PR23: Impact assessment on Schedule 8 'switch-off' mechanism for operators contracted by Great British Railways

15 June 2023

This impact assessment supports our draft decision on the PR23 framework for Schedule 8, as set out in our PR23 draft determination: policy position on the schedules 4 and 8 incentives regimes.

Background	The Schedule 8 performance regime places incentives on Network Rail and train operators to limit the disruption they cause and, therefore, to improve network performance. Through the regime, train operators receive compensation when Network Rail's performance is worse than its benchmark and pay Network Rail a bonus when it performs better than its benchmark. Schedule 8 is calibrated to be 'financially neutral on expectation', meaning that Network Rail and operators would not make or receive payments if prior expectations were met in terms of train performance. At present, all train operators are exposed to Schedule 8 through their track access contracts.
Proposed change being considered	The UK Government has proposed to create Great British Railways (GBR) as a vertically integrated entity comprising a franchise body and infrastructure manager. ORR is proposing to allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, in the event that there is sufficient legislative change to permit this. This can simplify contractual arrangements under GBR should the Government proceed with rail reform plans to create GBR as a new body. The proposal is that, for each of GBR's future contracted operators, a new conditional clause in Schedule 8 will state that no relevant Schedule 8 payments will be made between GBR and GBR operators. This clause would take effect if (1) the legal requirements for a performance scheme in the 2016 Regulations are changed, and (2) ORR issues a notice confirming that the relevant new paragraphs within Schedule 8 shall take effect (this is known here as the 'switch-off mechanism'). If there is no legislative change, payments under the Schedule 8 performance regime would continue to apply between the infrastructure manager (whether Network Rail or GBR) and all operators. Proposed contractual drafting to implement the policy was provided in Annex C to the October 2022 Schedule 4 & 8 conclusions document.

	In assessing impacts, we focus on the impacts that we expect will arise after the 'switch-off' mechanism has been given effect. We note here the conditions that ORR will apply before giving effect to the mechanism, including ensuring that a sufficiently robust regulatory and incentive framework is in place to promote improvements in railway service performance.
(1) GBR	**Financial impacts of payment flows:** Once the 'switch-off' mechanism has been given effect, relevant Schedule 8 payments between GBR and its future operators will cease. This will simplify financial arrangements for GBR and reduce the extent of volatility in its budgets. We would expect that payments between GBR and non-GBR operators would be unchanged. **Administrative burden**: Giving effect to the 'switch-off' mechanism may simplify the payment calculation process given that it will be used for a reduced number of operators. It will also allow GBR to establish its own performance arrangements that do not risk conflicting with Schedule 8. However, delay attribution will continue across the whole system. Therefore, the change in administration costs is likely to be limited. **Incentives impacts:** Overall, we do not expect adverse incentive impacts from the 'switch-off' mechanism, as it will only be given effect if we are satisfied that a sufficiently robust regulatory and incentive framework is in place. On its own, the 'switching off' of relevant Schedule 8 payments may reduce GBR's financial incentives. However, we expect that ORR will have a role holding GBR to account across infrastructure management and train services, which will be a strong non-financial incentive. Given its receipt of passenger revenues, GBR will have commercial incentives to run a high-performing railway so as to attract and retain passengers. Further, GBR will be exposed to Schedule 8 payments towards non-GBR operators, so there will be a strong financial incentive for GBR to limit the disruption caused by both its infrastructure and contracted train services.
(2) GBR's future contracted operators	**Incentive impacts:** While relevant Schedule 8 payments would no longer take place between GBR and its contracted operators, we would expect that these operators will be exposed to financial performance incentives in their service agreements with GBR.

	Therefore, we would expect that the operators will still have incentives to run high-performing services. We also note our understanding that, at present, publicly-contracted operators are largely 'held neutral' to Schedule 8 by their franchise authorities, i.e. the operators are not financially exposed to the regimes or their exposure is significantly limited. This means that the introduction of the 'switch-off' mechanism would, for publicly-contracted operators, have limited incentive impacts relative to the current arrangements.
(3) Non-GBR passenger operators	**Open access operators:** We do not expect any impacts on open access operators as a result of switching off payments for GBR's contracted operators. Open access operators will remain fully exposed to Schedule 8, as today. As noted above, we consider that any impact on GBR's incentives to deliver train performance will be limited, so we would not expect adverse consequences for train performance. **Operators contracted by devolved authorities:** The scope of any legislative change is expected to be limited to GBR future operators, so we are proposing to limit the switch-off mechanism to these operators. As such, we are not expecting any significant impacts for these operators. In relation to train services contracted or operated by Transport Scotland, if legislative amendments remove the requirement for a performance scheme from Transport Scotland's operators, GBR and each operator could jointly agree upon a change to their track access contract to include the 'switch-off' mechanism. This would be subject to ORR's approval. The analysis for such a scenario would be in line with the analysis for 'GBR' and 'GBR's future operators' set out above.
(4) Freight operators	**Freight operators** will still be fully exposed to Schedule 8's performance incentives, and all payments will continue to reflect the financial impacts of delay. We do not anticipate any adverse 'indirect' impacts on freight operators from different Schedule 8 payments between GBR and its operators. Therefore, GBR would still face the same Schedule 8 incentives to limit delays caused to freight operators, whether caused by itself as an infrastructure manager or by its contracted operators. In addition, the non-

	financial performance incentives described in the 'GBR' section will limit the risk that performance delivered to freight operators deteriorates.
Draft decision	To introduce a 'switch-off mechanism' to allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, if GBR is established and if there is sufficient legislative change to permit the removal of payments.
Next steps	We intend to include new clauses comprising the switch-off mechanism in our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'. As stressed above, these clauses will only be included for GBR's future operators.

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