

Carl Hetherington
Deputy Director, Railway Markets and Economics

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Peter Swatridge
Head of Regulatory Economics
Network Rail

Dear Peter,

Schedule 8 ‘overlay’ agreements

Following Network Rail’s request, and as agreed at our meeting on 18 November 2019, I am writing to summarise ORR’s thinking regarding Schedule 8 ‘overlays’. Our understanding is that overlays are commercial agreements which sit alongside Schedule 8 of track access contracts. You have explained that the use of overlay agreements is at a relatively early stage of development, but that firmer proposals exist for the ‘East Coast Partnership’ between Network Rail and LNER and also with Grand Central.

This letter has been published in March 2020, before the conclusion of the Williams Rail Review. ORR will consider the wider implications of that review in due course.

Purpose of overlay agreements

You explained to us the purposes of overlay agreements, which we understand as being to: improve working relationships and data-sharing between Network Rail and train operators; achieve performance improvements across the industry; reveal information to industry about Schedule 8 and train performance; provide evidence for the potential reform of Schedule 8 for control period 7 (CP7); and inform performance arrangements for future franchises.

These purposes reflect Network Rail’s view that collaboration on performance between Network Rail and train operators could be improved by entering into additional arrangements, which would sit alongside Schedule 8, and would be mutually beneficial to Network Rail and train operators. These arrangements would be designed so that they do not adversely impact other operators.

You have set out to us some of the potential features of overlay agreements, with examples drawn from the proposed East Coast Partnership agreement. We have not reviewed the details of any of the agreements, so our comments below are at a high level.

Network Rail envisages that overlays will be agreed bilaterally between Network Rail and individual train operators, such that each agreement is likely to be different, but some examples of the features follow below.

Features of overlay agreements

The overlay agreement may alter the financial impacts of disruption on the parties to the overlay agreement. We understand that changes to financial impacts may include, for example: payments related to sub-threshold delays and delays caused by external events; 'dead-bands' where no payments are made for small performance fluctuations; and Network Rail paying for a proportion of TOCs' Delay Repay compensation. In some cases, payments between a TOC and Network Rail will, rather than flow between the parties, enter a 'joint fund' to be used for incremental improvement schemes (i.e. schemes not already committed to or funded by either party).

Network Rail has told us that overlay agreements would be expected to be broadly financially neutral between the parties based on prior performance. You explained that their aim will be to improve train performance or other passenger outcomes (e.g. through better awareness of passenger compensation rights or funding improved station facilities). Network Rail has stated that any proposed Schedule 8 overlay which has no foreseeable benefit to these outcomes will not be implemented.

Network Rail has stated that Schedule 8 will run as normal alongside the overlay agreement, meaning for example that delay attribution continues unaffected. You have explained that overlay agreements with one operator will have no effect on the track access agreement (including Schedule 8) between Network Rail and other operators. This means, for example, that Schedule 8 payment flows relating to TOC-on-TOC delay will not be affected.

Principles to recognise and observe

In our view, there are general principles that parties to overlay agreements should recognise and observe. We discussed these when we met, and you have confirmed that you had already taken account of these in your discussions on Schedule 8 overlays. These principles are outlined below.

Non-discrimination: Network Rail should treat all train operators fairly in negotiating, agreeing and operating overlay agreements. Similarly, when using the money in a 'joint fund', Network Rail should act without undue discrimination. Train operators stressed the importance of non-discrimination when consulted on this letter. The requirement for non-discrimination reflects the terms of Network Rail's network licence, which prohibits it from unduly discriminating when carrying out its network-related activities. Network Rail has told us that it aims to speak to all train operators about overlay arrangements, and will not unduly discriminate in its engagement.

Transparency: Network Rail should be open with all train operators about the existence of overlay agreements and the use of the money in any joint fund. Operators should be given sufficient information so they can understand the broad terms of such agreements, and what types of arrangements are available to negotiate. We consider that it would be helpful if Network Rail produced a policy statement, setting out the principles it would use to consider and negotiate overlay agreements. You have told us that Network Rail has already discussed the principles of Schedule 8 overlays at industry meetings, including at

the RDG Board meeting on 17 December 2019; and that during these discussions, Network Rail has invited train operators to engage in discussions with it regarding Schedule 8 overlays.

Delay attribution: Underlying delay attribution should not be adversely affected, given the wider purposes it serves. Network Rail has already confirmed to us that delay attribution will not be affected by overlays.

Governance: Network Rail and the TOC concerned should set up appropriate governance arrangements for the use of any money that will form the basis of a joint fund, if such a fund forms part of an overlay agreement. We would expect that money in the fund is used to fund initiatives for the benefit of rail users. Network Rail has indicated to us that this is the case with the joint performance fund set up between Network Rail and LNER as part of the East Coast Partnership.

Termination: We would expect a mechanism to be built into the overlay agreement to allow for its termination by either party.

Enforceability: We understand that Network Rail does not intend to make changes to Schedule 8 or other parts of Track Access Agreements. However, it is worth emphasising that by virtue of the Railways Act 1993, agreements which have the effect of amending Schedule 8 (or the access agreement generally) without the approval of ORR under section 22 are void and unenforceable by either party. If that is the effect of any overlay agreement, then the enforceability would be a risk for the parties to it.

Also, it is worth noting that overlay agreements are very likely to be co-operation agreements for the purposes of The Railways (Access, Management and Licensing of Railway Undertakings) (Amendment) Regulations 2019. As such, their performance will need to be monitored by ORR.

As we said in the PR18 final determination, we are supportive of industry innovation aimed at improving train performance. There may be potential benefits from Schedule 8 overlays, subject to the general principles that parties should observe; we look forward to learning about the outcomes from this initiative. At all times a key guiding principle of such agreements should be improved train performance for the benefit of customers.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Carl Hetherington', written in a cursive style.

Carl Hetherington