

PR18 workshop on Schedules 4 and 8 policy options

Note of workshop held on 5 August 2016 at ORR's offices

Attendees: Chris Dellard (Arriva); Raminta Brazinskaite (ORR); Emily Bulman (ORR); Bill Davidson (RDG); Phil Dawson (Virgin Trains East Coast); Lindsay Durham (Freightliner); Russell Evans (First Group); Gregg Evans (Arriva); Lee Forester-Kirkham (DfT); Dan Grover (DfT); Nigel Jones (DB Cargo); Joel Moffat (ORR); Deren Olgun (ORR); Steve Price (ATOC); Joe Quill (ORR); Caitlin Scarlett (Network Rail); Peter Swatridge (Network Rail); Rob Whittleston (DfT)

Introduction

1. This note summarises the main points of discussion at the workshop. For a complete picture of these points this note should be read alongside the slides¹ that ORR presented at the workshop.

Purpose

2. The purpose of the workshop was to discuss policy options for areas for improvement from the regimes as identified from responses to ORR's November 2015 letter on Schedules 4 and 8 and the RDG's review of charges. The workshop also provided an opportunity for discussion about industry involvement in the review and the recalibration of the regimes.

Structure of the workshop

3. ORR presented its plan for the PR18 review of Schedules 4 and 8 and progress to date. It also set out the next steps of the review including its December 2016 consultation on charges and incentives and the key dates beyond this consultation.
4. For the discussion on policy options for Schedules 4 and 8: ORR presented the purpose and the summary of areas for improvement for each regime, which was then followed by discussion on each area and potential policy options to address issues associated with that area.
5. The workshop ended with a brief discussion on the role of industry in re-calibration of the regimes.

¹ Available here: http://orr.gov.uk/data/assets/pdf_file/0005/22775/schedules-4-8-brainstorm-session-on-policy-2016-08-05.pdf

Schedule 8: discussion on policy options

Comments on the scope of operator neutrality [Slide 18]

6. Passenger compensation was included in Schedule 8 in the previous control periods in the form of a separate “passenger charter rate” which was also linked with franchise agreements.
7. There are different delay repay schemes that train operators use to compensate their passengers for significant delays that they experience to their journeys. These schemes do not differentiate between delay caused by operators and delay caused by Network Rail.
8. The difficulties of adding passenger compensation into Schedule 8 payment rates were discussed, in light of the differences in the delay repay schemes. In particular: it was noted that if passenger compensation was included in Schedule 8 there would be difficulties in estimating the rate of passenger compensation. It would depend on the amount that is claimed which would then depend on the rate of compensation that is available to passengers in each scheme, the percentage of passengers that are entitled to claim and the percentage of passengers that actually claim.
9. It was noted that, if passenger compensation were to be incorporated into the liquidated damages regime then, on the assumption that this would be accompanied by greater uptake of compensation, there would also need to be better understanding of how passenger compensation affects long-run demand (and hence Schedule 8 payment rates).
10. Instead of formulaic compensation, it was suggested Network Rail could pay its share of passenger compensation through an ‘open-book’ process as well, i.e. payments made at the end of each period on the basis of what an operator has actually paid out.
11. Regardless of whether or not Network Rail faces the cost of compensating passengers, it was suggested that, in the interests of transparency and accountability, it would be useful to have a better understanding of the proportion of passenger compensation arising from delay caused by Network Rail.
12. It was suggested that including additional financial elements in Schedule 8 would increase the financial risk associated with the regime. For example, freight operators would struggle with further financial risk from Schedule 8.
13. The discussion concluded that there was little appetite to include passenger compensation within the Schedule 8 liquidated damages regime, although there was some appetite for handling payments separately through an ‘open-book’ process.

Comments on the scope of incentives [Slide 19]

14. Re-introducing a societal rate would add more complexity to the regime. The rates would require estimation and it would introduce additional financial risks to the regime.
15. It was noted that there were other incentives to encourage Network Rail to improve its performance. These include measures such as PPM. In this regard, it was noted that Schedule 8 does not have to solve all performance related problems on the network because there are other tools available.
16. With respect to the other performance measures and incentives on Network Rail, it was noted that it is important that the right measures are used and that they are set at the right level.
17. It was also noted that there could be wider impacts associated with adding more financial impacts to the Schedule 8 regime, e.g. higher capital costs as a result of higher Schedule 8 costs.
18. There was wide agreement among stakeholders not to use a financial approach to address any lacking incentives in respect of end user and wider societal impacts of delay.

Comments on the approach to setting benchmarks [Slide 20]

19. Some felt that their investments to improve performance did not get rewarded or recognised through Schedule 8. Furthermore, some expressed the view that the current approach means that there is little incentive for operators to continue to work hard to improve performance.
20. Also, it was argued that there are no incentives to invest to improve performance towards the end of a control period. A comment was made that there used to be a performance fund (which was scrapped for CP5), which helped to fund some schemes, including those commissioned near the end of the control period.
21. It was noted that if it is decided that the industry needs to set benchmarks differently for CP6, it is then very important to recognise where the industry is in terms of its performance. This is to ensure that the industry has realistic new benchmarks to manage its performance for the next control period.
22. It was also noted that achieving an improved level of performance requires investment. Industry needs to be able to afford this. If not, some operators could go out of business. It was suggested that this should be taken into account when choosing a new method and level at which to set benchmarks.

FINAL

23. There are some performance factors that operators have less control over than others, i.e. operators have some influence over the timetabling process, but this is dependent on other operators' requirements too. When industry has a well-designed timetable, performance on that part of the network is also likely to be very good.
24. ORR noted that the system operator will have a role to play to improve performance on the network, i.e. through its role in the design of the future timetables.
25. There is some appetite for change in the methodology for setting benchmarks as the current approach does create some perverse incentives. ORR stressed that all options would be assessed to identify financial impacts on all affected parties

Comments on the complexity of TOC regime [Slide 21]

26. It was recognised that the regime is complex and that some of the proposed options could help reduce its complexity, including options that could make the recalibration simpler than it currently is.
27. One of the options that was presented and that Network Rail is also exploring is about changing the passenger operator regime so that operators make Schedule 8 payments for the actual delay that they cause, rather than a modelled estimate of the delay (i.e. paying based on TOC-on-TOC minutes instead of TOC-on-self). It was recognised that with this option Network Rail may face reduced incentives to limit the impact of TOC-on-TOC delay incidents. However, as noted above, there are other incentives to encourage Network Rail to improve its performance.
28. The group agreed that this option needs to be looked at in more detail.

Comments on the treatment of TOC cancelled services [Slide 22]

29. It was pointed out that the way benchmarks are currently estimated means that cancellations are already addressed separately. Cancellations are first converted to 'deemed minutes late' (DML) and only then added to an estimate of 'average minutes late' (AML). It was suggested that TOC cancellations of their own services could simply be not added to DML. This, for example, would help to address the identified problem (i.e. when train operators cancel their own services and these cancellations do not delay other services, they still get treated as DML).
30. When train operators cancel their own trains, it does not always mean that there is no delay to other services, i.e. having to get a cancelled train out of platform may cause late running of other services.
31. In general, train operators are unwilling to cancel their own services because it has revenue implications as well as implications in terms of franchise agreements.
32. The group agreed that the proposed options should be explored further.

FINAL

Comments on the effectiveness of Sustained Poor Performance (SPP) regime [Slide 23]

33. The biggest issue related to the SPP regime was generating a revenue claim. From Network Rail's perspective, it often does not have enough information to assess claims made by operators and as such it was difficult for it to agree them
34. The disclosure of information could partly help address this issue of SPP revenue claims, but Network Rail would still need to carry out its own assessments.
35. One option could be to simplify SPP claims by only having cost compensation, with some guidance on which costs could be recovered through this part of the regime. Under such an approach, revenue compensation would be recovered solely through the liquidated damages regime.
36. Some expressed the view that the current SPP wording is an issue, e.g. the meaning of relevant losses needs to be better explained. It was noted that this was explored in PR13 and it was decided that the wording for SPP should not be amended.
37. Some suggested that the SPP regime needs to be more transparent than it currently is.
38. It was argued that the process of SPP claims could be improved, including having deadlines to make and process SPP claims – at the moment Network Rail is exposed to financial uncertainty associated with SPP claims that have not been claimed for a very long time.

Comments on the alignment with other performance incentives [Slide 24]

39. ORR said that it was proposing not to make changes in Schedule 8 to the use of average minutes lateness in the passenger regime or to the use of delay minutes per 100 train miles for the freight regime.
40. The group agreed with the ORR's proposed approach.

Any other comments on schedule 8

41. The group said it would like ORR to ensure that Schedule 8 is aligned with any changes proposed under the review of capacity charge.
42. Some suggested that the current cancellation rates were a source of concern; especially the lower rate which was said to be insufficient to cover the impacts of cancellations on freight operators.
43. It was mentioned that the freight industry had previously commissioned L.E.K to investigate freight costs associated with delay. This research could be looked at again to see if this could be used to inform PR18.

FINAL

44. It was also said that the freight contract wording mixes up issues across Schedules 4 and 8 making it difficult to know which Schedule to refer to.

Schedule 4: discussion on policy options

Comments on incentives created by Notification Discount Factors (NDFs) [Slide 32]

45. The group agreed that the two policy options ORR presented should be developed further. The options included reviewing NDFs; and reviewing notification discount thresholds.
46. It was suggested that any changes to the NDFs need to take account of the fact that there is a limit to how far in advance Network Rail and contractors can plan work on the network.
47. ORR explained that to develop policy in this area, it needs to consider the full set of issues and impacts, including how Schedule 4 fits with Network Rail's possessions planning, operators' processes, passenger behaviour and the associated costs. ORR said that it will seek evidence from industry on this as part of PR18.
48. To better understand passenger's behaviour in terms of planning journeys, it was suggested that operators could provide data on when passengers buy tickets. However, the comment was made that the point at which a ticket is booked does not necessarily represent how long the passenger has been planning the journey.
49. ORR has also discussed conducting passenger surveys on-board trains. This would be to gather information about passenger awareness of planned service disruption to help inform the NDF policy.

Comments on compensation for cancelled possessions [Slide 33]

50. Schedule 4 does not include revenue compensation for cancelled possessions. ORR explained that before a decision can be taken on what to do on this issue it needs to understand the scale of the issue (i.e. a number of cancelled of possession over the last few years) and associated costs.
51. It was suggested that the way Network Rail records possessions means that it cannot provide data on cancelled possessions. Operators could explore if they can provide information on cancelled possessions that they experienced over the last few years. In particular, it was suggested that those operators that suffered most from cancelled possessions may have that data.

Comments on the approach to ACS calculation [Slide 34]

52. The group agreed that ORR should further assess the options presented in the slides to address the issue that Network Rail may be inefficiently over-recovering Schedule

FINAL

4 costs. These options included the change in the basis for renewals assumptions and more frequent ACS calculation.

53. A concern was raised that the option related to more frequent ACS calculation would significantly increase transaction costs.
54. An alternative option suggested was to remove ACS for the Schedule 4 passenger regime. However, this option was not supported by the whole group.

Comments on sustained planned disruption (SPD) effectiveness [Slide 35]

55. Issues raised in this area are very similar to the issues under 'the effectiveness of SPP'. The group agreed that the options to be considered for SPD should be the same as the options for the SPP regime under Schedule 8.

Comments on TOC compensation [Slide 36]

56. Similarly to 'compensation for cancelled possessions', ORR explained that it needs evidence from industry on their costs. This includes evidence on costs that are not currently included in the Schedule 4 liquidated damages compensation, but are included in type 2 possessions claims.
57. The group agreed that they could look to provide ORR with data on passenger operator's costs to help develop options under this area.

Comments on FOC compensation [slide 37]

58. As per 'TOC compensation', the group agreed that they could look to provide ORR with data on freight operators' costs to help develop options under this area, i.e. to ensure that compensation under Schedule 4 is sufficient to cover the key impacts of planned disruption.

Comments on the scope of incentives [Slide 38]

59. It was agreed that this issue (i.e. Network Rail not incentivised to take account of end user and wider societal impacts) is very similar to the issues under Schedule 8. As a result, this was not discussed in additional detail.

Comments on incentives for amending timetables [Slide 39]

60. It was suggested that there was an issue of having to declare an amended timetable in bad weather. This was mainly a concern for third rail services because diesel services were not substantially disrupted by snow.
61. Processes were in place for establishing amended timetables in other instances, for example a bridge collapse.

FINAL

Comments on alignment with other incentive regimes [Slide 40]

62. The group agreed that ORR should consider and address any perverse incentives that may occur as a result of Schedule 4 not being well aligned with regulated outputs and/or Network Rail scorecards.

Any other comments on Schedule 4

63. A concern was raised about the approach to setting Schedule 4 payment rates on the basis of Schedule 8 payment rates. ORR explained that PDFH provides explanation of why it is the case.
64. Operators emphasised that they experience difficulties in making claims for type 3 possessions, in particular proving revenue losses. This is similar to the issues around SPP and SPD.
65. It was suggested that the contractual wording for Schedule 4 could be simplified; this point was also made for Schedule 8. It was discussed that in response to ORR's December 2016 consultation operators could provide specific comments on parts of the contract that they think need to be simplified.
66. As ORR emphasised the need for evidence from industry throughout its presentation on Schedule 4, workshop participants thought that ORR should make these evidence requests clear.

Role of industry

67. ORR stressed that Schedule 4 and 8 improvements will be easier to devise and assess if it has good evidence from industry.
68. ORR also explained that re-calibration of both regimes will require industry engagement.
69. As Schedule 8 is a contractual arrangement between Network Rail and operators, it was suggested that operators should get more involved in the recalibration of the regime, e.g. to help fund and challenge the process, and also provide data to feed into recalibration.
70. It was suggested that RDG could be one of the parties to the Schedule 8 recalibration. It was agreed that this will be explored.
71. It was agreed that we need to ensure the accuracy of the recalibration of the regimes. It was suggested that Network Rail could get more involved in scrutiny of the recalibration if there were appropriate confidentiality safeguards in place.