 and 8 possessions and performance regimes November 2012



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Abbreviations and acronyms

Abbreviation/ acronym	Meaning
ACS	Access Charge Supplement
ADRR	Access Dispute Resolution Rules
ATOC	Association for Train Operating Companies
BSOG	Bus Service Operators Grant
CaSL	Cancellations and significant lateness
CP3	Control Period 3 (April 2004 – March 2009)
CP4	Control Period 4 (April 2009 – March 2014)
CP5	Control Period 5 (April 2014 – March 2019)
DAB	Delay Attribution Board
DAG	Delay Attribution Guide
December 2011 consultation	Our 'Periodic Review 2013: consultation on incentives' document, published in December 2011
DfT	Department for Transport
EBM	Estimated Bus Mile
EBSM	Efficiency Benefit Sharing Mechanism

HLOS	High Level Output Specification
JNAPs	Joint Network Availability Plans
JPIPs	Joint Performance Improvement Plans
KPI	Key Performance Indicators
May 2011 consultation	Our '2013 Periodic Review: first consultation' document, published in May 2011
May 2012 document	Our 'Setting the financial and incentive framework in CP5' document, published in May 2012
MRE	Marginal Revenue Effect
PDFH	Passenger Demand Forecasting Handbook
PDI	Possessions Disruption Index
PDI-P	Possessions Disruption Index - Passenger
PPM	Public Performance Measure
PR08	2008 Periodic Review of Network Rail's outputs and funding for 2009-14
PR08 Determination	Our Determination of Network Rail's outputs and funding for 2009-14 in PR08
PR13	2013 Periodic Review of Network Rail's outputs and expenditure for 2014-19
REBS	Route-level efficiency benefit sharing mechanism
RPI	Retail Price Index
SDG	Steer Davies Gleave

Service Group	Group of train services, operating in a similar geographic area and of a similar type
SoFA	Statement of Funds Available
SPD	Sustained Planned Disruption
SPP	Sustained Poor Performance
TOC	Train Operating Company
TS	Transport Scotland

Executive summary

1. The Office of Rail Regulation (ORR) is committed to ensuring that the rail industry delivers a high quality service to passengers and freight customers in a way that secures value for money for taxpayers and funders. The 2013 periodic review of Network Rail (PR13) is a key mechanism for securing these aims.
2. PR13 will set Network Rail's outputs, funding and the wider regulatory and incentive framework from 1 April 2014 to 31 March 2019 (Control Period 5). As part of our PR13 review we are considering the possessions and performance regimes. Getting these right will help deliver greater efficiency from the sector and will give operators and Network Rail incentives to work in the best interests of passengers and freight customers by making mutual obligations, and the financial penalties for failing to meet these, clear.
3. In this document we set out our thinking and seek views on various issues relating to the Schedules 4 and 8 possessions and performance regimes currently contained in operators' track access agreements. We think Schedules 4 and 8 perform an important function and do this in a way that is more efficient than the alternatives. In this document we seek your views on detailed policy issues relating to possessions and performance regimes, to help us ensure they function effectively during CP5.

Background and context

What Schedules 4 and 8 are for

4. The primary role of Schedules 4 and 8 is to compensate train operators for the financial impact of planned and unplanned service disruption attributable to Network Rail or other train operators. Schedule 4 compensates train operators for the impact of planned service disruption due to possessions. Schedule 8 compensates train operators for the impact of unplanned service disruption due to poor performance. Compensation is intended to cover fare revenue losses, and costs, such as those associated with running replacement buses.
5. Schedules 4 and 8 ensure that train operators are less exposed to risk they cannot control than they would otherwise be. In the case of franchised passenger train operators, this helps reduce the risk premium factored into franchise bids. This ultimately feeds through to taxpayers through lower franchise costs and passengers through downward pressure on fares.
6. Schedules 4 and 8 also:
 - (a) help align financial incentives between Network Rail and train operators, so the impact of service disruption on revenue and/ or costs is incurred by the organisation to whom the disruption is attributable, rather than the train operator who faces the disruption; and
 - (b) help Network Rail understand the impact of service disruption on train operators' costs and revenues to help drive its decision making, for example, in relation to where to make investments and its possession planning at a local level.

7. Exposing Network Rail to the impact of its performance and possessions management on long term fare revenue means it is more likely to act in the interests of passengers, for example, by investing in improving the performance of services that more passengers use.

8. Franchised operators pay Network Rail a predetermined access charge supplement (ACS) in return for receiving Schedule 4 compensation during planned disruption. This covers the estimated cost to Network Rail of the Schedule 4 regime if it arranges an appropriate amount of possessions and plans them effectively.

9. Schedule 8 is a benchmarked regime where payments are made when Network Rail or train operators' performance diverges from a benchmark number of minutes of lateness. If Network Rail or a train operator performs worse than benchmark, it pays compensation to the train operator(s) affected, and if it performs better than benchmark it receives a bonus from the train operator(s).

10. Schedules 4 and 8 are liquidated sums regimes, which means that compensation payment rates are determined in advance rather than negotiated once an event has occurred. In the case of Schedules 4 and 8 they are pre-determined by formulae. This is a common feature of contracts and is a way of minimising legal and administrative costs.

History of Schedules 4 and 8

11. Schedules 4 and 8 have been in existence since rail privatisation. They were created as a result of vertical separation between infrastructure management and train operations, in order to align the interests of the infrastructure manager with those of train operators. This is to reflect the fact that the performance of the infrastructure manager has an impact on the revenues and costs of train operators.

12. Schedules 4 and 8 have been amended and updated over the years to ensure they function effectively. In PR08, this included a major update to the Schedule 4 passenger regime so it includes formulaic compensation to cover the cost of replacement buses; and the creation of standardised Schedule 4 and 8 freight regimes between freight operators so as to remove any competitive advantage to particular operators.

13. While Schedules 4 and 8 do have some incentive properties, as they expose Network Rail and train operators to the costs of disruption they cause to each other, it is our view that output targets combined with enforcement are also necessary to drive incentives on Network Rail and train operators to minimise disruption at a national level. In the last control period we set tough targets on the following:

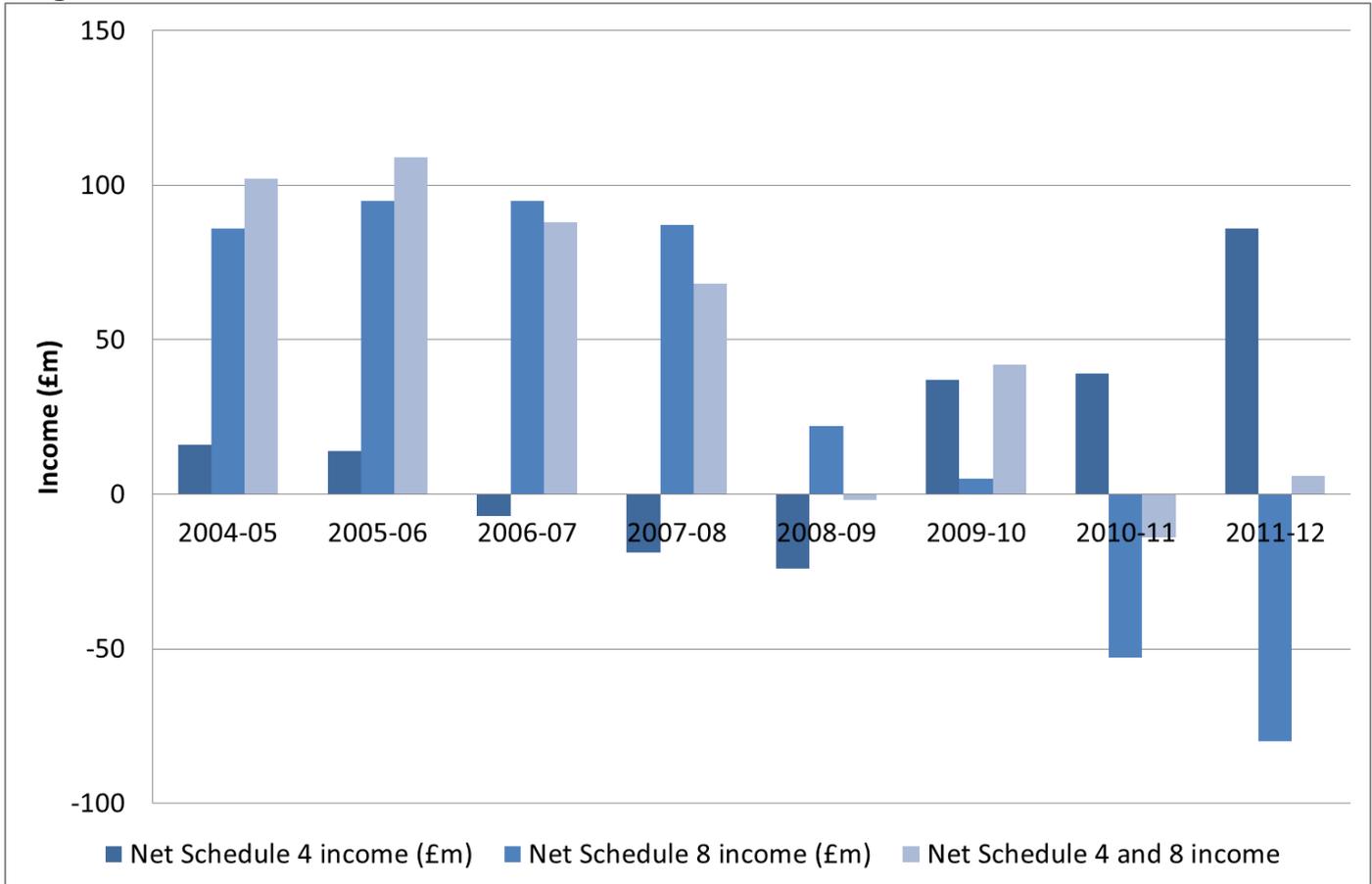
(a) rail industry punctuality and reliability targets (Public Performance Measure, PPM, Cancellations and Significant Lateness, CaSL);

(b) Network Rail delay minutes; and

(c) the maximum level of disruption due to possessions (Possessions Disruption Index, PDI).

14. Schedules 4 and 8 are only financially neutral when Network Rail and train operators are performing at expected levels. Figure 1 shows net Schedule 4 and 8 income to Network Rail during CP3 and CP4. Schedule 4 net income comprises ACS income Network Rail received to fund the expected level of possessions activity, net of Schedule 4 costs.

Figure 1 – Net Schedule 4 and 8 income to Network Rail



15. During CP4, Network Rail has so far faced net Schedule 8 costs. This reflects the fact that Network Rail has not been meeting its performance obligations and has as a consequence, over each year, been making net Schedule 8 payments to train operators¹. Conversely, Network Rail has been receiving a net income from the Schedule 4 regime (including ACS). This reflects the fact that Network Rail has been causing significantly less disruption to passenger services than was anticipated in PR08, due to fewer and better planned possessions.

16. For CP5, we have decided to retain Schedules 4 and 8 as liquidated sums regimes on the basis that a mechanism for train operators to claim compensation from Network Rail is needed, and liquidated sums regimes such as Schedules 4 and 8 are the most efficient way of doing this as they avoid costly administration and litigation.

17. As with all pre-determined liquidated sums compensation regimes, it is not possible to ensure the amount paid under Schedules 4 and 8 in every single instance precisely compensates for the impact of service disruption. However, it is important that on average it does so and that there are no systematic biases.

How we will ensure Schedules 4 and 8 work in the interests of passengers and freight customers

18. Feedback from stakeholders has been in favour of the continuation of Schedules 4 and 8, and broadly supportive of their effectiveness as compensation regimes. Some stakeholders have stressed the importance of us ensuring that the nature and level of compensation Schedules 4 and 8 provide:

¹ Network Rail's net Schedule 8 income reflects the net flow of Schedule 8 payments during the financial year. It is determined by how well Network Rail performs against its benchmark and how well train operators perform against their benchmarks.

- (a) does not encourage train operators to run replacement buses in instances where there are alternatives, such as train diversions or possessions at times that are less disruptive to passengers; and
- (b) does not reduce the incentive on Network Rail and train operators to work together in the best interests of passengers.

19. We are aware of concerns that some train operators have been receiving Schedule 4 compensation payments reflecting the cost of replacement bus services, while also benefiting from the Bus Service Operators Grant (BSOG). It has been suggested that this may lead in some circumstances to incentivise the running of replacement buses over running alternative rail timetables even where this is not in the best interests of passengers. There is therefore a risk of double counting with compensation being paid by Network Rail for replacement bus costs and subsidy being paid by the government as part of BSOG. The DfT intends to remove eligibility for receiving BSOG for rail replacement bus services and we therefore do not intend to look at this specific issue as part of PR13. We will, however, review the level of compensation train operators receive to cover the cost of replacement buses when we review Schedule 4 payment rates.

20. We are reviewing and updating Schedules 4 and 8 to ensure they act as effective compensation mechanisms in Control Period 5 (CP5). This involves:

- (a) updating Schedules 4 and 8 to ensure train operators receive an appropriate level of compensation. This includes:
 - (i) updating payment rates, both for revenue and cost compensation (and bonuses) so they reflect the best and most up to date available evidence; and
 - (ii) looking at whether compensation (and bonus) payments should be reduced to below 100% of the impact of service disruption on revenues and costs;
- (b) updating performance benchmarks in the Schedule 8 regime, including ensuring Network Rail's performance benchmarks reflect the output targets we set for CP5;
- (c) Improving other aspects of Schedules 4 and 8 to make sure they function effectively, do not result in perverse incentives, and work overall in the best interests of passengers, freight customers and tax-payers.

21. Of particular importance in relation to ensuring Schedules 4 and 8 result in appropriate incentive effects is our update of payment rates. For example, if replacement bus cost compensation payment rates were set above the cost per mile of running replacement buses, this could result in train operators being incentivised to run replacement buses instead of train diversions. Conversely it could encourage Network Rail to push train operators to divert trains to reduce the need to run replacement buses.

Incentives on Network Rail and train operators to minimise disruption to passengers

22. Research by Passenger Focus consistently demonstrates that passengers and freight customers care deeply about planned and unplanned disruption to their service. This includes research published in 2010 on passengers' priorities for improvements in rail services² which suggested that passengers regard train punctuality as their second highest priority over the price of train tickets offering value for money. In addition to this, recent Passenger Focus research on possessions³ has highlighted that:

² Passenger Focus (2010), Passengers' priorities for improvements in rail services

³ <http://www.passengerfocus.org.uk/research/publications/rail-passengers-experiences-and-priorities-during-engineering-works%20>

- (a) wherever possible rail passengers want to travel by train, and are prepared to accept a longer journey time by train to avoid a replacement bus;
- (b) when buses do replace trains, the help provided to passengers transferring from train to bus and vice versa is inadequate; and
- (c) passengers think it is inappropriate for the industry to charge the same for a bus journey as for a train journey.

23. This research demonstrates the importance of ensuring that Network Rail and train operators are incentivised to work in the best interests of passengers by avoiding disruption.

24. Our work on Schedules 4 and 8 sits alongside the other work we are doing to incentivise Network Rail to minimise service disruption to passengers and freight customers and ensure the industry provides information to passengers when disruption occurs.

25. As part of PR13 we are reviewing the outputs that Network Rail will be required to deliver for 2014-19; the key performance indicators (KPIs) that we could use to monitor delivery of outcomes more widely; and the measures of capability ('enablers') that Network Rail needs to put in place to deliver sustainable improvements over the long-term.

26. We also monitor other aspects of Network Rail's performance and possession management, such as the monthly number of replacement bus hours. This shows that the use of replacement buses has been decline since the beginning of CP4.

27. Network Rail has also been performing better than its CP4 targets in relation to disruption due to possessions. But there have been several instances where we have had to take enforcement action in relation to it not meeting its regulated punctuality targets.

28. In addition, how the industry provides information when disruption occurs is also very important for passengers. We are working with the industry to ensure improvements in this area by identifying areas that are not working well and should be changed. We will also be asking operators to demonstrate how they are taking on board feedback from passengers. We will be keeping up the pressure in this area.

29. There are also other arrangements in place that help encourage Network Rail and train operators to minimise service disruption to passengers:

- (a) financial incentives at a level of individual staff, such as Network Rail's Management Incentive Plan;
- (b) reputation (at company and individual level);
- (c) Condition 1 of Network Rail's licence, which states that Network Rail must 'satisfy the reasonable requirements of persons providing services relating to railways and funders, including potential providers or potential funders, in respect of:
 - (i) the quality and capability of the network; and
 - (ii) the facilitation of railway service performance in respect of services for the carriage of passengers and goods by railway operating on the network'; and
- (d) arrangements which encourage the industry to work together in the interests of passengers, such as:

(i) Joint Performance Improvement Plans (JPIPs), which are annual agreements between passenger train operators and Network Rail, detailing how each party will contribute to continuously improving performance, and are an obligation under the Network Code; and

(ii) Joint Network Availability Plans (JNAPs), which are an informal and voluntary process that has tended to focus largely on meeting customer needs in terms of minimising bus substitution and lengthy diversions or maintaining access for key freight flows.

30. The performance of franchised train operators is regulated by franchising authorities, for example, Department for Transport, Transport Scotland and Merseytravel. It is the role of franchising authorities to ensure that franchises are regulated in such a way that franchised train operators act in the interests of their passengers. This also includes considering as part of the franchising process the level and type of compensation passengers receive as compensation for disruption to services and, likewise, the fares that should be charged when there are replacement buses.

31. Train operators are obligated to comply with consumer law and we have an obligation to enforce it. We also have a role in improving the transparency of information for passengers. In this context:

(a) we will be exploring consumer awareness of current refund rights and compensation arrangements, and the extent to which consumers exercise their rights, including where vouchers rather than cash are used in compensation. We will publish a report of our findings together with recommendations in March 2013;

(b) we are working with the industry to improve the transparency of performance information provided to passengers. Our view is that this will help provide passengers with the level of insight they need to challenge their suppliers and to make choices where they can; and

(c) in this document we ask for stakeholder views on whether and how we should encourage Network Rail to consult passengers and freight customers in the planning of possessions.

Bespoke arrangements

32. As discussed previously, Schedules 4 and 8 allocate risk between Network Rail and train operators to ensure that the organisation best placed to control a particular risk is the one exposed to it. We are of the view that there are potential benefits from train operators and Network Rail reaching a view on who is best placed to bear what risk, on the basis of commercial considerations which reflect the specific circumstances of the particular train operators' operations and customer base.

33. In these instances, it may be appropriate for Network Rail and train operators to agree bespoke performance and possessions compensation arrangements in their track access contracts, subject to our approval. We plan to review the criteria we apply for the approval of bespoke arrangements, and will consult on any proposed changes after the end of PR13. This review will extend across bespoke arrangements in general; so for example, will also look at bespoke charging arrangements.

34. In the remainder of this executive summary, we summarise briefly the policy issues and proposals we consult on in the main part of the document.

Issues we consult on

Issues relating to Schedules 4 and 8

35. A key issue we consult on is **whether to set Schedule 4 and 8 payment rates to below 100% of the financial impact to train operators of planned and unplanned service disruption.**

36. Currently Schedule 4 and 8 compensation (and bonus) rates are set with the aim of providing full compensation for the financial impact to train operators of planned and unplanned service disruption, with the exception of some of the freight Schedule 4 and 8 payment rates.

37. The objective of setting payment rates at a level that would not fully compensate train operators for planned and unplanned service disruption would be to help encourage train operators to work with Network Rail to improve performance and minimise the number and impact of possessions. There are several ways in which below 100% payment rates could in principle encourage train operators to work more closely with Network Rail to minimise service disruption to passengers. Examples include through helping to speed up service recovery after infrastructure failures, or carrying out more careful scrutiny of Network Rail's possession plans.

38. We commissioned research into this area. The research findings and discussions we have had with stakeholders suggest that below 100% payment rates would not result in a significant change in behaviours by Network Rail or train operators. At the same time, below 100% payment rates would be likely to result in an increase in the risk premium factored into bids for passenger train operator franchises, resulting in higher industry costs.

39. Our emerging view is therefore that we should continue to set Schedule 4 and 8 payment rates with the aim that they compensate train operators in full for the financial impact of service disruption due to Network Rail and other train operators, where we do so currently. We are also of the view that alternative mechanisms, such as Route-level Efficiency Benefit Sharing mechanism (REBs) and alliances, which have wider incentive potential, are more likely to result in constructive engagement between Network Rail and train operators in the interests of passengers.

40. However, a disadvantage of continuing with 100% payment rates could be individuals within train operating companies being under less pressure to confront Network Rail regarding below standard performance or to resist possessions that are longer and more disruptive to passengers than necessary.

41. Another issue we consult on relating to Schedules 4 and 8 is a proposal by Network Rail on a way that the effectiveness of Schedules 4 and 8 during extreme disruption, such as severe weather, can be improved.

Schedule 4 passenger possessions regime

42. The Schedule 4 passenger possessions regime compensates franchised passenger operators for planned service disruption due to Network Rail possessions. Formulaic Schedule 4 payments are to compensate for a combination of:

- (a) the effect of possessions on fare revenue;
- (b) additional costs incurred when running replacement buses; and
- (c) costs or cost savings resulting from a change in train mileage.

43. The main issues we are consulting on are in relation to replacement bus cost compensation and the level of discount available for early notification of possessions.

44. We are proposing to update Schedule 4 **replacement bus cost compensation** payment rates so they realistically reflect the cost per mile of running buses. We are currently collecting data from train operators on how much they have spent on replacement buses and how much Schedule 4 compensation they have received to cover replacement bus costs.

45. Schedule 4 revenue loss compensation payment rates are based on Schedule 8 revenue loss compensation payment rates, but with a discount to reflect the fact that notice is given of possessions and therefore passengers are inconvenienced less per minute of additional journey time than when due to unscheduled delay. For example, passengers can allow more time to complete their journeys. These discounts are calculated using **notification factors and thresholds**. The amount of discount is determined by the notification factor. Concern has been expressed by some train operators that currently Network Rail has a tendency to book possessions early and then cancel them at short notice, which has led them to question whether the incentives are currently functioning effectively. We consult on a proposal by ATOC to amend Schedule 4 to enable the recovery of direct costs related to the cancellation of possessions at short notice. We also consult on a proposed adjustment to notification factors and invite detailed proposals for alternative notification factors and thresholds.

46. We are also consulting on the following issues:

(a) **Methodology for disaggregation of the Access Charge Supplement (ACS)**. For CP4, the calculation of the ACS was based on the expected Schedule 4 costs associated with planned activity volumes across the whole network. For CP5, Network Rail is proposing to use operating route based planned activity volumes to calculate expected Schedule 4 costs for each operating route. It has proposed allocating these operating route level totals between franchised train operators. For train operators where the geography of the services they operate closely corresponds to a Network Rail operating route, this will lead to ACSs that much more closely reflect the expected Schedule 4 cost during CP5.

(b) **Replacement bus revenue compensation**. We ask stakeholders for views on whether the current structure of the Schedule 4 revenue loss compensation, where there are replacement bus services, is fit for purpose.

(c) **Sustained Planned Disruption (SPD) threshold**. Additional compensation is available to train operators in instances where severe disruption is caused by possessions over a sustained period. The Sustained Planned Disruption (SPD) threshold is intended to represent the level of disruption where compensation under the standard Schedule 4 arrangements is materially less than the actual impact of the disruption on the train operator. If possession disruption exceeds that defined in the SPD threshold, train operators can claim additional compensation. We consult on the SPD threshold.

Schedule 4 freight possessions regime

47. Under Schedule 4, freight operators can claim compensation for planned disruption. Freight operators do not pay an access charge supplement in order to receive this compensation. The result is a net payment from Network Rail to freight operators. The cost of this is reflected in Network Rail's revenue requirement.

48. In PR08, compensation payment rates were set with the aim of ensuring total compensation reflected the level of funding that was provided. We consult on how freight Schedule 4 payment rates should be determined for CP5.

Schedule 8 passenger performance regime

49. The Schedule 8 passenger regime applies to franchised and open access passenger operators. Formulaic Schedule 8 payments are to compensate for the effect of lateness on a train operator's longer-term fare revenue.

50. We have recently commissioned external work to update payment rates and benchmarks. As part of this project, the contractors will be engaging with the industry. This includes seeking advice on where

adjustments are needed to the default methodology and to validate the results. We will then approve the benchmarks and payment rates for each track access contract.

51. There are several detailed issues on which we consult. These include:

(a) **Compensation during Sustained Poor Performance (SPP).** Additional compensation can be claimed when performance is worse than the Sustained Poor Performance (SPP) threshold. The intention is that the threshold should represent a level of poor performance where compensation under the current Schedule 8 arrangements is materially less than what is needed to reflect the actual impact of poor performance on the train operator. We consult on the contractual wording in relation to when SPP compensation can be claimed and also on the level of the threshold.

(b) **Whether to introduce a time delay on Schedule 8 payments.** Schedule 8 payments are designed to reflect the longer term impact of performance on train operators' revenues. However, Schedule 8 payments are made within 35 days of the preceding four-week period. We have assessed the available evidence and consult on this issue.

(c) **Whether paragraph 17 of Schedule 8 should be amended to reduce the number of circumstances in relation to which train operators may request changes in payment rates.** Paragraph 17 of Schedule 8 allows Network Rail or train operators to propose changes to metrics in appendix 1 of Schedule 8, such as payment rates and benchmarks, mid-control period. Network Rail has proposed that the use of paragraph 17 of Schedule 8 to change Network Rail payment rates should be restricted to situations where there are major timetable changes.

(d) **Compensation for passenger charter payments.** Currently a small number of train operators opt to pay an access charge supplement (ACS) in order to receive compensation to cover payments to passengers in relation to passenger charter regimes within franchise agreements. Net payments within the passenger charter element of Schedule 8 are now very small and for the first three years of CP4, Network Rail has received significantly more in access charge supplements for passenger charter compensation than it has paid out under Schedule 8. We ask for views whether this element of Schedule 8 should continue.

(e) **Treatment of cancellations by train operators to their own trains.** Currently when a train operator cancels one of its own trains, it has an impact on its Schedule 8 payments even when it does not cause delay to the services of other train operators. We consult on whether it would be worth changing this element of Schedule 8, when weighed against the costs of doing so. Our stakeholder engagement to date suggests it is a small issue that is not having any particular impact on behaviour and that a change, that is unlikely to justify its cost.

52. We have also looked at whether to set common principles for attributing delays for operators that operate partially on and partially off the Network Rail infrastructure. In certain circumstances train services operate both on and off the Network Rail infrastructure. Network Rail has expressed the view that there should be agreed industry principles in relation to attributing delays for these train services. We have discussed the stakeholders and agreed that this issue would best be dealt with through the way delay is attributed, rather than through an amendment to Schedule 8⁴. Network Rail is taking this forward.

⁴ The DAB is a body that manages and oversees the effectiveness and accuracy of the delay attribution process and the use of the Delay Attribution Guide (DAG). It also considers proposed amendments to DAG and provides guidance to rail industry parties to assist in the resolution of disagreements concerning delay attribution. The DAG is a document that provides guidance on the attribution of delay, between parties, across the network.

53. In PR08, in order to reflect the fact that we set targets requiring continuing improvement in performance throughout CP4, we applied an improvement trajectory to Network Rail's Schedule 8 benchmarks. The effect of this is that Network Rail's benchmark gets tougher each year. A methodology will need to be developed by Network Rail to calculate improvement trajectories for CP5. We will then need to approve this methodology and ensure the improvement trajectories that Network Rail calculates are in line with the performance targets we set Network Rail for CP5.

54. It is currently too early to do this as we are still considering the nature of the output targets we are going to set; including the level they will be set at and their level of disaggregation. We will work with the industry group to develop a suitable methodology for the calculation of improvement trajectories at an appropriate point, and consult on this.

Schedule 8 freight performance regime

55. The freight performance regime was comprehensively updated in PR08 with the creation of a standardised regime between freight operators so as to remove any competitive advantage to particular operators. The regime was also simplified considerably. We are of the view that the freight performance regime does not need comprehensive review in PR13. But, as with the passenger regime, we are of the view that the metrics should be adjusted to ensure they remain appropriate.

56. We intend therefore to update the following aspects of the freight Schedule 8 regime. Where appropriate, we ask stakeholders for views on the methodology that is used and possible improvements, and in some instances we also consult on policy issues:

- (a) **Freight operator benchmark.** This is measured as number of minutes of delay per 100 train operator miles and is the same for all freight operators.
- (b) **Freight operator payment rate.** This reflects the average impact of a minutes delay caused by a freight operator to another train operator, and is the same for all freight operators.
- (c) **Network Rail benchmark.** This is measured as number of minutes of delay per 100 train operator miles and is the same for all freight operators
- (d) **Network Rail payment rate.** This reflects the average financial impact on freight operators of a minute of delay attributable to Network Rail, and is the same for all freight operators.
- (e) **Cancellation arrangements.** When Network Rail cancels a freight train, freight operators will generally incur costs. Cancellation payments reflect this. There is a higher and a lower cancellation payment rate. The rate paid depends on the percentage of trains Network Rail cancels. We consult on the methodology for updating the lower and upper cancellation payment rate and also the methodology for determining the threshold where the higher rate gets paid for cancellations. Again, cancellation arrangements are the same for all freight operators.
- (f) **Bonus payment rates.** Currently bonus payments, which are paid when Network Rail and freight operators perform better than benchmark, are set at 50% of the compensation rate.
- (g) **Incident caps** Freight operators currently may opt to pay an access charge supplement in order to have a cap on the size of Schedule 8 payment that it would have to pay in respect to a single incident. These are selected from a menu of different caps and corresponding access charge supplements.
- (h) **Annual liability caps.** Freight operators and Network Rail may agree reciprocal annual caps on Schedule 8 payments to be included within track access contracts. For CP4, proposals were submitted by freight operators and Network Rail, and approved by ORR as part of our approval of track access contracts.

Compensation related to charter operators

57. Charter services are services for hire by members of the public, business or government and are currently subject to different Schedule 8 performance arrangements compared to other passenger operators. Arrangements for charter operators do not include the Schedule 4 possessions regime. We consult on two issues relating to Schedule 8 for charter operators: incident caps and the charter operator payment rate, which is to cover the financial impact of delays charter operators cause to other train operators.

Next steps

58. This document marks an important step in our review and update of the Schedules 4 and 8 possessions and performance regimes. We will set out our decisions on these issues in our draft determinations in June 2013 and our final determinations in October 2013.

59. A high level timeline of when things will happen throughout the PR13 review process is available on our PR13 microsite⁵.

60. Annex A provides a list of consultation questions that are asked throughout this document. We request responses from stakeholders by close of business on Monday 28th January 2013.

⁵ <http://www.rail-reg.gov.uk/pr13/about/key-dates.php>

Introduction

Purpose of the document

1. This document consults on detailed policy issues relating to the Schedules 4 and 8 possessions and performance regimes. It forms part of our 2013 periodic review of Network Rail's outputs and expenditure (PR13), which will set Network Rail's outputs, access charges and the wider regulatory and incentive framework for control period 5 (CP5) – which will run from 1 April 2014 to 31 March 2019.

2. In May 2011 we launched our first consultation on PR13 matters⁶. The annexes of that document included an outline of issues we intended to look at in relation to Schedules 4 and 8. Our December 2011 incentives consultation⁷ followed by consulting specifically on incentives. Within that consultation we asked questions on some key issues relating to Schedule 4 and 8.

3. Our May 2012 financial and incentive framework document⁸ gave clarity, as far as possible, to Network Rail, train operators (passengers and freight), government, taxpayers and other stakeholders involved in the periodic review in relation to the decisions and approach we are taking on certain issues, so that they could take those into account and note where we will be undertaking further work.

4. We stated in our May 2012 document that we would retain Schedules 4 and 8 as liquidated sums regimes on the basis that we are of the view that a mechanism for train operators to claim compensation from Network Rail and each other is needed, and liquidated sums regimes such as Schedules 4 and 8 are the most efficient way of doing this as they avoid costly administration and litigation

5. The issues we consult on in this document are in most cases proposals in relation to specific issues relating to Schedules 4 and 8. In a small number of areas, we do not at this stage have a preferred way forward and ask more general questions. When reaching decisions in relation to the issues we are consulting on we will need to weigh up the benefits of ensuring that Schedules 4 and 8 provide an appropriate level of compensation in specific instances with the fact that it would not be desirable to overcomplicate them, which would make them more costly to administer, or risk inadvertently introducing perverse incentives.

6. This document marks an important step in our review and update of the Schedules 4 and 8 possessions and performance regimes. We will set out our decisions on these issues in our draft determinations in June 2013 and our final determinations in October 2013.

⁶ <http://www.rail-reg.gov.uk/pr13/consultations/orr013.php>

⁷ <http://rail-reg.gov.uk/pr13/consultations/orr020.php>

⁸ <http://www.rail-reg.gov.uk/server/show/ConWebDoc.10907>

7. A high level timeline of when things will happen throughout the PR13 review process is available on our PR13 microsite⁹.

Structure of this document

8. This document is structured as follows:

- (a) Chapter 1 Background and context
- (b) Chapter 2 sets out our consultation on policy issues and proposals relating to both Schedules 4 and 8
- (c) Chapter 3 sets out our consultation on policy issues and proposals relating to the Schedule 4 passenger possessions regime
- (d) Chapter 4 sets out our consultation on policy issues and proposals relating to the Schedule 4 freight possessions regime
- (e) Chapter 5 sets out our consultation on policy issues and proposals relating to the Schedule 8 passenger performance regime
- (f) Chapter 6 sets out our consultation on policy issues and proposals relating to the Schedule 8 freight performance regime
- (g) Chapter 7 sets out our consultation on policy issues and proposals relating to charter operators
- (h) Annex A contains a list of all the consultation questions in the main part of the document

9. We welcome responses on any aspect of this consultation. In particular we welcome responses to the questions we ask throughout this document (which are listed in full in Annex A). We also post the full list of questions on our website in MS Word format to make it easier for you to respond to them <http://www.rail-reg.gov.uk/pr13/doc/sch4-8-consultation-questions.doc>

10. We recognise that some of the issues raised in this document are technical and quite complex, so we are proposing to hold a workshop on the key issues in January 2013.

11. Please send your responses in electronic (or if not possible, in hard-copy format) by close of business on Monday 28 January 2013 to:

Robert Mills
Office of Rail Regulation
One Kemble Street
London
WC2B 4AN
Email: Robert.mills@orr.gsi.gov.uk
Tel. 020 7282 3744

12. If you send a written response, you should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise, we would expect to make it available on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information, which can be treated as a non-confidential response.

⁹ <http://www.rail-reg.gov.uk/pr13/about/key-dates.php>

We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

13. Please note, when sending documents to us in electronic format that will be published on our website, we would prefer that you email us your correspondence in Microsoft Word format. This is so that we are able to apply web standards to content on our website. If you do email us a PDF document, where possible please:

(a) create it from the electronic Microsoft Word file (preferably using Adobe Acrobat), as opposed to sending us a scanned copy of your response; and

(b) ensure that the PDF's security method is set to 'no security' in the document properties.

1. Background and context

What Schedules 4 and 8 are for

1.1 The primary role of Schedules 4 and 8 is to compensate train operators for the financial impact of planned and unplanned service disruption attributable to Network Rail or other train operators. Compensation is intended to cover fare revenue losses or costs, such as those associated with running replacement buses. Schedules 4 and 8 ensure that train operators are less exposed to risk they cannot control. In the case of franchised passenger train operators, this helps reduce the risk premium factored into franchise bids, which ultimately feeds through to the taxpayer or passengers through lower fares.

1.2 Schedules 4 and 8 also:

(a) help to align financial incentives between Network Rail and train operators, so the impact of service disruption on revenue and/ or costs is incurred by the organisation to whom the disruption is attributable, rather than the train operator who faces the disruption. This helps ensure Network Rail and train operators act in their combined interest rather than purely in their own interests, and therefore more efficiently as a whole; and

(b) provide signals to Network Rail on the impact of service disruption on train operators' costs and revenues to help drive its decision making, for example, in relation to where to make investments and its possession planning at a local level.

1.3 Exposing Network Rail to the impact of its performance and possession management on long term fare revenue means it is more likely to act in the interests of passengers, for example, by investing in improving the performance of services that more passengers use.

1.4 Schedules 4 and 8 are, in the main, liquidated sums regimes which mean that compensation payment rates are determined in advance rather than negotiated once an event has occurred. In the case of Schedules 4 and 8 they are pre-determined by formulae. This is a common feature of contracts and is a way of minimising legal and administrative costs. The formulae used in the regimes are designed to ensure the amount of compensation (or bonus) paid reflects the expected revenue and cost impact of the disruption caused. Therefore no parties should profit as a result of Schedules 4 and 8 operating properly.

1.5 By helping ensure risk is incurred by the organisations most able to control it, and doing this in a way which helps minimise legal and administrative costs, Schedules 4 and 8 are helping improve the efficiency of the rail industry.

1.6 Schedule 8 compensates train operators for the impact of unplanned service disruption due to poor performance. It is a benchmarked regime where payments are made when Network Rail or train operators' performance diverges from a benchmark number of minutes of lateness or delay. If Network Rail or a train operator performs worse than its benchmark, it pays compensation to the train operator(s) affected. If it

performs better than benchmark it receives a bonus from the train operator(s) affected. The level of compensation or bonus paid for a certain amount of above or below benchmark performance is determined by the Schedule 8 payment rate. The payment rate reflects the impact of performance on revenue and costs. In the case of the Schedule 8 passenger regime, payments relate specifically to the impact of performance on fare revenue, which is generally felt over the longer term rather than on the day in which disruption occurs.

1.7 Schedule 4 compensates train operators for the impact of planned service disruption due to possessions. It involves compensation payments from Network Rail to train operators only. For franchised passenger operators, under the liquidated sums element of Schedule 4, payments are based on:

(a) Schedule 8 compensation payment rates but with a discount applied to reflect the fact that possessions are planned in advance; and

(b) the costs associated with running replacement buses and changes in costs associated with changes in train miles, and other possession management related costs.

1.8 Franchised operators pay a predetermined access charge supplement (ACS) in return for this compensation. The ACS is to cover a proportion of the estimated cost to Network Rail of the Schedule 4 regime if Network Rail arranges an appropriate amount of possessions (for it to be able to maintain and renew the network to an adequate standard and in a way that is sustainable), and plans them effectively. This can be seen as being analogous to the performance benchmarks in Schedule 8. Over time compensation available under Schedule 4 has increased, for example, with the introduction of formulaic compensation for replacement bus hire costs.

1.9 Freight operators do not pay an ACS, and as a result only receive Schedule 4 compensation for significant disruption. Open access passenger operators only receive compensation for very long possessions or sustained disruption unless they opt to pay an ACS.

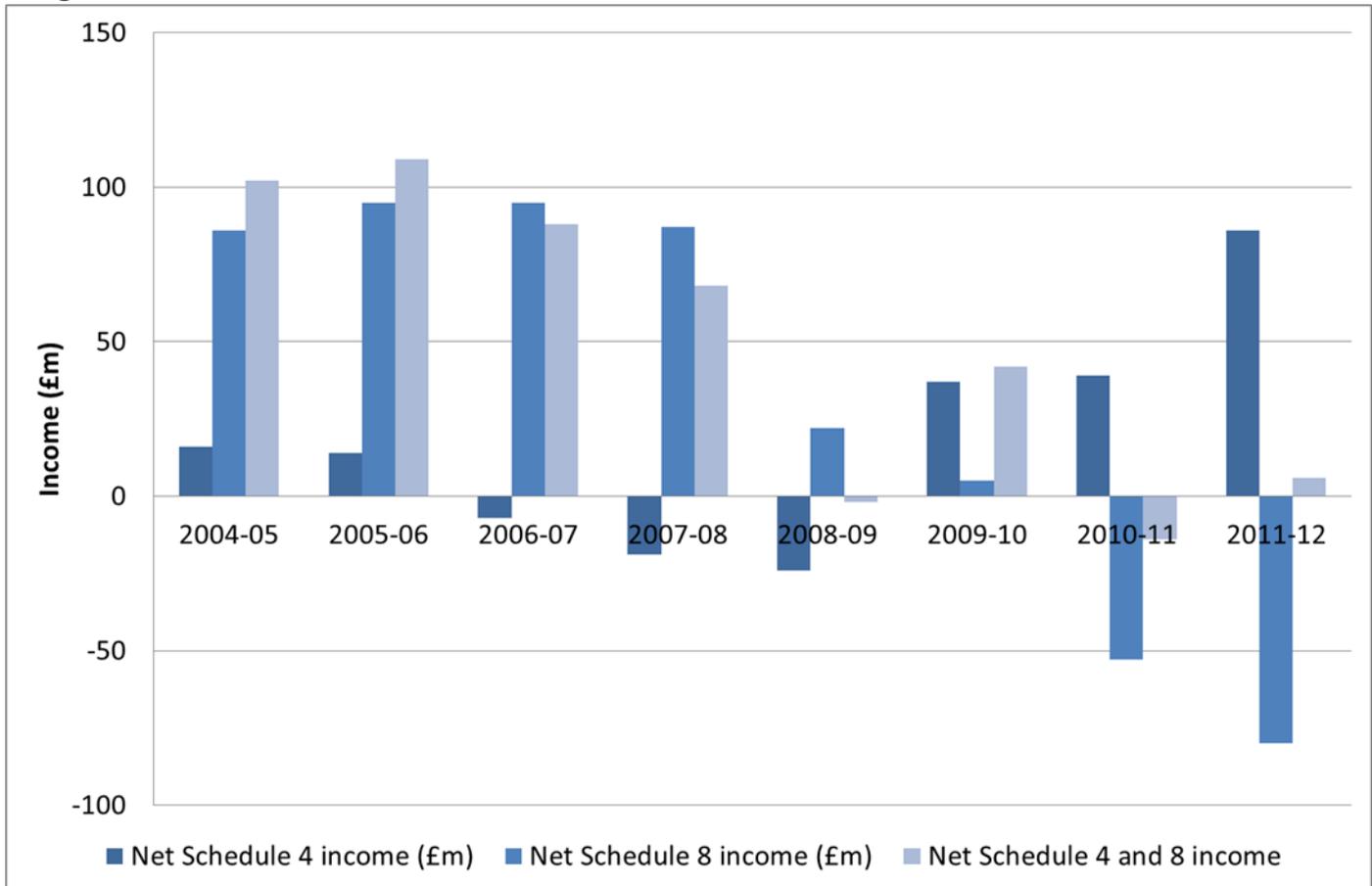
History of Schedules 4 and 8

1.10 Schedules 4 and 8 have been in existence since rail privatisation. They were created as a result of vertical separation between infrastructure management and train operations, in order to align the interests both parties. This is to reflect the fact that the performance of the infrastructure has an impact on the revenue and costs of train operators.

1.11 Schedules 4 and 8 have been amended and updated over the years to ensure they function effectively. In PR08, this included a major update to the Schedule 4 passenger regime so it includes formulaic compensation to cover the cost of replacement buses; and the creation of standardised Schedule 4 and 8 freight regimes between freight operators so as to remove any competitive advantage to particular operators.

1.12 Schedules 4 and 8 are only financially neutral when Network Rail and train operators are performing at expected levels. Figure 1 shows net Schedule 4 and 8 income to Network Rail during CP3 and CP4. Schedule 4 net income comprises of ACS income Network Rail received to fund the expected level of possessions activity, net of Schedule 4 costs.

Figure 1 – Net Schedule 4 and 8 income to Network Rail



1.13 During CP4, Network Rail has so far faced net Schedule 8 costs. This reflects the fact that Network Rail has not been meeting its performance obligations and has as a consequence been making net Schedule 8 payments to train operators¹⁰. Conversely, Network Rail has been receiving a net income from the Schedule 4 regime (including ACS). This reflects the fact that Network Rail has been causing significantly less disruption to passenger services than was anticipated in PR08, due to fewer and better planned possessions.

1.14 This has not always been the case. During CP3, Network Rail was receiving a net Schedule 8 income from train operators, which reflected the fact Network Rail was performing better than its regulatory obligations.

1.15 In our May 2012 document, we stated that for CP5 we have decided to retain Schedules 4 and 8 as liquidated sums regimes. This is on the basis that we are of the view that a mechanism for train operators to claim compensation from Network Rail is needed and liquidated sums regimes such as Schedules 4 and 8 are the most efficient way of doing this as they avoid costly administration and litigation

1.16 As with all pre-determined liquidated sums compensation regimes, it is not possible to ensure the amount paid under Schedules 4 and 8 in every single instance precisely compensates for the impact of

¹⁰ Network Rail's net Schedule 8 income reflects the net flow of Schedule 8 payments during the financial year. It is determined by how well Network Rail performs against its benchmark and how well train operators perform against their benchmarks.

service disruption. However, it is important that on average it does and that there are no systematic biases, for example, always over-compensating a particular train operator for delays to peak services.

How we will ensure Schedules 4 and 8 work in the interests of passengers and freight customers

1.17 Feedback from stakeholders has been in favour of the continuation of Schedules 4 and 8, and broadly supportive of their effectiveness as compensation regimes. Some stakeholders have stressed the importance of us ensuring that the nature and level of compensation Schedules 4 and 8 provide:

- (a) does not encourage train operators to run replacement buses in instances where there are alternatives, such as train diversions or possessions at times that are less disruptive to passengers. It has been suggested; and
- (b) does not reduce the incentive on Network Rail and train operators to work together in the best interests of passengers.

1.18 We are reviewing and updating Schedules 4 and 8 to ensure they act as effective compensation mechanisms in CP5, and also that the incentive effects that they have are in the interests of passengers, freight customers and tax-payers. This consists of:

- (a) updating Schedules 4 and 8 to ensure train operators receive an appropriate level of compensation for (planned or unplanned) service disruption attributable to Network Rail and other train operators. This includes:
 - (i) updating payment rates, both for revenue and cost compensation (and bonuses)¹¹ so they reflect the best and most up to date available evidence; and
 - (ii) looking at whether compensation (and bonus) payments should be reduced to below 100% of the impact of service disruption on revenue and costs.
- (b) updating performance benchmarks in the Schedule 8 regime so they are set at a level that reflects output targets and relative changes in levels of traffic on different parts of the network; and
- (c) improving other aspects of Schedules 4 and 8, such as, the contractual arrangements around last minute cancellations to possessions, to make sure they function effectively, do not result in perverse incentives and work overall in the best interests of passengers, freight customers and tax-payers.

1.19 In order to ensure that Schedules 4 and 8 remain appropriate and effective, we:

- (a) have commissioned Halcrow to update Schedule 8 payment rates and benchmarks in the passenger regime. The work is co-funded by Network Rail. In addition to this we are jointly funding some work with ATOC to update estimates in the Passenger Demand Forecasting Handbook (PDFH) of how passengers respond to delays. The updated payment rates will also be used to update Schedule 4 payment rates and to help calculate the capacity charge;
- (b) are working with the industry to review, and where appropriate, update the other metrics within Schedules 4 and 8, for example Schedule 4 bus cost payment rates, freight Schedules 4 and 8 benchmarks and payment rates;

¹¹ In the Schedule 8 passenger regimes, payment rates to reflect the impact of poor performance on long term fare revenue have not been updated since 2005, based on 2003 revenue data. These rates also feed into the Schedule 4 payment rates.

(c) commissioned Steer Davies Gleave (SDG) to carry out some research into the estimated impact of setting Schedule 4 and 8 payment rates below 100% of the financial impact on train operators of service disruption due to Network Rail and other train operators. The results of this research are published on our PR13 microsite¹²

1.20 We have established two industry expert groups to discuss technical issues relating to Schedules 4 and 8: one for the passenger regimes and the other for the freight regimes. These groups provide technical advice and views from Network Rail and train operators to help ensure we update the metrics of Schedules 4 and 8 in a way that is robust. Through these groups we hold discussions on specific issues to identify areas where improvements can be made, and what these improvements might be. Many of the issues we consult on in this document have been discussed in these groups.

Incentives on Network Rail and train operators to minimise disruption to passengers and freight customers

1.21 Research by Passenger Focus consistently demonstrates that passengers and freight customers care deeply about planned and unplanned disruption to their service. This includes research published in 2010 on passengers' priorities for improvements in rail services¹³ which suggested that passengers regard train punctuality as their second highest priority over the price of train tickets offering value for money. In addition to this, recent Passenger Focus research on possessions¹⁴ has highlighted that:

- (a) wherever possible rail passengers want to travel by train, and are prepared to accept a longer journey time by train to avoid a replacement bus;
- (b) when buses do replace trains, the help provided to passengers transferring from train to bus and vice versa is inadequate; and
- (c) passengers think it is inappropriate for the industry to charge the same for a bus journey as for a train journey

1.22 This research demonstrates the importance of ensuring that Network Rail and train operators are incentivised to work in the best interests of passengers by avoiding disruption.

1.23 As discussed above, we view the main role of Schedules 4 and 8 as compensation regimes, which protect train operators from service disruption attributable to Network Rail, and as result reduce the size of risk premiums factored into franchise bids, and help protect the freight industry from loss of profit.

1.24 Our work on Schedules 4 and 8 sits alongside the other work we are doing to incentivise Network Rail to minimise service disruption to passengers and freight customers and ensure the industry provides information to passengers when disruption occurs. This includes the work we are doing on output targets to incentivise Network Rail to minimise service disruption to passengers and freight customers, either by performing well or through effective planning and management of possessions.

1.25 Examples of output targets which we set in PR08 are:

¹² <http://www.rail-reg.gov.uk/pr13/PDF/sch4-8-payment-reduction.pdf>

¹³ Passenger Focus (2010), Passengers' priorities for improvements in rail services

¹⁴ <http://www.passengerfocus.org.uk/research/publications/rail-passengers-experiences-and-priorities-during-engineering-works%20>

- (a) Public Performance Measure (PPM) targets, which relate to train punctuality;
- (b) Cancellation and significant lateness (CaSL) targets; and
- (c) Possession Disruption Index (PDI) targets, which relate to the amount of planned disruption faced by passengers and freight customers.

1.26 Network Rail has also been performing better than its CP4 targets in relation to disruption due to possessions. But there have been several instances where we have had to take enforcement action in relation to it not meeting its regulated punctuality targets. Examples of recent enforcement activity we have taken has included:

- (a) Enforcement orders made in the following instances:
 - (i) delivery of performance targets for the long distance passenger sector for 2011-12 and 2012-13; a recovery plan was required (against Network Rail, under condition 1 of the network licence in 2012);
 - (ii) delivery of performance for the freight sector; Network Rail to set up and facilitate a recovery board comprising relevant freight operators to agree steps to be taken to remedy the breach within a specified timescale (under condition 1 of the network licence in 2012); and
 - (iii) delivery of performance targets for the long distance passenger sector in 2013-14. Includes a reasonable sum should Network Rail fail to meet its commitments, set on a sliding scale of £1.5m for each 0.1 of a percentage point that it falls below the target (under condition 1 of the network licence in 2012).
- (b) Penalties we have imposed include:
 - (i) in 2008, a £14m penalty was imposed on Network Rail because we found systemic weaknesses in Network Rail's planning and execution of engineering work requiring possessions, which represented a serious continuing breach of its network licence; and
 - (ii) in 2010, we imposed a £3m penalty on Network Rail after it breached its network licence for failing to run an effective and efficient timetabling process for Britain's rail network.

1.27 As part of PR13 we are reviewing the outputs that Network Rail will be required to deliver for 2014-19, the key performance indicators (KPIs) that we could use to monitor delivery of outcomes more widely, and the measures of capability ('enablers') that Network Rail needs to put in place to deliver sustainable improvements over the long-term. We have recently consulted on Network Rail's output framework and are now reviewing responses – we will take them into account as we review Network Rail's strategic business plan and define the output framework in our draft determinations. We are of the view that output targets combined with enforcement action and its associated financial and reputational impact, provide a strong incentive on Network Rail to perform and manage possessions well.

1.28 We also monitor other aspects of Network Rail's performance and possession management, such as the monthly number of replacement bus hours. The use of replacement buses has been decline since the beginning of CP4. This is illustrated on the graph on p15 of the Network Rail Possession Indicator Report, Period 01 2012-13, which shows that the moving annual average of replacement bus hours has been falling since Period 5 2009-10.

1.29 In addition, how the industry provides information when disruption occurs is also very important for passengers. We are making sure that the industry improves in this area by identifying areas that are not working well and should be changed. We will also be asking operators to demonstrate how they are taking on board feedback from passengers. We will be keeping up the pressure in this area.

1.30 There are also other arrangements in place that help encourage Network Rail and train operators to minimise service disruption to passengers

- (a) financial incentives at a personal level, such as Network Rail's Management Incentive Plan, which financially incentivises Network Rail's executive directors and other senior staff to meet its output targets by providing bonus payments if objectives are met;
- (b) reputation (at company and personal level); failure to meet targets or poor customer survey results will damage the reputation of the company and the people who work for it;
- (c) Condition 1 of Network Rail's licence, which states that Network Rail must 'satisfy the reasonable requirements of persons providing services relating to railways and funders, including potential providers or potential funders, in respect of:
 - (i) the quality and capability of the network; and
 - (ii) the facilitation of railway service performance in respect of services for the carriage of passengers and goods by railway operating on the network'; and
- (d) arrangements which encourage the industry to work together.

Industry working together

1.31 We are mindful that what matters to passengers and freight customers is the standard of service they receive overall, which requires the whole system to work well, including the interface between Network Rail and train operators.

1.32 Existing arrangements such as Joint Performance Improvement Plans (JPIPs) already require Network Rail and train operators to work together in the interests of passengers. JPIPs are annual agreements between passenger train operators and Network Rail, detailing how each party will contribute to continuously improving performance, and are an obligation under the Network Code. JPIPs were introduced as an industry initiative following the collapse in performance after the Hatfield derailment in 2000. Since then performance has steadily improved.

1.33 In addition to this, the introduction of network availability targets for the first time in CP4 has led to the development of Joint Network Availability Plans (JNAPs) between Network Rail and both passenger and freight operators. These have tended to focus largely on meeting customer needs in terms of minimising bus substitution and lengthy diversions or maintaining access for key freight flows in addition to meeting regulated targets. For the time being, JNAPs are an informal and voluntary process, which we do not regulate.

1.34 However, we are of the view there is still further scope for the industry to work more closely together in the best interests of users of the railway. Network Rail has announced that it plans to form a number of 'alliances' with train operators with the aim of delivering a better service for passengers and freight users at lower overall cost to tax-payers. The term 'alliances' is currently being used to describe a wide range of different relationships from project-based partnerships through to potentially long-term and comprehensive commercial arrangements covering a wide range of activities carried out by Network Rail routes and train operators. The common factor is that Network Rail and a train operator reach agreement to work together

more closely and share the benefits of doing so, within the framework of their existing individual accountabilities and responsibilities.

1.35 We support the concept of alliances and welcome their potential to add value in the rail sector, delivering benefits for rail users and taxpayers. For example, they could encourage better planning of engineering possessions, resulting in less disruption to passengers. However, Network Rail must act in a way that is non-discriminatory, by treating all operators fairly in negotiating, agreeing and operating alliances, and we will ensure that safeguards exist so that other customers of Network Rail are not disadvantaged.¹⁵

1.36 In December 2012 we will publish our decisions on our proposals to strengthen the alignment of the incentives on Network Rail and train operators (both passenger and freight operators) to work together to improve cost efficiency by developing the existing efficiency benefit sharing mechanism (EBSM), with the introduction of a route-level efficiency benefit sharing (REBS) mechanism. This would reward train operators for working with Network Rail to outperform the efficiency assumptions that we set out for CP5 as part of our PR13 determination. Train operators would also bear some of the risk of Network Rail not achieving the efficiencies we assume in our determination for CP5.

1.37 We discussed whether Schedule 4 and 8 costs should be included in our proposed REBs mechanism in our May 2012 document on aligning incentives to improve efficiency¹⁶, and have also held discussions with stakeholders on this issue. Our current view is that any REBs mechanism should include Schedule 4 and 8 payments. As well as helping improve incentives to work together to achieve cost savings, it should therefore also help encourage train operators to work more closely with Network Rail to improve performance and the management of possessions.

Performance of train operators

1.38 The performance of franchised train operators is regulated by franchising authorities; for example Department for Transport, Transport Scotland and Merseytravel. Since performance has an impact on fare revenue, franchised train operators have a financial incentive to minimise delays they cause to their own services.

1.39 However, for certain passengers, demand patterns for train services are fixed and not very responsive to levels of service disruption. In many cases this is due to passengers having few or no alternatives, for example, other train operators or other transport options. There are therefore additional conditions within franchise agreements to ensure train operators perform well. These vary between franchise agreements, but examples include:

- (a) targets for maximum minutes of delay attributed to the franchised train operator; and
- (b) targets for maximum proportion of services cancelled.

1.40 Franchised train operators who fail to meet the targets in their franchise agreements may be required by the franchising authority to agree to remedial plans to ensure performance recovers. Ultimately, if performance fails to improve to a satisfactory level, the franchising authority may terminate the franchise.

¹⁵ <http://www.rail-reg.gov.uk/server/show/ConWebDoc.10854>

¹⁶ <http://www.rail-reg.gov.uk/pr13/consultations/orr021.php>

1.41 Under the majority of franchise agreements, franchised train operators are required to compensate passengers for poor performance, under schemes such as delay repay¹⁷. This provides an additional incentive on train operators to perform well or assist Network Rail with service recovery when delays are caused by infrastructure failure.

1.42 It is the role of franchising authorities to ensure that franchises are regulated in such a way that franchised train operators act in the interests of their passengers. This also includes considering as part of the franchising process the level and type of compensation passengers receive as compensation for disruption to services. It is not within our remit to ensure franchised train operators adequately compensate passengers.

1.43 Train operators have an obligation to comply with consumer law and we have a role in enforcing it. In this context, we will be exploring consumer awareness of current refund rights and compensation arrangements, and the extent to which consumers exercise their rights, including where vouchers rather than cash are used in compensation. We will publish a report of our findings together with recommendations in March 2013.

Summary of incentive arrangements in place

1.44 Table 1.1 summarises the arrangements in place to encourage Network Rail and train operators to minimise service disruption to passengers and freight customers.

¹⁷ Under the delay repay scheme, all passengers, including holders of season tickets valid between 1 month and 1 year, are entitled to claim compensation for each delay of more than 30 minutes whatever the cause. 50 per cent compensation of the single fare is available for delays of 30 to 59 minutes and 100 per cent of the single fare for delays of more than 60 minutes. For delays of more than 2 hours, 100 per cent of the return fare is available. The entitlement for holders of season tickets is calculated using the proportional daily cost of the season ticket.

Table 1.1: Arrangements in currently place which incentivise Network Rail and train operators to minimise planned and unplanned service disruption

Network Rail	
Performance	Possessions
<ul style="list-style-type: none"> • Public Performance Measure (PPM) output targets set in our determination (following on from the HLOS) • Cancellations and significant lateness (CaSL) output targets set in our determination (England & Wales only) • Network Rail delay minutes to passenger and freight service output targets set in our determination • Requirements in Network Rail’s licence • Annual customer satisfaction survey of passenger and freight train operators • Joint Performance Improvement Plans (JPIPs)¹⁸ • Link between performance and payments made under Management Incentive Plan • Reputation • Schedule 8 performance regime 	<ul style="list-style-type: none"> • Passenger possession disruption index (PDI-P) target set in our determination • Freight possession disruption index (PDI-F) target set in our determination • Joint Network Availability Plans (JNAPs) • Reputation • Schedule 4 possessions regime
Franchised train operators	
Performance	Possessions
<ul style="list-style-type: none"> • Loss of fare revenue • Franchise terms and conditions, and ultimate threat of withdrawal of franchise • Reputation and passenger satisfaction and their (real or perceived) impact on ability to be awarded future franchises • JPIPs • Schedule 8 (in terms of factoring impact of performance on other operators) • Cost incurred under the delay repay scheme 	<ul style="list-style-type: none"> • Loss of fare revenue (during possession and in the longer-term) • Reputation and passenger satisfaction and their (real or perceived) impact on ability to be awarded future franchises • JNAPs
Open access freight and passenger operators	
Performance	Possessions

¹⁸ Annual agreements between passenger train operators and Network Rail, detailing how each party will contribute to continuously improving performance, and which are an obligation under the Network Code

<ul style="list-style-type: none"> • Revenue • Reputation and customer satisfaction and their impact on long-term revenue • Schedule 8 (in terms of factoring impact of performance on other operators) 	<ul style="list-style-type: none"> • Revenue • Reputation and customer satisfaction and their impact on long-term revenue <p>Costs (Schedule 4 does not provide full compensation for possessions)</p>
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Transparency

1.45 We are of the view transparency has a vital role to play in driving the behavioural changes necessary for industry reform, delivering better value for money and an industry that has a sharper focus on its customers. By improving the quality and visibility of information, we can help to improve the efficiency and effectiveness of all the incentives listed in the table above.

1.46 We are also working with the industry to improve the transparency of performance information provided to passengers. Our view is that this will help provide passengers with the level of insight they need to challenge their suppliers and to make choices where they can. In May 2012 we published performance data broken down below the train operator level. In July 2012 we published ‘right time’ performance data, showing passengers the number of services that arrive within a minute of their scheduled arrival time for London and Southeast, regional and long distance services¹⁹.

1.47 A number of further initiatives are currently taking place:

- (a) We are working with the industry to validate the accuracy and reliability of right time data at train operator level and we or the industry will publish it when it has been quality assured;
- (b) National Rail Enquiries is adding right time functionality to its journey planner. This will enable passengers to see the right time punctuality over the previous few weeks of the actual train they are considering taking; and
- (c) Network Rail is investigating adding Cancellation and Significant Lateness (CaSL) data at train operator level to its annual return.

1.48 There may also be scope for the industry to improve the transparency of possession management, including ensuring those affected by planned service disruption are adequately consulted. As noted above, we have a limited role in respect of franchisees, who are regulated primarily by the franchise authorities through the franchise contract. We do not therefore consider that it would be appropriate for us to seek to require them to consult their passengers in order to inform their discussions on planned service disruption with Network Rail. This would be something for the franchise authorities to consider.

1.49 However, we could require Network Rail to consult with passengers and freight customers in planning disruption. In our view there could be merit in such a requirement, in ensuring that decision-making in disruption was conducted having regard to the interests of the user. In this document we therefore ask for stakeholder views on whether and how we should encourage Network Rail to consult passengers and freight customers in the planning of possessions.

¹⁹ <http://www.rail-reg.gov.uk/server/show/ConWebDoc.10963>

1.50 We do not wish to duplicate or undermine any consultation that train operators already undertake with their passengers and are keen to:

- (a) understand more about the consultation that train operators currently do and plan to do; and
- (b) hear suggestions as to how Network Rail could consult in a way that complements any consultation activity already being carried out by train operators.

1.51 What are your views on whether or not passengers and freight customers adequately consulted on the planning of possessions? What activity currently takes place?

1.52 What are your views on whether we should encourage Network Rail to consult with passengers and freight customers in the planning of its possessions?

1.53 If we were to encourage Network Rail to consult with passengers and freight customers in the planning of its possessions, do you have any suggestions on how we might go about doing this, for example, how such an obligation would be phrased and monitored?

Bespoke arrangements

1.54 As discussed above, Schedules 4 and 8 allocate risk between Network Rail and train operators to ensure that the organisation best placed to control a particular risk is the one exposed to it. We are of the view that there are potential benefits from train operators and Network Rail themselves agreeing the best balance of risk, on the basis of more commercial considerations reflecting the specific circumstances of the particular train operators' operations, customer base and engineering requirements.

1.55 In these instances, it may be appropriate for Network Rail and train operators to agree bespoke performance and possessions compensation arrangements in their track access contracts, subject to our approval. In instances where Network Rail and train operators are already considering bespoke arrangements, we encourage them to engage with us during PR13, so they can be considered at the same time we update the template Schedules 4 and 8 regimes. However, this does not mean we will not approve subsequent requests for bespoke arrangements, once CP5 has begun.

1.56 We plan to review the criteria we apply for the approval of bespoke arrangements to the template track access contracts. This is to ensure the criteria remain fit for purpose, do not result in undue discrimination against minority operators, and do not discourage such arrangements when they are in the interests of passengers or freight customers. This review will extend across bespoke arrangements in general; so for example, it will also consider bespoke charging arrangements. If we reach the view that the wording of our Criteria and Procedures for the approval of track access contracts²⁰ should be changed, we will consult on the proposed changes. The issues we consult on in this document relate to Schedules 4 and 8 in our template track access contracts, and we do not consult specifically on bespoke arrangements. We anticipate carrying out this consultation after the end of PR13.

Franchise protections

1.57 Under the financial adjustment mechanism ("Schedule 9") in some franchise agreements, franchise payments to operators are adjusted following a Charging Review to address the changes we determine in

²⁰ <http://www.rail-reg.gov.uk/server/show/nav.2409>

relation to the services specified in their franchises. This is a one-off adjustment based on the revised charges compared against assumptions made at the time franchises are agreed. These adjustments therefore do not in general affect the impact of any changes we make on the day to day incentives of franchise train operators, for example in relation to causing delays to train services operated by other train operators. However, we are mindful that if we make changes to Schedules 4 and 8 for which the estimated impact cannot readily be estimated through the financial models relating to the franchise agreements, it can result in complex negotiations between franchising authorities and train operators.

1.58 We have been working with Department for Transport (DfT) to see if, for new franchise agreements, there are certain changes we make at periodic review against which train operators should no longer be held neutral. DfT has already made a decision to discount some changes we make to traction electricity (EC4T) charges during periodic review. Our current view is that franchising authorities should strongly consider, (for new franchise agreements,) not holding train operators neutral to changes we make to Schedule 4 and 8 payment rates.

2. Issues relating to Schedules 4 and 8

2.1 This chapter consults on issues that relate to both the Schedules 4 possessions regime and the Schedule 8. The main one is whether to set payment rates to below 100% of the financial impact to train operators of planned and unplanned service disruption

Whether to set payment rates to below 100% of the financial impact to train operators of planned and unplanned service disruption

Issue

2.2 Currently Schedule 4 and 8 payment rates are set at 100% of the financial impact to train operators of planned and unplanned service disruption, with the exception of some freight Schedule 4 and 8 payments. The financial impact reflects how revenues and costs are affected by disruption caused by Network Rail and train operators compared with benchmark levels.

2.3 The objective of setting payment rates at a level that would not fully compensate train operators for planned and unplanned service disruption would be to help encourage train operators to work with Network Rail to improve performance and minimise the number and impact of possessions. With 100% compensation, Schedules 4 and 8 do not provide a financial incentive on train operators to work with Network Rail to minimise service disruption to passengers.

2.4 However, we are mindful that a disadvantage of capping Network Rail payment rates below 100% is that it would weaken the financial incentive for Network Rail to reduce disruption to services by reducing the amount that the company would pay to train operators for poor performance or disruption.

2.5 In light of the drive for Network Rail and train operators to work jointly to reduce costs and act together in the best interests of customers, we commissioned Steer Davies Gleave (SDG) to carry research to establish whether it is appropriate to set payment rates to below 100% of the financial impact of disruption, including whether the economic benefits of doing so would outweigh the costs²¹ Box 2.1 outlines the SDG research methodology and key findings.

²¹ [\[Add link to SDG report\]](#)

Box 2.1: SDG research methodology and key findings

SDG was commissioned to study the potential impact of a 10% and 25% reduction in both Schedule 4 and Schedule 8 payment rates faced by passenger and freight operators. Impacts were identified in two principal categories:

- (a) Financial effects on the level of franchise bids, and on the profits of freight and open access operators; and,
- (b) Changes in the behaviour of Network Rail and train operators in terms of minimising disruption.

Accordingly, SDG's methodology contained two distinct elements:

- (a) Analysis of the additional risk to income of train operators arising from a reduction in payment rates, and an assessment of how this would affect the pricing of franchise bids. Estimates of potential effects on profits of freight and open access operators were also made. Analysis of these areas used historic data on Schedule 4 and 8 payments.
- (b) Identification of the actions that train operators and Network Rail might take in response to a reduction in payment rates and quantitative analysis of the resulting impacts. This part of the study was based on a combination of SDG's own assessment of potential impacts, a programme of interviews with train operators, Network Rail and the Department for Transport (DfT), and quantitative analysis of the expected effects of a change in rates on potential changes to operator behaviour.

Headline findings from the study are:

- (a) The total financial cost of an increase in risk faced by train operators arising from a 25% reduction in Schedule 4 and 8 payment rates is estimated to be in the region of £45 million over a control period (based on central estimates subject to a high degree of uncertainty). This figure combines an estimated £30 million loss in franchise value and £15 million loss in freight operator and open access operator profits.
- (b) A reduction in payment rates to 75% or 90% of their current levels would not lead to a significant change in behaviour by Network Rail or train operators, due to the dominance of other, stronger incentives.

Options

2.6 We have considered the following options.

- (a) Set Schedule 4 and 8 payment rates so that they compensate train operators for the full financial impact of service disruption due to Network Rail and other operators, where they do so currently; or
- (b) Set payment rates below 100%, for example, at 90% or 75% of the full financial impact of service disruption (the proportionate reductions in rates considered by our research).

Our emerging view

2.7 We are minded to choose option (a) and set Schedule 4 and 8 payment rates so that payments are based on compensation to train operators for the full financial impact of service disruption due to Network

Rail and other operators, where they do so currently. This view reflects the findings of the research by SDG and our subsequent evaluation of the advantages and disadvantages of the two options.

SDG findings

2.8 SDG have estimated that a 25% reduction in Schedule 4 and 8 rates would produce a £30 million increase in franchise bids on average over a control period. This figure is a central estimate and subject to a high degree of uncertainty given that the way in which a franchise bidder would price risk would depend on a number of factors. Illustrating the uncertainty, SDG estimated a range for the impact of a 25% reduction in Schedule 4 and 8 rates of £0 to £133 million on average over a franchise period.

2.9 It should be noted that these quantitative estimates reflect the size of the risk that passenger train operators are exposed to under reduced Schedule 4 and 8 payments rather than the amount that train operators would value this risk at. The two values may not necessarily be the same when the train operator prefers certain to uncertain outcomes, and performance projections becoming more uncertain following a reduction in Schedule 4 and 8 rates.

2.10 Table 1.1 shows SDG’s central estimates of the potential changes in franchise value resulting from Schedule 4 and 8 payment rates being set below 100%. The estimates represent value across all train operating companies over the length of a control period, and reflect the value of additional risk being taken on by train operators. The values also potentially represent increases in costs to the tax-payer if fully reflected in franchise value.

Table 2.1 – Potential reductions in franchise value (over single control period and all train operating companies, £ millions)

	Rates reduced by 10%	Rates reduced by 25%	Rates reduced by 10% with REBS in place	Rates reduced by 25% with REBS in place
Schedule 4 medium value of risk premium	8	19	6	15
Schedule 8 medium value of risk premium	4	11	3	8

Source: SDG Calculations based on historical Schedule 4 and 8 data

2.11 It is currently proposed that Schedule 4 and 8 payments are included within the REBS mechanism. A REBS arrangement would dilute the effect of Schedule 4 and Schedule 8 payments, and hence the financial impact of reductions in payment rates shown in Table 1.

2.12 SDG estimated that the loss of profits of freight operators and open access operators as a result of a 25% reduction in Schedule 4 and 8 rates would be £15 million on average over a control period. This is the central estimate and SDG report a range of £10-£27 million in potential loss of income for freight operators and open access operators. SDG indicate that the majority of losses accrue to freight operators due to the reduction in Schedule 4 payment rates.

2.13 Based on interviews with the rail industry and DfT during the study, and from discussions at the Schedule 4 and 8 industry groups, SDG reached a consistent view that the level of Schedule 4 and Schedule 8 payments do not provide strong incentives on behaviour. Hence, the consensus among stakeholders is that a reduction in payment rates to 75% or 90% of their current levels would not lead to a significant change in behaviour by Network Rail or train operators. According to the stakeholder interviews this is because there are other, stronger, incentives which include:

- (a) Regulatory targets;
- (b) Reputational risk; and
- (c) Risk of loss of business.

2.14 When initial findings of the study were presented by SDG at the Schedule 4 and 8 industry group, stakeholders reinforced the views above. SDG produced more detailed quantitative appraisal of the potential benefits associated with measures that could be put in place by train operators to mitigate the effect of a reduction in Schedule 4 and 8 payment rates. The quantitative assessment was designed to better substantiate the above qualitative findings.

2.15 In order to test the claim that train operators would not increase possession planning resources in response to a Schedule 4 rate reduction, SDG's quantitative analysis estimated the benefit to train operators if additional possession planning were to enable less disruptive possessions.

2.16 The analysis suggests that the potential benefits are small, if there were inefficiencies in possession arrangements which could be unlocked by additional train operators challenge prompted by a change in rates. If the proportion of the long possessions that could be substituted with a series of shorter and less disruptive possessions were 10%,²² then the benefit of additional possessions planning would exceed the notional cost of employing an additional member of staff for this purpose for only three train operators in the event of a 25% reduction in Schedule 4 rates. And where benefits would exceed costs the net effect is small compared with the considerable extra costs estimated in franchise bids.

2.17 Estimates are for net benefits of £150,000 over a five-year period to train operators for which the additional possessions planning is worthwhile, along with an estimated £3 million benefit to society (discounting not applied). Total estimated net benefits of £3.2 million compare with an estimated £19 million of extra costs in franchise bids on average over a control period caused by a 25% reduction in Schedule 4 payment rates.

2.18 SDG's quantitative assessment of the effect of potential train operator reactions to a change in Schedule 8 rates supports the contention of train operators that a reduction in rates would not cause a change in behaviour. Service group analysis of reductions in Schedule 8 payment rates has been conducted and in all cases examined a reduction in Schedule 8 rates by 25% would increase the benefit of additional train crew by less than £110,000 per annum, while the provision of additional train crew would typically cost in the region of £300,000.

2.19 In all cases, the reduction in Schedule 8 payment rates by 25% would increase the benefit of additional rolling stock, with train crew, by between £0 and £1 million per annum. The cost of provision of the train crew and rolling stock (including stock operating costs) would typically lie in the range of £400,000

²² An assumption of 10% of long possessions is SDG's judgement in the absence of a detailed examination of the way in which Network Rail organises its possessions.

to £4 million per annum depending on the number and type of trains employed. In none of the cases examined would the additional benefit exceed the cost.

Our view of the SDG findings and proposed approach

2.20 We are content that the qualitative research and quantitative analysis developed in the SDG study provides a sensible assessment of the likely industry responses to a reduction in Schedule 4 and 8 payment rates. We consider that a reduction in payment rates by the levels tested would not materially improve industry incentives towards improved joint working between Network Rail and train operators (given other stronger incentives) and would lead to loss to franchise value to the detriment of taxpayers.

2.21 Our confidence in SDG's estimate of the loss of franchise value is tempered by the difficulty in appraising exactly how train operators would price the risk of uncertainty in possessions and performance activity into franchise bids following a reduction in Schedule 4 and 8 payment rates.

2.22 Nevertheless we are minded to choose option (a) based on SDG's qualitative assessment from stakeholder interviews, backed by quantitative analysis, discussions with the Schedule 4 and 8 industry groups and our validation of the research findings.

2.23 It should be borne in mind, however, that a disadvantage of this option (a) compared with option (b) could be individuals within train operating companies being under less pressure to confront Network Rail regarding below standard performance or to resist possessions that are longer and more disruptive to passengers than necessary.

Consultation questions

2.24 **Do you agree with the SDG research findings and conclusions on whether to set Schedule 4 and 8 payment rates so they do not compensate train operators in full for the impact of service disruption due to Network Rail and other train operators? If not, please tell us why?**

2.25 **Do you agree that we should continue to set Schedule 4 and 8 payment rates so that they compensate train operators for the full financial impact of service disruption due to Network Rail and other operators, where we do so currently? If not, please tell us why?**

2.26 **Are you of the view that there are other steps we could take to encourage train operators to have a stronger influence on the behaviours of Network Rail, in addition to those we are doing already? If not, please tell us why?**

The contractual provisions for dealing with extreme disruption due to external factors

Issue

2.27 In its response to our May 2011 consultation, Network Rail argued that during extreme disruption, such as, that resulting from severe weather, it has a perverse incentive to cancel the entire scheduled timetable in advance, whereas train operators have a perverse incentive to request a full but undeliverable timetable. This on the basis that, with the latter, the amount of compensation paid to train operators is likely to be higher.

2.28 Network Rail also stated that sometimes it has to pay replacement bus compensation under Schedule 4 for buses that are not able to run due to adverse weather conditions, and then claim it back. Network Rail

expressed the view that in practice the industry tries to do the right thing but that the contractual provisions do not help with this.

2.29 Network Rail has suggested the above issues could be addressed with the introduction of a 'Joint Restrictions of Use' concept into Schedule 4. Currently restrictions of use can either be declared by Network Rail or a train operator, but not jointly. It has proposed that it could be possible for Network Rail and train operators to agree a number of "trigger scenarios" for an amended timetable, guided by operational criteria. Where these scenarios are triggered both by Network Rail and the train operator, then the amended timetable is viewed as a 'Joint Restriction of Use'. Network Rail suggested that when a Joint Restriction of Use is triggered, the following could apply:

(a) Network Rail pays 50% of the formulaic revenue compensation defined in Schedule 4 Part 3 Paragraph 3; and

(b) no compensation to be paid in relation to estimated bus mileage under Schedule 4 Part 3 Paragraph 4, in the scenario where the use of buses does not form part of the amended plan.

2.30 Network Rail highlighted the difficulty of defining the concept of Joint Restrictions of Use in the first place. There is also a risk that parties may decide not to request a Joint Restrictions of Use if they are of the view they would be financially better off by waiting for the other party to declare a Restrictions of Use.

Options

2.31 Options we are considering are as follows:

(a) Introduce the Joint Restrictions of Use concept into Schedule 4. We would need a more detailed proposal from Network Rail on how this would be defined. The Joint Restrictions of Use could be an optional clause within the template Schedule 4; or

(b) Do not introduce the Joint Restrictions of Use concept into Schedule 4.

Our emerging view

2.32 When Network Rail set out its proposals to the Schedules 4 and 8 passenger regimes industry group, the majority of train operators were of the view that the current wording within Schedule 4 did not act as a barrier to the industry working together in the interests of passengers during extreme disruption, such as severe weather, and that in general the industry does work together effectively to minimise disruption to passengers. The majority of train operators were also not of the view that the introduction of a Joint Restrictions of Use would achieve its stated objective.

2.33 We share this view as we are not convinced train operators would agree to a Joint Restrictions of Use in instances where Network Rail is unable to run the scheduled timetable.

2.34 This view is not shared by all train operators. In its response to our May 2011 consultation, South West Trains argued that Schedule 4 currently creates a perverse incentive on Network Rail to maintain a stance that the network is fully available in order to avoid calling a Restriction of Use. It stated that as a result, decisions are often not in the best interests of passengers and result in a situation where a train operator which decides to run a contingency timetable in order to maintain an operationally robust service for its passengers is not entitled to any compensation from Network Rail.

2.35 Based on the evidence we have received so far and proposed solution from Network Rail, we are currently minded to choose option (b) and not introduce the Joint Restrictions of Use concept into Schedule 4. We are concerned that if we were to introduce a Joint Restrictions of Use concept into Schedule 4 it

could result in unintended consequences in instances where the current contractual wording is not causing any problems. An example of an unintended consequence might be Network Rail not declaring a Restrictions of Use where it would have done with the current contractual wording, in the hope that the train operator would agree a Joint Restrictions of Use.

2.36 In most parts of the network, the current wording of Schedule 4 does not appear to be preventing Network Rail and train operators from working together in the interests of passengers during extreme disruption. However, we are keen to hear more from stakeholders on this issue. This includes on whether the contractual wording of Schedules 4 and 8 is causing a perverse incentives on either Network Rail or train operators not to work in the best interests of passengers and freight customers during severe disruption. And if so, we are keen to hear any proposals for how the contractual wording could be improved.

2.37 We are also of the view that may be more effective for Network Rail and train operators to propose bespoke arrangements to ORR if there are particular localised circumstances where the current contractual wording does not work well, which do not apply to the majority of train operators. We are mindful that the 'deep alliance' between South West Trains and Network Rail's Wessex operating route will reduce the likelihood of the issues highlighted in South West Trains' consultation response from occurring in the future, since they appear specific to the Wessex route.

Consultation questions

2.38 Do you agree with our proposal not to introduce the Joint Restrictions of Use concept into Schedule 4 of template track access contracts? If not, please tell us why?

2.39 To what extent (if at all) do you think the current contractual wording of Schedules 4 and 8 is acting as a barrier to Network Rail and train operators minimising disruption to passengers and freight customers during extreme disruption, e.g. during severe weather. If you are of the view that it does act as a barrier, we welcome any specific proposals on how it can be improved.

Indexation of payment rates for inflation

2.40 In CP4 we compensated Network Rail for general inflation risk by establishing our PR08 Determination of Network Rail's Outputs and Funding in real terms and indexing the access charges each year based on the November value of the retail prices index (RPI). In our August 2012 consultation on financial issues for Network Rail in CP5, we consulted on this issue and we will publish our decisions in December 2012. Our approach to the treatment of inflation in relation to Schedule 4 and 8 payment rates will need to be consistent with that decision

3. Schedule 4 passenger possessions regime

Introduction

3.1 The Schedule 4 passenger possessions regime compensates franchised passenger operators for planned service disruption due to Network Rail possessions. Formulaic Schedule 4 payments are to compensate for a combination of:

- (a) the effect of possessions on fare revenue and
- (b) additional costs incurred when running replacement buses;
- (c) costs or cost savings resulting from a change in train mileage.

3.2 Franchised passenger operators receive Schedule 4 compensation in return for paying an access charge supplement (ACS) to cover the expected level of Schedule 4 compensation determined at periodic review. Open access passenger operators may opt to pay an ACS if they wish to receive full Schedule 4 compensation on the same basis as that received by franchised passenger operators²³.

3.3 This chapter consults on the following issues:

- (a) methodology for disaggregating of the Access Charge Supplement (ACS);
- (b) replacement bus cost compensation;
- (c) replacement bus revenue loss compensation;
- (d) notification factors and thresholds;
- (e) sustained Planned Disruption threshold.

3.4 These issues relate predominately to Type 1 possessions, which are compensated through a formulaic revenue and cost compensation mechanism. The Schedule 4 regime operates on a tiered basis whereby additional compensation becomes payable in cases of sustained disruption categorised under the definitions of Type 2 and Type 3 possessions. We see no reason to change the current possession definitions types as part of this review but we will consider comments from stakeholders who provide us with any such reasons.

²³ Open access operators' ACS is calculated by pro-rating the above network-wide aggregated total (for franchised passenger operators) on a mileage basis.

Possessions Types

In return for the payment of an access charge supplement, franchised passenger operators receive formulaic cost and revenue compensation for all possessions, but with additional compensation available depending on the level and impact of disruption. The Schedule 4 passenger regime operates a tiered structure of possessions defined by the following possession types:

- (a) **type 3 possessions:** single possession greater than 120 hours (including public holidays), receive formulaic compensation as default but with the possibility of actual revenue losses and costs (subject to a materiality threshold);
- (b) **type 2 possessions:** single possession greater than 60 hours, but equal to or less than 120 hours, (excluding public holidays), receive formulaic compensation as default but with the possibility of actual costs (subject to a materiality threshold and in respect of categories of direct costs only);
- (c) **type 1 possessions:** All other possessions receiving formulaic revenue and cost compensation.

Methodology for disaggregating the Access Charge Supplement (ACS)

Issue

3.5 Schedule 4 payments are funded through an ACS paid to Network Rail by franchised passenger train operators; the total ACS reflects the amount Network Rail is expected to pay out in Schedule 4 possession compensation over the control period. Network Rail's estimate of the total Schedule 4 cost for each control period is based on planned volumes of maintenance and renewals activities. Network Rail groups these activities separately for maintenance and renewals into the following categories: track, signalling and communications, switches and crossings, civils, electrification and 'other'. It then calculates the Schedule 4 unit cost for each activity. For example, for track renewals, the Schedule 4 unit cost is the average Schedule 4 cost per km of track renewed.

To estimate Schedule 4 unit costs, Network Rail undertakes an analysis of Schedule 4 payments in a base year. For each possession in the base year, Network Rail knows how much Schedule 4 compensation was paid for each activity and what kind of work was carried out in each possession. From this, it estimates how much Schedule 4 compensation was paid in relation to each activity; and given that it knows the volume of each activity, dividing one by the other gives the Schedule 4 cost for each unit of activity. This is currently carried out at the national level, rather than, for example, route level. This is because Network Rail considers there is insufficient data at the route level to provide robust unit cost estimates of Schedule 4 unit costs.

3.6 The base Schedule 4 cost for a control period is then estimated by multiplying the planned volumes of each activity by the relevant Schedule 4 unit cost. This total is then adjusted to take account of factors such as the update of Schedule 4 payment rates (based on updated Schedule 8 payment rates); changes in access strategies; changes in the geographic mix of where the work is carried out on the network,

changes in levels of notification factors and Network Rail's possession volumes management and efficiency targets²⁴.

3.7 The total projected Schedule 4 cost is then disaggregated into individual ACSs for each TOC divided pro-rata to historic schedule 4 payments paid by each franchised passenger operator in a selected base year (at the last periodic review the base year was 2006/07).²⁵

3.8 Generally respondents to our May 2011 and December 2011 consultations did not specifically raise the issue of how the ACS is apportioned but Network Rail did highlight (discussed below) methodological difficulties associated with achieving greater precision in aligning the level of the ACS paid by franchised passenger train operators with the amount of possession activity faced. However, in subsequent discussions at the Schedules 4 and 8 industry group, train operators have requested that we review how the ACS is allocated so that it better reflects possession costs in the areas in which they operate. This reflects the concern expressed by a number of operators that they are paying significantly more out in ACS than they receive in Schedule 4 payments.

3.9 For CP5, Network Rail has improved the methodology it plans to use for calculating the level of ACS. Previously, Schedule 4 costs were estimated at a national level. As part of this periodic review, and reflecting Network Rail's move to a route based management structure, it plans to use route based planned activity volumes within each of Network Rail's operating routes²⁶ to estimate route based Schedule 4 costs. This will help to bring Schedule 4 costs closer to the actual level of possessions faced by franchised passenger operators in each area, although the ACS will still be apportioned pro-rata amongst franchise passenger operators based on historic Schedule 4 payments. Network Rail intends to improve the allocation further by using two years of historic data rather than one year's as was used in PR08.

3.10 However, Network Rail has informed us that it considers it impractical to estimate the per activity Schedule 4 unit costs at route level. Network Rail argues this is because calculating accurate route based unit cost estimates raises methodological issues because of the large degree of variability in possession cost (for each asset type) between areas. For example, the number of signalling schemes and cost per signalling scheme varies considerably between different routes in any given year. Network Rail argue that the variability in data is too great to provide reasonable estimates of signalling related (and other structures) Schedule 4 costs other than at a national level.

Options

3.11 We have considered the following options:

- (a) continue with the methodology used in PR08 for disaggregating the ACS;
- (b) as (a) but absorb the ACS into the fixed track access charge;
- (c) adopt Network Rail's revised route based Schedule 4 costs estimation methodology.

²⁴ Network Rail receives a discount on the amount of Schedule 4 compensation it pays to franchised passenger train operators to cover for revenue losses for early notification of planned possessions, known as the notification factor.

²⁵ If open access passenger operators elect to pay an ACS to receive full Schedule 4 compensation the amount of ACS they pay is calculated by pro-rating the network-wide aggregated total (for franchised passenger operators) on a mileage basis.

²⁶ Network Rail's operating routes are: Kent & HS1, Sussex, Wessex, Western, Anglia, East Midlands, Wales, London North Western, London North Eastern and Scotland.

Our emerging view

3.12 We are minded to go for option (c) because greater accuracy in the way Network Rail calculates the ACS provides greater cost transparency meaning franchised operators are better able to challenge Network Rail's Schedule 4 costs. Choosing Option (b) would result in franchised passenger operators' ACS payments becoming less transparent. Options (a) and (b) both involve no change from how the ACS was calculated and allocated in PR08 and as such does not address franchised passenger operators' concerns that the ACS does not reflect the possessions cost they are likely to face.

3.13 Option (c) enables Network Rail to estimate Schedule 4 costs based on planned activity volumes at route level, rather than at the national level and this will help achieve better alignment between Schedule 4 costs and the amount of ACS paid by franchised passenger operators operating within each route. The final allocation of the route level ACSs will still be allocated between train operators pro-rata based on historic past Schedule 4 payments in selected base years.

3.14 Our emerging view is that Network Rail's proposal represents a step forward in estimating total Schedule 4 costs. We also consider that Network Rail's view that the variability of cost data relating to some asset types, such as signalling, makes it difficult to estimate robust unit possession costs at the route level is valid.

Consultation questions

3.15 Do you agree that the Access Charge Supplement (ACS) should be calculated using Network Rail's revised route based Schedule 4 costs estimation methodology?

3.16 Do you consider there is further value in Network Rail achieving greater disaggregation in the methodology of the ACS calculation and, if so, do you have any suggestions how this might be achieved?

Replacement bus cost compensation

Issue

3.17 Formulaic bus compensation was introduced in PR08 as part of a broader review of Schedule 4 to ensure franchised passenger train operators are fully compensated for the provision of replacement bus services during possessions. Concerns have been raised in this periodic review by some stakeholders as to whether the level of bus compensation reduces the incentive on train operators to fully explore timetable solutions when dealing with service disruption as a result of possessions and encourages them, instead of running trains, to over rely on running rail bus replacement services, which are unpopular with passengers. For example in a recent Passenger Focus survey of passengers attitudes to possessions, 55% of passengers surveyed said they would not travel by train if it involved the use of a bus for part or all of the journey (See text box below). Conversely, in industry discussions a number of train operators have stated that the current formula does not fully compensate them for bus costs.

'Rail passengers' experiences and priorities during engineering works', Passenger Focus September 2012

Passenger Focus recently surveyed passengers' views on possessions. When asked about the provision and management of alternative transport arrangements during possessions:

- 55% of passengers surveyed said that they would not make a journey by rail if all or part of their journey involved a bus on sections of their journey; and
- 76% of those surveyed said they would travel if the alternative arrangements involved a change of trains, for a previously direct journey or diverted train with longer journey times;

Passengers also stated that where buses replace trains:

- the help provided to passengers transferring from train to bus and vice versa is inadequate; and
- it is inappropriate for the industry to charge the same for a bus journey as for a train journey.

3.18 Train operators receive compensation to cover the cost of procuring replacement buses where trains are cancelled due to possessions; compensation is paid net of any operational cost savings from cancelling trains²⁷. The amount of compensation received for each possession is based on a parameter known as the estimated bus mile (EBM) compensation rate and is paid to operators on a (£) per mile rate. The bus mileage for each possession is derived from pre-determined estimates of bus miles between stations which are set out in track access contracts. The estimated bus miles for each station were set at PR08 when the bus cost formula was established and are based on the concept of viable transfer points. These are stations, agreed between franchised operators and Network Rail, at which passengers can be safely and efficiently transferred to other modes of transport, predominately but not exclusively buses. EBMs are paid at two regional rates, currently for London and South East these are £15.10 and all other regions £10.15. These rates are based on a sample of franchised passenger operators' bus replacement costs carried out by consultants Faber Maunsel during the development of the bus cost compensation formula during in PR08²⁸.

3.19 We consider it is important that the level of compensation received by train operators reflects the actual cost of bus provision they face. It is also important that the compensation scheme does not lead to a perverse incentive on train operators to run buses where the option to run a revised train service exists, and would be better for passengers.

3.20 To inform our assessment of how the bus cost formula is working, we are carrying out a survey of the amount of bus cost formula compensation franchised passenger train operators received compared to the actual bus cost incurred. The results so far suggest that for financial year 2010/11 train operators received 8% more in bus cost compensation than they paid out for procuring replacement buses. Whereas in 2011/12 the formula paid out 2% less than operators paid in bus costs (this is based on 68% response rate). However, for both financial years, our survey shows that at individual operator level, the variance

²⁷ There have been some concerns expressed that operators, in addition to bus cost compensation, benefit from the provision of Bus Service Operators' Grant paid to bus operators. The DfT intends to remove eligibility for receiving BSOG for rail replacement bus services. More information can be found at <https://www.gov.uk/government/consultations/consultation-on-bus-subsidy-reform>;

²⁸ Review of Possession Cost Compensation: Stage 2 Final Report. A Report to Network Rail, ORR and ATOC. 30 November 2007. Available on our website: http://www.rail-reg.gov.uk/upload/pdf/cnslt-rev_poss_cost_comp_FM.pdf

between the formulaic payments and the actual bus costs amounts is large enough to suggest that the bus cost formula does not reflect well the actual level of bus costs faced by individual operators. If this is confirmed by the result of our completed survey, then a more detailed review might be required, beyond uprating the EBM compensation rates by inflation.

Options

3.21 We are considering the following options for our review of the bus cost formula. The first two options apply if we conclude that the bus cost formula is paying the correct level of compensation:

- (a) uprate estimated bus mile compensation rate by inflation - using the retail price index;
- (b) uprate estimated bus mile compensation rate by inflation - using a bus industry cost index²⁹; or
- (c) revise estimated bus mile compensation rate based on actual amounts paid during CP4.

Emerging views

3.22 We are minded to choose option (c). The results we have had so far from our survey of bus cost compensation payments to franchised passenger operators suggest that the bus cost formula does not match well the actual cost of providing replacement buses. This suggests that the EBM rates set at CP4 should be revised to bring compensation payments in line with the actual cost of procuring bus replacement services. EBM rates were set at PR08 based on a relatively small sample of possessions; we consider that actual bus cost data from CP4 can be used to provide a better EBM rate estimate.

3.23 We anticipate that we will update Schedule 4 estimated bus mile compensation rates based on the actual cost of replacement buses in 2010/11 and 2011/12 as this coincides with the recalibration period for revenue compensation payment rates. However, we would be interested in stakeholders' views about how payment rates should be reviewed.

Consultation questions

3.24 Do you agree that we should update the estimated bus mile payment rate based on actual amounts paid during CP4, rather than simply uplift the current rates by cost inflation?

Replacement bus revenue loss compensation

Issue

3.25 Franchised passenger train operators receive formulaic revenue loss compensation where service disruption due to possessions leads to extended journey times or the need for replacement buses where trains are cancelled. This is to compensate operators for revenue loss due to passengers being deterred from using rail services because of disruption caused by possessions and is based on Schedule 8 compensation rates, with a discount for early notification.

3.26 Under the formula used in Schedule 8, where trains are cancelled and replaced by buses, franchised train operators receive compensation based on 1.5 times the train frequency of the respective service group. For example, if the train frequency is every thirty minutes, the compensation rate would be based on passengers experiencing a delay of 45 minutes. Cancellations are treated the same way under Schedule 4. However, during a possession a replacement bus service is supplied in place of the cancelled

²⁹A bus industry cost index is produced by the Confederation of Passenger Transport.

train but the additional journey time may not equate to 1.5 times the frequency of train service, because of factors such as the additional time to change between train and bus.

3.27 This means that franchise passenger operators are not in general being correctly compensated for revenue losses where they run replacement bus services. In some instances, where there is overcompensation, it could act as a perverse incentive for operators to agree to possessions and run replacement buses in instances where less disruptive alternatives would be more appropriate. An alternative might therefore be to base compensation rates used for the extended journey time element of the revenue loss formula, as they are in cases where train journey times are extended due to possessions, for example due to diversionary routes. If this approach were taken, the compensation rates would also need to reflect the fact that for a given length of journey time, the bus is a less popular transport mode than the train.

3.28 We are mindful that Schedule 4 cannot deal with the complexities surrounding every possession, which can vary greatly depending on the type and circumstances of the possession. In this sense Schedule 4 is an 'average regime', i.e. it is designed to broadly reflect the circumstances surrounding most 'typical' possessions. This means that there are likely to be circumstances where franchised passenger operators are overcompensated for providing buses and other times when they are undercompensated.

Options

3.29 We are considering the following options:

- (a) continue with the current system for calculating revenue loss compensation for cancelled train services;
- (b) review the current revenue formula and base compensation rates on extended journey time rates.

Emerging views

3.30 Although there are anomalies in how the revenue loss formula compensates franchised passenger train operators where replacement buses are used as substitutes for cancelled train services, we are not minded to make changes to this aspect of Schedule 4 and therefore minded to choose option (a). This is because the 'average regime' nature of Schedule 4 means it is likely to result in cases where it over or undercompensates operators, and we are keen not to make changes unless they are likely to result in real benefits. Furthermore, this issue has not been raised by stakeholders in any of our consultations or through the Schedule 4 and 8 industry working group. However, we are interested to hear stakeholders' views on whether this is something which we should change.

Consultation questions

3.31 Do you agree that we should continue with the current formula for calculating revenue loss compensation for cancelled train services when there are replacement buses? If not, do you have any suggestions for how we could improve this aspect of Schedule 4?

3.32 Do you consider the way in which the revenue loss formula compensates franchised passenger operators when using replacement buses encourages passenger train operators to run too many buses (rather than trying to run train services using diversionary routes, for example)? If so, please explain why you think this is the case?

Notification factors and thresholds

Issue

3.33 As discussed above, Network Rail receives a discount on the amount of Schedule 4 compensation it pays to franchised passenger train operators for early notification of planned possessions; known as the notification factor³⁰. The discount reflects the reduced impact on train operators' revenues where passengers receive early notice of service disruption due to possessions. This is because passengers are deemed to be better able to revise their transport plans the earlier they are aware of service alterations due to possessions. There are three levels of notice (known as notification thresholds) and the amount of discount differs for each threshold. Table 3.1 summarises the notification factors applied at each notification threshold for the majority of rail services as set at PR08. Notification discount thresholds are the same for all franchised train operators, whereas the level of discount varies slightly depending on the characteristics of particular services.

Table 3.1: Notification factors and thresholds

	By New Working Timetable ³¹	By Informed Traveller Timetable	By Actual Timetable
Service groups with delay multiplier of 2.5	55% of MRE ³² Payable	70% of MRE Payable	85% of MRE payable
Service groups with delay multiplier 5.1/6.5	45% of MRE Payable	65% of MRE Payable	85% of MRE payable

Notification factors

3.34 As part of PR08, notification factors were adjusted to better reflect passengers' awareness of possessions at the time they are notified, and thereby the actual level of revenue losses experience by franchised passenger operators. The recommendation was based on evidence about passenger awareness provided by consultants Steer Davies Gleave (SDG) in its report³³ on possessions carried out for the Industry Steering group, established in PR08 to oversee the review of Schedule 4. This evidence suggested that not all passengers (and potential passengers) are aware of the possession even if notified in time for inclusion in the New Working Timetable³⁴. Notification to operators by the New Working Timetable broadly reflects the earliest point in time that service alterations due to possessions are made

³⁰ Defined as % of marginal revenue effect (MRE) payable.

³¹ Formerly known as the First Working Timetable.

³² MRE refers to the Marginal Revenue Effect. This is the amount of long term revenue estimated to be lost by a passenger operator per minute of lateness per passenger. The revenue lost is because a proportion of passengers switch away from travelling by rail because of delays. The Network Rail payment rate therefore reflects the MRE

³³ Train Operator Compensation for Possessions: Compensation for loss of Passenger Revenue. Final Report August 2007.

³⁴ The New Working Timetable is the earliest notification to operators of a validated version of the next timetable to come into operation. It broadly reflects the earliest operators are able to inform passengers of planned service disruption.

public and represents the notification threshold that gives the maximum discount Network Rail receives on its compensation rate payments.

3.35 Notification factors differ according to the 'delay multiplier' used to calculate the Network Rail Schedule 8 payment rates. The delay multiplier reflects the fact that passengers are more inconvenienced by unscheduled delay than by timetabled, advertised increases in journey time, as is the case for possessions. Delay multiplier values are based on evidence in the Passenger Demand Forecasting Handbook (PDFH) and vary by type of service. For example, the delay multiplier for most London and South East services is 2.5. The higher the delay multiplier, the more passengers are inconvenienced by unscheduled delay relative to timetabled increases in journey time, and therefore, the greater benefit to passengers of early notification of possessions.

3.36 The delay multiplier for each service group is therefore instrumental in calculating the notification factors. The delay multiplier value is currently being updated by the Passenger Demand Forecasting Council as part of its update of the PDFH. If this leads to a change in the value of the delay multipliers for particular types of service, there would be a strong argument for updating notification factors to reflect this.

3.37 Prior to PR08, the notification factors for possessions notified by the new working timetable were calculated in such a way as to cancel out the effect of the delay multiplier used in calculating the Schedule 8 payment rate.

3.38 To take account of the SDG finding that not all passengers are aware of possessions when notified at by the New Working Timetable an extra term relating to passenger levels of awareness was added to the notification formula (as below), where p represents the proportion of potential passengers aware.

$$\text{Notification factor} = \left(p \times \frac{1}{\text{delay multiplier}} \right) + (1 - p)$$

3.39 Based on the SDG research, it was assumed 75% of potential passengers³⁵ would be aware of possessions that are notified at New Working Timetable. The remaining 25% would travel as usual but regard the addition journey as unscheduled. This had the effect of increasing the notification factor and thereby the amount of compensation payable.

3.40 In response to our May 2011 and December 2011 consultations, a number of franchised passenger train operators said that the current system incentivises Network Rail to book too many possessions early in order to receive the maximum discount. Train operators argued that as a consequence too many possessions are poorly planned and / or subject to late notice changes or cancellations. These late changes, they argue, impact on franchise operators in terms of reputational damage and because they incur direct costs that cannot be recovered under Schedule 4.

3.41 As a result, franchised operators suggested we should focus on improving incentives on Network Rail to plan possessions efficiently and increase the level of protection available to operators where late changes/ cancellations to possessions occur.

³⁵ Those that would have travelled were there not a possession.

3.42 Following discussions within the Schedule 4 and 8 industry group, we asked ATOC³⁶ to provide us with a proposal on how the notification discount thresholds and factors could be improved to provide more appropriate levels of compensation to train operators and align Network Rail's financial incentives more closely with the impact of the timing of possession notification on passenger revenue. ATOC put forward a number of proposals on how this might be achieved. These are as follows.

Regulatory scrutiny of Network Rail's performance in regard to late changes / cancellations

3.43 ATOC proposed that we place more regulatory scrutiny of Network Rail's performance in regard to late changes/ cancellations. Network Rail's performance in respect of late changes to its possession plans is monitored as part of its Possession Indicator Reports³⁷. ATOC suggested one way in which better regulatory oversight might be achieved is to include Network Rail's performance in this respect in the Possessions Disruption Index- Passenger (PDI-P) to ensure the negative impacts of changes to late possessions is captured.

Increasing franchised passenger train operators compensation for late changes/ cancellations of possessions

3.44 Train operators consider that there currently is no incentive on Network Rail to consider the impact on operators of cancelling or changing possessions at short notice. This is because under Schedule 4 they only receive compensation for Type 1 possession based on amended services that are uploaded into the Train Planning System (TPS³⁸). If a possession is subsequently cancelled after these services have been uploaded, operators receive no further compensation. However, operators argue that they face significant costs if they re-instate the original services, which is in the best interests of passengers.

3.45 In order to recover these additional costs and also act as an incentive on Network Rail to reduce the instances of late cancellations, ATOC propose extending the scope of the protection provided by paragraph 2.9 of Schedule 4³⁹ to enable the recovery of direct costs related to amended or cancelled Type 1 possessions. ATOC suggest that the threshold for triggering a claim should be set at £5,000 per possession.

Notification factors and thresholds

3.46 ATOC also proposed that we seek industry views on the where the current notification discount thresholds are set and the level of discount available at each threshold. Among the issues suggested by ATOC on which industry's views might be sought are, whether:

- (a) the existing thresholds create the behaviours for which they were originally intended?
- (b) the thresholds are aligned with passengers expectations and requirements?
- (c) alternative approaches such as the use of sliding scales or a smaller number of thresholds generate better outcomes for passengers.

³⁶ Association of Train Operating Companies.

³⁷ Network Rail provides ORR with information about its possession management performance as part of our monitoring of Network Rail's Network Availability targets.

³⁸ TPS is the system Network Rail uses to create the working timetable.

³⁹ In broad terms, under paragraph 2.9, where a booked possession is changed from one type to another (or even cancelled entirely), the affected operator's compensation rights are limited to what would have been available as if the new type of possession had been booked in the first place. If the operator has already committed or incurred reasonable costs before the amendment, however, it may still recover those, but only to the extent that the same would have been recoverable for the original type of possession anyway.

Options

Increasing franchised passenger train operators compensation for late changes/ cancellations of possessions

3.47 We are considering the following options in relation to compensation for late changes/ cancellations of possessions:

(a) extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions.

(b) do not extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions.

Notification factors and thresholds

3.48 We are considering the following options in relation to review notification factors and thresholds:

(a) update the new working timetable notification factor to reflect changes to delay multiplier values in the PDFH.

(b) do not change notification factors and thresholds at all.

Emerging views

Regulatory scrutiny of Network Rail's performance in regard to late changes / cancellations

3.49 We will not be consulting in this document on options relating to our regulatory scrutiny of Network Rail's performance in regard to late changes to possessions. This is covered by our separate work stream for setting Network Rail's Outputs in PR13⁴⁰, which, amongst other things, considers how Network Availability targets should be set. While our outputs consultation has now closed, if stakeholders have any comments on this issue that they have not already included within their responses to our outputs consultation, we welcome their views.

Compensation for late changes/ cancellations of possessions

3.50 We are minded to choose option (a) and extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions as this is consistent with the way operators can already claim for emerging possession costs not covered by the formulaic cost recovery element of the Schedule 4.

3.51 We consider this option is in keeping with the general principle of the Schedule 4 regime that franchised passenger operators should be compensated for costs incurred due to possessions. By making costs transparent to operators they are better able to challenge Network Rail's management of possessions and drive costs down. Also, if operators consider there is risk that they cannot recover all costs associated with possessions they will price this into their franchise bids, reducing franchise value. We also consider, that if Network Rail faces a financial penalty for making late changes to its possession plan, it will strengthen the incentive on Network Rail to plan possessions better in the first place, reducing the need for late changes to possession plans.

⁴⁰ <http://www.rail-reg.gov.uk/pr13/consultations/outputs.php>

Notification factors and thresholds

3.52 We are minded to choose option (a), to update notification factors in response to changes in the PDFH delay multiplier values. As Schedule 4 payment rates are driven by Schedule 8, we consider it correct to ensure consistency between the basis for calculating Schedule 4 and 8 payment rates. This is because Schedule 8 provides the basis for calculating the revenue loss due to extended journeys and train cancellations and feeds into Schedule 4 payment rates, maintaining consistency between the two regimes means that payments made under Schedule 4 reflect the latest evidence about how passengers respond to disruption to their journeys.

3.53 We welcome industry views on other ways the notification factors and thresholds can be improved, as suggested by ATOC. However, we have already held discussions with the Schedule 4 and 8 working group and asked ATOC to provide a proposal for any changes that could be made to notification factors and thresholds that would better reflect the impact of notification at different points in time on train operators' revenue. Our view is that at this late stage of the period review there is no scope for a fundamental review of the thresholds or discount levels, but we would consider specific proposals.

Consultation questions

3.54 Do you agree that we should extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions? If not, please tell us why.

3.55 If so, do you agree the threshold for triggering a claim should be £5,000 per possession?

3.56 Do you agree that we should update the new working timetable notification factor to reflect changes to delay multiplier values in the Passenger Demand Forecasting Handbook (PDFH), If not please tell us why.

3.57 Do you have any further proposals for changes to notification discount thresholds and factors? If so, please explain your reasoning?

Sustained Planned Disruption threshold

Issue

3.58 The sustained planned disruption (SPD) mechanism is designed to protect train operators from instances where there is severe disruption caused by possessions over a sustained period. Additional compensation for SPD is triggered when the impact of severe disruption crosses a pre-defined level (in terms of revenue lost and increased costs) under which train operators may claim additional revenue/ cost compensation above that covered by the liquidated sums payable under Schedule 4. In responses to our May 2011 and December 2011 consultations a number of train operators asked us to review the SPD threshold, arguing that the current level was too high such that it is unlikely to be triggered.

3.59 In subsequent discussions at the Schedule 4 and 8 working group, papers submitted by both Network Rail and ATOC agreed that there was no desire for a major change to the existing system apart from clarification of the contractual wording to provide greater clarity between franchised passenger operators and Network Rail over the interpretation of the SPD provisions. ATOC in particular stated that different interpretations of contractual provisions relating to the SPD mechanism can make claiming compensation more contentious and difficult to price than it ought to be.

Options

3.60 We are considering the following options regarding the SPD threshold:

- (a) keep the SPD revenue and cost thresholds as present;
- (b) keep the SPD revenue loss threshold the same and uprate the cost compensation by inflation (RPI);
- (c) review thresholds to ensure the SPD mechanism covers the 1% most disruptive possessions.

Emerging views

3.61 We are minded to choose option (b) as we have not received any evidence supporting the view that the current thresholds are inappropriate. We would not expect that the SPD thresholds to have been triggered during CP4 because the possession disruption has been much less than expected, as evidenced by the PDI-P index being below expected levels.

3.62 Overall, we consider that the SPD mechanism has performed as intended and only requires uplift of the thresholds to take account of cost increases due to inflation, so that the thresholds increase in real terms.

3.63 We welcome proposals for improvements to the contractual wording to make it clearer and will consider these as part of our update to Schedule 4.

Consultation questions

3.64 Do you agree that we should keep the SPD revenue loss threshold the same and uprate the cost compensation by inflation (RPI), if not, please tell us why?

3.65 Are you of the view that the provisions for claiming compensation under the SPD mechanism would benefit from clarification? If yes, please highlight which areas should be clarified?

4. Schedule 4 freight possessions regime

4.1 Under Schedule 4, freight operators can claim compensation for planned disruption. Freight operators do not pay an access charge supplement in order to receive this compensation. The result is a net payment from Network Rail to freight operators. The cost of this is reflected in Network Rail's revenue requirement.

4.2 In PR08, compensation payment rates were set with the aim of ensuring total compensation reflected the level of funding that was provided. We said we would revisit the payment rates if in 2009-10 the cost of the freight Schedule 4 was outside a particular range. In December 2010 payment rates were adjusted downwards as a result of this.

4.3 We consult on how freight Schedule 4 payment rates should be determined for CP5.

Compensation for planned disruption

Structure of the Schedule 4 freight possessions regime

4.4 Freight operating companies receive compensation for late notice possessions (possessions notified after T-12⁴¹) under the 'late notice service variations and cancellations' provision of Schedule 4. The level of compensation freight operators receive for late notice possessions is based on criteria set out in Schedule 4 intended to cover circumstances such as the use of a longer diversionary route or delayed departure time which are likely to cause the freight operator significant additional costs. Freight operators also receive compensation for cancellations notified after T-12.

4.5 Freight operators also receive compensation for extreme planned disruption for possessions notified before T-12. This provides additional tiers of compensation reflecting higher levels of disruption faced by operators and is based on criteria established at PR08.

4.6 Each tier of compensation reflects the impact disruption has on freight services. Flat rate liquidated damages compensation is paid for the first two tiers, with the possibility of additional actual costs/ losses available for the most disruptive possessions. The compensation is designed to enable freight operators to recover costs and revenue losses incurred associated with possessions, net of any benefits.

The criteria for possession types and compensation rates (2006/07 prices) for each tier as set out in our PR08 final determination is set out below in Table 4.1

⁴¹ T-12 refers to Network Rail informing freight operators about the final timetable 12 weeks before it is due to come into operation.

Table 4.1 Freight Schedule 4 Compensation Regime

Possession notified before T-12	Possession notified after T-12
<p>Category 1 compensation - £360 per service</p> <ul style="list-style-type: none"> • Additional end to end journey distance greater than 10 miles; or • Planned departure time from Origin differs by more than 60 minutes; or • Planned arrival time at Destination differs by more than 60 minutes; or • More demanding length or weight restrictions imposed. 	<p>Service variation - £493 per service</p> <ul style="list-style-type: none"> • Additional end to end journey distance is greater than five miles; • the addition of at least one Planned reversing movement; • more demanding length, weight or gauge restrictions imposed; • the use of at least one additional locomotive; • the use of diesel instead of an eclectic locomotive is required; • Planned departure time from Origin differs by more than 30 minutes; • Planned arrival time at Destination differs by more than 30 minutes; • The service is treated as a Spot Bid
<p>Category 2 compensation - £959 per service</p> <ul style="list-style-type: none"> • The affected service is cancelled, or; • more demanding gauge restrictions , or; • The use of at least one additional locomotive is required, or; • The use of a diesel locomotive as a substitute for an electric locomotive. 	<p>Late Notice Cancellation - £1,295 per service</p> <ul style="list-style-type: none"> • The service is cancelled
<p>Category 3 compensation - possibility of actual costs/ losses in addition to liquidated damages</p> <ul style="list-style-type: none"> • Access from Origin or to Destination is blocked (inc. where a suitable gauge cleared route is not available for longer than 60 hours); or • Any of the freight conveyed on the service has to be transported by other means; or • The use of at least one additional locomotive is required; or • The use of a diesel locomotive as a substitute for an electric locomotive is required. 	<p>Category 3 compensation - possibility of actual costs/ losses in addition to liquidated damages</p> <ul style="list-style-type: none"> • Access from Origin or to Destination is blocked (inc. where a suitable gauge cleared route is not available for longer than 60 hours); or • Any of the freight conveyed on the service has to be transport by other means; or • The use of at least one additional locomotive is required; or • The use of a diesel locomotive as a substitute for an electric locomotive is required.

Modification provision

4.7 The Schedule 4 freight possession regime was significantly reviewed as part of PR08, as part of this review the provisions for claiming Schedule 4 compensation under Part G of the Network Code were replaced by the tiered system of compensation described above. In our PR08 final determination the amount of compensation available to operators was set to broadly reflect the amount previously payable under Part G, at £9m per year. Our conclusions on the freight Schedule 4 possessions regime included a

provision that allowed the compensation sums and related provisions to be revisited after a year of operation if the regime was not providing broadly the level of compensation envisaged. The criteria established that the compensation sums and criteria will need to be revised where the total of:

- (a) any compensation that Network Rail is liable to pay to freight operators under Schedule 4 in respect of the financial year 2009-10 relating to possessions notified in all material aspects prior to the relevant possession notice date;
- (b) any additional compensation that Network Rail is liable to pay to freight operators under Schedule 4 for the financial year 2009-10 as a consequence of the increase in the late notice cancellation sum from £942 to £1,308 (2006-07 prices); and
- (c) any additional compensation that Network Rail is liable to pay to freight operators under Schedule 4 for the financial year 2009-10 as a consequence of extending the coverage of category 3 (actual cost) compensation to late notice cancellations and service variations which satisfy the appropriate criteria;

is 50% greater or less than £9m (in 2007-08 prices, £8.63m in 2006-07 prices) (being the level of total compensation assumed at the date of these conclusions) after taking into account the difference in the level of disruption to freight operators by possessions on the Network and the change in the level of freight train mileage.

4.8 In December 2010 Network Rail gave notice to us that the modification provision had been triggered because the level of compensation paid in defined disruption categories in 2009/10 had exceeded a level of 50% above that envisaged by our PR08 determination. We agreed that the conditions for the modification provision had been met and following consultation with stakeholders we published our decision on 02 November 2012. In our decision⁴² we revised the compensation rates for possessions notified before T-12 as set out in Table 4.2 below.

Table 4.2: Freight schedule 4 modification provision - Revised compensation rates

Compensation Rates	Revised compensation rates (2011 -12 prices)
Category 1	£285
Category 2	£760

4.9 The modification provision was included as part of PR08 final determination because of uncertainty about the amount of compensation likely to be paid under the new freight Schedule 4 regime. We now have sufficient information about payment levels over CP4 on which to make an assessment of the level of funding required over CP5. We therefore do not intend to include a modification provision as part of CP5.

Issue

4.10 In response to our May 2011 and November 2011 consultations freight operators stated that they broadly support the structure of the freight Schedule 4 regime however they expressed the strong view that the revised compensation levels are too low to reflect the costs of disruption faced by operators or to act as an incentive on Network Rail to reduce as far as possible the levels of disruption to freight services.

⁴² <http://www.rail-reg.gov.uk/server/show/nav.214>

4.11 Currently, the level of freight compensation is set at a level broadly reflecting the amount paid out under Part G of the Network Code prior to PR08. (The Schedule 4 provisions under Part G were removed when schedule 4 was overhauled as part of PR08.) Freight operators consider that this level of funding no longer reflects the costs incurred due to possessions and that ORR should adopt a different basis for setting compensation rates.

4.12 Freight operators have suggested that updated rates should reflect the change in value of train loads to freight operators (most likely in terms of tonnes per train) as this reflects the change in revenue at stake. Freight operators have stated that this has increased significantly since PR08.

4.13 It is important to note that compensation paid to freight operators is not intended to provide full compensation; rather, it is to provide a measure of compensation, approximately equal to the amount paid out under Part G of the Network Code. This is because, unlike the passenger regime, freight operators do not pay an access charge supplement to cover the expected levels of Schedule 4 compensation, so currently freight operating companies receive compensation of around £9m per annum funded by government subsidy. It remains open for freight operators to receive increased Schedule 4 payment rates in return for paying an access charge supplement.

4.14 A reason for keeping this subsidy is that there are wider social benefits of rail freight, for example, due to the fact that it reduces the amount of freight being transported on the roads, and the associated social and environmental costs. However, there are also other mechanisms for subsidising rail freight and equivalent compensation is not available for road hauliers when there are delays on the road, for example, due to road works or traffic congestion.

Options

4.15 We are considering the following options:

- (a) Removing Schedule 4 freight regime as an unfunded regime, by requiring freight operators to pay an ACS in order to be eligible to receive Schedule 4 compensation;
- (b) Uprate the level of available funding by inflation and adjust rates accordingly, reflecting forecast possession volume activity;
- (c) Uprate compensation rates by inflation and adjust available funding accordingly;
- (d) Uprate compensation rates to reflect average number of tonnes per train and adjust available funding accordingly.

Emerging views

4.16 We are not minded to choose option (a) and require freight operators to pay an ACS in order to be eligible to receive Schedule 4 compensation. If freight operators were to opt not to pay an ACS in order to receive Schedule 4 compensation, the cost to Network Rail of planned disruption to freight operators would be zero, which would have undesirable incentive effects.

4.17 Option (b) to continue the current level of compensation, uprating only for inflation, would allow certainty about the cost of funding the freight Schedule 4 regime and for the size of the subsidy to remain consistent with the level in CP4.

4.18 If we were to choose option (c) or (d), the total level of funding required would depend on the level of possession activity Network Rail plans to carry out in CP5. We will not have a clear indication of this until we have assessed Network Rail's possession plans in its Strategic Business Plan, which will be published

in January 2013. Option (d) would require more funding than option (c), since there has been an increase in average freight volumes per train since PR08.

4.19 We are minded not to choose options that result in an increase in the level of funding of the freight Schedule 4 regime as this would result in additional cost to the taxpayer. Given that it is open to freight operators to receive additional compensation through payment of an access charge supplement, we would need compelling reasons for why increases in compensation for the freight regime should be funded through additional government subsidy.

Consultation questions

4.20 Do you consider the current regime appropriately compensates freight operators for losses resulting from severe disruption caused by possessions? If not, what do you consider the level of compensation should be based on?

4.21 Do you consider that the current regime appropriately incentivises Network Rail to reduce the amount of disruption faced by freight operators due to possessions? If not, how do you think incentive effects can be strengthened?

4.22 If Schedule 4 compensation payment rates for freight operators were increased, should this be funded by government? If so, please explain why you think this should be the case.

5. Schedule 8 passenger performance regime

5.1 The Schedule 8 passenger regime applies to franchised and open access passenger operators. It is a benchmarked regime, with Network Rail and train operators paying compensation when they perform worse than the benchmark and receiving bonuses when they perform better than the benchmark.

5.2 We have recently commissioned Halcrow to update Schedule 8 payment rates and benchmarks in the passenger regime. The work is co-funded by Network Rail. As part of this project, the contractors will be engaging with the industry. This includes seeking advice on where adjustments are needed to the default methodology and to validate the results. We will then approve the benchmarks and payment rates for each track access contract.

5.3 In addition to this we are jointly funding some work with ATOC to update estimates in the Passenger Demand Forecasting Handbook (PDFH) of how passengers respond to delays. The updated payment rates will also be used to update Schedule 4 payment rates and to help calculate the capacity charge.

5.4 Our recalibration of benchmarks will be based on performance during a two year recalibration period which runs from 1st April 2010 to 31st March 2012. For the payment rates, the recalibration period is 1st April 2011 to 31st March 2012. We have chosen these time periods on the basis that:

- (a) it is desirable to use the most recent data possible as this better reflects the current network characteristics and service patterns;
- (b) it is desirable to use time periods that relate to Network Rail financial years so improvement trajectories can be applied to Network Rail's benchmarks in a way that is simple and transparent;
- (c) year-on-year fluctuations in performance due to external factors such as a severe winter can have a significant impact on benchmarks. A two year period helps minimise the impact of these fluctuations while still ensuring the data used is relatively recent;
- (d) due to the high volume of data required for the update of benchmarks and payment rates, it would be costly to use data from a longer time period than necessary.

5.5 The update of Schedule 8 benchmarks and payment rates will require engagement with industry to ensure that the updated benchmarks and payment rates are robust. The Schedules 4 and 8 passenger regimes industry group, alongside workshops and direct engagement between Halcrow and Network Rail and individual train operators will facilitate this.

5.6 Below we consult on several detailed policy issues and proposals in relation to the Schedule 8 passenger regime.

Compensation during Sustained Poor Performance (SPP)

5.7 Under Schedule 8, additional compensation can be claimed when performance is worse than the Sustained Poor Performance (SPP) threshold. In our PR08 Determination we stated our intention that the threshold should represent the level of poor performance where compensation under the standard Schedule 8 arrangements is materially less than what is needed to reflect the actual impact of poor performance on the train operator.

5.8 The SPP threshold was established in our 2005 passenger performance regime review. Where performance is worse than the SPP threshold, train operators can claim additional compensation for relevant losses incurred, above that which they already receive under the liquidated sums element of Schedule 8. This replaced a broadly equivalent provision in Part L of the Network Code that is no longer available to franchised passenger operators.

5.9 In our PR08 determination, we set the SPP threshold so additional compensation could be claimed when performance is at least 10% worse than benchmark over a period of 12 consecutive months. This was to reflect the fact that the SPP threshold set for CP3 had not been reached at the time we produced our PR08 determination.

5.10 Table 5.1 shows what levels the SPP threshold has been set at since it was introduced:

Table 5.1: Threshold levels for SPP in CP3

Year	SPP threshold
2006-07	25% worse than benchmark performance over at least 12 months
2007-08	22.5% worse than benchmark performance over at least 12 months
2008-09	20% worse than benchmark performance over at least 12 months
2009-14	10% worse than benchmark performance over at least 12 months

5.11 In response to our May 2011 and December 2011 consultations, the following concerns have been raised regarding the arrangements for claiming additional compensation during periods of SPP:

- (a) Network Rail and train operators have suggested the wording in relation to when additional compensation for SPP can be claimed should be made clearer; and
- (b) Network Rail has argued that the threshold is too easy to trigger, which undermines the effectiveness of Schedule 8 as a liquidated sums regime in minimising administration and legal costs associated with compensation payments.

Circumstances when additional compensation for SPP can be claimed

Issue

5.12 Schedule 8 currently allows train operators to claim additional compensation for Relevant Losses as a direct result of minutes delay and cancelled stops due to Network Rail exceeding the SPP threshold. These claims must be accompanied with evidence, and formulaic Schedule 8 payments are netted off this amount.

5.13 'Relevant Losses' is defined in the template track access agreement for passenger operators as being 'all costs, losses (including loss of profit and loss of revenue), expenses, payments, damages, liabilities, interest and the amounts by which rights or entitlements to amounts have been reduced, in each case incurred or occasioned as a result of or by such [breaches specified in the definition]'.

5.14 Network Rail has advised us that so far in CP4, it has received three SPP claims, all relating to a time period covering CP3 and CP4. Only one of these resulted in a payment.

5.15 Views expressed in discussions with the Schedule 4 and 8 industry group have been that there is not enough clarity in the contractual wording as to what can be claimed, in particular in relation to whether claims can be made for losses incurred due to management decisions arising from SPP, for example, the delayed introduction of ticket restrictions. There is not, however, a universal view on what losses incurred should be covered by SPP.

5.16 Our emerging view is that SPP compensation should continue to only be claimable for losses which are a direct result of SPP, given the difficulties in determining whether indirect losses are genuinely a result of SPP by Network Rail and not something else. This is also something for which bespoke arrangements could be made in instances where Network Rail and train operators both agree that some alternative wording would be preferable.

Options

5.17 With this in mind, we are considering the following options:

- (a) change the wording of Schedule 8 so it provides a clear list of the types of losses that train operators can claim for under the SPP arrangements;
- (b) change the wording of Schedule 8 so it provides a clear list of the types of losses that train operators cannot claim for under the SPP arrangements; or
- (c) keep the current wording of Schedule 8 about the scope of what can be included in claims made under the SPP arrangements.

Our emerging view

5.18 We are minded to choose option (c) and keep the current wording. If we opt for option (a), it would be almost impossible to identify all the types of claim that would arise. It would be possible for something else to arise from a specific set of circumstances that we were unable to see at the time of updating the track access contracts. If this occurred, train operators would not be able to claim additional compensation.

5.19 We are of the view the current wording provides an appropriate level of clarity. It is clear that claims should only be for relevant losses directly incurred as a result of Network Rail's performance, but allows sufficient flexibility on what constitutes relevant losses directly incurred, to enable an appropriate interpretation to be reached in specific circumstances, with appropriate evidence.

5.20 In addition to this, despite Network Rail's performance being at a level which has meant that a high proportion of train operators have been eligible to make claims under SPP arrangements (see section below for more detail), very few have in fact been made, which gives us confidence that the current wording is not resulting in an excessive number of spurious claims.

5.21 If we opt for option (b) and place explicit exclusions on what can be claimed, this could be interpreted as 'everything else is included', which could result in more spurious claims than at present. If the wording

were instead only to give examples of what is not allowed, then it would still leave the uncertainty which stakeholders have claimed to face.

5.22 With options (a) or (b), there would be significant risk of unintended consequences by being so prescriptive, which is why commercial contracts tend not to adopt such an approach.

Consultation question

5.23 Do you agree that we should keep the current Schedule 8 contractual wording in relation to what train operators can claim for under the SPP arrangements? If you do not agree, do you have any proposals for alternative wording?

The level the SPP threshold should be set at

Issue

5.24 Network Rail has argued that the current SPP threshold is set at a level which is too easily triggered. It argues that this contributes to a trend towards an increasing number of bespoke claims, undermining the effectiveness of the liquidated-sums based regime.

5.25 As discussed above, Network Rail has confirmed that there have been discussions about four possible compensation claims for SPP during CP4, one of which related solely to performance during CP3. Network Rail has also provided us with analysis showing the proportion of train operators that are eligible to claim additional compensation for SPP at the end of each 4 week period. With the current threshold of 10%, 60% of franchised train operators were eligible to claim additional compensation under the SPP arrangements at the end of 2011-12. Therefore, only a small proportion of train operators eligible to make a claim have come forward so far⁴³.

5.26 Table 5.2 shows the proportion of train operators that would have been eligible to claim additional compensation at the end of period 13 at different SPP thresholds.

Table 5.2 – proportion of train operators that would have been eligible to claim additional compensation at the end of period 13 at different SP thresholds

Year	10% (current threshold)	15%	20% (end of CP3 threshold)	25% (beginning of CP3 threshold)
2009-10	25%	25%	20%	10%
2010-11	70%	55%	50%	30%
2011-12	60%	45%	40%	35%

⁴³ We are not sure of the exact reasons there have not been many claims, but possible reasons include: compensation available through the liquidated sums regime is adequate; the extent to which costs and revenue losses have been above that covered in the liquidated sums regime is not high enough to justify the legal and administrative costs of making a claim; train operators operating under ‘cap and collar’ provisions in existing franchise agreements would have to give a proportion of the additional compensation to the franchise authority, further weakening the financial case for a train operator to make a claim; it is difficult to determine which costs incurred arise from SPP; or it is difficult to identify long term revenue impacts arising specifically from a period of SPP.

5.27 The results in this table should be taken in the context of Network Rail missing its performance targets for England and Wales and Scotland in 2010-11 and 2011-12, and Scotland in 2009-10, (but exceeding its performance targets in England and Wales in 2009-10 and Great Britain as a whole in 2009-10).

5.28 Table 5.3 shows Network Rail's punctuality performance against target in 2009-10, 2010-11 and 2011-12

Table 5.3 – Network Rail's punctuality performance compared to target, using the Public Performance Measure (PPM)

Year	England and Wales PPM target (all passenger operators)	Scotland PPM target (First Scotrail)	England and Wales actual PPM (all passenger operators)	Scotland actual PPM (all passenger operators)	Great Britain actual PPM (all passenger operators)
2009-10	91.0%	90.9%	91.6%	90.6%	91.5%
2010-11	91.5%	91.3%	90.9%	90.1%	90.8%
2011-12	92.0%	91.7%	91.7%	90.7%	91.6%

Source: PR08 Determination and ORR data portal. PPM performance marked in red where below target

5.29 Network Rail has argued that by the end of CP4, Network Rail performance that is 10 per cent worse than benchmark will typically equate to a drop in PPM of around 0.5 percentage points for a train operator. Network Rail argues that while this would obviously be a cause for concern in terms of Network Rail delivering its commitments to customers, it is questionable whether the 'poor' performance is really having a different impact on revenue, beyond that already covered by the liquidated sums regime.

Options

5.30 A couple of options are as follows:

- (a) continue with SPP threshold set at 10%; or
- (b) increase the SPP threshold.

Our emerging view

5.31 Our emerging view is, while it is difficult to determine exactly where the SPP threshold should be set, it is currently too easily triggered. The SPP threshold is intended to represent the level of poor performance where compensation under the standard Schedule 8 arrangements is materially less than what is needed to reflect the actual impact on the train operator.

5.32 We consider that train operators should be protected from the financial impacts of sustained poor performance by Network Rail. This includes the impact on both revenue and costs, where it materially exceeds the formulaic revenue compensation under the liquidated sums regime. However, we are also of the view that a key strength of Schedule 8 is its liquidated sums nature which is simpler and less costly to administer than a bespoke claims process. Although during CP4, there have not been many claims for SPP compensation so far, the potential for claims represents a risk for Network Rail.

5.33 We are of the view that Network Rail should not face a large risk in this respect in instances where it is performing at benchmark in aggregate. In 2009-10, when Network Rail exceeded its PPM targets across Great Britain as a whole, 25% of train operators were eligible to claim additional compensation for SPP. In our judgement this seems too high, although ideally we would have a higher number of years in which to base this judgement. Network Rail has produced some modelling which suggests there would also be a high number of train operators eligible to claim additional compensation for SPP in 2010-11 and 2011-12, if it were meeting its performance targets in aggregate.

5.34 Even though Network Rail did not meet its performance targets in 2010-11 and 2011-12, the proportion of train operators eligible to claim additional compensation for SPP at the end of each of these years, 70% and 60% respectively, also seems too high in relation to the extent Network Rail was underperforming.

5.35 We are therefore minded to choose option (b) but would welcome any practical proposals from stakeholders on how we could determine what level the SPP threshold should be set at, if we do decide to increase it.

Consultation questions

5.36 **Should we continue with the SPP threshold set at 10% or increase it?**

5.37 **If we increase the SPP threshold, what are your views on the level we should set it at?**

Whether to introduce a time delay on Schedule 8 payments

Issue

5.38 Schedule 8 payments between Network Rail and train operators are currently made following the end of the four-week periods to which they correspond. The only delay in payments is due to the operation of standard payment terms under which Network Rail and train operators have 35 days to make a Schedule 8 payments reflecting minutes lateness over the preceding four-week period.

5.39 In our May 2012 document we questioned whether it is appropriate or practical to introduce a time delay on Schedule 8 payments which would reflect the fact that the impact of performance on revenue is not immediate, and if so, what the delay should be. The impact on rail demand and associated revenues from changes in punctuality may take time to occur because of some inter-related factors:

- (a) people may not be aware of the change in rail punctuality;
- (b) people develop habits and it takes them time to change these; and
- (c) people may have constraints (for example not being able to move house or change jobs immediately).

Options

5.40 We have considered two options relating to whether to introduce a time delay on Schedule 8 payments:

- (a) do not change the timing of Schedule 8 payments (payments remain due within 35 days following the end of four-week rail accounting periods); or

(b) introduce a time delay of one calendar quarter on 50% of Schedule 8 payments. This approach is based on limited but best available economic and statistical evidence.

Our emerging view

5.41 We are minded to choose option (a) and not change the timing of Schedule 8 payments between Network Rail and train operators.

5.42 Although there is evidence to support a time delay, the introduction of delay we consider would introduce complexity and an administrative burden without materially improving industry incentives or the operation of Schedule 8.

5.43 We have collected evidence on the likely occurrence and scale of time delays from the Passenger Demand Forecasting Handbook (PDFH) and discussed with experts on this subject. Studies consistently demonstrate the existence of time delays on demand effects following punctuality changes; however, there is very limited academic evidence from statistical modelling to show the profile of time delays.

5.44 Table 5.4 shows values recommended by the PDFH for proportions of demand effects felt by the end of time periods following punctuality changes. Demand effects following punctuality improvements take slightly longer to occur, reflecting time for new users to gain information.

Table 5.4 – PDFH recommended values for time delays on demand effects following punctuality changes (percentages of total demand effect felt)

	End Q1	End Q2	End Q3	End Year 1	End Year 2	End Year 3
Deteriorations in reliability or punctuality	60%	75%	80%	85%	100%	100%
Improvements in reliability or punctuality	55%	70%	75%	80%	95%	100%

5.45 A time delay would bring payments into closer alignment with when revenue impacts resulting from punctuality changes are felt. The end result should be sharper financial incentives for TOCs and Network Rail to act more efficiently in their combined interest.

5.46 A time delay could be helpful in ensuring that passenger operators do not benefit unduly from Schedule 8 payments toward the end of franchise periods when they do not suffer a subsequent loss in revenues (which could be felt by incoming franchisees). In the absence of a time delay new franchise holders are not fully protected from the impact of poor performance just before the change of a franchise, although changes in passengers’ perceptions after franchise handovers may lead to far larger revenue effects. Other mechanisms in franchise agreements already deal with performance and the short term view that operators may take towards the end of franchise periods.

5.47 Costs of introducing a time delay include the extra administrative burden of implementing the delay to Schedule 8 payments and additional complexity in terms of understanding what payments relate to. There

is also a risk that delays on payments may not be appropriate to reflect more immediate rail demand responses following extreme poor performance (for example weather events).

5.48 The evidence and arguments for and against introducing a time delay on Schedule 8 payments were discussed with train operators at the Schedules 4 and 8 passenger regimes industry group. On balance operators were of the view that a time delay would not materially improve industry incentives, but would increase complexity and administrative burden in the system. Even if delayed for a particular period, it was thought that Schedule 8 payments may still be accrued in accounts at the time of poor performance – negating any behavioural changes that may result from the timing of payments being aligned more closely with the impact of punctuality changes on fare revenue.

Consultation questions

5.49 **Do you agree that we should leave timings of Schedule 8 payments unchanged, with payments due within 35 days following the end of each four-week accounting period? If not, please tell us why?**

Whether paragraph 17 of Schedule 8 should be amended to reduce the number of circumstances in relation to which train operators may request changes in payment rates

Issue

5.50 Appendix 1 of Schedule 8 contains payment rates, benchmarks and other metrics relating to each service group⁴⁴. These are in general determined during periodic review. Paragraph 17 enables Network Rail or a train operator to propose changes to Appendix 1 mid-control period. If parties fail to reach an agreement, ORR may determine the matter itself or refer the dispute for resolution in accordance with the Access Dispute Resolution Rules (ADRR).

5.51 A typical reason for modifications being made mid-control period is as a consequence of a major timetable change. Another circumstance where Network Rail or train operators may propose changes is when new evidence becomes available. Schedule 8 states that ORR requires that proposed amendments are accompanied by information and evidence in reasonable detail, supporting the change proposed and setting out the reasons for it.

5.52 Network Rail has expressed the view that use of paragraph 17 should be restricted to when there are major changes to the timetable. Network Rail has put forward the following reasons for this:

- (a) given the extensive investment in the recalibration during periodic review, making changes mid-control period can represent an inappropriate use of industry resource; and
- (b) changes are sometimes sought for commercial gain rather than for reasons of genuine data accuracy.

Options

5.53 We have considered two options relating to paragraph 17 of Schedule 8:

⁴⁴ Group of train services, operating in a similar geographic area and of a similar type

(a) do not change the circumstances in which Network Rail and train operators can propose amendments via paragraph 17; or

(b) restrict the circumstances in which Network Rail and train operators can propose changes via paragraph 17 to when there is a timetable change (this may include significant changes to service patterns, or full scale remapping).

Our emerging view

5.54 We are minded to choose option (a) and not change the circumstances in which Network Rail and train operators can propose amendments via paragraph 17.

5.55 We have only received one notification of a disputed proposal via paragraph 17 for changes to Appendix 1 of Schedule 8 during CP4. Network Rail has provided us with information on four other cases where train operators have proposed to Network Rail changes to Appendix 1 of Schedule 8 via paragraph 17, due to reasons other than timetable changes. We have considered the number and nature of proposals and are not of the view that paragraph 17 is being widely misused.

5.56 There also could be legitimate reasons for Network Rail or train operators to propose changes to Appendix 1 mid-control period, other than a timetable change. This includes due to events that are not foreseeable during PR13 or in the event that any errors in the metrics of Appendix 1 are uncovered after the end of PR13. Even if both parties agree there are errors, they would not necessarily agree on the revisions. Restricting the use of paragraph 17 to timetable changes would mean that in other circumstances, there would not be a change mechanism that does not require the approval of Network Rail.

5.57 We do, however, intend to review the text of paragraph 17 and make clarifications where it is unclear, for example in relation to what happens when both parties fail to reach an agreement, and how paragraph 17 links to section 22 of the Railways Act.

Consultation questions

5.58 **Do you agree that we should keep the circumstances in which Network Rail and train operators can propose amendments to Schedule 8, appendix 1 via paragraph 17 the same? If not, please tell us why?**

5.59 **Are there any specific areas of paragraph 17 where you are of the view the drafting needs to be made clearer?**

Compensation for passenger charter payments

Issue

5.60 Some franchise agreements contain passenger charters that require train operators to give season ticket discounts or extensions when performance falls below a certain level over a period of time. These train operators are able to opt to pay an access charge supplement in return for receiving compensation from Network Rail for a proportion of season ticket discounts and extensions arising from poor performance due to Network Rail or other train operators.

5.61 There are currently four train operators that have opted into this scheme. However, several service groups have a train operator passenger charter payment rate, under which train operators make or receive payments in relation to their own performance. This is to reflect the knock-on impact that lateness of services within these service groups has on passenger charter operators that have opted into the scheme.

5.62 Net payments within the passenger charter element of Schedule 8 are now very small and for the first three years of CP4, Network Rail received significantly more in access charge supplements for passenger charter compensation than it paid out under Schedule 8. This is despite the fact that Network Rail in aggregate has been performing below benchmark for the majority of CP4. This reflects the fact that passenger charters within franchise agreements tend to be designed to compensate passengers when performance is at much lower levels than is currently being delivered.

5.63 Removing the elements of Schedule 8 relating to passenger charter payments would simplify the regime and also reduce the costs of updating Schedule 8 payment rates.

Options

5.64 We have considered the following options:

- (a) continue with the passenger charter element of Schedule 8 and update as part of the recalibration of Schedule 8. This would involve updating the access charge supplement for train operators that opt in to this element of Schedule 8 and also the train operator passenger charter payment rate for all applicable service groups;
- (b) continue with passenger charter element of Schedule 8 but do not update payment rates; or
- (c) remove passenger charter element of Schedule 8.

Our emerging view

5.65 We are minded to choose option (c) and remove the passenger charter element of Schedule 8.

5.66 With option (b) the passenger charter element of the Schedule 8 regime would remain imbalanced, with the likelihood of payments from train operators to Network Rail remaining very high relative to payments from Network Rail to train operators. The size of the sums of money involved does not justify choosing option (a) and updating this element of Schedule 8. Choosing option (c) will also help simplify the Schedule 8 regime as a whole.

5.67 Despite the imbalance in payments, it's possible that some of the train operators that opt into the passenger charter element of Schedule 8 view it as catastrophe insurance to protect them if there are significant declines in Network Rail's performance. Those passenger operators would be free to agree bespoke arrangements with Network Rail as part of their track access contract, subject to approval by ORR, or seek insurance from the private market. However, due to the removal of the train operator passenger charter payment rate, Network Rail would not be able to recover from third party operators, the proportion of passenger charter Schedule 8 payments arising from lateness caused by those operators. Given the relatively small size of the train operator passenger charter payment rate in most service groups, our view is that this is not a significant enough issue to justify continuing with this element of Schedule 8.

5.68 The removal of the passenger charter element of Schedule 8 should not have an adverse impact on compensation received by passengers when passenger charter commitments are not met. This is because track access contracts do not and cannot govern what passengers receive in compensation for poor performance or disruption. Passenger charter arrangements are determined by franchise agreements, which would not be affected by this change. Removing the passenger charter element of Schedule 8 may indirectly benefit passengers, through the positive contribution of simplification on industry costs.

5.69 Separately, we are undertaking work to explore consumer awareness of current refund rights and compensation arrangements and the extent to which consumers exercise their rights (and to highlight the

differences between the industry facing and passenger facing arrangements). This includes work in relation to delay repay⁴⁵ compensation.

Consultation question

5.70 Are you content for us to remove the passenger charter element of the Schedule 8 performance regime? If not, please could you tell us why and whether you would like us to take any alternative course of action?

Whether to set common principles for attributing delays for operators that operate partially on and partially off the Network Rail infrastructure

5.71 In certain circumstances train services operate partially on and partially off the Network Rail infrastructure, using infrastructure that is owned and operated by other parties. The number of circumstances during CP5 is likely to increase with the introduction of Crossrail.

5.72 Network Rail has expressed the view that there should be agreed industry principles in relation to attributing delays for train services that operate partially on and partially off the Network Rail infrastructure. This is to remove unnecessary inconsistencies and ambiguities in relation to the way delay is attributed in these circumstances.

5.73 In September 2012, we held a meeting with stakeholders who currently operate train services partially on and partially off the Network Rail infrastructure, and those that are likely to in the future. It was agreed at the meeting that the most appropriate place to introduce a set of defined principles would most likely be within the Delay Attribution Guidance (DAG), rather than Schedule 8.

5.74 ORR does not have the power to propose amendments to the DAG. Network Rail is taking this forward and we do not propose to consult on this issue in this document.

Methodology for calculating improvement trajectories to Network Rail benchmarks

5.75 In PR08, in order to reflect continuing improvement targets we established for CP4, we applied an improvement trajectory to Network Rail's Schedule 8 benchmarks. The effect of this is that Network Rail's benchmark gets tougher each year. A methodology will need to be developed by Network Rail to calculate improvement trajectories for CP5. We will then need to approve this methodology and ensure the improvement trajectories Network Rail calculates are in line with the performance targets we set Network Rail for CP5.

5.76 It is currently too early to do this as we are still considering the nature of the output targets we are going to set; including the level at which they will be set and their level of disaggregation. We will work with the industry group to develop a suitable methodology for the calculation of improvement trajectories when we have seen the performance outputs Network Rail will publish in its Strategic Business Plan on 7th

⁴⁵ Under the delay repay scheme, all passengers, including holders of season tickets valid between 1 month and 1 year, are entitled to claim compensation for each delay of more than 30 minutes whatever the cause. 50 per cent compensation of the single fare is available for delays of 30 to 59 minutes and 100 per cent of the single fare for delays of more than 60 minutes. For delays of more than 2 hours, 100 per cent of the return fare is available. The entitlement for holders of season tickets is calculated using the proportional daily cost of the season ticket.

January 2013. We will consult on the proposed methodology with relevant industry stakeholders, both through the Schedules 4 and 8 industry group and written consultation.

Treatment of cancellations by train operators of their own trains

Issue

5.77 Under the Schedule 8 mechanism a cancelled train is defined as being a specified number of minutes late. This is usually 1.5 times the weighted average frequency of services within a service group and reflects the fact that when a train is cancelled passengers have to wait for the next train, and in some instances the next train will be full or uncomfortably crowded.

5.78 In its response to our May 2011 consultation, Network Rail suggested that we revisit the provisions for operator-responsible cancellations to their own trains.

5.79 In practice, if a train operator cancels one of its own trains, it does not result in other train operators having to cancel trains and is unlikely to result in delays to other operators and as such does not justify such a large payment rate. In many cases, a train operator cancelling one of its own trains will have much less of an effect on other operators than running the same train late. It would therefore be logical not to treat cancellations by train operators of their own trains in the same way as Network Rail cancellations to trains.

5.80 Network Rail has advised us that changing the way cancellations by train operators of their trains are treated under Schedule 8 would require an update to its PEARS system which translates delay attribution data into Schedule 8 payments. Network Rail has advised us that, unless combined with a wider update of PEARS, this could be costly.

5.81 Changing the way Schedule 8 treats cancellations by train operators to their own trains would also require an adjustment to the data used in the external work to recalibrate Schedule 8 benchmarks, which would also be likely to have financial implications.

Options

5.82 We have considered the following options:

- (a) continue to treat train operator cancellations to own trains in the same way as currently; or
- (b) do not treat train operator cancellations to own trains as cancellations under Schedule 8 regime.

Our emerging view

5.83 We have held discussions on this issue in the Schedules 4 and 8 passenger regimes industry group. In these discussions, train operators and Network Rail expressed the view that this is not an issue they regard as material enough to be worth us making changes to this element of Schedule 8. Train operator cancellations are relatively rare. In 2011-12 1.0% of trains were cancelled across the network⁴⁶. This figure includes cancellations due to Network Rail and train operators, so the proportion of trains cancelled by train operators is even lower than this. It should be noted, however, that the proportion of average minutes of lateness attributable to train operators due to cancellations is considerably higher than this. This is because

⁴⁶ Calculated using data on number of trains cancelled against their planned timetable as agreed with the operator at 2200hrs the night before or against an emergency timetable, and number of trains planned against the timetable as agreed with the operator at 2200hrs the night before or against an emergency timetable. This is available on our data portal <https://dataportal.orr.gov.uk/>.

of the fact that a cancellation is typically treated as minutes delay equal to 1.5 times the train frequency of the respective service group.

5.84 We are not of the view that the way Schedule 8 currently treats train operator cancellations of their own train services is something which materially impacts on incentives in a way that disadvantages passengers, as it acts as a disincentive on train operators to cancel their own trains.

5.85 We are minded therefore to choose option (a) as we are not of the view that there is any evidence that the benefits of option (b) would justify the costs of updating PEARS or the additional costs associated with making data adjustments during the recalibration of Schedule 8. However, we recommend that at the next substantive update of PEARS, Network Rail considers the merits of including within PEARS, the capability of allowing such a change to Schedule 8 should we decide to do so in the future.

5.86 However, we are keen to hear from stakeholders about any instances where the current arrangements are resulting in perverse incentives which are resulting in poorer performance for passengers.

Consultation question

5.87 Do you agree that we should not change the way train operator cancellations to their own trains are treated under Schedule 8? If not, please tell us why?

6. Schedule 8 freight performance regime

6.1 The freight Schedule 8 performance regime was comprehensively reviewed and updated in PR08, with the creation of a standardised regime between freight operators so as to remove any competitive advantage to particular operators. The regime was also simplified considerably. We are not of the view that the freight performance regime needs a comprehensive review in PR13 but, as with the passenger regime, are of the view that the metrics should be adjusted to ensure they remain appropriate.

6.2 In this chapter we ask for the views of stakeholders on various aspects of the freight performance regime. In most cases we ask stakeholders for views on the methodology that is used to calculate the metrics but we also consult on some policy issues.

Network Rail benchmark

6.3 There is a single standardised benchmark across all freight operators. It is measured as number of minutes delay per 100 train operator miles. When Network Rail performs worse than benchmark in relation to the services of a particular operator, it pays compensation to that operator. When it performs better than benchmark, it is paid a bonus.

6.4 We propose to update the Network Rail benchmark so it reflects the performance targets we set Network Rail for CP5, including any improvement trajectories. We will develop our methodology for calculating the Network Rail benchmark when we have seen the freight performance outputs that Network Rail will publish in its Strategic Business Plan on 7th January 2013.

6.5 We propose to work with the freight Schedules 4 and 8 industry group to develop a robust methodology for this.

6.6 We do not have any issues relating to the calculation of the Network Rail benchmark to consult on in this document, but would welcome any views on our proposed approach.

Network Rail payment rate

Issue

6.7 The Network Rail payment rate is the basis for compensation paid to freight operators or bonuses paid to Network Rail, when it performs below or above benchmark respectively. The payment rate should reflect the average financial impact of each minute of delay to a freight train attributable to Network Rail, and is the same for all freight operators. A review of the Network Rail payment rate is required to ensure the rate is fit for purpose as the basis for compensation and bonus payments between freight operators and Network Rail.

6.8 The compensation payment rate is currently set at £17.47 per minute of delay (and 50% of this figure in the case of bonus payments). In the freight performance regime, the Network Rail payment rate has previously been based on the costs that freight operators incur as a result of lateness.

6.9 In updating the Network Rail payment rate we need to ensure that its value reflects the impact on freight operators, whilst maintaining the benefits of simplicity in the system (including a uniform payment rate for all freight operators). The impact on freight operators over recent years may have been affected by changes in freight train kilogram tonne kilometres on the network.

Options

6.10 We have considered four options in updating the Network Rail payment rate:

- (a) keep the Network Rail payment rate the same but uplift it for inflation;
- (b) uprate the existing payment rate by the change in freight train kilogram tonne kilometres;
- (c) ask all freight operators to provide us with up-to-date information on the impact of Network Rail delays on their costs and revenues, and use this information to update the payment rate; or
- (d) use evidence from previous ORR research into delay impacts on costs and revenues of operating rail freight services to update the rate, carried out for ORR's review of access policy consultation published in January 2010.⁴⁷

Our emerging view

6.11 After carefully considering these alternatives we are minded to choose option (a) and keep the payment rate the same but uplift for inflation.

6.12 Initial analysis that we have carried out based on the previous ORR research (consulted on as part of the 2010 review of access policy) relating to delay impacts on freight operator and freight user costs suggests that the payment rate may currently over-compensate freight operators for delays to their services caused by Network Rail.

6.13 In the ORR research, estimates of delay impacts on rail freight operator costs (for example rolling stock or driver costs) were based on historic Department for Transport (DfT) cost models for the rail freight industry and information from freight operators themselves. There is some uncertainty over whether the DfT cost models still accurately represent costs faced by the industry. Estimates of delay impacts on freight user costs (for example inventory costs of goods in transit and terminal handling costs) were identified by consultants AECOM / ITS using a representative survey of rail freight users.⁴⁸

6.14 Our initial analysis uplifts freight operator and freight user costs from the previous ORR research for inflation, and converts costs for different commodity sectors and lengths of delay into point estimates based on rail freight industry commodity shares and average length of delay assumptions (also based on information collected as part of the previous ORR research). Rail freight user cost impacts are translated

⁴⁷ Research reported in Annex C of ORR review of access policy consultation (2010) available at: <http://webarchive.nationalarchives.gov.uk/20111108204718/http://www.rail-reg.gov.uk/server/show/nav.2254>

⁴⁸ The AECOM/ITS report is available at: <http://webarchive.nationalarchives.gov.uk/20111108204718/http://www.rail-reg.gov.uk/server/show/nav.2254>

into freight operator revenue impacts using assumptions regarding the proportion of higher freight user costs passed through into reduced operator revenues.⁴⁹

6.15 The initial analysis, varying assumptions on commodity shares, lengths of delay and the proportion of higher freight user costs passed through to operators in the form of reduced revenues, indicates a Network Rail payment rate in the range of £2.90 to £23.10. The size of the range is principally due to uncertainty around the proportion of higher freight user costs passed through to freight operators in the form of a reduction in revenue.

6.16 Despite the wide range provided by the initial analysis, the central estimate of £13.50 is below the current Network Rail payment rate. We are not minded to choose this value as the Network Rail payment rate in this consultation because of uncertainty surrounding the proportion of higher freight user costs passed through to freight operators in the form of reduced revenues.

6.17 Time constraints of the PR13 process make it difficult to collect information from freight operators on this issue in the very short term. However given the emerging finding (the £13.50 payment rate estimate), we propose re-examining with the freight industry and Network Rail early in CP5 the evidence base underpinning the payment rate, and adjust the rate if appropriate to ensure that it reflects the cost and revenue impacts of Network Rail caused delays. Our investigation would focus on the proportion of freight user costs passed through to freight operators in the form of revenue losses, and the principle costs faced by the industry (possibly updating the previously used cost models).

6.18 We are minded not to choose option (b) due to the fact that the existing rate already appears towards the top of the range indicated for freight operator costs and revenues, and because the kilogram tonne kilometre measure is likely to reflect only revenue impacts.

Consultation questions

6.19 Do you agree that we should keep the Network Rail payment rate the same, but uplifted for inflation? If not, please tell us why?

6.20 Do you think that the current Network Rail payment rate accurately reflects the financial impacts incurred by freight operators as a result of Network Rail caused delays to freight trains? If not, please tell us why?

6.21 Do you agree that we should re-examine the evidence base for the Network Rail payment rate with the freight industry and Network Rail in CP5, and if necessary adjust the rate to reflect cost and revenue impacts on freight operators due to Network Rail caused delays? If not, please tell us why?

Network Rail cancellation payments

Issue

6.22 Network Rail cancellation payments compensate freight operators for the financial impact of each freight train cancellation attributable to Network Rail. Unlike the Network Rail payment rate, cancellation

⁴⁹ In a perfectly competitive market we would expect 100% of freight user cost increases to be passed through to freight operators in the form of lower revenues, although revenue losses for freight operators would be partly offset by savings in running fewer services. In practice a proportion of freight user costs passed through to freight operators would be in the range 0% to 100%.

payments are not part of the benchmarked regime. In CP4, Network Rail is funded for this part of the regime.

6.23 If cancellations exceed a threshold representing the average number of cancellations (currently 0.41% of services scheduled) a higher cancellation payment applies. The higher cancellation payment is currently set at £4,416, and the lower payment at £1,656. These levels were determined as part of the PR08 based on evidence put forward by freight operators on the costs they incur as a result of cancellations.

6.24 In updating Network Rail cancellation payments we need to ensure that we balance the need for values that reflect the financial impact on freight operators (which may represent short term costs and revenue losses or long term effects if freight switches to road), with Network Rail funding needs and implications for the tax payer, and maintain the benefits of simplicity in the system.

Options

6.25 We have considered three options for updating Network Rail cancellation payments:

- (a) keep the Network Rail cancellation payments the same but uplift them for inflation;
- (b) uprate existing Network Rail cancellation payments by the change in freight train kilogram tonne kilometres;
- (c) ask all freight operators to provide us with up to date information on the impact of Network Rail cancellations on their costs and revenues, and use this information to update payments; or
- (d) use evidence from previous ORR research into cancellation impacts on the costs and revenues of operating rail freight services to update cancellation payments.

Our emerging view

6.26 After carefully considering these alternatives we are minded to choose option (a) and keep cancellation payments the same payment, uplifted for inflation.

6.27 Initial analysis based on the previous ORR research shows that the current cancellation payments are broadly in line with evidence showing the financial impacts on freight operators of Network Rail caused cancellations. However, there is some uncertainty over whether the DfT cost models and information from freight operators, on which the previous ORR research is based, are still representative of the cost and revenue impacts faced by the industry as a result of cancellations.

6.28 We are minded to keep a threshold representing the average number of cancellations, above which the higher cancellation payment would apply. We will determine this threshold later in the periodic review, when we have reached a clearer view on what Network Rail's output targets will be in relation to cancellation of freight trains.

6.29 We are minded not to choose option (b) because the initial analysis shows that current cancellation payments are broadly in line with evidence showing the financial impacts on freight operators of Network Rail caused cancellations, and because the kilogram tonne kilometre measure is likely to reflect only revenue impacts.

Consultation questions

6.30 Do you agree that we should keep the Network Rail cancellation payments the same but uplift them for inflation? If not, please tell us why?

Freight operator benchmark

Issue

6.31 As with the Network Rail benchmark, there is a single standardised freight operator benchmark across all freight operators. It is measured as the number of minutes delay per 100 train operator miles. When a freight operator performs worse than benchmark, it pays compensation to Network Rail, which Network Rail then passes to third party train operators to reflect the impact of this poor performance. The opposite occurs when a freight operator performs above benchmark, with the operator receiving a bonus from Network Rail.

6.32 We plan to update the freight operator benchmark so it reflects the performance of freight operators during the two year recalibration period relating to the rail period with dates closest to 1st April 2010 to 31st Mar 2012. It was suggested by some freight operators in the Schedules 4 and 8 freight industry group that we use a three year recalibration period.

6.33 However, we have chosen the above time period on the basis that:

- (a) it is desirable to use the most recent data possible as this better reflects the current network characteristics and service patterns;
- (b) it is desirable to use time periods that relate to Network Rail financial years so improvement trajectories can be applied to Network Rail's benchmarks in a way that is simple and transparent;
- (c) year-on-year fluctuations in performance due to external factors such as a severe winter can have a significant impact on benchmarks. A two year period helps minimise the impact of these fluctuations while still ensuring the data used is relatively recent;
- (d) due to the high volume of data required for the update of benchmarks and payment rates, it would be costly to use data from a longer time period than necessary.

6.34 The time period is consistent with the one we are using to update benchmarks in the passenger Schedule 8 performance regime, for which external work has already been commissioned. Our view is that the freight operator benchmark should be based on data from the same time period as the Network Rail benchmark under the passenger regime, since this is in part affected by the performance of freight operators.

6.35 If traffic growth (or traffic reduction) is above (or below) a particular materiality threshold, an adjustment is made to the freight operator benchmark. This is to reflect the fact that delays freight operators cause to their own trains cause, on average, a greater number of delays to other trains when there is more traffic on the network and vice versa.

6.36 The formula adjusting the freight operator benchmark when the materiality threshold is exceeded is as follows:

$$\text{Adjusted freight operator benchmark} = \text{Current train operator benchmark} \\ \times [(\text{Traffic growth} \times \text{congestion factor}) + 1]$$

6.37 The congestion factor is designed to represent the increased extent to which freight operator delays to their own trains will result in delays to third party trains, when there is increased traffic on the network.

Currently it is set at 1.5, which is a standard assumption often used in economic analysis relating to networks.

6.38 Network Rail has proposed updating the congestion factor to reflect the findings of analysis being carried out for the update of the capacity charge, which recovers the increased costs incurred by Network Rail as a result of increased traffic on the network. Given that the underlying reasons for updating the freight payment rate to reflect traffic on the network are similar to the reasons for the existence of the capacity charge, we support Network Rail's proposal. Our expectation is that this analysis will result in a congestion factor based on much more robust evidence than the existing one. However, we are also of the view that the detail of the analysis behind any proposed change in the congestion factor will need to be considered carefully and discussed at the freight Schedules 4 and 8 industry group.

Consultation question

6.39 Do you agree that we should update the congestion factor used in the calculation of adjustments to the freight operator benchmark, in order to take into account of evidence being collected as part of the update of the capacity charge? If not, please tell us why?

Freight operator payment rates

Issue

6.40 The purpose of the freight operator payment rate is to reflect the average impact of a minute of delay caused by a freight operator to another train operator, and is the same for all freight operators. As a result of discussions at the Schedules 4 and 8 freight regimes industry group, Network Rail has suggested an improvement to the methodology that was used to calculate the freight operator payment rate in PR08.

6.41 It has proposed that the freight operator payment rate is calculated by weighting Network Rail £ per delay minute payment rates for each service group⁵⁰ by third party freight operator delay affecting each service group. In PR08, the freight operator payment rate was calculated using Network Rail £ per delay minute payment rates weighted by delays caused by Network Rail and all third party train operators.

Options

6.42 Possible options are as follows:

- (a) continue with the methodology that was used in PR08;
- (b) continue with the methodology that was used in PR08 but weight the Network Rail £ per delay minute payment rates by third party freight operator delay affecting each service group

Our emerging view

6.43 We propose to choose option (b) and continue with the PR08 methodology but weight the Network Rail £/ delay minute payment rates by third party freight operator delay affecting each service group. This would result in a freight operator payment rate that better reflects the actual impact of delays caused by freight operators to other train operators. Network Rail has advised that the additional workload and complexity involved with making these improvements is relatively modest.

⁵⁰Payment rates under the Schedule 8 performance regime are based on weighted average lateness across a service group, but can be converted into £/ delay minute for the purpose of this calculation.

6.44 We intend to use performance data from 2010/11 and 2011/12 to update the freight operator payment rate. This is to be consistent with the calibration period we are using for the recalibration of the Schedule 8 passenger performance regime. We will work with the Schedules 4 and 8 freight industry group to scrutinise the detail of Network Rail's calculations.

Consultation questions

6.45 **Do you agree that the Network Rail £ per delay minute payment rates used in the calculation of the freight operator payment rate should be weighted by third party freight operator delay affecting each service group? If not, please tell us why?**

Bonus payment rates

Issue

6.46 Currently bonus payments, paid when Network Rail or a freight operator performs better than benchmark, are paid at rates which are 50% of the compensation payment rates. This applies to both the Network Rail payment rate and the freight operator payment rate.

6.47 Since payment rates are partly to reflect the impact of performance on long term revenue, operators have to make bonus payments before the improved performance has had its full impact on revenue. While the same is true in the opposite direction for compensation payments, bonus payments can have harmful cash-flow implications, in particular for small operators.

Options

6.48 We are considering the following options for what we should set the bonus payment rate at:

- (a) zero;
- (b) 50% of compensation payment rate; or
- (c) 100% of compensation payment rate.

Our emerging view

6.49 We are minded to continue with option (b) and set bonus rates at 50% of the compensation rate, as this offers some protection to freight operators, particularly small operators, when Network Rail is performing above benchmark.

6.50 Option (c) would make the Schedule 8 freight regime administratively simpler and mean freight operators and Network Rail are fully rewarded when their performance is better than benchmark. But we are concerned that if we were to set bonus payments set at 100% of the compensation rate, it would make the Schedule 4 regime too risky for small operators and new entrants.

6.51 Option (a) would remove the financial incentive the regime provides for Network Rail and freight operators to improve beyond benchmark performance.

6.52 Both options (a) and (b) would result in insufficient cost recovery for the regime to be financially neutral at benchmark levels of performance. However, this problem is much more severe with option (a). Also by continuing to apply differential payment rates above and below benchmark performance levels to both freight operators and Network Rail, the possibility of insufficient cost recovery would be further reduced.

Consultation questions

6.53 Do you agree with our proposal to continue to set the bonus payment rates at 50% of the level of the compensation payment rate? If not, please tell us why?

Incident cap menu

Issue

6.54 Freight operators may opt to pay Network Rail an access charge supplement to have an incident cap in their performance regime. This caps their performance regime liabilities for lateness and cancellations caused to other train operators resulting from a single incident. As a result, it protects freight operators from the risk of significant costs arising from a particular incident.

6.55 Schedule 4 of the model track access contract for freight operators provides a menu of caps and associated access charge supplements, from which freight operators may choose. Performance payments to third party operators still need to be made by Network Rail. Incident caps effectively act as an insurance policy for freight operators.

6.56 For CP5, Network Rail is proposing updating the menu of incident caps and associated access charge supplements as follows:

- (a) calculate the number of delay minutes caused by each incident above each of the given thresholds, during the Schedule 8 recalibration period (2010-11 and 2011-12);
- (b) for each threshold, sum the number of delay minutes to find total minutes in excess of each incident cap;
- (c) for the total minutes in excess of each cap, multiply by the CP5 payment rate to calculate the total cost of all incidents above each threshold;
- (d) calculate cost per mile of incidents above each threshold; then
- (e) uplift by a factor of 10% to reflect the risk premium and moral hazard (operators that cause more incidents are more likely to purchase a lower cap).

Options

6.57 Options we are considering are as follows:

- (a) Network Rail to produce menu of incident caps and associated access charge supplements using the methodology it proposes, above;
- (b) Network Rail to produce menu of incident caps and associated access charge supplements using the methodology it proposes, above, but for us to review further whether 10% is an appropriate uplift to reflect the risk premium; or
- (c) we remove the requirement on Network Rail to offer incident caps in return for an access charge supplement.

Our emerging view

6.58 We are minded to choose option (c) and remove the requirement on Network Rail to offer incident caps in return for an access charge supplement. The main role of Schedule 8 is to protect train operators from the risk arising from the actions of Network Rail and third party train operators. But incident caps are protecting freight operators against risk relating to their own performance.

6.59 We recognise the importance of the financial protection incident caps provide to freight operators. However, in principle, incident caps are something which could be supplied by the private insurance market, and therefore not something that Network Rail is a monopoly provider of. If we remove the requirement on Network Rail to offer incident caps in return for an access charge supplement, Network Rail may continue to offer this, but if does not do so at a competitive rate, or it chooses not to at all, freight operators could choose to purchase this form of protection from the private insurance market.

Consultation questions

6.60 Do you agree with our proposal not to require Network Rail to offer incident caps in return for an access charge supplement? If not, please tell us why?

6.61 Do you agree that incident caps are something that could be provided by the private insurance market if Network Rail were not to offer incident caps at a reasonable price? If not, please tell us why?

Annual liability caps

Issue

6.62 Freight operators and Network Rail have reciprocal annual caps on the liability they face under the Schedule 8 performance regime. These provide an important protection, particularly for freight operators, providing certainty about the maximum liabilities they could face.

6.63 In PR08, we reached the view that they should remain specific to each particular operator and we allowed certain well-established and larger freight operators to negotiate their own reciprocal annual caps with Network Rail. Where agreement could not be reached, we determined the level of cap. For other freight operators, to provide certainty about the maximum liabilities that they could face under the performance regime, we applied the established maximum annual reciprocal cap of £500,000.

6.64 Our Criteria and Procedures for the approval of track access contracts⁵¹ states that we expect that new freight operators will also commence with a reciprocal annual cap of £500,000 (subject to the relevant 'uplift' to 2009/10 prices). We state that where a different reciprocal value has been agreed with Network Rail, justification will need to be provided in the application submitted to us.

Options

6.65 We are considering the following options:

- (a) do not allow freight operators and Network Rail to agree annual liability caps;
- (b) continue to allow operator specific annual liability caps; or
- (c) introduce a standard annual liability cap which is the same for all operators.

Our emerging view

6.66 We are minded to choose option (b) and continue to allow operator specific annual liability caps. Our view is that liability caps should not be set at a level that is too low to incentivise continuous improvements in performance. This level will differ depending on the scale of operations and therefore it would be inappropriate to choose option (c) have the same liability cap for all operators.

⁵¹ <http://www.rail-reg.gov.uk/server/show/nav.2409>

6.67 We also recognise that annual liability caps offer an important protection to freight operators and Network Rail and therefore plan to continue to allow Network Rail and freight operators to agree annual liability caps.

6.68 We will consider further whether it remains appropriate for us to continue to set a default reciprocal annual cap of £500,000 (adjusted for inflation) for smaller operators and new operators. Possible alternatives would be for us to set the default reciprocal cap at a different level (given that the freight operator payment rate is likely to change for CP5), or not set one at all. If we do the former, we will make sure that it is not too easy for the cap to be reached, as beyond this point, the incentive effects of Schedule 8 would be lost. If we opt for the latter, it would be open for the freight operator and Network Rail to agree a cap.

6.69 As with incident caps, it is possible that annual liability caps are something that could be provided by the private insurance market.

Consultation questions

6.70 Do you agree that we should continue to allow operator specific annual liability caps? If not, please tell us why?

6.71 Should we continue to set reciprocal annual liability caps for smaller and new freight operators? If not, please tell us why?

6.72 Should we continue to set reciprocal annual liability caps in instances where Network Rail and freight operators cannot agree on the level the cap should be set at? Or are caps on annual liability something the private insurance market could provide if no agreement is reached?

7. Compensation related to charter operators

7.1 Charter services (generally excursion trains or privately hired corporate trips) do not carry passengers at ordinary fares and the revenue implications of disruption are complex. Hence they are currently subject to different possessions and performance arrangements compared to other passenger operators. Arrangements for charter operators do not currently include the Schedule 4 possessions regime because in practice most charters are scheduled around engineering work that has been planned further in advance.

7.2 We consult on two issues relating to Schedule 8 for charter operators: the charter operator payment rate, which is to cover the financial impact of delays charter operators cause to other train operators; and incident caps, which provide a cap on the maximum amount that has to be paid by charter operators in relation to a single incident.

Charter operator payment rate

Issue

7.3 In the Schedule 8 regime for charter operators, the charter operator payment rate is currently set equal to the Schedule 8 freight payment rate. The charter operator payment rate should reflect the average impact of a minute of delay caused by a charter operator to another train operator.

7.4 In this consultation, we propose modifications to the approach to calculate the freight payment rate that the charter operator payment rate currently mirrors. These are based on a couple of improvements we are proposing regarding the methodology used to calculate the freight operator payment rate. These have been suggested by Network Rail as a result of improved data availability.

7.5 For CP4, the freight operator payment rate is based on Network Rail £/ delay minute rates averaged across each train operator, weighted by the proportion of Network Rail and third party delay caused to each operator. For CP5, we are proposing that the freight operator payment rate is based on Network Rail £/delay minute payment rates for each service group and that we weight the Network Rail £/ delay minute payment rates by the proportion of third party freight operator delay affecting each service group.

7.6 We could apply a similar methodology to the charter operator payment rate so it is based on:

- (a) the CP5 Network Rail £/ delay minute payment rates for each service group; and
- (b) the Network Rail £/ delay minute payment rates for each service group weighted by the proportion of third party charter operator delay affecting each service group.

7.7 The latter of these two changes would mean the charter operator payment rate would most likely be different to the freight operator payment rate. This would reflect the fact that the pattern of charter operation differs from freight operators.

Options

7.8 Possible options in relation to the charter operator payment rate are as follows:

- (a) keep the payment rate for charter operators equal to the freight payment rate, uplifting for inflation; or
- (b) develop a specific charter operator payment rate, based on the methodology used to calculate the freight operator payment rate.

Our emerging view

7.9 Since there is now data available on the delay that charter operators cause to other train operators, our view is that this data could be used to calculate a charter specific payment rate. We are therefore minded to choose option (b) and calculate a separate charter operator payment rate using the same methodology as that used to calculate the freight operator payment rate. This would result in a charter operator payment rate that better reflects the actual impact of delays caused by charter operators to other train operators.

Consultation questions

7.10 Do you agree that a separate charter operator payment rate should be calculated using the same methodology used to calculate the freight operator payment rate, but based on delays caused by charter operators to other train operators? If not, please tell us why?

Incident caps

Issue

7.11 The Schedule 8 performance regime applies to charter operators although currently incident caps limit the amount of compensation per incident paid by these operators to Network Rail at £5,000. The same incident cap applies to compensation paid by Network Rail to charter operators, but has not been employed in practice.

7.12 Charter operators do not currently pay an access charge supplement (ACS) for incident caps. There are no Schedule 8 benchmarks within the charter operators' regime; Network Rail and charter operators make compensation payments in respect of all delays to other operators of 3 or more minutes.

7.13 Analysis of data on all Schedule 8 financial flows between charter operators and Network Rail, and charter operator on third-party operator delay minutes from the start of CP4, shows that without incident caps charter operators would have paid an estimated additional £660,000 to Network Rail since the start of CP4 (reflecting the impact of charter operator caused delays on third parties).

Options

7.14 We have considered the following options relating to incident caps in the performance regime as it applies to charter operators:

- (a) introduce an ACS in combination with Schedule 8 incident caps;
- (b) remove the requirement on Network Rail to offer incident caps; or
- (c) continue to provide charter operators with an incident cap, without them being required to pay an ACS.

7.15 All of these options would lead to charter operators funding a greater proportion of the revenue loss suffered by other train operators due to charter caused delays (rather than it being something that could be reflected in Network Rail's funding requirement, with implications for the tax payer).

Our emerging view

7.16 We are minded to choose option (b) and remove the requirement for Network Rail to offer incident caps to charter operators. We would also remove the cap on Network Rail incidents (although, as stated above, this is not employed in practice). The main role of Schedule 8 is to protect train operators from the risk arising from the actions of Network Rail and third party train operators. But incident caps are protecting charter operators against risk relating to their own performance.

7.17 We recognise the importance of the financial protection to charter operators provided by incident caps. However, in principle this form of protection could be arranged through private insurance markets; although this does not prevent Network Rail continuing to offer incident caps in return for an ACS. It would be up to charter operators to pursue the option of private insurance for cover that is appropriate to them.

7.18 Our view is that the current situation, where charter operators are not contributing to the protections that they receive from incident caps, is not the correct approach. So if we do not choose option (b), we would be minded to choose option (a) and require charter operators to pay an ACS in order to receive the protection provided by incident caps. The aim of this would be to make this element of the charter Schedule 8 regime financially neutral at expected levels of performance.

Consultation questions

7.19 Do you agree with our proposal not to require Network Rail to provide incident caps to charter operators on the basis this currently results in a subsidy to charter operators? If not, please tell us why?

7.20 Do you agree that incident caps are something that could be provided to charter operators by the private insurance market? If not, please tell us why?

Network Rail payment rate

7.21 Currently the Network Rail payment rate under the Schedule 8 for charter operators is the same as the Network Rail payment rate for freight operators. Ideally, there would be a separate Network Rail payment rate for charter operators, especially if we no longer set the charter operator payment rate so it is the same as the freight operator payment rate.

7.22 A difficulty in updating the Network Rail payment rate in the freight performance regime is the fact there is not much evidence on the size of impact of delays on the long term revenue of freight operators. Likewise, we are not aware of any evidence on the impact of delays to charter operators on long term revenue. We are also mindful that it could be burdensome for charter operators if we require them to provide us with evidence on this.

7.23 We therefore currently plan to set the Network Rail payment rate for charter operators so it is the same as the Network Rail payment rate under the freight regime. However, we would be keen to hear from stakeholders if there is evidence already available on the financial impacts of delays to charter operators that could be used to calculate a separate Network Rail payment rate for the charter regime.

7.24 Are you content for us to set the Network Rail payment rate in the charter operator performance regime so it is the same as the Network Rail payment rate in the freight performance regime? If not, do you have any proposals on how we should update it including on the evidence we could use?

7.25 Are you of the view that there are any other areas of the charter Schedule 8 performance regime that should be amended? If not, please tell us why?

Annex A: List of consultation questions

Transparency of possession management

1. What are your views on whether or not passengers and freight customers adequately consulted on the planning of possessions? What activity currently takes place?
2. What are your views on whether we should encourage Network Rail to consult with passengers and freight customers in the planning of its possessions?
3. If we were to encourage Network Rail to consult with passengers and freight customers in the planning of its possessions, do you have any suggestions on how we might go about doing this, for example, how such an obligation would be phrased and monitored?

Schedules 4 and 8 overall

4. Do you agree with the SDG research findings and conclusions on whether to set Schedule 4 and 8 payment rates so they do not compensate train operators in full for the impact of service disruption due to Network Rail and other train operators? If not, please tell us why?
5. Do you agree that we should continue to set Schedule 4 and 8 payment rates so that they compensate train operators for the full financial impact of service disruption due to Network Rail and other operators, where we do so currently? If not, please tell us why?
6. Are you of the view that there are other steps we could take to encourage train operators to have a stronger influence on the behaviours of Network Rail, in addition to those we are doing already?
7. Do you agree with our proposal not to introduce the Joint Restrictions of Use concept into Schedule 4 of template track access contracts? If not, please tell us why?
8. To what extent (if at all) do you think the current contractual wording of Schedules 4 and 8 is acting as a barrier to Network Rail and train operators minimising disruption to passengers and freight customers during extreme disruption, e.g. during severe weather? If you are of the view that it does act as a barrier, we welcome any specific proposals on how it can be improved.

Schedule 4 passenger possessions regime

9. Do you agree that the Access Charge Supplement (ACS) should be calculated using Network Rail's revised route based Schedule 4 costs estimation methodology? If not, please tell us why?
10. Do you consider there is further value in Network Rail achieving greater disaggregation in the methodology of the ACS calculation and if so do you have any suggestions how this might be achieved?

11. Do you agree that we should update the estimated bus mile payment rate based on actual amounts paid during CP4, rather than simply uplift the current rates by cost inflation? If not, please tell us why?
12. Do you agree that we should continue with the current formula for calculating revenue loss compensation for cancelled train services when there are replacement buses? If not, do you have any suggestions for how we could improve this aspect of Schedule 4?
13. Do you consider the way in which the revenue loss formula compensates franchised passenger operators when using replacement buses encourages passenger train operators to run too many buses (rather than trying to run train services using diverted route, for example)? If so, please explain why you think this is the case?
14. Do you agree that we should extend the scope of the protection provided by paragraph 2.9 of Schedule 4 to enable the recovery of direct costs related to amended or cancelled Type 1 possessions? If not, please tell us why?
15. If so, do you agree the threshold for triggering a claim should be £5,000 per possession? If not, please tell us why?
16. Do you agree that we should update the new working timetable notification factor to reflect changes to delay multiplier values in the Passenger Demand Forecasting Handbook (PDFH)? If not, please tell us why?
17. Do you have any further proposals for changes to notification discount thresholds and factors? If so, please explain your reasoning?
18. Do you agree that we should keep the Sustained Planned Disruption (SPD) revenue loss threshold the same and uprate the cost compensation by inflation (RPI)? If not, please tell us why?
19. Are you of the view that the provisions for claiming compensation under the SPD mechanism would benefit from clarification? If yes, please highlight which areas should be clarified?

Schedule 4 freight possessions regime

20. Do you consider the current regime appropriately compensates freight operators for losses resulting from severe disruption caused by possessions? If not, what do you consider the level of compensation should be based on?
21. Do you consider that the current regime appropriately incentivises Network Rail to reduce the amount of disruption faced by freight operators due to possessions? If not, how do you think incentive effects can be strengthened?
22. If Schedule 4 compensation payment rates for freight operators were increased, should this be funded by government? If so, please explain why you think this should be the case? If not, please tell us why?

Schedule 8 passenger performance regime

23. Do you agree that we should keep the current Schedule 8 contractual wording in relation to what train operators can claim for under the SPP arrangements? If you do not agree, do you have any proposals for alternative wording?

24. Should we continue with the SPP threshold set at 10% or increase it? If not, please tell us why?
25. If we increase the SPP threshold, what are your views on the level we should set it at?
26. Do you agree that we should leave timings of Schedule 8 payments unchanged, with payments due within 35 days following the end of each four-week accounting period? If not, please tell us why?
27. Do you agree that we should keep the circumstances in which Network Rail and train operators can propose amendments to Schedule 8, appendix 1 via paragraph 17 the same? If not, please tell us why?
28. Are there any specific areas of paragraph 17 where you are of the view the drafting needs to be made clearer? If not, please tell us why?
29. Are you content for us to remove the passenger charter element of the Schedule 8 performance regime? If not, please could you tell us why and whether you would like us to take any alternative course of action?
30. Do you agree that we should not change the way train operator cancellations to their own trains are treated under Schedule 8? If not, please tell us why?

Schedule 8 freight performance regime

31. Do you agree that we should keep the Network Rail payment rate the same, but uplifted for inflation? If not, please tell us why?
32. Do you think that the current Network Rail payment rate accurately reflects the financial impacts incurred by freight operators as a result of Network Rail caused delays to freight trains? If not, please tell us why?
33. Do you agree that we should re-examine the evidence base for the Network Rail payment rate with the freight industry and Network Rail in CP5, and if necessary adjust the rate to reflect cost and revenue impacts on freight operators due to Network Rail caused delays? If not, please tell us why?
34. Do you agree that we should keep the Network Rail cancellation payments the same but uplift them for inflation? If not, please tell us why?
35. Do you agree that we should update the congestion factor used in the calculation of adjustments to the freight operator benchmark, in order to take into account of evidence being collected as part of the update of the capacity charge? If not, please tell us why?
36. Do you agree that the Network Rail £ per delay minute payment rates used in the calculation of the freight operator payment rate should be weighted by third party freight operator delay affecting each service group? If not, please tell us why?
37. Do you agree with our proposal to continue to set the bonus payment rates at 50% of the level of the compensation payment rate? If not, please tell us why?
38. Do you agree with our proposal not to require Network Rail to offer incident caps in return for an access charge supplement? If not, please tell us why?

39. Do you agree that incident caps are something that could be provided by the private insurance market if Network Rail were not to offer incident caps at a reasonable price? If not, please tell us why?

40. Do you agree that we should continue to allow operator specific annual liability caps? If not, please tell us why?

41. Should we continue to set reciprocal annual liability caps for smaller and new freight operators? If not, please tell us why?

42. Should we continue to set reciprocal annual liability caps in instances where Network Rail and freight operators cannot agree on the level the cap should be set at? Or are caps on annual liability something the private insurance market could provide if no agreement is reached?

Compensation for charter operators

43. Do you agree that a separate charter operator payment rate should be calculated using the same methodology used to calculate the freight operator payment rate, but based on delays caused by charter operators to other train operators? If not, please tell us why?

44. Do you agree with our proposal not to require Network Rail to provide incident caps to charter operators on the basis this currently results in a subsidy to charter operators? If not, please tell us why?

45. Do you agree that incident caps are something that could be provided to charter operators by the private insurance market? If not, please tell us why?

46. Are you content for us to set the Network Rail payment rate in the charter operator performance regime so it is the same as the Network Rail payment rate in the freight performance regime? If not, do you have any proposals on how we should update it including on the evidence we could use?

47. Are you of the view that there are any other areas of the charter Schedule 8 performance regime that should be amended?

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