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2 November 2011

To:
Colas Rail Limited
DB Schenker Rail (UK) Limited
DRS Limited
Freightliner Limited
Freightliner Heavy Haul Limited
GB Railfreight Limited
Network Rail Infrastructure Limited

Dear Colleague

Modification Notice for freight schedule 4 compensation rates for planned disruption

Purpose

1. I am writing to explain why we have issued a Modification Notice, under paragraph 8.8(a) of Part 6, Schedule 4 of the track access contract. This notice changes the figures in the definitions of 'Normal Planned Disruption Sum' and 'Enhanced Planned Disruption Sum' in paragraph 1 of Schedule 4 from 13 November 2011.

Background

2. Schedule 4 of the model freight track access contract sets out the restrictions of use regime through which Network Rail compensates train operators when it disrupts their services with planned restrictions of use. Our PR08 determination included a provision which allowed aspects of Schedule 4 to be changed after the first year of operation of the

new regime if they were not providing the envisaged level of compensation.¹ Under schedule 4 in all freight operators' track access contracts with Network Rail, Network Rail can determine that the criteria for making modifications to the Specified Provisions have been met or the train operator may notify Network Rail that it considers the criteria have been met. More about the background and the process is set out in **Annex 1** (see paragraphs 1 to 4) to this letter.

The process

3. In line with the process outlined at **Annex 1** (see paragraph 3(b)), Network Rail gave notice to ORR (copied to all freight operators holding access contracts at the time) in the form of a letter dated 30 September 2010 to Paul McMahon, Deputy Director, Railways Markets and Economics, stating that it considered that the criteria for reviewing specified provisions in Schedule 4 had been met. After initial consideration of the documentation we met with Network Rail (via a telephone conference) on 15 December to enable us to:

- (a) gain a more detailed understanding of the basis for the information supporting Network Rail's view that the Criteria had been met;
- (b) discuss the further information we required; and
- (c) discuss the way forward.

4. We confirmed to Network Rail on 22 December 2010 that our initial view was that the Criteria for making modifications to the specified provisions had been met and that we would proceed with the modification process, subject to the receipt of the requested additional information (this was received on 20 January 2011). Our next step was to email all the freight operators on 16 February 2011:

- (a) confirming receipt of the Notice from Network Rail,
- (b) stating that following initial discussions with Network Rail we were minded to proceed with the process; and
- (c) seeking representations by 23 February 2011.

5. We received responses from DBS Schenker Rail (UK) Ltd (DBS) and Freightliner Group (Freightliner). DBS's representations, which related to whether the Criteria had been met and the veracity of the data, are discussed below in paragraphs 7 and 8 and in more detail in **Annex 2**. Freightliner's response, which related solely to the issue of the proposed implementation date of any modification, is discussed below (see paragraphs 25 to 28).

¹ Paragraphs 26.17 -26.25 of the Determination of Network Rail's outputs & funding for 2009-14 available at <http://www.rail-reg.gov.uk/upload/pdf/383.pdf> and paragraphs 3.33 - 3.35 of Final Conclusions – Compensation for Possessions available at http://www.rail-reg.gov.uk/upload/pdf/comp4poss_180808.pdf

Have the Criteria been met?

6. In support of its Notice, Network Rail said that since the implementation of the PR08 determination in April 2009, the level of compensation paid in defined disruption categories had exceeded a level of 50% above that envisaged by our PR08 determination. It provided a breakdown of the compensation paid in defined disruption categories by operator. Network Rail also said that, in its assessment of the total level of compensation, it had taken into account variations resulting from reductions to freight train mileage and the level of disruption (as measured by the Possession Disruption Index – Freight). When these were taken into account, total compensation was more than 50% above the level set out in our PR08 determination.

DBS's view.

7. In its letter of 23 February 2011, DBS said that it did not agree that the relevant criteria had been met because it disputed Network Rail's claim that the £9m figure (2007/08 process) stated in the Criteria had been exceeded by around 60%. Its view was that the actual figure was nearer 40%. In support of its view it raised a number of points about how the figures quoted by Network Rail in respect of qualifying payments had been arrived at and it challenged some of the data.

8. Network Rail was invited to respond and did so on 17 March 2011. Network Rail said that in the light of DBS representations it had revisited its work and had, "*uncovered some minor errors in its original submission*". However, it made it clear that the errors did not alter its overall view that the Criteria had been met. The specific issues raised by DBS, together with Network Rail's response to them, are discussed in detail at **Annex 2**.

ORR's view

9. Our views are also set out in **Annex 2**. In summary, having carefully reviewed DBS's representations and Network Rail's revised figures, we are satisfied that:

- (a) the information we have received confirms that the Criteria have been met; and
- (b) Network Rail has responded adequately to DBS's points.

However, it is disappointing that Network Rail did not take more care in compiling and checking the accuracy of the information provided and in ensuring that it was presented clearly.

ORR's conclusion

10. In light of the above and given that there were no other representations on this issue we decided that the Criteria had been met and that it was appropriate for us to proceed to determine what modifications may be required in accordance with Part 6, clause 8.5 to Schedule 4.

Consideration

11. We subsequently analysed the information presented to us by Network Rail, including considering the methodologies used and reviewing the data underpinning its conclusions. Following Network Rail's response to DBS's representations we also asked for updated information on qualifying payments and compensation rates to take account of the corrections made. We received this on 4 April 2011.

Network Rail's proposed modifications

12. Network Rail presented two options for recalibrating the Category 1 and 2 compensation rates for possessions notified before T-12. Its preferred option involved decreasing the compensation rates so that, based on its 2009 - 10 data, Category 1 and 2 payments combined would give the same level of compensation as envisaged in PR08. This option also involved keeping the Category 1 rate at a constant proportion of the Category 2 rate. It would lead to payment rates of £244 and £650 for Categories 1 and 2 respectively in 2007 - 08 prices. Network Rail's proposals are set out in more detail in **Annex 1** (see paragraphs 5 and 11).

ORR's view

13. We supported Network Rail's view that rates should be revised so as to keep Category 1 payment rate as a constant proportion of the Category 2 rate. This precedent was set in the original calibration undertaken by Faber Maunsell in which it set the Category 1 and Category 2 rates so that expected compensation from all three categories would sum to £9m. This also follows the manner in which rates are set for possessions notified after T-12.

14. However, we disagreed with Network Rail's view that the regime should be recalculated taking account of only Category 1 and Category 2 compensation. Rather, we consider that total (that is, Category 1, 2 and 3) compensation should be used to recalibrate according to the level envisaged in PR08. Again, this is consistent with our approach in PR08, as set out by Faber Maunsell in its original report. We estimated in PR08 that total compensation from Categories 1, 2 and 3 would be £9m in 2007/08 prices. This was subject to consultation at the time, and we do not propose changing this figure as part of the current modification.

15. The methodology behind our conclusions is set out in **Annex 1** and summarised in **Table 1** below.

ORR's conclusion

16. In conclusion, after adjusting for inflation, we proposed payment rates of £285 and £760 for Category 1 and 2 respectively for 2011 – 12. Table 1 below summarises the proposals for the payment rates.

Table 1: Proposals for revised compensation rates

Compensation Rates	Original (2007 - 08 prices)	Network Rail proposal (2007 - 08 prices)	Our proposal (2007 - 08 prices)	Our proposal (2011 -12 prices)
Category 1	£375	£244	£259	£285
Category 2	£1,000	£650	£690	£760

Further consultation with freight operators

17. However, given the errors discovered by Network Rail and the consequential recalibration, we considered it necessary to give Network Rail and freight operators a further opportunity to review the figures before consulting **formally** on the terms of the draft modification notice modifying the Specified Provisions.

18. We did this on 24 May 2011 and we received no substantive comments on either the methodology, or the figures.

Consultation on the draft modification notice

19. In accordance with the Schedule 4 process, on 13 July 2011 we consulted Network Rail and freight operators on the draft Modification Notice and the reasons for our proposed decision to revise the payment rates. We received responses from GB Railfreight, DBS, Direct Rail Services, Freightliner and Network Rail. The responses raised concerns about meeting the criteria, the implementation date and the effects on the industry of changing the compensation sums.

Consultees' view - Criteria for fulfilment of the review and methodology

20. Many of the responses from freight operators said that they did not think that the criteria for review had been met because the 50% threshold had not been breached. Both DRS and DBS said that the total compensation paid out in 2009-10 was £12,726,269 (2007-08 prices) which was below the £13.45m (2007-08 prices) threshold set out in our criteria.

21. Freight operators also raised concerns about our methodology for adjusting for freight train miles and the period of the data used, noting that 2009-10 was an exceptional year for possessions. Furthermore, there was no obligation on ORR to use only 2009-10 data. There were other concerns about the use of the Possessions Disruption Index for Freight (PDI-F) methodology. With respect to the way in which the compensation paid total was adjusted to take account of changes in freight train miles, freight operators argued that there was no proven direct link between freight train miles and the level of compensation and that using more than one year's train miles data would provide better information about the possible nature of any link.

ORR's views

22. On the first point about the threshold, in accordance with the criteria set out in our PR08 determination, the compensation paid total must be adjusted to take account of the difference in freight train miles run in 2007-08 and those run 2009-10 and changes in the level of disruption to freight train operators as measured by the PDI-F compared over the same two comparator years.

23. Figures supplied by Network Rail showed that there was a difference of 13% in the number of train miles run in 2007-08 and those run in 2009-10. In line with the criteria, Network Rail applied an uplift to the £12.73m (2007-08 prices) in proportion to the difference in train miles, i.e. 13%, increasing the compensation paid total to £14.4m (2007-08 prices), which is around 60% above the trigger threshold figure of £9m, (2007-08 prices). Network Rail did not make any further adjustment arising from changes in the PDI-F index. However, if it had done so the effect is likely to have increased the compensation paid total further.

24. In respect of our methodology for adjusting freight train miles, we consider that although there is no specific requirement for us to use 2009-10 data, the fact that the timescales in the provision only allow the review to be triggered between April and October 2010 implies that we should only use the data from the previous financial year. As to the methodology used to adjust for train miles, we responded to DBS on this point earlier during the review process. We said that it was appropriate to adjust the total payment value in this manner (see paragraphs 24-25 of **Annex 2**) and we do not consider that DBS has provided any further arguments to support changing our view on this.

Consultees' view - Implementation date

25. In response to our February consultation, Freightliner noted that the uncertainty around the future levels of Schedule 4 compensation was making it difficult to agree restrictions of use for the timetable starting in December 2011. Consequently there was a risk that this would lead to more disputes between freight operators and Network Rail. Freightliner considered that the review should apply from the December 2012 timetable to give time for any changes to be understood before the process for agreeing the December 2012 Engineering Access Statement begins informally in about July 2011. This would also allow 2 full years of data to be included in the review.

26. In response to our July consultation, many of the freight operators raised concerns about the implementation date of 18 September 2011, saying that they would prefer a later start date, for example, the current set of agreed possessions, the start of the 2012 financial year or the start of CP5. Freightliner reiterated that it may affect the amount of agreed possessions if the freight operators receive a lower compensation sum than what was agreed.

ORR's views

27. The timing of the review is in line with the process explained in PR08 and set out in Schedule 4 of freight operators track access contracts. As already explained, the Criteria

which have to be met to make the modifications relate to levels of compensation which Network Rail had paid to freight operators during 2009/2010 (see paragraph 3.34 of ORR's Final Conclusions - Compensation for Possessions). In our view, this means that it is appropriate for us to be proceeding on the basis of 1 year's data - delaying implementation would only perpetuate a situation which the provision envisaged should not exist.

28. On the question of the implementation date, we believe that the modification should be made as soon as possible after this process is complete and the modification notice issued. Although no timescales for completion of the review are set down it would be wrong to delay implementation more than necessary. Furthermore, we believe that it is appropriate that the change takes effect on the next convenient billing date.

Consultees' view - Compensation rates and operating costs

29. Freight operators raised the issue that the reduction in compensation rates would not take into effect the recent increases in operating costs.

ORR's views

30. Whilst we recognise that operating costs for freight operators have increased recently, the methodology only refers to taking into account the most recent evidence on possessions. We further note that the original methodology for our PR08 determination also did not take operating costs into account and was based on previous compensation levels. For these reasons it would not be appropriate for us to take into account operating costs during this review process.

Consultees' view - Effects of the changes to the compensation sums

31. Freight operators said that the changes may result in less efficient planning of possessions and more disputes between freight operators and Network Rail. Network Rail will also have less incentive to plan possessions outside of main periods when freight trains operate

ORR's views

32. Whilst we understand freight operators' concerns we do not agree that the reduction in compensation rates will reduce the incentive on Network Rail to take account of freight operations when planning possessions. This modification simply ensures that compensation is held at the levels envisaged by the PR08 determination.

ORR's conclusion

33. For the reasons given above, we have decided issue a Modification Notice in line with the draft included with our letter of 13 July.

Effective date of the Modification Notice

34. **The modification notice will take effect at 0200 13 November 2011.** This is because, as explained above, we consider that the modification should take effect as soon as possible and at the start of a new billing period. The effective date differs from that in our consultation because Network Rail asked for a minimum of 7 days before the effective date to enable it to update its systems. The compensation sums received by freight operators for possessions notified at T-12 after this date will decrease from the effective date. Where Network Rail and freight operators have already agreed possessions then these will be paid at the existing rates of £375 for Category 1 disruption and £1000 for Category 2 Disruption (at 2007-08 prices).

Yours sincerely

A handwritten signature in blue ink that reads 'Brian Kogan'. The signature is written in a cursive, flowing style.

Brian Kogan

ANNEX 1

BACKGROUND, PROCESS AND METHODOLOGY FOR THE REVIEW

1. As part of the Periodic Review 2008 Determination (PR08)², we determined rates of compensation to be paid by Network Rail to freight operators for possessions notified before T-12 (more than 12 weeks in advance of the date of the possession). We followed a number of steps in arriving at these rates:

- (a) We estimated the amount of compensation paid by Network Rail under Part G (Network Change) of the Network Code (the compensation regime previously in place for T-12 disruptions). This gave a figure of £9m in 2007/08 prices.
- (b) We appointed Faber Maunsell to use possessions data from periods 12 and 13 of 2007/08 to estimate the levels of disruption in each category³ for 2009/10.
- (c) The consultants then used these estimates to construct payment rates that would give rise to this £9m of compensation in total. The resulting rates were £375 and £1000 for Category 1 and Category 2 respectively in 2007/08 prices.

2. Because the rates were calibrated on the basis of only two periods of data, we included a provision in our determination to allow the compensation sums and related provisions in Schedule 4 of freight track access contracts to be revisited after the first year of the new regime if the level of compensation varied significantly from what was envisaged⁴.

3. All freight operators' contracts were amended to include a new Schedule 4, which included an appropriate modification provision (Part 6) setting out the process to be followed. Briefly this is as follows:

- (a) Network Rail determines that the Criteria⁵ for making modifications to the Specified Provisions (i.e. certain definitions and related provisions in Schedules 4 and 8) have been met.

² Paragraphs 26.17 -26.25 of the Determination of Network Rail's outputs & funding for 2009-14 available at <http://www.rail-reg.gov.uk/upload/pdf/383.pdf>.

³ A description of the types of disruption (Category 1 disruptions, Category 2 Disruptions and Category 3 Disruptions) and levels of compensation for notification before and after T – 12 are set out in table 5 of Final Conclusions – Compensation for Possessions http://www.rail-reg.gov.uk/upload/pdf/comp4poss_180808.pdf.

⁴ See link in footnote 2 above.

⁵ Paragraphs 3.33 - 3.35 of Final Conclusions – Compensation for Possessions set out the criteria in more detail. Available at http://www.rail-reg.gov.uk/upload/pdf/comp4poss_180808.pdf.

- (b) Network Rail must serve notice on ORR and the affected operators (clause 8.1(a)) and set out its reasons, supported by evidence, as to why it considers the Criteria have been met (clause 8.3).
 - (c) When ORR has received a Notice, we must then consult Network Rail and freight operators on whether it is appropriate to proceed to determine whether and to what extent modifications should be made (clause 8.5).
 - (d) ORR will then consider all the information received, including any representations, and, if appropriate, prepare a draft Modification Notice. Before issuing that Notice ORR must consult on the proposed modification terms (clause 8.8).
4. In this appendix we have set out Network Rail's proposals for the revised rates, together with the revised rates we have included in the modification notice.

Proposed Modifications by Network Rail

5. In its letter dated 04 April 2011, Network Rail presented two options for re-calibrating Category 1 and 2 compensation rates. These options were based on data collected on actual disruptive events in 2009-10. This data is set out in Table 1 and we have outlined briefly Network Rail's options in the following text.

Table 1: 2009-10 T-12 disruptive events by category

	A	B	C = A x B	D
Compensation	Disruptive events	Compensation Rate (2008/09 prices)	Actual Compensation (2007/08 prices)	PR08 Envisaged compensation (2007/08 prices)
Category 1	8,357	£375	£3,133,875	£3,037,125
Category 2	8,881	£1,000	£8,881,000	£4,771,000
Category 3	N/A	N/A	£711,394 ⁶	£1,191,875
Total	N/A	N/A	£12,726,269	£9,000,000

Source: Network Rail

Network Rail Option 1

6. Option 1 entailed recalculating the rates based on the 2009/10 data so that compensation from Categories 1 and 2 would be as envisaged in PR08. That is (2007-08 prices),

$$\begin{aligned} \text{Category 1 rate} &= £3,037,125 / 8,357 = £363 \\ \text{Category 2 rate} &= £4,771,000 / 8,881 = £537 \end{aligned}$$

⁶ Not equal to A*B. Provided separately by Network Rail.

Network Rail Option 2

7. Option 2 entailed recalculating the rates based on the 2009-10 data so that the compensation from Categories 1 and 2 combined was as envisaged in PR08, whilst ensuring that the Category 1 rate remained at a constant proportion of the Category 2 rate. Specifically, the Category 2 compensation rate was to be kept at 37.5% of the Category 1 rate.

8. Total Category 1 and Category 2 compensation at the level envisaged in PR08 could be expressed algebraically as follows,

$$8,357x + 8,881y = 7,808,125$$

where x was the Category 1 compensation rate and y was the Category 2 compensation rate. The figures were taken from table 1.

9. Also, to keep the Category 1 rate at 37.5% of the Category 2 rate could be expressed as

$$x = 0.375y$$

10. Solving these equations gave the following compensation rates, submitted by Network Rail (2007-08 prices),

Category 1 rate = £244

Category 2 rate = £650

11. Network Rail stated that it preferred Option 2, since it reflected the relative impacts better of the two types of disruptive events.

ORR Modification to Network Rail Preferred Option

12. As we explained in our letter and above, we support Network Rail's view that rates should be revised so as to keep Category 1 payment rate as a constant proportion of the Category 2 rate. This precedent was set in the original calibration undertaken by Faber Maunsell, in which it set the Category 1 and Category 2 rates so that expected compensation from all three categories would sum to £9m. This also followed the way in which rates are set for possessions notified after T-12.

13. However, we disagree with Network Rail that the regime should be recalculated taking account of only Category 1 and Category 2 compensation. Rather, we considered that total (i.e., Category 1, 2 and 3) compensation should be used to recalibrate according to the level envisaged in PR08. Again, this was consistent with our approach in PR08, as set out by Faber Maunsell in its original report. We estimated in PR08 that total compensation from Categories 1, 2 and 3 would be £9m in 2007/08 prices. This was subject to consultation at the time, and we did not propose changing this figure as part of the current modification.

14. Against that background the rates should be calibrated so as to ensure that total compensation based on the 2009/10 data would be equal to £9m in 2007/08 prices. This could be expressed algebraically as,

$$8,357x + 8,881y + 711,394 = 9,000,000$$

15. As before, we sought to maintain the proportional relationship between the Category 1 and Category 2 rates, $x = 0.375y$. These equations could be solved to give the payment rates in 2007-08 prices as,

Category 1 rate = £259

Category 2 rate = £690

16. We used the indexation factor of $1.034 \times 1.0243 \times 0.995 \times 1.046 = 1.102$ to uplift from 2007-08 prices to 2011-12 prices. This gave rates to the nearest pound for 2011-12 as,

Category 1 rate = £285

Category 2 rate = £760

17. In future, rates would need to be computed to the nearest pound relative to 2007-08.

ANNEX 2

DBS'S RESPONSE ON WHETHER THE CRITERIA HAVE BEEN MET

1. DBS was the only freight operator to respond to our email of 16 February regarding whether the criteria had been met, although DBS, Freightliner, GB Railfreight and DRS all referred to this issue in response to our July 2011 consultation on the draft modifications.
2. In this annex, we have examined the issues raised by DBS and Network Rail's response to them and have provided our own view on each matter individually. Overall, we consider that Network Rail responded adequately to DBS and that the criteria for review have been met. Where appropriate we also refer to the issues raised in response to our consultation of July 2011.

DBS's response

3. In its letter of 30 September 2010, Network Rail advised that in its view the criteria for reassessment had been met, and set out a detailed rationale underpinning its view. Network Rail provided further details and some adjustments to its methodology in a presentation delivered to ORR in December 2010. We subsequently invited the views of other stakeholders.
4. DBS responded to Network Rail's representations in a letter dated 23 February 2011, in which it stated that it disagreed that the relevant criteria had been met. We invited Network Rail to respond to DBS's letter and received its response on 17 March 2011.

Qualifying payments to freight operators other than DBS

DBS representation

5. Due to the confidential nature of qualifying payments made to relevant freight operators, DBS was unable to verify the payment amounts made to other freight operators (DBS had requested its own data direct from Network Rail). DBS stated that it would trust ORR's independent verification in this respect.

Network Rail response

6. Network Rail was able to identify errors in its original submission. It advised that this resulted in an under-representation of the amounts paid to all freight operators and submitted revised data.

ORR view

7. Network Rail advised that the data provided in its letter of 17 March 2011 superseded information provided earlier, and should be used to assess whether the Criteria had been met. Network Rail provided a breakdown setting out the qualifying payments it had made to each operator.

8. To verify the revised data received from Network Rail we consulted all freight operators on their individual qualifying payments on 23 May and 13 July 2011.

9. We expect Network Rail as an efficient network manager to ensure that the data submitted to us provides an accurate, complete and fair representation of the information.

10. We shared the information supplied by Network Rail with DBS who confirmed that it was within acceptable parameters.

Qualifying payments to DBS

DBS's representation

11. DBS identified two discrepancies in the data provided by Network Rail relating to its own operations. The first related to Late Notice actuals and the second related to Late Notice cancellations.

Network Rail response

12. Network Rail recognised that mistakes were made in its initial submissions, although these were small. It confirmed the figures submitted by DBS (although it noted that DBS had used figures to adjust for inflation which were inconsistent with our PR08 determination).

Late Notice Cancellation Sum

DBS's representation

13. DBS noted that Network Rail did not provide calculations to arrive at its figure for the change in Late Notice Cancellation Sum payments.

14. DBS proposed that the appropriate methodology to arrive at the change in Late Notice Cancellation Sum payments is to:

- (a) express the original figure for the Late Notice Cancellations Sum of £942 (2006-07 prices) and the 2009-10 Late Notice Cancellations Sum of £1,430 (2009-10 prices) in 2007-08 prices; and
- (b) determine the difference between the original and 2009-10 Late Notice Cancellation Sums expressed in 2007-08 prices.

15. DBS used inflation figures from the Office for National Statistics (see below) to arrive at figures of £972 and £1,314 for the original and 2009 – 10 Sum respectively (both in 2007 – 08 prices). The resulting increase in the Late Notice Cancellation Sum is £342.

Network Rail response

16. Network Rail accepted that in its initial submission, it did not apply a consistent price base in carrying out its calculations. It accepted that the approach presented by DBS was the appropriate one.

17. However, Network Rail noted that DBS did not apply the inflation uplifts determined by ORR (see paragraphs 39-42). Using DBS's methodology, and employing the correct inflation uplift, Network Rail computed the change in the Late Notice Cancellation Sum to be £368.

ORR view

18. We noted that Network Rail and DBS agreed on the methodology. We reviewed this approach and were content with it. We noted that the figures provided by Network Rail and DBS could be reconciled by using the appropriate inflation uplifts.

Inflation uplifts

DBS's representations

19. DBS recognised the inflation figure provided by Network Rail from 2007-08 to 2008-09 as 4.27%, which was calculated using RPI data published by the Office for National Statistics. However, DBS did not recognise the inflationary uplift figure of 2.43% from 2008-09 to 2009-10 used by Network Rail.

Network Rail response

20. Network Rail advised that the inflation uplift figure from 2008-09 to 2009 -10 of 2.43% was determined by ORR during PR08.

21. However, Network Rail also pointed out that it made an error in its letter to ORR. The inflation figure of 4.27% from 2007-08 to 2008-09 was not consistent with ORR's PR08 determination. In a presentation delivered to ORR in December 2010, Network Rail corrected this to the figure of 3.40% set by ORR in its PR08 determination. Overall, this gave rise to an indexation factor of 1.059 to discount payments from 2009 – 10 to 2007 – 08 prices.

ORR view

22. We confirmed the appropriate inflation uplift from our PR08 determination was 3.40% from 2007 – 08 to 2008 – 09, and 2.43% from 2008 – 09 to 2009 – 10. This gave rise to an indexation factor of 1.059 to convert between 2007 – 08 and 2009 – 10 prices.

Adjustments for freight train mileage and possessions disruption

DBS's representations

23. DBS noted that the process for taking account of train mileage and disruption levels is not set out in our PR08 determination. It submitted that:

- (a) it would like to see evidence supporting Network Rail's assumption in its initial letter that a percentage change in train mileage would result in the same percentage change in Schedule 4 payments; and
- (b) there would be an element of double counting since a reduction in freight train miles would result in a reduction in the disruption to freight services due to possessions.

Network Rail's response

24. In its response, Network Rail did not provide evidence relating to the precise nature of the relationship between Schedule 4 payments and freight train mileage.

25. It addressed DBS's second point more thoroughly. In particular, Network Rail stated that the Possessions Disruption Index for freight (PDI-F) measures the proportion of the network which was unavailable to traffic due to possessions during a given period. It claimed that the PDI-F was not sensitive to changes in the volume of traffic so that changes in traffic volumes would not result in double counting.

26. Network Rail stated that 2009 – 10 actually saw reduced levels of disruption according to the PDI-F. Network Rail did not develop its arguments further, but stated that this suggested that the overall level of disruption did not contribute to the increase in compensation.

ORR View

27. In our determination we stated that, in examining the compensation sums and criteria, we would take into account "the difference in the level of disruption to freight operators on the network and the change in the level of freight train mileage".

28. We agreed with DBS in that it would be desirable to see evidence around the precise nature of the relationship between Schedule 4 payments and train mileage. Unfortunately, neither party was able to submit such information.

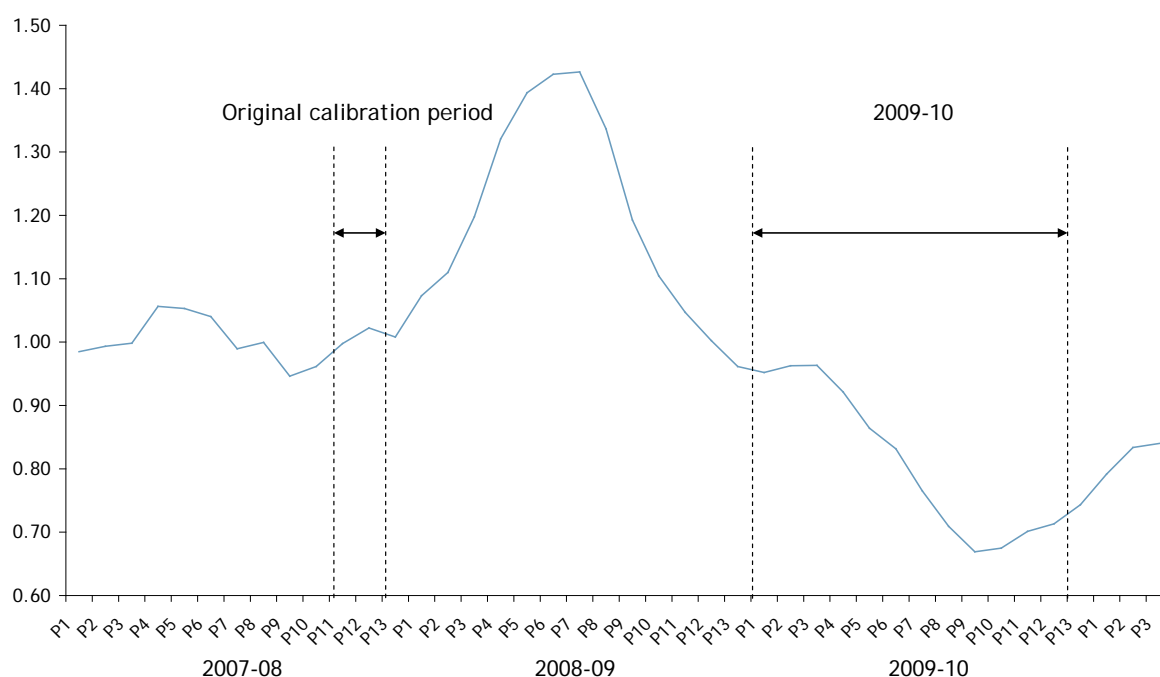
29. In an approximate sense, and for the network as a whole, it is likely that the payments made by Network Rail under each Schedule 4 freight payment Category would be given by the product of freight train mileage, the probability of that Category of disruption being encountered on each train mile, and the payment rate for that Category. This relationship implied that a given percentage change in freight train mileage would result in the same percentage change in Schedule 4 payments.

30. Figures supplied by Network Rail showed that around 13% fewer freight train miles were run in 2009-10 than in 2007-08. To take account of this, Network Rail applied an uplift to the £12.73m (2007-08 prices) in proportion to the difference in train miles, i.e. 13%, increasing the compensation paid total to £14.4m (2007-08 prices), which is around 60% above the trigger threshold figure of £9m, (2007-08 prices). In the absence of additional information therefore, we considered that it would be appropriate to adjust the payment rate criterion by the same proportional amount as that of freight train mileage. This corresponded to the approach adopted by Network Rail.

31. The second issue raised by DBS was the possibility of double counting since it believed that the reduction in freight train miles would result in a reduction in the disruption to freight services due to possessions. The standard measure of possessions on the network which is relevant to freight services is the Possessions Disruption Index for freight (PDI-F). This is a measure of the proportion of the network that is under possession over a particular period, weighted appropriately so as to be relevant to freight traffic. As such, it is invariant with respect to the level of traffic on the network. We therefore agreed with Network Rail that its approach did not constitute double counting.

32. Figure 1 shows the PDI-F going back to the beginning of 2007 – 08. During the initial calibration, which used the final two periods of 2007 - 08, the average PDI-F was 1.05, above the target level of 1. During 2009-10, the average PDI-F was 0.8, which was well below target. Network Rail's view, that the overall level of disruptive activities undertaken in 2009 – 10 does not account for the higher than expected compensation payments under Schedule 4, therefore appeared reasonable.

Figure 1 – Possessions Disruption Index for freight (PDI-F), 2007 – 08 Period 1 to 2010 – 11 Period 3, Five-Month Moving Average – Source: ORR



Formulaic payments

DBS's representations

33. DBS noted that much of the reduction in train mileage might be a result of shorter average journeys, as opposed to fewer journeys. DBS claimed that, since only a single formulaic payment can be made for each train, the reduction in train miles should be adjusted to reflect this.

Network Rail's response

34. Network Rail stated that, in the absence of further information, its approach was pragmatic and reasonable.

ORR view

35. In our PR08 determination, we stated that we would take into account the change in the level of freight train mileage. We did not state that we would take into account the changes in those factors that affect overall train mileage, such as the average length of journeys.

36. In the absence of evidence of the exact nature of the relevant relationships, we considered that the assumptions made by Network Rail were reasonable and fair.

Conclusion

37. We have carefully reviewed the representations of DBS, and the responses of Network Rail and from freight operators in August 2011. However, we consider that Network Rail has responded adequately to these issues, and has demonstrated that the criteria to review the Schedule 4 compensation rates for freight have in fact been met. The freight operators have not provided sufficient evidence to demonstrate that the criteria have not been met.



Annex 3 – Modification Notice

Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

Colas Rail Limited
Dacre House
19 Dacre Street
London
SW1H 0DH

2 November 2011

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND COLAS RAIL LIMITED DATED 21 DECEMBER 2006 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

The figure in the definition of 'Normal Planned Disruption Sum' shall be '£285'; and

The figure in the definition of 'Enhanced Planned Disruption Sum' shall be '£760'.

This modification shall have effect from 02:00 on 13 November 2011.

Terms defined in the Track Access Contract shall have the same meaning in this notice, unless otherwise defined in this notice.

A handwritten signature in blue ink that reads "Brian Kogan".

BRIAN KOGAN

Duly authorised by the Office of Rail Regulation



Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

DB Schenker Rail (UK) Limited
Lakeside Business Park
Carolina Way
Doncaster
DN4 5PN

2 November 2011

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND DB SCHENKER RAIL (UK) LIMITED DATED 9 FEBRUARY 2006 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

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This modification shall have effect from 02:00 on 13 November 2011.

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BRIAN KOGAN

Duly authorised by the Office of Rail Regulation



Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

Direct Rail Services Limited
Herdus House
Westlake Science & Technology Park
Moor Row
Cumbria
CA24 3HU

2 November 2011

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND DIRECT RAIL SERVICES LIMITED DATED 8 JANUARY 2010 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

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This modification shall have effect from 02:00 on 13 November 2011.

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BRIAN KOGAN

Duly authorised by the Office of Rail Regulation



Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

Freightliner Heavy Haul Limited 2 November 2011
The Podium
1 Eversholt Street
London
NW1 2FL

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND FREIGHTLINER HEAVY HAUL LIMITED DATED 26 SEPTEMBER 2007 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

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The figure in the definition of 'Enhanced Planned Disruption Sum' shall be '£760'.

This modification shall have effect from 02:00 on 13 November 2011.

Terms defined in the Track Access Contract shall have the same meaning in this notice, unless otherwise defined in this notice.

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BRIAN KOGAN

Duly authorised by the Office of Rail Regulation



Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

GB Railfreight Limited
15-25 Artillery Lane
London
E1 7HA

2 November 2011

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND GB RAILFREIGHT LIMITED DATED 29 JANUARY 2008 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

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The figure in the definition of 'Enhanced Planned Disruption Sum' shall be '£760'.

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BRIAN KOGAN

Duly authorised by the Office of Rail Regulation



Network Rail Infrastructure Limited
Kings Place
90 York Way
London
N1 9AG

Freightliner Limited
The Podium
1 Eversholt Street
London
NW1 2FL

2 November 2011

TRACK ACCESS CONTRACT BETWEEN NETWORK RAIL INFRASTRUCTURE LIMITED AND FREIGHTLINER LIMITED DATED 17 DECEMBER 2007 ("TRACK ACCESS CONTRACT"): MODIFICATION NOTICE

In a notice dated 30 September 2010 from Network Rail to the Train Operator and the Office of Rail Regulation ('ORR') under paragraph 8.2 of Schedule 4 of the Track Access Contract, Network Rail stated that the criteria for undertaking a review of the Specified Provisions had been met. After consulting the parties to the Track Access Contract and taking into account any representations received, we agreed that the criteria have been met. Having consulted the parties on the draft modification notice and the reasons for ORR's decision, ORR hereby gives notice under paragraph 8 of Schedule 4 of the Track Access Contract that the figures in the definitions of Planned Disruption Sum and Enhanced Planned Disruption Sum in paragraph 1.1 of Schedule 4 shall be modified as follows:

The figure in the definition of 'Normal Planned Disruption Sum' shall be '£285'; and

The figure in the definition of 'Enhanced Planned Disruption Sum' shall be '£760'.

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Terms defined in the Track Access Contract shall have the same meaning in this notice, unless otherwise defined in this notice.

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BRIAN KOGAN

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