

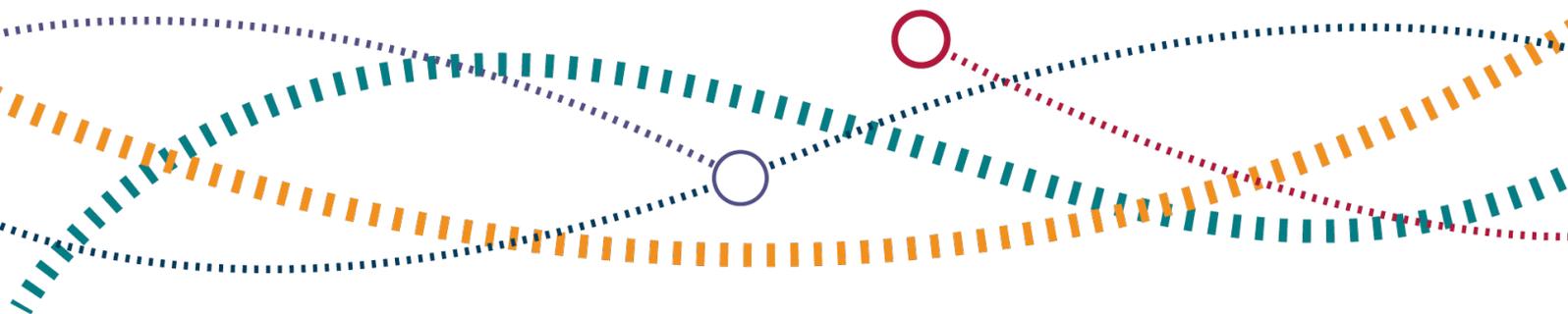


PR23 – Review of Schedule 4 possessions regime and Schedule 8 performance regime

Technical consultation

Preferred options

14 April 2022



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Executive Summary

Network Rail's possessions and performance regimes compensate train operators for financial impacts arising from planned and unplanned service disruption. The possessions and performance regimes are contained within Schedules 4 and 8 of track access contracts. Schedule 4 places incentives on Network Rail to plan possessions efficiently so as to minimise disruption, and Schedule 8 places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance.

As part of PR23 we are reviewing the frameworks for Schedules 4 and 8. This review is taking place amid significant on-going change and uncertainty. The industry's rapid change in response to COVID-19 has already affected the way Schedules 4 and 8 work for many, though not all, operators. And the UK Government's rail reform programme intends to bring forward legislation that will formally create a new body, Great British Railways (GBR), and further change the commercial arrangements for many passenger operators. While we must make decisions under the current legal framework, we are taking into account the wider context in our review.

Our initial consultations, published in June 2021 (Schedule 8) and September 2021 (Schedule 4), proposed to retain the essential structure of the regimes, rather than carry out more fundamental reforms. We proposed that operators should be allowed to opt out of the Schedule 4 regime, while all operators would remain within Schedule 8 pending wider industry reforms. Regarding the technical details of Schedules 4 and 8, we put forward a limited set of proportionate changes and invited views from stakeholders.

Following these initial consultations, we considered requests by Network Rail and DfT for some passenger operators to be able to opt out of Schedule 8, in particular to simplify the incentive arrangements for GBR's future operators. Our view of the current legal framework is that a performance regime that is financial in nature must continue to apply across the whole network. Therefore, we envisage that the Schedule 8 performance regime will continue to apply between Network Rail/GBR and all operators.

We will consider new proposals for timely and practicable alternative arrangements that meet the legal requirements for a performance regime – these would need to be settled by autumn 2022 in order to be reflected in our PR23 decisions on charges and incentives. If current legislation is amended, it may be possible to adopt alternative arrangements that for example do not feature Schedule 8's financial payments.

Given on-going industry change, and the prospect of further reform, we consider it proportionate to proceed with an incremental approach to reform, and to pursue only a

small number of the changes we put forward in our initial consultations. This will also free up industry resources for recalibration of the regimes in CP7, which we expect to be particularly challenging given the effects of COVID-19 on train services in the years within the current control period that would usually form the basis of the recalibration. The proposals we intend to take forward are set out below.

In relation to **Schedule 4**, we are minded to proceed with the following proposals:

- to introduce an opt-out mechanism to Schedule 4;
- to monitor possessions notifications on a more granular basis;
- to monitor and report on late possession changes and cancellations on a more granular basis; and
- to review and, if necessary, update freight compensation rates.

In relation to **Schedule 8**, we are minded to proceed with one proposal:

- industry to update evidence base underpinning calibration of freight payment rate.

Structure of this document

In this consultation, we recap the context for the PR23 review of Schedules 4 and 8, and present the overall approach we are minded to take (Chapter 1). We then set out the preferred approach to Schedule 4 (Chapter 2) and Schedule 8 (Chapter 3), considering the evolving industry context, responses to our initial consultations and further analysis we have carried out.

Responding to this consultation

We welcome views on the proposals set out in this consultation. Please send responses by email to performance.incentives@orr.gov.uk by **Friday 1 July 2022**. A full list of consultation questions is set out in Annex 2. We have also made available a [consultation response template](#) which contains further information on publication of responses.

Overall timetable for review of Schedules 4 and 8

We intend to publish our conclusions on these issues in autumn 2022, at which point we will confirm the implementation plan for CP7. In the meantime we will be working closely with industry on detailed recalibration issues as highlighted in Chapter 1.

1. Introduction and overall approach

Summary

We are minded to allow operators to opt out of Schedule 4.

We envisage that Schedule 8 will continue to apply between Network Rail/GBR and all operators. We would consider timely and practicable new proposals for alternative arrangements that meet legal requirements – these would need to be settled by autumn 2022 for them to be reflected in our PR23 decisions on charges and incentives. If current legislation is amended, it may be possible to adopt alternative arrangements that for example do not feature Schedule 8's financial payments.

We are minded to take a proportionate, incremental approach to changes to the regimes.

The Schedule 4 and 8 regimes

- 1.1 Network Rail's **possessions regime** compensates participating train operators for revenue and cost impacts resulting from planned service disruption, which typically arises due to Network Rail taking possession of the network to conduct engineering works. As well as providing compensation, the regime acts as an incentive on Network Rail to plan possessions efficiently to minimise disruption to operators and final customers¹.
- 1.2 Network Rail's **train performance regime** compensates train operators for the financial impact of unplanned disruption to services caused by other train operators and Network Rail. The regime is intended to provide protection against the financial impacts of delay, and to put incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve performance on the railway.

¹ Throughout this consultation, we refer to Network Rail in its capacity as the current infrastructure manager on the mainline network. A key element of the Plan for Rail is that, in future, Great British Railways (GBR) will take on the role of infrastructure manager (as well as commissioning many passenger services). References in this consultation document to Network Rail also apply to GBR once it has taken over as infrastructure manager.

- 1.3 The possessions and performance regimes are respectively contained in **Schedule 4** and **Schedule 8** of track access contracts and are referred to in this consultation as ‘Schedule 4’ and ‘Schedule 8’.
- 1.4 As part of PR23, we are reviewing the frameworks for Schedules 4 and 8. This combined ‘preferred options’ consultation follows on from separate initial consultations:
- (a) On Schedule 8, we issued an [initial consultation](#) in June 2021, along with a [Schedule 8 factsheet](#) providing a basic explanation of the regime². We received consultation responses from 29 organisations, which we [published](#) in October 2021.
 - (b) On Schedule 4, we issued an [initial consultation](#) in September 2021, along with a [Schedule 4 factsheet](#)³. We received consultation responses from 23 organisations, which we [published](#) in February 2022.
- 1.5 In Annex 1 we present updated objectives for Schedule 4 and 8 in CP7, i.e. the key functions of the regimes in providing compensation and improving train performance.
- 1.6 This consultation presents preferred options for the regimes in CP7.

The current legal framework

- 1.7 A train performance scheme is a requirement of the [Railways \(Access, Management and Licensing of Railway Undertakings\) Regulations 2016](#) (‘the 2016 Regulations’). Network Rail meets this requirement through Schedule 8. The 2016 Regulations state that each infrastructure manager must establish, as part of its charging system, a performance scheme “to encourage railway undertakings [train operators] and the infrastructure manager to minimise disruption and improve the performance of the network” (regulation 16(1)). The scheme must be based on basic principles listed in paragraph 7 of Schedule 3 of the 2016 Regulations and also “must apply in a non-discriminatory manner throughout the network to which that scheme relates” (regulation 16(3)).

² ORR has also published [detailed guidance on the Schedule 8 performance regime](#).

³ ORR has also published [detailed guidance on the Schedule 4 possessions regime](#).

- 1.8 Since our initial consultations, we have carried out further analysis of the legal requirement for a performance scheme in the context of requests for ‘opt-outs’ from Schedule 8 – see paragraphs 1.33 to 1.37.

Industry and legislative change

- 1.9 PR23 is taking place amid significant on-going change and uncertainty, which in turn is impacting our approach to the review of Schedules 4 and 8.
- 1.10 As noted in our initial consultations, the industry’s rapid structural change in response to COVID-19 has already affected the way Schedules 4 and 8 work for many, though not all, operators. Governments have replaced traditional franchises (where operators took on revenue risk) with concession-style agreements, and have brought some services under greater direct control. For these operators, there may no longer be the same need for the regimes to provide financial protection against disruption. Further, we understand that operators on such concession-style agreements are typically not exposed to passenger revenue risk, and that at present these operators are typically ‘held neutral’ to Schedules 4 and 8 by their contracting authorities. This means it is government bodies, rather than train operators, that are ultimately exposed to payments to and from Network Rail.
- 1.11 The [Williams-Shapps Plan for Rail](#) (the ‘Plan for Rail’) is bringing further change. The Plan for Rail has confirmed that arrangements which build on concession-style contracts, in the form of new ‘passenger service contracts’ (‘PSCs’), will be the dominant model for rail contracts let by the UK Government and in future Great British Railways (GBR). The UK Government’s intention is that these contracts will have strong financial incentives for operators to improve train performance (distinct from Schedule 8’s incentives), and it has started to explain how this will be achieved, including through a [market engagement exercise](#). Work is being taken forward by the Department for Transport (DfT) in conjunction with the GBR Transition Team (GBRTT), a forerunner to GBR.
- 1.12 We understand that the UK Government intends to issue a consultation on legislation to implement the Plan for Rail. At present we do not know whether, and if so when, legislation will amend the requirements for a performance scheme contained in regulation 16 and paragraph 7 of Schedule 3 to the 2016 Regulations. We are unlikely to have full clarity on this before autumn 2022, the point at which we need to conclude on the form of the Schedule 8 regime in CP7. We must therefore assume that the current legal framework remains in place, while planning for the possibility that legislation is passed that changes the framework before or

after the start of CP7. This assumption underpins our approach to Schedule 8 in PR23, as set out in the following section.

- 1.13 The Plan for Rail does not seek to change the powers and responsibilities held by the Scottish and Welsh Governments and other devolved rail authorities. Furthermore, even once the Plan for Rail is fully implemented, there will continue to be freight, charter and open access passenger operators that are purely commercial operations which will be at risk from the financial impacts of disruption. As at present, the long-term revenue receipts of these parties, and the experience of passengers in those parts of the network, will be impacted by the performance of the infrastructure manager (and other operators). For operators outside GBR, the Schedule 4 and Schedule 8 mechanisms can have an on-going role in providing some protection against this risk.

Approach to PR23

- 1.14 We have considered the most appropriate approach to PR23 in light of responses to our initial [Schedule 4](#) and [Schedule 8](#) consultations, and the UK Government's progress in implementing the Plan for Rail through its Rail Transformation Programme. We present here our preferred approach, firstly in relation to the scope of application of Schedules 4 and 8, and secondly with respect to changes to the detailed workings of the regimes.

Scope of application of Schedules 4 and 8

- 1.15 As part of PR23 we are making decisions on the scope of application of Schedules 4 and 8 – i.e. the operators to which we expect the regimes to be applied. We summarise here our proposed way forward.

Schedule 4

- 1.16 For **Schedule 4**, we proposed in our initial consultation (as Proposal A in paragraph 3.2) to give all operators the possibility to opt out of the regime, either completely or partially. This was in response to the transition towards concession-style contracts, which is altering the need for possession compensation arrangements for many operators.
- 1.17 We asked stakeholders whether they supported an opt-out, and whether it should be full or partial. A full opt-out, once triggered, would mean that operators receive no Schedule 4 compensation and pay no access charge supplement ('ACS', the fee currently levied in return for compensation). In considering a partial opt-out, we

consulted on two possible mechanisms – an opt-out of formulaic payments for shorter possessions and an opt-out of revenue loss compensation only⁴.

- 1.18 We also consulted on whether operators' decisions to opt out should be taken at the beginning of the control period and last for the entire control period, or whether operators should be allowed to opt in and out at any time during a control period.
- 1.19 In response, DfT and Network Rail supported the creation of a Schedule 4 opt-out mechanism, but DfT expressed concern about the partial opt-out option and Network Rail similarly argued that only the full opt-out option should be available. Transport Scotland supported an opt-out mechanism but raised concerns about discrimination between operators. TfL and TfW expressed no view on the options but said that any compensation scheme should reflect revenue loss and costs.
- 1.20 Most passenger operators supported or partly supported an opt-out mechanism although some asked for more detail on how it would work and were concerned about the reduced incentive on Network Rail to plan possessions efficiently. This concern was among the main reasons put forward by those operators that opposed an opt-out mechanism. FOCs tended to oppose the idea of an opt-out mechanism, echoing the concerns about reduced incentives on Network Rail, and stating that freight operators were very unlikely to use an opt-out given the value they place on the Schedule 4 regime.
- 1.21 **We are minded to take forward the Schedule 4 opt-out proposal, as 'Preferred Option 1' within this consultation.** We consider that having an opt-out mechanism provides operators with the flexibility to adjust to rail reform in line with their commercial circumstances. We are minded to limit this to a full opt-out option only. It will be available to freight and passenger operators, but open access operators will retain the right to opt out of paying the Schedule 4 access charge supplement and receive only limited compensation. This approach limits complexity, as having two types of Schedule 4 scheme would increase the steps involved in calculating access charge supplements for operators.
- 1.22 We are also minded to limit the timing of the opt-out decision to prior to the start of each control period: we expect operators to decide whether to opt in or out in

⁴ An opt-out of formulaic payments for shorter possessions would see operators given the possibility to opt out of the full scheme and receive compensation only for type 3 possessions (those longer than 120 hours) and sustained planned disruption. An opt-out of revenue loss compensation would allow operators to choose to opt out of revenue loss compensation (which reflects lost fares arising from cancelled services) but continue to receive cost compensation (e.g. covering costs of replacement buses). Under both options, access charge supplements would be adjusted accordingly. The two options are not mutually exclusive, i.e. they could be pursued in combination.

advance of the start of the control period. Once an operator has opted in or out, this decision will last for the entire control period. This approach will address concerns that an on-going ability to opt in or out would offer the opportunity for existing operators to take advantage of knowledge about upcoming engineering works, potentially driving a decision about whether to opt in or out of compensation for a particular period of time. The limitations will also allow Network Rail to plan possessions and budget its Schedule 4 costs efficiently.

1.23 Exceptions to this approach would be when one of the following takes place mid-control period:

- (i) a refranchise of an existing concession contract;
- (ii) a change of ownership of a concession contract mid-term that involves significant changes in service levels; or
- (iii) launch of a completely new franchise or open access operator.

Mitigating the loss of financial incentives

1.24 We recognised in our September consultation that an opt-out mechanism might blunt the financial incentives on Network Rail to plan possessions efficiently and minimise disruption to passenger services. We consider this risk can be mitigated through enhanced monitoring of Network Rail's possession planning and notification system and we discuss this in more detail below.

1.25 In addition we propose an additional level of reporting, which would require Network Rail to collect information on the number and length of planned possessions. ORR would monitor this information for indications of a trend increase in overall possessions taken by Network Rail after the opt-out mechanism is implemented, or for an increase in the average length of possessions. (We recognise there could be justifiable reasons for such changes through time, e.g. greater track maintenance requirements.)

1.26 We will also consider whether this information could be included within ORR's approach to holding Network Rail to account, to monitor for increases in the average length of possessions, later timings of when possessions are notified, or an overall increase in possessions by route and over the network. The results of this regime would be reported publicly. This might generate reputational incentives for Network Rail to reduce possessions, although it would not be clear whether this represented efficient behaviour (rather than, for example, a failure to adequately maintain the network).

- 1.27 We consider the above measures, together with our proposals on monitoring late possessions and notifications, will provide sufficient scrutiny of how Network Rail plans possessions under the opt-out proposal for Schedule 4.

Timing of the opt-out decision

- 1.28 In order for an operator to decide whether to opt in or out it would need to have an understanding of the likely level of access charge supplement it expects to pay over the control period. This will require Network Rail to provide an estimated ACS for all TOCs earlier than has been provided in previous control periods. Once Network Rail has provided indicative ACSs we expect franchised TOCs to decide whether to opt out. During the Schedule 4 recalibration stage we will determine the date by which this will need to be done. After this date we will treat any franchised TOCs that have not stated an intention to opt out as opting to remain in the Schedule 4 regime.
- 1.29 Open access operators will also need to decide whether to opt out to the same timescales, after which, open access operators that have not stated an intention to opt out will remain in receipt of the baseline levels of Schedule 4 currently applicable in open access operator track access contracts.

Consultation question

Question 1: Do you agree with ORR's position that train operators should be able to opt out of Schedule 4 in CP7, subject to limitations on timings of decisions to opt in or out?

Schedule 8

- 1.30 For **Schedule 8**, we proposed in our initial consultation (paragraphs 2.8 to 2.9) that the regime would remain in place for all operators, in light of the legal requirement for a performance scheme and the benefits of co-ordinating any fundamental changes with wider government-led reforms. We welcomed views on this, including any implications this would have for funders.
- 1.31 In response, DfT and Network Rail asked ORR to consider ways for DfT's operators, and potentially those of devolved bodies, to 'opt out' of Schedule 8. DfT told us that this could help to simplify incentives given that its operators will continue to face financial incentives in their concession-style contracts. Additionally, Network Rail argued that current arrangements are administratively costly and risk 'leakage' of funds from the industry – i.e. when a funder makes an annual 'surplus' from Schedule 8 the funds may be lost from the railway. Transport

Scotland acknowledged the on-going legal requirement for a performance scheme, but has indicated to us that it would welcome the capacity for Scottish operators to opt out of Schedule 8 if this was possible.

- 1.32 Some devolved bodies, such as TfW and TfL, responded that they strongly value the protection and incentives provided by a regime such as Schedule 8. Freight and open access passenger operators overall strongly wish to remain part of the regime, given their exposure to the financial impacts of disruption – the legitimacy of these interests was also widely recognised by other respondents. Other passenger operators were mixed in their desire to remain exposed to Schedule 8, with some recognising that other arrangements might come to replace it given the direction of reform set out in the Plan for Rail. They did consider that, so long as there are operators that bear some revenue risk, it will be appropriate for Schedule 8 or a replacement mechanism to continue in some form.
- 1.33 As already noted, until any legislation is passed by the UK Parliament, we must assume that the current legal framework remains in place, while planning for the possibility that it changes before or after the start of CP7. Following representations received in relation to our initial consultation, we have re-examined the degree of flexibility within the current legal framework.
- 1.34 We have considered alternatives to the current regime put forward by Network Rail, including: an option for some operators to fully ‘opt out’ from Schedule 8; setting the scheme’s payment rates to zero for GBR’s future operators; and permitting side-agreements between Network Rail/GBR and operators that would cancel out payment flows. Network Rail considers that these alternatives would recognise the operators’ lesser need for financial protection against the revenue effect of disruption, and would have the benefit of simplifying incentive arrangements for these operators.
- 1.35 Following further legal analysis, we consider that it would be possible for the performance scheme to vary for different categories of passenger operator, if justified by the characteristics of each category of operator. However, we consider that the requirement that a performance scheme must apply across all operators on the network means that removing categories of operators from the scheme entirely (as would be the effect of an opt-out) would not be consistent with the legal framework. Further, there is an expectation that the scheme should be financial in nature and therefore we do not consider that a proposal to ‘switch off’ payments or set payment rates to zero would be consistent with the legal

framework⁵. Similarly, a side-agreement between Network Rail/GBR and operators that has the effect of cancelling out Schedule 8's payment flows would also not be consistent with the 2016 Regulations as this would mean there were effectively no financial incentives in place in the scheme⁶.

- 1.36 We have also explored whether it is possible to rely on the performance incentives in concession-style agreements to satisfy requirements for a performance scheme. Based on our understanding, we do not consider that operators' concession-style agreements as currently envisaged are sufficient on their own to satisfy the requirements for a performance scheme in the 2016 Regulations. We understand that those agreements lack some of the required elements of a performance scheme, for example incentives on the infrastructure manager⁷.
- 1.37 For these reasons, we consider that the alternative proposals we have received to date in relation to GBR's future operators are not compatible with the requirements of the 2016 Regulations.
- 1.38 Therefore, we envisage that for PR23 the Schedule 8 performance regime will continue to apply between Network Rail/GBR and all operators. We would consider new proposals presented to us in a timely way for alternative arrangements that meet the requirements of the 2016 Regulations; these must be practicable to implement, must be demonstrated to be consistent with the legal framework, and would need to be settled by autumn 2022 for them to be reflected in our PR23 decisions on charges and incentives.
- 1.39 If legislation is passed that amends the 2016 Regulations, sufficiently relaxing the requirement for a performance scheme, we consider that Schedule 8 payments may no longer need to be made between GBR and its operators.

⁵ This expectation arises from the overall framing of regulation 16 of the 2016 Regulations in financial terms, its positioning of the performance scheme within the charging system, and the requirement that the performance scheme must observe certain principles in paragraph 7 of Schedule 3 of the 2016 Regulations, which refer to financial concepts such as the value of delays and thresholds for payments.

⁶ Side-agreements between Network Rail and operators are already in existence or development – these agreements sit alongside Schedule 8 and do not cancel out Schedule 8 payments. ORR has issued a [letter](#) setting out principles to recognise and observe regarding such agreements (which are also known as 'overlays'). In our letter we emphasised that, by virtue of the Railways Act 1993, agreements which have the effect of amending Schedule 8 (or the track access agreement generally) without the approval of ORR under section 22 are void and unenforceable by either party.

⁷ DfT's market engagement exercise on passenger service contracts states that "payments to PSC operators will depend mainly on trains being on time and minimal disruption for passengers", but our understanding is that the contracts do not feature similar incentives on the infrastructure manager.

- 1.40 Depending on the scope of any amendments to the legislative provisions regarding a performance scheme, it may also be possible to extend the option for such alternative arrangements to other operators such as those contracted or run directly by devolved bodies. Depending on the nature of any legislative change, consideration could be given to this in Scotland where Transport Scotland's responsibilities cover both commissioning passenger train services and funding Network Rail/GBR.
- 1.41 The contractual performance regime has on-going importance for third-party operators – i.e. FOCs, charter operators, passenger open access operators, and operators contracted by devolved bodies that are not funders of Network Rail/GBR. Therefore, in line with representations from a wide range of stakeholders and funders, we are not proposing any change to the scope of the regime for these operators – for example we are expecting no structural change to the TOC-on-TOC payments to and from such third-party operators.

Consultation question

Question 2: We envisage that Schedule 8 will continue to apply between Network Rail/GBR and all operators. We would consider timely and practicable new proposals for alternative arrangements that meet legal requirements – these would need to be settled by autumn 2022 for them to be reflected in our PR23 decisions on charges and incentives. If current legislation is amended, it may be possible to adopt alternative arrangements that for example do not feature Schedule 8's financial payments. Do you agree with this position?

Approach to changes to Schedules 4 and 8

- 1.42 In our initial consultations we considered whether it was proportionate and worthwhile to make changes to the detailed workings of Schedules 4 and 8 to improve their functioning. We proposed to retain the essential structure of the regimes rather than carry out more fundamental reforms (aside from the Schedule 4 opt-out proposal). We put forward what we considered to be incremental and proportionate changes to address issues that we and stakeholders had identified.
- 1.43 In response to our initial **Schedule 4** consultation, Network Rail argued in favour of reform of the regime to ensure it is fit for purpose for operators that remain in the scheme, but that the likely efficacy of all proposals will need to be considered alongside the costs of change. DfT supported steps to simplify Schedule 4 where

possible where this would not worsen incentive effects. Passenger and freight operators largely supported ORR's incremental reform approach, while having mixed views on the merits of individual proposals.

- 1.44 In response to our initial **Schedule 8** consultation, Network Rail supported ORR's high-level proposal to incrementally reform the regime, and largely supported ORR's specific proposals. DfT was more reserved, stressing the importance of a mechanism such as Schedule 8 for freight and open access operators and that ORR should seek to focus its work on the regimes for those parties. Passenger operators largely opposed changes to Schedule 8 – several argued that making changes now would be inappropriate when the wider Rail Transformation Programme is underway with associated uncertainties about the shape of the future system and contractual architecture. Freight operators saw value in some of the proposals put forward, but had little appetite for substantial change amid wider rail reform.
- 1.45 A theme within many responses to both consultations was to question the value of making changes to Schedule 4 and 8 given that concession-style operators are currently not exposed to the financial impacts of disruption and are held neutral to payments. Further, respondents noted that fewer operators will be exposed to Schedule 4 if the opt-out proposal is implemented, as we intend. Similarly, if wider reforms take place that affect the application of Schedule 8 for some passenger operators (for example following legislative change), fewer operators would be fully exposed to the regime than in previous control periods.
- 1.46 These assumptions considerably lower the expected benefits of changes to the Schedule 4 and 8 passenger regimes. Furthermore, it is relevant to note that we are expecting the recalibration of the regimes to be particularly challenging due to the impact of COVID-19 on reference data (as highlighted later in this chapter), so there is an advantage in avoiding any changes that could complicate this process. Based on our expectation that freight operators will remain part of Schedules 4 and 8 in CP7, there is a clearer benefit to changes that can improve the freight regimes.
- 1.47 For these reasons we are now minded to pursue only a small number of changes to the Schedules 4 and 8 regimes, as set out in the next two chapters. We assess the impacts of proposed changes within these chapters.

1.48 In relation to Schedule 4 (see Chapter 2), we are minded to proceed with the following proposals:

- **to introduce an opt-out mechanism to Schedule 4, whereby train operators could opt out of Schedule 4 ('Preferred Option 1' within this consultation);**
- **to monitor possessions notifications on a more granular basis (Preferred Option 2);**
- **to monitor and report on late possession changes and cancellations on a more granular basis (Preferred Option 3); and**
- **to review and, if necessary, update freight compensation rates (Preferred Option 4).**

1.49 In relation to Schedule 8 (see Chapter 3), we are minded to proceed with the following proposal:

- **industry to update evidence base underpinning calibration of freight payment rate (Preferred Option 5).**

Consultation question

Question 3: Do you agree with ORR's proposal to limit the number of changes to Schedules 4 and 8?

Recalibration of Schedules 4 and 8 for CP7

PR23 recalibration

1.50 Recalibration of Schedules 4 and 8 is likely to be particularly challenging in PR23, as flagged in our initial Schedule 8 consultation (see box on 'Calibration challenges in PR23', pages 24-25)⁸. Several Schedule 8 consultation responses also noted these challenges, which include:

- Train performance data from 2020-21 onwards is affected by the impact of COVID-19. It is therefore not obvious what historical performance data to use

⁸ Calibration of Schedule 4 currently relies upon payment rates generated for the calibration of Schedule 8, so the calibration processes are linked.

to inform scheme parameters, and whether further adjustments are required to reflect future circumstances.

- The nature of demand has changed, perhaps permanently. Demand patterns may be enduringly different, for example in the mix of commuter, business and leisure journeys. These assumptions affect the financial impacts of disruption and therefore, in particular, payment rates.
- An on-going RDG-led study into the impacts of disruption may provide additional evidence for the PR23 recalibration, potentially changing the level of Network Rail's payment rates for passenger operators.

1.51 These important issues can best be resolved in a timely way through discussions with industry. ORR has therefore established Schedule 4 and 8 recalibration working groups for the passenger and freight regimes, and work is now underway on these significant questions.

1.52 The recalibration working groups are likely to discuss options that include more frequent updates to some parameters – see paragraph 3.3 and Table 3.1. We will take account of these discussions in reaching conclusions on those of our proposals that included annual updates to parameters.

Mid-control period recalibration

1.53 Following PR18 we issued [guidance](#) on the circumstances under which we would consider a mid-control period recalibration of Schedule 8 for passenger operators (paragraphs 28 to 46). This guidance included the possibility of a 'type 3' recalibration based on 'forecast uncertainty', which was conceived of as a way to 'correct' benchmarks during the control period to make them better reflect expected performance.

1.54 It may be appropriate to consider such a recalibration during CP7 if uncertainties about the path of recovery from COVID-19 mean that parameters turn out to have been inaccurately determined. However, recalibration is a costly exercise, and we could worsen Schedule 8's incentive properties if a recalibration point is fixed in advance, so it will only be undertaken if there is strong evidence that it is necessary. As work proceeds in the recalibration working groups, we will consider whether there is merit in updating the guidance on circumstances under which we will consider mid-control period recalibrations.

Indexation of payment rates

- 1.55 Schedule 4 and 8 payment rates are indexed to general price inflation. ORR's parallel [PR23 consultation on access charges](#) is consulting on the appropriate general inflation measure to use to re-index access charges and payment rates in mechanisms such as Schedule 4 and 8. As that consultation states, we are minded to retain the Consumer Price Index (CPI) as the general inflation index for this purpose.

Delay attribution

- 1.56 Delay attribution is the system through which delay incidents are attributed a primary cause, including allocating responsibility to an industry party. Delay attribution has a wider purpose in understanding and helping to improve operational performance and it also provides information that is a key input into Schedule 8 calculations. Concerns have been raised, including within the Plan for Rail (page 15), that the system is resource-intensive and results in disputes which are adverse to industry relationships. These long-standing concerns resulted in efforts led by ORR and industry to achieve improvements – a number of actions are now underway, with a [progress update](#) given by ORR in January 2022.
- 1.57 In our initial Schedule 8 consultation, we stated that the review of Schedule 8 was not the right place to revisit delay attribution, but we committed to supporting industry efforts to achieve reform. In response, Network Rail and DfT encouraged ORR to consider the steps we can take to improve the functioning of the current system.
- 1.58 Network Rail is seeking to establish a programme to update and improve underlying performance and delay systems and processes. This would be likely to be a multi-year programme given the complexities of changing long-standing systems, and clarity is needed on how this would be funded. However, such changes would be capable of supporting improved cross-industry processes for understanding delay and managing the contractual consequences, through the Network Code and Schedule 8. We welcome this initiative, and we will liaise with Network Rail to make clear our expectations for any such programme, for example for early cross-industry involvement, and what we expect ORR's role to be in respect of any proposals. If there are consequential changes required for Schedule 8, it may be possible for these to be accommodated through a mid-control period recalibration of Schedule 8. In the meantime, we will continue to monitor progress of initiatives from the previous reviews of delay attribution.

2. Schedule 4 – technical review

Summary

Given the wider context, we intend to take a proportionate approach to changes to Schedule 4, and are minded to take forward four of our initial proposals.

Introduction

- 2.1 Chapter 1 explained that we are minded to take a proportionate approach to changes to the Schedule 4 regime. We are proposing to take forward four of our original proposals. The most significant change is the introduction of an opt-out mechanism as discussed in Chapter 1.
- 2.2 This proportionate approach reflects the move to concession-style contracts, in particular the removal of revenue risk for most operators. In addition, there is a need to focus resources on calibration given the significant challenges the impact of COVID-19 presents to the recalibration exercise.
- 2.3 Table 2.1 below summarises our updated position in respect of the proposals in our initial consultation. This chapter then expands upon the proposals that we intend to take forward, and Annex 4 sets out our reasoning for each Schedule 4 proposal we are minded not to pursue.

Table 2.1 Summary of ORR’s initial Schedule 4 proposals and our minded-to positions

Initial proposal	Minded-to position
Proposal A To introduce an opt-out mechanism to Schedule 4, whereby train operators could completely or partially opt out of Schedule 4	Minded to take forward, as Preferred Option 1 We consider an opt-out offers industry the flexibility to respond to rail reform while maintaining the protection offered by the Schedule 4 regime to third-party operators.

Initial proposal	Minded-to position
<p>Proposal B</p> <p>To increase incentives on Network Rail to notify possessions early once the ‘informed traveller’ notification threshold (T-22) has been passed, either by:</p> <p>Option B1: introducing an additional notification threshold, or</p> <p>Option B2: monitoring possessions notification on a more granular basis</p>	<p>Minded to take forward Option B2, as Preferred Option 2</p> <p>There was little support from respondents for Option B1 and, given the feasibility of introducing an additional late threshold was looked at and rejected in PR18, we do not intend to take this forward.</p> <p>We intend to take forward Option B2. We will consider also whether the monitoring can be incorporated into the CP7 accountability framework.</p>
<p>Proposal C</p> <p>To develop a method and/or process for settling compensation claims for lengthy possessions and periods of sustained planned disruption</p>	<p>Minded not to take forward</p> <p>We received a mixed response on both parts of this proposal, and there was an expectation that any benefits from either would be low compared with the costs.</p> <p>We consider an industry-led solution preferable at this stage and will encourage the industry to work together on improving the negotiating framework.</p>
<p>Proposal D</p> <p>To monitor and report on late possession changes and cancellations on a more granular basis</p>	<p>Minded to take forward, as Preferred Option 3</p> <p>This proposal gained widespread support and we intend to take it forward. We consider more granular information about when Network Rail informs operators about possessions will help our assessment of whether it is booking too many possessions early, and provide useful data in monitoring how efficiently Network Rail is planning possessions.</p> <p>We intend to develop a monitoring framework working with Network Rail on its capability.</p>
<p>Proposal E</p> <p>To develop a tool to estimate Schedule 4 formulaic compensation</p>	<p>Minded not to take forward</p> <p>Network Rail stated it had made previous attempts at developing such a tool but found it problematic and expressed concerns about cost. Given these concerns, we do not intend to take this forward as a regulatory requirement, but we encourage Network Rail to keep the idea for such a tool under review.</p>
<p>Proposal F</p> <p>To review the methodology for calculating the ACS for open access operators</p>	<p>Minded not to take forward</p> <p>Overall respondents thought changing the methodology would introduce undue complexity with few benefits. We therefore are minded not to take forward this proposal.</p>

Initial proposal	Minded-to position
<p>Proposal G</p> <p>To review and, if appropriate, update freight compensation rates</p>	<p>Minded to take forward, as Preferred Option 4</p> <p>We intend to take forward a review of freight payment rates and we will take account of the funding implications of any changes when setting out any proposals.</p>

2.4 We discuss next the proposals that we intend to take forward as part of PR23. These comprise a small set of ‘preferred options’, the first of which was the Schedule 4 opt-out proposal (‘Preferred Option 1’) in Chapter 1.

Preferred Option 2: To increase incentives on Network Rail to notify possessions early once the ‘informed traveller’ notification threshold (T-22) has been passed

September 2021 consultation

2.5 In our September consultation, as Proposal B, we proposed increasing the incentives on Network Rail to notify possessions early, once the ‘informed traveller’ notification threshold (T-22) has been passed.

2.6 Network Rail receives a discount on the amount of compensation it pays to passenger operators, depending on how early it notifies operators about possessions. The discount reflects the fact that the sooner operators know about a possession, the sooner they can inform passengers, thereby causing less inconvenience to passengers as a result of late service changes.

2.7 There are currently three notification thresholds, for which Network Rail obtains a different level of discount:

- (i) D-26 (read as ‘D minus twenty-six’) is known as the ‘early threshold’ and is set at 26 weeks before a new working timetable comes into effect (in May and December each year)⁹.
- (ii) T-22 (read as ‘T minus twenty-two’) is known as the ‘informed traveller’ threshold and is set at 22 weeks before a possession is planned to take place.

⁹ About 80% of possessions are notified in advance of the early threshold.

- (iii) Late threshold. This relates to what is known as the ‘applicable timetable’, which is when operators are notified of a possession by 10pm on the day before the possession is due to take place.

2.8 In the current regime, there is no explicit incentive on Network Rail to give notification to operators as early as possible once the informed traveller threshold has been passed.

2.9 We identified two options to strengthen the incentives on Network Rail to notify possessions as early as possible once the informed traveller threshold has been passed:

- **Option B1 – Add a notification threshold.** A notification threshold could be added between the ‘informed traveller’ threshold at T-22 and the late threshold¹⁰.
- **Option B2 – Monitor and report on possessions notification on a more granular basis.** ORR would require Network Rail to record the exact date on which each possession was notified, and not just the threshold that was met.

Responses to September 2021 consultation

2.10 There was generally support from respondents for increasing Network Rail’s incentives to notify as early as possible after the T-22 threshold, with only three respondents opposing the proposal entirely. In particular, there was support for Option B2, to increase the granularity of monitoring and reporting. There was little support for Option B1, to add an additional notification threshold.

2.11 Many respondents agreed with the issue this proposal is seeking to address, that Network Rail has little incentive to make earlier notifications once T-22 is passed. Most respondents in favour of Option B2 welcomed the approach because it would provide data on late notice possessions and better inform future decision making in this area. It was also welcomed by respondents for not adding any complexity to the Schedule 4 regime, a weakness of Option B1 that was pointed out in multiple responses. Transport Scotland argued that Option B2 is “more aligned to the role of [Network Rail] as a government body and their statutory responsibilities to the UK/Scottish taxpayer”. This was seen as another reason to support Option B2, noting that Option B1 had been proposed and dismissed in PR18.

¹⁰ The industry investigated in detail the possibility of adding a notification threshold, at T-14, in PR18. At that time, we decided not to take the proposal forward due to a lack of consensus around the appropriate threshold to add and concerns around the impact on the timetabling process.

- 2.12 The few respondents that opposed the proposal altogether argued that it increased the regime's complexity at a time when ORR should be focusing on simplicity, or that the proposal would be ineffective at driving behavioural change.

Our assessment

- 2.13 The option to include an additional notification threshold at T-14 was investigated as part of in PR18. However, we decided not to take the proposal forward due to a lack of consensus around the appropriate threshold to add and concerns around the impact on the timetabling process. This view has not changed and given that there was little support from respondents for Option B1 we do not intend to take this forward.
- 2.14 However, we consider there is merit in Option B2 and are minded to take this forward. This is because it would allow for more effective monitoring by ORR and the industry of how much in advance of the relevant threshold Network Rail is notifying operators of possessions. It also provides Network Rail with a reputational incentive to notify possessions as early as possible once a notification threshold has been passed. Lastly, it will help to mitigate the potential loss of financial incentives on Network Rail to plan possessions efficiently that could arise from the proposed opt-out mechanism.

Preferred Option 3: To monitor and report on late possession changes and cancellations on a more granular basis

September 2021 consultation

- 2.15 In our September consultation, as Proposal D, we said we would consider strengthening our monitoring and reporting of late possession changes and cancellations, as part of our wider CP7 monitoring and reporting approach.
- 2.16 As noted above, Network Rail obtains a discount on the revenue loss compensation it pays to operators the sooner it gives notice of a possession. After notifying a possession, Network Rail may still change its plans (e.g. change start time or duration) or cancel the possession, normally up until seven weeks before the delivery of the possession¹¹.
- 2.17 Operators had told us that this incentivises Network Rail to notify too many possessions early in order to receive the maximum discount, with the

¹¹ Changes to possessions after this point are only permitted if they are business or safety critical.

consequence that Network Rail may often need to later change or cancel possessions, sometimes at short notice.

- 2.18 We noted in our consultation that we do not have sufficient evidence to determine the proportion of late possession changes and cancellations, or the impact on operators and passengers. The reasons for Network Rail's changes to, or cancellations of, previously notified possessions were also unclear.
- 2.19 We therefore proposed to monitor possession changes and cancellations on a more granular basis. This would provide us with greater evidence to assess the scale of the issue, identify if any immediate actions are required, and inform our policy in future periodic reviews.
- 2.20 We also said we would consider whether this proposal could be developed jointly with ORR's PR23 workstream covering CP7 outcomes and the monitoring and reporting framework.

Responses to September 2021 consultation

- 2.21 All stakeholders that provided a view on this proposal supported it. Many operators supported the proposal on the grounds that late cancellations have a substantial impact on operators' businesses, and on the grounds of increased industry collaboration. Some operators provided anecdotal evidence of late possession changes and cancellations causing them issues in a way that they deemed to be unfair.
- 2.22 Some supporters of the proposal suggested that Schedule 4 was not the correct vehicle for monitoring Network Rail's performance on making late changes to its possession plans, and that instead it should be undertaken specifically by ORR. Other stakeholders requested additional detail on the proposal. TfL had no view on the issue itself but supported the monitoring of Network Rail, and Transport Scotland asked for any evidence gathered from the consultation responses to be shared with it.
- 2.23 Network Rail argued that, if ORR can provide evidence that late possession changes and cancellations are an issue, imposing a fine would be an inappropriate option and instead removal of the discount could be more appropriate. For CP7, however, Network Rail said that rather than introduce a new fine or discount, ORR should simply monitor the situation to better understand if issues exist.

Our assessment

- 2.24 This proposal gained widespread support. We consider that information about when Network Rail actually informs operators about possessions will help our assessment of whether Network Rail is booking too many possessions early. It can also provide more generally useful data in monitoring how efficiently Network Rail is planning possessions, to include Network Rail recording the actual date of first notification, and dates and reasons of any subsequent cancellations or changes to possessions.
- 2.25 We are therefore minded to take this proposal forward and will work with Network Rail to develop a monitoring framework that better informs industry about how Network Rail plans its possessions.

Preferred Option 4: To review and, if appropriate, update freight compensation rates

September 2021 consultation

- 2.26 In our September consultation, as Proposal G, we proposed to review freight operator compensation rates in light of any new evidence supplied by freight operators. This was in response to concerns raised by freight operators that while Schedule 4 broadly works as intended, there is a mismatch between compensation levels and the costs they incur due to possessions. This, they argued, effectively means Network Rail does not consider the full impact of disruption on freight operators when planning possessions.
- 2.27 Freight operators also told us that the cost to them of cancellations, relative to diversions or delays, is greater than that implied by the ratio between the corresponding Schedule 4 payment rates. This could lead Network Rail to choose to cancel services when a diversion be a better outcome from the overall industry perspective.
- 2.28 However, as part of any work to recalibrate freight payment rates, we also said we would need to consider the funding implications of any changes in payment rates, and that any rise in compensation levels may be conditional on the payment of an ACS by freight operators to fund the additional Schedule 4 costs.

Responses to September 2021 consultation

- 2.29 All stakeholders that responded on this issue supported a review of freight payment rates. Some concerns and suggestions were raised about the process ORR would use to recalculate freight payment rates.

- 2.30 GB Railfreight supported a review because this would provide a more accurate payment rate and therefore a sharper incentive on Network Rail to plan possessions efficiently. The Rail Freight Group noted this is of particular importance in a scenario where passenger operators opt out, because any resulting weakening of incentives for Network Rail would increase the challenges freight operators face. Transport Scotland agreed this proposal should be a priority for PR23 given the likelihood that the current rates are outdated.
- 2.31 DB Cargo warned that reviewing freight payment rates would not be straightforward because the compensation rates apply to all freight operators, and therefore should be based on average costs incurred as a result of possessions. DB Cargo also wondered how revised rates would be funded in a scenario in which the revised rates are higher than the current rates. Specifically, it queried whether the revised rates would only apply to FOCs that elect to pay an ACS to fund Network Rail's increased compensation liabilities. Freightliner also queried whether the revised rates should be fully cost reflective if this would require direct funding from FOCs through an ACS. RDG raised concerns about the administrative costs to FOCs of the review and suggested these could be minimised if the review is done in conjunction with Schedule 8 changes.
- 2.32 Network Rail was content with the proposal but proposed that, if it is implemented, ORR reforms the Network Code to minimise operators objecting to Network Rail's possession plans and adds a minimum threshold for actual cost claims. Network Rail also expressed some concerns over the funding of any proposed increases to payment rates, and was supportive of the introduction of an ACS if necessary.

Our assessment

- 2.33 We are minded to take forward a review of freight compensation rates as part of PR23, subject to freight operators providing new evidence on the costs incurred as a result of possessions. We also propose reviewing the evidence on the cost differential between cancellations and diversions or delays. Freight operators may in future benefit from more accurate levels of compensation than at present. More cost-reflective rates could enhance the incentive on Network Rail to plan possessions efficiently, minimising disruption to freight operators. And they may also encourage greater co-operation between Network Rail and freight operators in planning maintenance and renewals and implementing emergency timetables.
- 2.34 However, as stated we need to consider the funding implications of any changes in payment rates. Our view is that any rise in compensation will require the additional cost to be met by the payment of an ACS by freight operators, or through additional funding from railway funders, or a combination of the two.

- 2.35 We therefore propose that, at a minimum, compensation rates should be recalibrated in line with general inflation. At the same time, subject to information supplied by freight operators, we propose an enhanced compensation regime for freight operators, which would cover the additional costs and revenue loss that they incur from possessions above the costs already covered by existing compensation rates.
- 2.36 The enhanced payments would either be funded through an ACS covering the additional expected compensation, or ultimately by railway funders through Network Rail's net revenue requirement (i.e. the money Network Rail receives through network grant and track access charges).
- 2.37 The existing freight Schedule 4 regime is currently funded out of Network Rail's revenue requirement. We calculate that Schedule 4 payments to freight operators were £15m in 2019-20 and £12m in 2020-21¹². It is not possible at this stage to determine the funding implications of increased freight payment rates. However, by way of illustration, if freight payment rates were to be indexed for inflation and then increased by 1.5 to 3 times current rates, the funding requirement could increase to between £24m and £47m¹³ in 2024-25.
- 2.38 Under this option, Network Rail would clearly specify the additional compensation that would be provided to freight operators if they opt in and the associated ACS that they would have to pay. Freight operators would retain the option to pay no ACS and continue to receive current levels of compensation.

Consultation question

Question 4: Do you agree with ORR's preferred approach to take forward the proposals detailed in this chapter? Do you have comments on these proposals and the specific implementation approaches for each?

¹² These figures exclude actual cost compensation negotiated between Network Rail and operators for short notice cancellations and service variations.

¹³ This assumes the number of possessions in 2024-25 reflects the average for 2019-20 and 2020-21.

3. Schedule 8 – technical review

Summary

Given the wider context, we intend to take a proportionate approach to changes to Schedule 8, and are minded to take forward only one of our initial proposals.

Introduction

- 3.1 Chapter 1 has explained the approach to the scope of the application of Schedule 8 in CP7. We envisage that Schedule 8 will continue to apply between Network Rail/GBR and all operators. However, we would consider timely and practicable new proposals for alternative arrangements that meet the requirements of the 2016 Regulations. Further, if current legislation is amended, it may be possible to adopt alternative arrangements that for example do not feature Schedule 8's financial payments.
- 3.2 Chapter 1 has also explained that we are minded to take a proportionate approach to changes to the Schedule 8 regime: we are proposing to take forward only one of our original proposals. This proportionate approach reflects the current treatment of Schedule 8 within concession-style contracts, the possibility of future reduced scope of application of Schedule 8, the lack of support within the industry for our initial proposals, and the need to focus resources now on the PR23 recalibration given the significant challenges we expect in this task.
- 3.3 Table 3.1 below summarises our updated position in respect of the proposals in our initial consultation. This chapter then expands upon the proposal that we intend to take forward, and Annex 5 sets out the reasoning for our position on each Schedule 8 proposal we are minded not to pursue. We note that some of the proposals in Table 3.1 may contain features, such as more frequent updates to parameters, that merit consideration by the recently-created recalibration working groups. We will take into account the discussions in these working groups when we make final decisions on the proposals.

Table 3.1 Summary of ORR’s initial Schedule 8 proposals and our minded-to positions

Initial proposal	Minded-to position
<p>Proposal A</p> <p>Change the way Network Rail’s benchmarks are set, basing them only on historical data</p>	<p>Minded not to take forward</p> <p>Keeping the current approach is proportionate and keeps consistency with the wider PR23 settlement. The current approach is contingent on production of performance trajectories – see paragraph 3.8.</p>
<p>Proposal B</p> <p>Update benchmarks annually to make them more flexible during control periods, either through:</p> <p>Option B1 – average of rolling historical performance, or</p> <p>Option B2 – modelled approach</p>	<p>Minded not to take forward</p> <p>Keeping the current approach keeps intact incentives to improve performance. While we do not currently envisage taking forward the proposal, due in part to concerns about its incentive effects, the recalibration working groups will consider the merits of more frequent updates to Schedule 8 parameters. We will take these discussions into account when making a decision on this proposal.</p>
<p>Proposal C</p> <p>Share allocation of some types of delay within Schedule 8, to help to reduce a possible barrier to industry collaboration</p>	<p>Minded not to take forward</p> <p>We consider that the principle of the proposal has merit, but that it is best taken forward ‘at source’ through an industry-led review of delay attribution</p>
<p>Proposal D</p> <p>Change how TOC-on-TOC delay is handled within Schedule 8 to address an existing gap in TOCs’ incentives, either through:</p> <p>Option D1 – full TOC-on-TOC delay measure, or</p> <p>Option D2 – annual update of TOC responsibility matrix</p>	<p>Minded not to take forward</p> <p>Option D1 is not feasible due to limitations in the current systems.</p> <p>The expected benefit of Option D2, to slightly improve the accuracy of calibration, does not appear sufficient to take the proposal forward in isolation. However, the recalibration working groups are considering the merits of more regular updates to Schedule 8 parameters. We will take these discussions into account when making a decision on this proposal.</p>
<p>Proposal E</p> <p>Change the allocation of delay within Schedule 8 for unidentified incidents to make the split more accurate</p>	<p>Minded not to take forward</p> <p>The issue is linked to issues which we expect to be considered in an industry-led review of delay attribution, so is best dealt with through that review</p>

Initial proposal	Minded-to position
<p>Proposal F</p> <p>Change Schedule 8 compensation to more fully reflect the financial impacts of delay (to include cost compensation), either through:</p> <p>Option F1 – formulaic recovery, or</p> <p>Option F2 – actual sums recovery</p>	<p>Minded not to take forward</p> <p>Maintaining the current approach is proportionate given the limited benefits of a change when most passenger operators are held neutral to payments</p>
<p>Proposal G</p> <p>Update the evidence base underpinning the calibration of freight payment rate</p>	<p>Minded to take forward, as Preferred Option 5</p> <p>Network Rail’s freight payment rate should be updated to reflect more up-to-date evidence</p>
<p>Proposal H</p> <p>Revisit calibration of caps in freight regime</p>	<p>Minded not to take forward</p> <p>We considered a different approach to freight incident caps, but maintaining the current approach is a better way to handle risk and ensure a level playing field</p>

3.4 We set out here more detail on the proposal that we intend to take forward.

Preferred Option 5: Updating the evidence base underpinning the calibration of the freight regime

June 2021 consultation

3.5 In our initial consultation, Proposal G was to update the calibration of Network Rail’s freight payment rate, which is designed to reflect the average financial impact of delay on freight operators. The evidence base supporting the payment rate was generated in the 2008 periodic review (PR08) and has subsequently only been adjusted to reflect general price inflation. It therefore may not accurately reflect the financial impacts freight operators experience when one of their services is delayed or cancelled. We therefore proposed that freight operators, working closely with ORR and Network Rail, begin the process of updating the necessary evidence.

Responses to June 2021 consultation

3.6 This proposal was widely supported in responses to our consultation. Respondents agreed that the current evidence base is now out of date – for example Freightliner noted that assumptions on the length and weight of trains

now differ considerably since the current payment rate was calculated in PR08. Several respondents also pointed out that the basis on which the current payment rate was calculated is unclear and therefore a necessary starting point is to be clear about what financial impacts the payment rate should reflect. Respondents also stressed the importance of carrying out any update exercise in a proportionate manner, with effective working between ORR, FOCs and Network Rail to complete the necessary analysis.

Our assessment

3.7 We are minded to begin the process of updating the evidence base underpinning Network Rail's freight payment rate, and this work should be co-ordinated through the freight recalibration working group (see paragraphs 1.50 to 1.52). This exercise will be co-ordinated with the work described in Preferred Option 4. It will require the industry to agree on a process through which data can be confidentially submitted and scrutinised. A preliminary step in the exercise is to clarify and agree the financial impacts for which Network Rail's freight payment rate should compensate, given the current ambiguity mentioned by some stakeholders.

Performance trajectories and Proposal A

3.8 Proposal A from our initial consultation suggested basing Network Rail's benchmarks on historical data alone. While we are minded not to proceed with Proposal A, and instead to maintain the current approach of incorporating trajectories within benchmarks, this position is contingent on ORR's regulatory approach determining suitable performance trajectories for Network Rail. This will be determined separately as part of ORR's approach to holding Network Rail to account in CP7. While we are minded not to proceed with Proposal A, we will revisit the likely availability of suitable trajectories before reaching final conclusions in autumn 2022.

Consultation question

Question 5: Do you agree with ORR's preferred approach to only take forward one of our initial proposals? Do you have any comments on this proposal?

Annex 1: Objectives for Schedules 4 and 8 in CP7

Schedule 4 objectives

Core objectives:

1. To compensate train operators for the financial impact of possessions.
2. To provide incentives for Network Rail to minimise the level of service disruption as a result of possessions.
3. To provide information about the impact of possessions on users of the railway.

In addition, the following are further objectives for the scheme:

4. To avoid undue discrimination between different services.
5. To avoid perverse incentives.
6. To be simple, predictable and practicable.
7. To be resilient to changing circumstances (for example developments in rail reform).

Schedule 8 objectives

Core objectives:

1. To provide incentives for the infrastructure manager to minimise disruption and improve performance on the network for the benefit of customers.
2. To provide incentives for train operators and freight operators to minimise disruption and improve train performance for the benefit of customers.
3. To provide train operators with appropriate protection from losses arising from delays and cancellations outside their control.
4. To provide information on the costs of delays to enable efficient allocation of resources.

In addition, the following are further objectives for the scheme:

5. To avoid undue discrimination between different services.
6. To avoid perverse incentives.
7. To be simple, predictable and practicable.
8. To be resilient to changing circumstances (for example developments in rail reform).
9. To provide consistent performance incentives across the industry (for example between different industry parties and different industry incentive regimes).

Annex 2: Summary of preferred options and questions in this consultation

Preferred options

Schedule 4

Preferred Option 1: Introduce an opt-out mechanism to Schedule 4, whereby train operators could opt out of Schedule 4.

Preferred Option 2: Monitor possessions notifications on a more granular basis

Preferred Option 3: Monitor and report on late possession changes and cancellations on a more granular basis

Preferred Option 4: Review and, if necessary, update freight compensation rates

Schedule 8

Preferred Option 5: Industry to update evidence base underpinning calibration of freight payment rate

Consultation questions

Overall approach

Question 1: Do you agree with ORR's position that train operators should be able to opt out of Schedule 4 in CP7, subject to limitations on timings of decisions to opt in or out?

Question 2: We envisage that Schedule 8 will continue to apply between Network Rail/GBR and all operators. We would consider timely and practicable new proposals for alternative arrangements that meet legal requirements – these would need to be settled by autumn 2022 for them to be reflected in our PR23 decisions on charges and incentives. If current legislation is amended, it may be possible to adopt alternative arrangements that for example do not feature Schedule 8's financial payments. Do you agree with this position?

Question 3: Do you agree with ORR's proposal to limit the number of changes to Schedules 4 and 8?

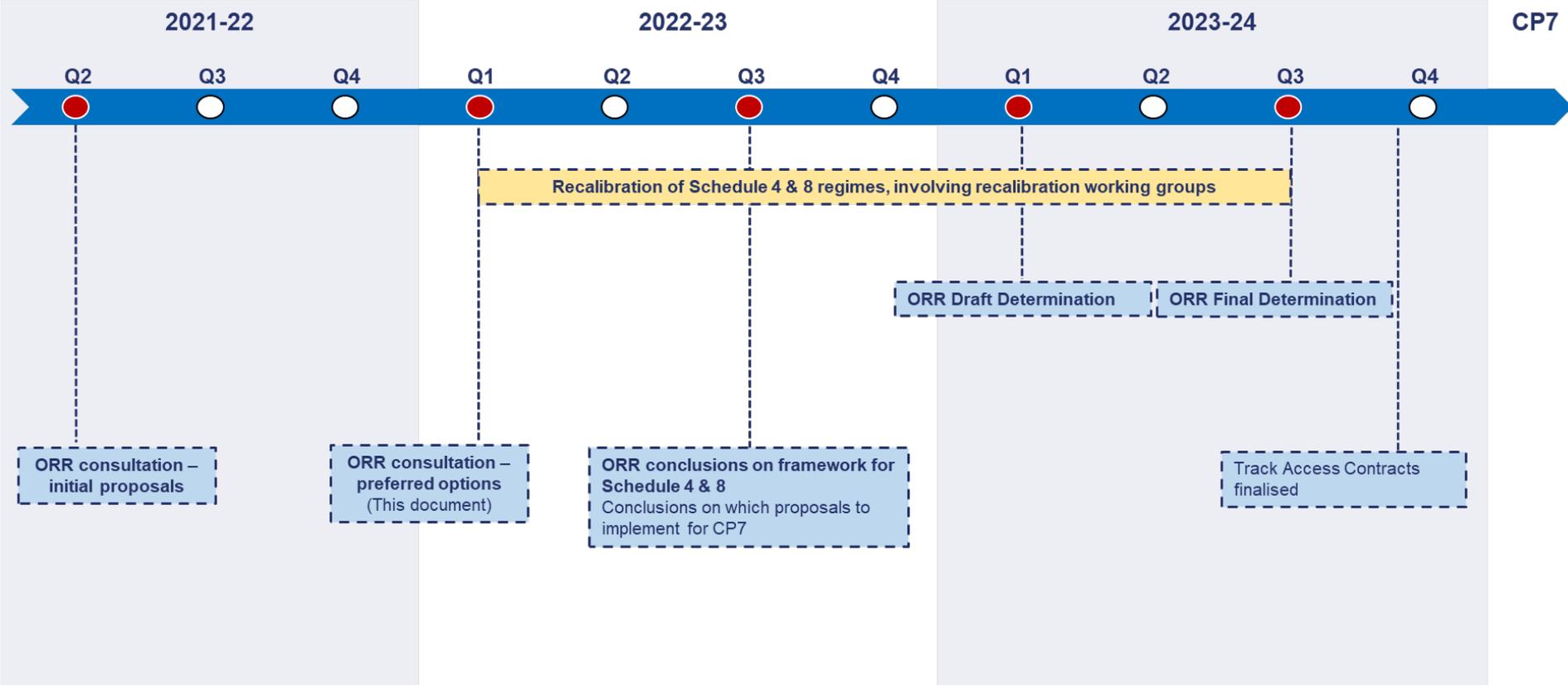
Schedule 4

Question 4: Do you agree with ORR's preferred approach to take forward the proposals detailed in chapter 2? Do you have comments on these proposals and the specific implementation approaches for each?

Schedule 8

Question 5: Do you agree with ORR's preferred approach to only take forward one of our initial proposals? Do you have any comments on this proposal?

Annex 3: Timeline for Schedule 4 & 8 review and recalibration



Annex 4: Initial Schedule 4 proposals not being taken forward

1. This annex provides more detail regarding the proposals from our initial consultation that we are now minded not to take forward. The proposal reference letters are from our initial consultation in September 2021.

Proposal C: To develop a method and/or process for settling compensation claims for lengthy possessions and periods of sustained planned disruption.

September 2021 consultation

2. In our initial consultation we proposed developing a more specific method and/or process for settling compensation claims for type 2 and type 3 possessions¹⁴ and periods of sustained planned disruption (SPD), as a priority for PR23.
3. Currently for type 2 possessions, operators paying an ACS can claim actual cost compensation, if this is considered by either Network Rail or the operator to be different by more than £10,000 from the formulaic compensation provided (if applicable). Currently for type 3 possessions and SPD, all operators can claim actual cost and revenue loss compensation, if this is considered by either Network Rail or the operator to be different by more than £10,000 from the formulaic compensation provided (if applicable).
4. Network Rail and operators told us that negotiating actual cost and/or revenue loss compensation for type 2 and type 3 possessions and SPD is costly and time-consuming due to the absence of established methods for demonstrating the impact of possessions on operators' businesses. As a result, these compensation claims can use significant industry resources, be harmful to relationships between Network Rail and operators, and yet often fail to reach a satisfactory resolution for either party.
5. Operators had suggested that there is a problem which lies in the absence of detail in track access contracts about how compensation should be calculated. In addition,

¹⁴ Type 2 possessions are those which are longer than 60 hours but shorter than 120 continuous hours; type 3 possessions are longer than 120 continuous hours.

track access contracts also do not provide much detail to help guide the negotiation process, such as provisions for a mediation process when there is disagreement over compensation amounts.

6. In our September consultation we proposed two options for developing a method and/or process for settling compensation claims for type 2 and type 3 possessions and SPDs, which are not mutually exclusive:
 - **Option C1** – Develop a method for calculating cost and revenue loss compensation. There is a spectrum of options to do this, including for example: (1) list which cost and revenue loss categories should be included in the negotiation; (2) set out a high-level methodology for calculating payments; and/or (3) set out specific formulas and parameters.
 - **Option C2** – Specify in track access contracts a process for negotiating compensation claims for type 2 and type 3 possessions and SPD.

Responses to September 2021 consultation

7. There was some support for developing a method for improving negotiated compensation for lengthy disruptions and SPD, and a number of responses acknowledged that there are flaws in the current compensation negotiation process and that a mutually agreed framework would be beneficial. However, responses to both Options C1 and C2 were mixed. In both cases there were concerns over increased complexity, and often the benefits of either approach were viewed as being limited relative to the administrative burden. Transport Scotland considered that the proposed opt-out mechanism negates the need for either option.
8. Some TOCs argued against Option C1 because the existing ‘formulaic’ regime for type 1 and 2 possessions is already in use and therefore Option C1 does not address the issue at hand. Other respondents considered that Option C1 was too restrictive in terms of its impact on operators’ flexibility in negotiating losses, relative to the current system, and would ultimately be a hindrance. There was support though from some operators for the idea of appointing an arbiter to compensation negotiations. A number of respondents supported a combination of the two options, arguing there would be a benefit from combining the two options and additionally setting out a clear methodology for assessing non-formulaic compensation that cross-references the outputs of the formulaic approach, to avoid over or under-compensation. Another argument in favour of combining the two options was that negotiations wished to retain the option to go outside a formulaic methodology for the infrequent but high-impact occasions where there is sustained disruption.

9. Network Rail supported both options for opted-in operators in CP7 and stated that “additional clarification of the methodology and/or process for calculating and evidencing actual cost and revenue losses for type 2 and type 3 claims could be helpful, particularly for revenue claims as this has historically been a difficult process”. TfL supported a methodology being used to calculate cost and revenue loss compensation and noted that it has an existing methodology for calculating revenue loss from closures, which it could share if ORR desired.

Our assessment

10. **We are minded not to take either of these proposals forward.** We received a mixed response on both proposals, and there was an expectation that any benefits from either would be low compared to the costs. In respect of Option C1, we agree that since there would still be the need for negotiated compensation, this does not ultimately address the issue of improving the negotiation process. Similarly, Option C2 does not deal with specific areas of concern such as evidence of losses.
11. Network Rail has said it is working on a framework to improve the negotiation process. We consider an industry-led solution preferable at this stage and will encourage both sides to work together on improving the negotiating process.

Proposal E: Develop a tool to estimate Schedule 4 formulaic compensation.

September 2021 consultation

12. In our initial consultation we proposed to work with Network Rail to design a user-friendly tool to estimate Schedule 4 formulaic compensation.
13. Revenue loss and cost compensation for operators that pay an ACS is calculated using pre-set formulas, which are defined in track access contracts (paragraphs 3 and 4 of the model contracts)¹⁵. The actual compensation payments are calculated by Network Rail for each possession and for each operator affected and notified after the possession has occurred.
14. A number of infrastructure project planners told us it can be difficult for them to estimate Schedule 4 compensation costs at the project planning stage. This is particularly important in cases where operators are sponsors of infrastructure projects as operators may find it difficult to compare how different possession configurations

¹⁵ For type 2 and type 3 possessions and SPDs, operators can also claim actual revenue loss and/or cost compensation if it is above what is covered by formulaic compensation.

are likely to impact on Schedule 4 costs. This hampers an operator's assessment of Network Rail's possession strategy for the project.

Responses to September 2021 consultation

15. The idea of a tool to estimate Schedule 4 compensation was generally supported by respondents that provided a view, with GB Railfreight arguing it should be a priority for PR23. However, the feasibility of the tool was called into question by Network Rail and others.
16. One operator was opposed to the tool in principle, on the grounds that it is not required. It argued that Network Rail is responsible for the management of Schedule 4 and has the resources to do the analysis, and the industry has so far managed to use the formulas in track access contracts to calculate compensation without significant difficulty.
17. A number of other respondents supported the tool in principle but were concerned about the costs of developing the tool, and that the benefits would be limited by the proposed opt-out mechanism. Transport Scotland was not convinced that it was feasible for such a tool to be available in time for CP7 and after that its usefulness may diminish due to opt-outs. Some respondents acknowledged its usefulness but did not see it as a priority reform in PR23.
18. Network Rail agreed that such a tool would be useful in principle, but asked that ORR revisits the proposal once it is known how many operators are likely to opt out of Schedule 4. Network Rail argued producing such a tool would require a large amount of work, with potentially limited benefit if it is only relevant to a small number of operators.

Our assessment

19. **We are minded not to take this proposal forward.** We consider such a tool, if deliverable and cost effective, would be useful in assisting operators that also manage infrastructure to plan infrastructure projects on parts of the network for which they are responsible. There was support for the tool in principle, but given concerns that the cost of producing it would likely outweigh any benefits, there was a lack of overall support for taking its development forward as part of this periodic review.
20. Furthermore, in its response Network Rail stated that it had made previous attempts at developing such a tool and found it problematic. It also expressed concern about the cost which it estimates at around £2m. Given the costs involved, we do not intend to take this forward as a regulatory requirement, but we encourage Network Rail to keep the idea for such a tool under review.

Proposal F: To review the methodology for calculating the ACS for open access operators.

September 2021 consultation

21. In our initial consultation, we sought views on whether we should review the methodology for calculating the ACS for open access operators.
22. Currently open access operators can elect to pay an ACS in return for receiving full Schedule 4 compensation. However, to date no open access operator has ever chosen to pay an ACS. As a result, they are only eligible for compensation for type 3 possessions and SPD (a 'baseline' Schedule 4 regime); and compensation amounts are subject to negotiation rather than determined by formulas.
23. That no open access operator has ever chosen to pay an ACS could indicate that the ACS is not appropriately calibrated and therefore acts as a barrier to these operators receiving appropriate levels of compensation. One potential reason why operators have chosen not to sign up to enhanced levels of compensation is that they might expect their up-front ACS payment to exceed the additional compensation that they are likely to receive.
24. We therefore proposed to review the methodology for calculating the ACS for open access operators. This would have involved calibrating the ACS for open access operators so that it covers only the additional expected compensation that would be provided (i.e. compensation for type 1 and type 2 possessions, including formulaic compensation).
25. However, we also said that we were unsure if the benefits of a change would outweigh the costs.

Responses to September 2021 consultation

26. There was little support for this proposal. Many respondents considered that it added unnecessary complexity and risked creating perverse incentives for Network Rail, with Transport Scotland arguing that as far as possible one single method for calculating ACS should be used. The benefits of the proposal were not perceived to be significant.
27. Open access operators highlighted that any calculation of an ACS for open access operators firstly needs to be clear and transparent for operators to be able to assess whether or not to opt in.

28. RDG supported the proposal on the grounds that the current ACS calculation mechanism is very complicated. RDG agreed that no open access operators have chosen to pay an ACS. It argued that issues have been noted with the provision of ACS estimates that, if resolved, would help inform open access operators in making this decision. Transport Scotland stated that it would be helpful to understand why open access operators continue to choose not to pay an ACS.

Our assessment

29. **We are minded not to take forward this proposal.** Overall respondents thought changing the methodology would introduce undue complexity with few benefits. We agree that changing the methodology would introduce additional complexity and is not proportionate in the context of our preference for incremental change.

Annex 5: Initial Schedule 8 proposals not being taken forward

1. This annex provides more detail regarding the proposals from our initial consultation that we are now minded not to take forward. The proposal reference letters relate to our initial June 2021 consultation.

Proposal A: Change the way Network Rail's benchmarks are set, basing them only on historical data

June 2021 consultation

2. In our June 2021 consultation, we proposed to base Network Rail's benchmarks on historical data alone, without adjustment for forward-looking regulatory performance trajectories. This is the approach currently followed in relation to operators' benchmarks.
3. We considered that this option could have the benefits of simplifying the process through which Network Rail's benchmarks are set and aligning the approach to setting benchmarks for Network Rail and train operators. However, we noted that it would create an inconsistency with any regulatory performance trajectories that might be established, and could risk creating incentives for Network Rail to underperform against benchmarks.

Responses to June 2021 consultation

4. The majority of respondents opposed this proposal. Most opposition to the proposal from TOCs and FOCs suggested that basing benchmarks only on past performance could lead to a downward spiral of under-delivery, particularly if combined with resetting benchmarks annually. Several respondents took the view that Network Rail's benchmarks should reflect the expected level of performance, including the impacts of investment in the network. This was seen as particularly important given Network Rail's position as a regulated monopoly funded by government to deliver a certain level of performance.
5. In a similar vein, DfT considered that benchmarks should include an improving trajectory that is consistent with the Statement of Funds Available. Transport

Scotland considered that upgrades and planned infrastructure projects must be factored into benchmarks.

6. The proposal was supported by Network Rail. The proposal would remove the need to try and forecast performance up to seven years ahead of time, with inevitable inaccuracy. Network Rail considered that a more realistic target, based on actual historical performance, would be more attainable and therefore more motivating for the organisation. It argued that the application of broader regulatory rules and targets meant that it was unlikely that performance would decline through gaming of benchmarks.

Our assessment

7. **We are minded not to take forward this proposal.** Instead, we are minded to maintain the status quo in which benchmarks are based on a forward-looking performance trajectory that is consistent with Network Rail's funding settlement.
8. The status quo maintains consistency between benchmarks and the funding settlement in terms of enhancement expenditure, maintenance and renewals. Consistency between forward-looking funding levels and performance benchmarks reduces the risk that Network Rail's benchmarks are set either too high or too low based on a previous control period's funding settlement.
9. Removing any forward-looking element from the benchmark-setting process would weaken the incentive for Network Rail to improve its performance relative to the status quo, because improved performance would lead to tougher benchmarks in the future. This is likely to be a small effect given other influences on Network Rail's decisions, but it is still a relevant consideration.
10. There could be benefits of simplification from basing benchmarks on historical data alone. However, it is not clear that these benefits exceed the downsides noted here, particularly regarding consistency with the funding settlement. Therefore we are minded not to proceed with Proposal A.
11. Paragraph 3.8 of the main document has noted that the status quo is dependent on the continued production of regulatory trajectories as part of ORR's wider approach to holding Network Rail to account for train performance. While we are minded not to proceed with Proposal A, we will revisit the likely availability of suitable trajectories before making final conclusions in autumn 2022. We will also consider how best to take account of discussions at the recalibration working groups on handling of COVID-19 impacts on performance data.

Proposal B: Update benchmarks annually to make them more flexible during control periods

June 2021 consultation

12. In our June 2021 consultation, we proposed to introduce annual updates of benchmarks during the control period, allowing for benchmarks to respond to shocks and therefore to reflect changing circumstances. We proposed two alternative methodologies aimed at achieving an annual update of benchmarks – either a rolling average of each service group’s historical performance (Option B1) or a modelled approach based on network traffic levels observed during the past year (Option B2).
13. We suggested that the proposal could have the benefit of more quickly reflecting changes in network activity caused by external shocks, reducing the scope for volatile payment flows that result from benchmarks failing to respond to changes in circumstances.

Responses to June 2021 consultation

14. Responses were mixed on whether to annually update benchmarks. The proposal to annually update benchmarks was supported by Network Rail and Transport Scotland, but opposed by DfT, RDG and most TOCs and FOCs. Some operators offered qualified support, acknowledging the upsides of the proposal but making the case that a change should not be pursued now amid wider changes linked to rail reform and COVID-19 recovery.
15. Network Rail argued that the proposal would provide a simple mechanism to update benchmarks for the latest evidence each year, such that benchmarks would be more accurate and realistic than under the status quo. Network Rail favoured Option B1, arguing that Option B2 was not feasible because it is too difficult to accurately estimate the relationship between traffic volumes and performance, particularly at service group level. Transport Scotland supported the proposal and favoured Option B2, stating that a rolling update would be too volatile given the last couple of years of performance.
16. TOCs and FOCs preferred that benchmarks should be aligned with performance targets set by funders and client bodies prior to the beginning of the control period – and that this should be achieved by setting Network Rail’s benchmarks in line with funder/client trajectories. Concerns were raised by some operators that annual benchmarks would reduce incentives to invest in initiatives that improve performance, by allowing benchmarks to respond very quickly to any improvement, quickly eroding any gains from benchmark out-performance. An additional concern

among operators was that annual updates could create large swings in benchmarks, reflecting volatility in performance, and potentially increasing financial risk for operators.

17. DfT argued that an annual update to benchmarks should not be a priority for PR23, as an annual update may be challenging to achieve and require significant resources and new processes. This point was also mentioned by some TOCs, who said that the annual setting of benchmarks could result in annual discussions requiring additional management resources.

Our assessment

18. **We are minded not to take forward this proposal.** However, flexibility in the setting of Schedule 8 parameters (including more frequent updates to parameters) is an option that the recalibration working groups are considering. We will take into account the discussions in these working groups when we make final decisions on this proposal.
19. We consider that Proposal B does have some merit, in allowing benchmarks to adapt to changing circumstances during the control period. Of the two options presented, our preferred implementation approach would be to use a rolling historical average (Option B1), given the difficulties stakeholders have highlighted with a modelled approach. However, there may be issues with mechanistic updates given that performance continues to be affected by COVID-19 impacts. Applying a rolling historical average from the start of CP7 would automatically include COVID-impacted years such as 2020-21 and 2021-22 in benchmarks for the early years of the control period, before the years fall out of the calculation. This suggests that this may not be the optimal way to introduce an annual update.
20. We also note the arguments that poor performance should not be 'baked into' benchmarks on an annual basis, making benchmarks easier to achieve the subsequent year. As mentioned by some operators, using a rolling performance mechanism could reduce the incentive to undertake investment to improve performance as that would lead to more challenging benchmarks in future years. (This drawback would not apply to the modelled update, as under the modelled update any change in benchmarks would be driven solely by changes in traffic rather than by changes in performance that have resulted from investment.)
21. As noted in paragraphs 1.53 to 1.54, there may be circumstances where a mid-control period update of benchmarks is appropriate, for example given the high degree of uncertainty around both the COVID-19 recovery and on-going rail reform.

This could provide some of the benefits of an annual update with smaller downsides (e.g. regarding negative incentive effects, annual administration costs).

22. The recalibration working groups are discussing options for flexibility in Schedule 8 in CP7. We will take into account the discussions in these working groups when we make final decisions on Proposal B.

Proposal C: Share allocation of some types of delay within Schedule 8, to help to reduce a possible barrier to industry collaboration

June 2021 consultation

23. We proposed that Schedule 8 should treat certain classes of delay as joint or shared for the purpose of allocating delay minutes in the calculations that determine financial flows.
24. We invited comments from stakeholders on whether this change would be proportionate and whether it would demonstrate clear value in relation to the system's objectives and our priorities for PR23. We suggested that a move to sharing allocation of some types of delay within Schedule 8 could help to reduce a possible barrier to industry collaboration, incentivising all parties to mitigate risks and aid service recovery. However, we also expressed concern that joint or shared allocation could add complexity to the terms and calibration of Schedule 8.
25. Under this proposal, delay attribution itself would remain unchanged – only the Schedule 8 financial payments would change. However, a key question for respondents was whether parties would favour changes to be made 'at source' in delay attribution itself through greater use of joint attribution, rather than through Schedule 8 as proposed.

Responses to June 2021 consultation

26. Network Rail supported Proposal C on the grounds that there are multiple incident types where the potential to share delays would be beneficial – for example externally caused incidents, weather related incidents, and incidents where multiple causes are identified. Similarly, DfT supported Proposal C on the basis that it could address some of the problems that it thinks have historically been encountered where delays caused by certain incidents have been allocated to a single party in situations where joint responsibility should be recognised.

27. Train operators gave differing views on the merits of Proposal C, and whether now is the right time to make a change. Some TOCs supported joint/shared allocation of delay minutes as a means of enabling and incentivising collaboration. However, other TOCs and FOCs opposed the proposal as it would be too significant a change to make in parallel with the Rail Transformation Programme. Some TOCs made the case that joint/shared allocation of delay minutes could add complexity to the regime, and they voiced concerns that the proposal would deter accountability and create perverse incentives to misattribute the root causes of delay.
28. Some TOCs voiced support for the proposal conceptually, as a way to encourage collaboration, but were strongly of the view that delay attribution and Schedule 8 calculations should remain consistent (which was seen as being undermined by Proposal C). For example, the Delay Attribution Board (DAB) said there are “strong arguments for applying reforms to Delay Attribution and Schedule 8 concurrently where possible, due to the clear and direct dependence of the latter on the former”. This implies making any changes through a review of delay attribution, outside of the PR23 process and timelines, and recalibrating Schedule 8 accordingly.

Our assessment

29. **We are minded not to take forward this proposal.** While we consider that the proposal conceptually has some merit, we favour the proposal being considered in an industry-led review of delay attribution. Delay attribution information flows into other industry processes – for example ORR’s monitoring of performance, and performance incentives within operators’ concession-style contracts – and there are benefits to maintaining consistency between the way information is used in Schedule 8 and those other processes. We are sympathetic to DAB’s point that it is better to make changes concurrently where possible, which will ensure consistency and limit confusion.

Proposal D: Change how TOC-on-TOC delay is handled within Schedule 8 to address an existing gap in TOCs’ incentives

June 2021 consultation

30. In our June 2021 consultation, we proposed changing how TOC-on-TOC delay is handled within Schedule 8, which could address a gap in TOCs’ incentives in considering delay caused to other operators. We noted that, due to TOCs’ benchmarks relating to their own delay minutes, the system limits financial incentives for TOCs to take steps to reduce the delay they cause to other operators as distinct

from delays caused to themselves, or to take decisions that help mitigate reactionary delays. Currently, the TOC-on-Self approach is used partly due to limitations in systems that have restricted the industry's ability to trace impacts of delays caused by one party to other parties.

31. We proposed two options to implement this proposal:

- **Option D1:** moving to a full TOC-on-TOC approach (as currently used for freight operators); or
- **Option D2:** annually updating payment rates using an updated TOC responsibility matrix.

32. We expressed a preference for Option D2, as this could improve the accuracy of TOCs' incentives while maintaining Network Rail's incentives to manage reactionary delay – and would be more straightforward to implement using existing systems.

Responses to June 2021 consultation

33. There was a mix of views in response to the proposal.

34. Network Rail supported an annual update of the TOC responsibility matrix (Option D2): it argued that using the latest available data would improve accuracy, as more recent evidence is likely to be a better proxy for current relationships between operators than older evidence. Network Rail acknowledged that its Paladin Data Extract and Reporting System ('PEARS'), which is used in the calculation of delay minutes, is currently unable to support a full TOC-on-TOC approach, limiting scope to implement Option D1.

35. DfT saw the merit in both Options D1 and D2, but stressed that any changes should be proportionate and not create significant burdens – and considered that implementation should be limited to operators outside of the future GBR. Transport Scotland favoured Option D2 over D1, as "Network Rail still has much more control over network management of disruptive incidents than a TOC".

36. TOCs mostly argued that there is not a gap in operators' incentives in how TOC-on-TOC delay is handled, and therefore no clear problem to be solved. However, RDG (on behalf of TOC owning groups) said that operators were willing to support TOC-on-TOC calculations being made more accurate through a process of annually updating the TOC responsibility matrix (Option D2). On the downside, operators noted the resource costs associated with an annual update.

Our assessment

37. **We are minded not to take forward this proposal.** While we consider that Option D2 has some merit, its benefits do not appear sufficient to pursue this option in isolation.
38. We do not consider that Option D1 is viable. This is because it would risk a negative effect on Network Rail's incentive to resolve reactionary delay caused by operators. Further, the option is not currently feasible using the PEARS system used to calculate delay, and we understand from Network Rail that there would be considerable time and expense involved in upgrading or replacing the system.
39. The main benefit of Option D2, to annually update the TOC responsibility matrix, is that it would improve the accuracy of payment rates by more accurately reflecting the latest data in terms of the reactionary delays that passenger operators cause to other operators. A more frequent update to payment rates would also reduce the risk of imbalance in the 'star model', lowering Network Rail's financial exposure to risks that it cannot control¹⁶. There could be an incentive benefit to an annual update, but this is not clear-cut, as a lower payment rate from reduced TOC-on-TOC delay may not result in a financial gain for an operator. If an operator outperforms benchmarks in a future period, a lower payment rate would mean that they receive less financial benefit compared with what they would have received with a higher payment rate. The incentive properties of an annual update to the matrix are therefore somewhat ambiguous. In addition, the possibility of a reduced scope of application of Schedule 8 limits the benefits of making a change if fewer operators are exposed to the regime in future.
40. There are some administration costs associated with Option D2. Multiple consultation responses from operators indicated that recalibration of the TOC responsibility matrix was a burdensome exercise. Network Rail has estimated to us that around 25% of time spent in the PR18 recalibration involved the TOC responsibility matrix. Network Rail has stated that there are steps that could be taken to automate the process, and estimates that to enable updating of the matrix each year would entail around 0.3 FTE in one-off consultancy costs.
41. While Option D2 has some limited benefits in terms of greater accuracy, the incentive benefits of the option are not clear-cut. In addition, there are non-trivial costs of

¹⁶ Under the star model, all Schedule 8 payments are made bilaterally between Network Rail and operators, with no payments flowing directly between operators. The star model must be carefully calibrated so as for Network Rail to be left financially neutral based on expectations of disruption caused by operators to one another. The advantage of this approach is that there is no need for contracts between individual operators.

enabling and carrying out annual updates. While we are not currently minded to take forward this proposal in isolation of other annual updates, we note that the recalibration working groups are discussing options for greater flexibility in CP7. We will take into account the discussions in these working groups when we make final decisions on the proposal.

Proposal E: Change the allocation of delay within Schedule 8 for unidentified incidents to make the split more accurate

June 2021 consultation

42. Proposal E was to change the allocation of delay within Schedule 8 for unidentified incidents to make the split more accurate. Unidentified incidents are those where there is insufficient information to determine a primary cause. Schedule 8 currently allocates delay minutes from unidentified incidents according to a set formula. Network Rail suggested that it is allocated an excessive amount of delay under this formula, and it requested that new analysis be conducted to better understand the causes of unexplained delays and which party is best placed to mitigate them. This could lead to a changed methodology for allocating unidentified delays within Schedule 8.
43. We invited further comments from respondents on whether changing the allocation methodology for unidentified incidents would be proportionate and demonstrate clear value in relation to the system's objectives and our priorities for PR23. Recognising that there are arguments for and against the change, we also invited respondents to submit evidence on whether a changed allocation methodology is appropriate and would deliver significant benefits.

Responses to June 2021 consultation

44. Respondents were largely opposed to Proposal E to change the allocation of unidentified delays between Network Rail and operators.
45. The proposal was supported by Network Rail, which argued that “rebalancing the allocation of unidentified delay minutes would make the regime more representative of reality”. DfT supported Proposal E; Transport Scotland considered that it could have merit but flagged a concern about just moving money flows around with no impact on performance.
46. Almost all TOCs responding to the consultation opposed the proposal. TOCs suggested that the process to investigate and allocate delays sits with Network Rail

and therefore, if delays are unidentified due to a lack of investigation or information, then Network Rail must improve its processes to better identify root cause and thus the proper owner of the delay.

47. Several TOCs argued that changing the allocation of unidentified delays should be considered beyond the scope of ORR's PR23 process. For example, some TOCs argued that sub-threshold delays, which make up a significant share of unidentified delays, should be managed outside the Schedule 8 regime as part of wider industry performance improvement processes. Similarly, technology could be used to improve the identification of delays to reduce the amount of unallocated delay.

Our assessment

48. **We are minded not to proceed with Proposal E.** We are conscious that this issue is closely linked to underlying delay attribution, in particular regarding the allocation of sub-threshold delays, and that industry-led efforts (including those already underway) may interact with this issue. We consider that it makes sense first to consider how sub-threshold delay is handled within delay attribution, and that Proposal E should not be a priority. In addition, the possibility of a reduced scope of application of Schedule 8 limits the benefits of making a change if fewer operators are exposed to the system in future.

Proposal F: Change Schedule 8 compensation to more fully reflect the financial impacts of delay (to include cost compensation)

June 2021 consultation

49. In our June 2021 consultation, we sought views on whether we should prioritise changing Schedule 8 compensation to more fully reflect the financial impacts of delay, so as to make compensation more accurate and to incentivise parties to take account of the full impacts of delays they cause. This would factor in costs such as the 'Delay Repay' scheme through which passengers are compensated for service delays.
50. We proposed two alternative methodologies aimed at better reflecting the wider financial impacts of delay in Schedule 8:
 - **Option F1 – Formulaic recovery.** Under this approach, payment rates would be calibrated to reflect a pre-determined proportion of the cost impacts expected to result from delay.

- **Option F2 – Actual sums recovery.** Under this approach, passenger operators would, on a case-by-case basis, recover from Network Rail the costs they actually incur as a result of delays caused by Network Rail.

51. We acknowledged some benefits of accurate incentives from changing compensation to more fully reflect the impacts of delays. But we also mentioned that taking forward one of these options would increase the complexity of the scheme's calibration and administration. Implementing the proposal would also raise the sums at stake, and we noted that stakeholders had told us that the quantities of money involved can be a barrier to co-operation and collaboration.
52. Network Rail had argued ahead of the consultation that making payment rates more 'complete' would allow the existing sustained poor performance (SPP) mechanism to be removed, on the grounds that it would no longer be needed if costs were already automatically recovered through Schedule 8.

Responses to June 2021 consultation

53. Consultation respondents were mixed on whether to reflect the wider financial impacts of delays in Schedule 8 compensation.
54. Network Rail agreed that payment rates should fully reflect the impact on passengers and the operator's business. It argued that the inclusion of Delay Repay in Schedule 8 payments would incentivise operators to encourage greater take-up of passenger compensation, and could therefore reduce the revenue impacts of disruption (as passengers are less likely to be dissatisfied if they receive the compensation they are due). To achieve this, Network Rail favoured Option F1 (formulaic recovery), adapting payment rates to reflect expected passenger compensation payable by the operator.
55. In the context of making payment rates more reflective of the wider financial impact of delay, Network Rail again made the case for abolishing the SPP mechanism from Schedule 8.
56. TOCs had mixed views on the proposal. There was some agreement that Schedule 8 compensation should be more 'complete' in covering cost as well as revenue impacts. The most common concern of TOCs was that administrative costs would be excessive. Some TOCs objected to linking the inclusion of costs within Schedule 8 rates with the removal of SPP, noting that SPP is in place to compensate for additional costs and revenue loss due to prolonged underperformance by Network Rail, and just adding an element of costs to the rates would not replicate the mechanism. There was slightly more support for pursuing a formulaic recovery

(Option F1) methodology than an actual sums recovery (Option F2): TOCs broadly took the view that an actual sums recovery methodology would be the more costly methodology and it was therefore not favoured.

Our assessment

57. **We are minded not to proceed with this proposal.** We consider that the proposal has some merit in making Schedule 8 payments more fully reflect the financial impacts of delay. However, there would be a greater element of complexity, particularly if costs beyond Delay Repay were factored into compensation. In addition, this proposal is only relevant to the passenger regime, and the reduced exposure of passenger operators to Schedule 8 that has already happened through concession-style contracts means that a change would have limited benefits to operators – and the possibility of a reduced scope of application of Schedule 8 further limits the benefits of making a change. Therefore, it does not appear proportionate to take forward this proposal.
58. We also consider that the SPP mechanism has an on-going role to provide a financial safeguard in the case of prolonged disruption, and therefore remains an important protection for operators. The number of parties making claims is likely to be considerably lower in future given the reduced exposure to Schedule 8 of operators on concession-style contracts, so the on-going costs of administration are unlikely to be high.

Proposal H: Revisit calibration of caps in freight regime

June 2021 consultation

59. In the freight Schedule 8 regime, Network Rail and freight operators have reciprocal annual caps which limit the net annual liability they face. Additionally, operators can choose to purchase an incident cap, which acts as a form of insurance limiting the amount they must pay under Schedule 8 for any single delay incident for which they are responsible. For this insurance, FOCs pay incident cap access charge supplements (ICACS).
60. Network Rail had suggested that caps can limit FOCs' incentives to reduce the delay they cause to other parties: once FOCs hit a cap, they are no longer financially incentivised, beyond their own commercial incentives, to limit the delays they cause. Network Rail considered that incident caps are hit too frequently at present, weakening FOCs' incentives to limit delay.
61. In our June 2021 consultation we set out our view that caps play an important role in limiting FOCs' financial risks, and therefore that they should be retained in their

current form. We invited submissions from all parties on whether caps are currently determined appropriately, which would help to determine whether the calibration of caps should be revisited.

Responses to June 2021 consultation

62. The majority of respondents opposed revisiting the structure of caps. Typically FOCs expressed the view that the current structure of incident and annual caps raises no issues. They considered that caps give FOCs a degree of financial stability while maintaining incentives to perform well. FOCs acknowledged that caps should be recalculated in the normal way as part of PR23, which should help to ensure that the system is kept in balance.
63. Network Rail argued that larger commercial FOCs may no longer need the financial protection provided by caps, and that smaller operators that require protection should have their cap levels reviewed. Network Rail suggested that freight operators lack incentives to recover from delays and assist in recovery efforts once an incident cap has been hit. Network Rail also proposed to us an alternative system whereby ICACS are calculated based on the performance of individual operators rather than the whole industry as at present, suggesting that this would sharpen each FOC's incentives. Further, Network Rail suggested that ICACS could be updated annually to reflect new information. MTR pressed for a complete change to the incentivisation of freight operators, suggesting that there are problems with FOCs causing disruption on the network and lacking incentives to resolve problems in a timely way.
64. DfT offered support for revisiting the calibration of caps on the condition that more evidence is supplied demonstrating that the current regime has an impact on FOCs' incentives to reduce the delay caused to other parties. DfT requested that a clear cost benefit analysis is conducted before changes to caps are proposed.

Our assessment

65. **We are minded not to revisit the structure of freight caps.** We remain of the view that incident and annual caps are an important part of the Schedule 8 regime for FOCs. While caps can carry adverse incentive effects on FOCs after their incident or annual cap is breached, they provide useful insurance which gives FOCs a greater degree of financial stability, providing them with greater confidence to invest in the industry. ICACS should be recalibrated in PR23 to ensure they are set at the appropriate level.
66. Following Network Rail's proposal, we have considered the relative merits of an alternative system of operator-specific ICACS rates, based on each FOC's own

historical performance. We consider that the idea has some merit, in giving a more accurate reflection of each operator's underlying risks of causing large delays. However, it would add complexity to the freight regime which is currently a relatively simple scheme calibrated at the level of the whole sector. In so doing, it could affect the competitive dynamics that exist between operators¹⁷. Therefore, we are minded not to change to operator-specific calculation of ICACS rates.

67. We have also considered whether to update ICACS rates annually. The main benefit would be to more quickly reflect information on the cost of delays within ICACS rates, which could raise the likelihood that the system is kept in balance (with ICACS payments matching compensation paid by Network Rail). This would imply a small improvement in incentives at the industry level to improve performance. However, it would reduce the simplicity of the current system, and introduce an element of unpredictability whereby ICACS rates could change significantly from year to year. There could be unhelpful updates to ICACS rates that are caused by temporary shocks or one-off events that do not reflect permanent changes in freight operators' underlying risks. We are therefore not currently persuaded that the benefits of a change outweigh the costs, so we are minded not to update ICACS annually.

¹⁷ The extent to which FOCs cause delays to other parties may partly depend on the rail freight customers that they serve, as this will affect the location and timing of their freight trains. Competition may be distorted if FOCs have to price in different ICACS rates when competing for a new rail freight contract due to differences in their wider historical portfolio of rail freight customers.



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