

As part of the 2008 Periodic Review, ORR asked the Industry Steering Group (economic and contractual framework) to review the arrangements for compensating train operators for the effects of disruptive possessions, covering both Schedule 4 and Part G of the Network Code.

The following consultation document has been published by the industry to inform the development and submission of a recommendation to us in January 2008.

The date for responses to this consultation is Friday 23 November 2007. Please see paragraph 1.15 of the consultation proposal for details of how to respond.

The consultation document is also published on Network Rail's website

Periodic Review 2008:
**Consultation on the possessions
compensation regime**

September 2007



OFFICE OF RAIL REGULATION

Periodic Review 2008:

Consultation on the possessions compensation regime

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**Published by the Schedule 4 policy group
established by the Industry Steering Group
(economic and contractual framework)**

Contents

Executive Summary	4
1. Introduction	6
Background.....	6
ORR remit.....	6
Method of work.....	8
Purpose of this document.....	9
Structure of this document.....	9
Responses.....	9
2. Existing approach for compensation of disruptive possessions	11
Schedule 4 for passenger operators.....	11
Schedule 4 for freight operators.....	13
Part G of the Network Code.....	13
Strengths of the current regime.....	14
Concerns with the current regime.....	14
3. Summary of workstreams	16
Overview of workstreams.....	14
Compensation to passenger operators for revenue loss.....	17
Notification factors.....	18
Thresholds for possession categorisation.....	20
Compensation to passenger operators for costs.....	21
Proposed cost formula.....	21
Thresholds for possession categorisation.....	23
Compensation to freight operators.....	24
Option 1. Trigger thresholds for extreme disruption.....	24
Option 2. Identification of diversionary routes.....	25
4. Proposals of the policy group and issues for consultation	26
Overview.....	26
Franchised passenger operators.....	27
Tiered structure for compensation.....	27
Reasons for the tiered structure proposal.....	29
Revenue boundaries.....	29
Treatment of long-running Restrictions of Use.....	32
Possessions Compensation Guide.....	33

Cost boundaries	34
Type 4 possessions – an alternative approach	36
Development of the cost formula proposal	37
Processes and timescales for agreeing compensation	38
Notification factors	38
Implementation issues for franchised passenger operators	41
Open access passenger operators	45
Freight operators	45
Thresholds for extreme disruption	45
Implementation issues for freight operators	47
Access Charge Supplements	48
5. Next steps	50
Shadow running	50
Timescales	50
Annexes:	51
Annex A: Proposed revision of notification factors	51
Annex B: Estimated Bus Miles (EBMs)	53
Annex C: Process for implementation of the cost formula	54
Annex D: Discussion on legal issues for passenger regime	54
Annex E: Franchise renewal dates	66
Annex F: Shadow running for freight regime	67
Annex G: Consultation questions	70

Executive Summary

The efficient planning of work to maintain, renew and enhance the railway is important for all users of the network. In planning its engineering work efficiently, Network Rail takes into account the impact of disruption on passengers and freight users and, in doing so, the cost of paying compensation to train operators for the effects of disruptive possessions.

Operators will incur costs and losses when disruptive possessions are taken, and it is important that the compensation regime for dealing with these does not introduce distortions. It is also important for Network Rail to be provided with clear price signals to reflect the level of disruption associated with the work. The existing compensation arrangements for the effects of disruptive possessions in Schedule 4 of track access agreements and the Network Code currently provide a number of different mechanisms for doing this. Whilst the current arrangements have strengths, over recent years the industry has identified a number of concerns about inconsistency, accuracy and the boundaries between the existing mechanisms, in particular the current differentiation between how compensation for maintenance, renewal and enhancement is treated.

ORR asked the industry in January 2007 to consider possible improvements to the existing provisions with the aims of achieving consistency, simplicity, transparency, incentivising Network Rail, and to make a proposal such that all compensation for possessions is made through Schedule 4 of a track access agreement (or its freight equivalent) to the exclusion of Part G of the Network Code, with the proposal striking the appropriate balance between accuracy and efficiency of compensation mechanisms.

The work since January 2007 has been undertaken by a cross-industry policy group (and separate freight group) established by the Industry Steering Group (economic and contractual framework), engaging external consultants where necessary.

This consultation paper sets out the proposed amendments to Schedule 4 of track access agreements (and Schedule 8 of freight access agreements) which are intended to achieve the single compensation mechanism for disruptive possessions and how such changes could be implemented.

The policy group believes that it is appropriate for there to be different types of compensation to reflect the scale and impact of different levels of disruption. One of the features common to the proposals for both passenger and freight operators is therefore the identification of thresholds and boundaries which trigger different treatment of compensation.

For franchised passenger operators, the cornerstone of the proposal is the formulation of a single tiered structure of thresholds which recognises the importance of the differentiation discussed above. Following analysis of the existing formulaic approach within Schedule 4 of track access agreements for revenue loss compensation and investigation of a possible new formulaic approach for cost compensation, the tiered structure provides the possibility

for compensation to be calculated either on a formulaic basis or a bespoke basis for revenue and/or costs subject to the respective thresholds of disruption.

The existing Schedule 4 formula for revenue loss compensation is believed to represent the appropriate structure for formulaic compensation although some changes are proposed to the data used within the formula, such as notification factors, in order to reflect new research into the actual impact of disruption on passengers. On the cost side, the consultation proposes an ongoing feasibility study into a liquidated sums regime for rail replacement bus costs and the cost impact of changes in train mileage, which might apply in the case of possessions below an agreed disruption threshold, if not more widely. When the relevant thresholds are exceeded, there will be a transition first which will permit the recovery of Direct Costs on a similar basis to the current Significant Restriction of Use quantum arrangements and second which will permit compensation to be based on actual costs and revenue losses net of benefits.

Such a revised Schedule 4 would allow the removal of compensation for disruptive possessions from Part G. The consultation discusses two options for the timing and implementation of this. The intention is that a revised Schedule 4 would apply to all franchised passenger operators and that Network Rail would be funded for this through the charging regime, options for which are also set out in this consultation.

This regime would also be available to open access passenger operators, who would be automatically entitled to compensation above the upper threshold for disruption but could choose whether to sign up to the formulaic components of the regime, subject to the payment of an Access Charge Supplement.

The proposal for compensating freight operators for the effects of disruptive possessions is also based on the concept of a different type of compensation to reflect the scale and impact of different levels of disruption. There will be no change to the existing provisions for disruptive possessions advised after T-12, but where thresholds defined by extreme levels of disruption are breached by possessions advised before T-12, additional compensation provisions would exist to capture the effects.

In all aspects of this consultation, issues of practicability are still being considered, and further work on the threshold proposals and a number of shadow running exercises will need to take place in parallel with this consultation, involving parties across the industry.

The policy group believes that the proposal addresses the issues highlighted by ORR in its remit of January 2007 and strikes the right balance between the accuracy and efficiency of potential compensation mechanisms. The policy group now welcomes the views of the wider industry both in answer to the questions posed in this paper and on any other relevant matters by 23 November 2007 to inform the development and submission of a recommendation to ORR in January 2008.

1. Introduction

Background

1.1 The current possessions compensation regime comprises the following chief components:

- For the vast majority of train operators, Part G of the Network Code (Network Change) provides compensation for costs, direct losses and expenses (including loss of revenue) net of benefits for possessions associated with the implementation of Network Changes.
- For franchised passenger operators, the Schedule 4 regime of track access agreements provides a formulaic methodology to calculate revenue loss compensation for possessions (including amended timetables) and a bespoke methodology for compensating specified Direct Costs of Significant Restrictions of Use (relating to long possessions and Major Projects); the Schedule 8 regime provides for liquidated sums to compensate for unplanned disruption to services (including possessions overruns).
- For open access passenger operators, there is currently no templated Schedule 4 regime; some operators have signed up to different parts of the provisions common to franchised passenger operators whilst some have no Schedule 4 provisions at all.
- For freight operators, Schedules 4 and 8 provide compensation for service variations and cancellations in respect of short-notice possessions notified after T-12.

1.2 The current possessions compensation structure therefore currently differentiates between whether, and if so what level of, compensation applies to possessions by reference, amongst other things, to whether those possessions are consequent on a Network Change.

ORR remit

1.3 ORR wrote to the Industry Steering Group on the economic and contractual framework (ISG) in January 2007 and stated:

“We understand from discussions with Network Rail and train operators that the current compensation mechanisms for possessions are not working as effectively as they should, in particular due to:

- (a) issues around the boundaries between Schedule 4 and Part G;
- (b) an inconsistent approach to compensating train operators for the effects of possessions;

- (c) concerns over the accuracy of compensation arrangements and the resulting economic signals;
- (d) a lack of transparency in the Part G and Schedule 4 process;
- (e) unnecessarily high transaction costs.”

1.4 ORR included in its letter of January 2007 the following remit to the industry for a review of the current mechanisms:

- (a) all compensation for possessions should be made through Schedule 4 of a Track Access Agreement (or its freight equivalent) to the exclusion of Part G;
- (b) a consistent approach should be taken for compensation for possessions for differing purposes i.e. there should be no differentiation between a possession taken for a renewal or an enhancement. Differentiation may however be introduced to reflect the scale and impact of a possession or number of different possessions if this is considered appropriate. Differentiation may lead to different rates and/or approaches to compensation;
- (c) transaction costs should be minimised;
- (d) Network Rail should be incentivised, where possible, to manage the use of possessions efficiently and effectively;
- (e) operators should receive “fair” compensation for the restriction on contractual rights if these are affected by a possession. A balance should be struck between accuracy and the efficiency of compensation mechanisms;
- (f) a right of appeal should be retained to enable train operators and Network Rail to seek redress if compensation is disputed;
- (g) transparency of costs / benefits to be paid should be established, where possible, so that the risks and impact of disruption caused by possessions can be anticipated;
- (h) there should be a consistent approach for paying compensation to franchised and non-franchised passenger operators and freight operators unless there is a compelling case to take a different approach.

1.5 In its covering letter to the above remit, the ORR also noted the need to take account in making changes to possessions compensation regime of any changes to risk profiles, the application of Clause 18.1/Schedule 9 provisions in the franchise agreements of franchised passenger operators and any other relevant factors. The remit stated that ORR

expected the policy group to consult on draft proposals by the end of September 2007, with recommendations made to ORR by the end of January 2008.

Method of work

- 1.6 The ISG established a Schedule 4 policy group to consider the matters set out in ORR's remit. The policy group is a cross-industry body which has met regularly since February 2007, with attendees from:
- Passenger operators
 - Freight operators
 - Network Rail
 - ATOC
 - Department for Transport
 - Transport Scotland
 - Office of Rail Regulation (as observer and secretariat)
- 1.7 The policy group has used the ORR remit to develop this work into three distinct workstreams to address the areas where it believed that the regime would benefit from analysis. In each case, one of the main areas of focus was on considering possible thresholds at which disruption became of greater significance to the affected operators.
- Compensation to passenger operators for revenue loss
 - Compensation to passenger operators for costs
 - Compensation to freight operators
- 1.8 The first two workstreams were taken forward by consultants jointly appointed by ATOC, Network Rail and ORR, although they have involved many conversations directly with passenger operators in the course of the analysis. Passenger operators and Network Rail have provided data directly to the consultants in both cases. In the revenue workstream, all passenger operators were invited to a workshop on 9 July 2007. Minutes from this workshop, including a list of attendees, are provided in the appendices to the consultants' report (SDG), which is to be found on the Network Rail website from 1 October 2007. (www.networkrail.co.uk / Resource Library / Regulatory Documents / Access Charges Review / PR2008 / Review of Possessions Compensation Regime).

- 1.9 The freight work has been carried out jointly between freight operators, Network Rail and ORR.

Purpose of this document

- 1.10 This document reports on the outcome of work which has been undertaken by the Schedule 4 policy group, some of which has been informed by the consultants' work.
- 1.11 Wherever it has been possible to do so, this document then makes recommendations on changes to the possessions compensation regime and seeks the views of the wider industry to these recommendations.
- 1.12 In other areas, the document presents options which are still being considered and seeks the views of the wider industry in order to help inform how it is proposed that these will be taken forward.
- 1.13 In a number of cases, the policy group is continuing to investigate and test the emerging options and their practicability. The views of the wider industry will complement and support that work.

Structure of this document

- 1.14 The remainder of this document is structured as follows:
- Overview of the work done to date in the areas of passenger revenue and cost compensation and freight compensation;
 - Recommendations and emerging views of the Schedule 4 policy group, including identification of ongoing work such as shadow running and consideration of options for implementation and timing;
 - Next steps

Responses

- 1.15 This paper now invites all industry parties to comment on the issues raised in this consultation, the period for comments is eight weeks. Any comments should be sent in electronic format by Friday 23 November to:

Richard Wall
Network Rail
(on behalf of policy group)
richard.wall@networkrail.co.uk

AND

Tim Griffiths
ORR
(acting as secretariat)
tim.griffiths@orr.gsi.gov.uk

- 1.16 These comments will then be shared with the Schedule 4 policy group. Together with the ongoing investigation of practicability issues, the views of the wider industry will inform a final recommendation to ORR in January 2008, in order to fit with the timescales for the 2008 Periodic Review of access charges.
- 1.17 Respondents should indicate clearly if they wish all or part of their response to remain confidential and, if so, clearly state which organisations they wish the information to remain confidential to. Otherwise, it is expected that the information will be published on the Network Rail and/or ORR website and may be quoted in future. Where a response is made in confidence, it should be accompanied by a summary excluding the confidential information that can be treated as above. We may also publish the names of respondents in future documents or on our website, unless a respondent indicates that they wish their name to be withheld. Should a respondent wish to include confidential information that cannot be shared with Network Rail, they should send their full response to ORR and the summary excluding the confidential information to both Network Rail and ORR.
- 1.18 Copies of this consultation paper, and the consultants' reports are available at the Network Rail website from 1 October 2007. (www.networkrail.co.uk / Resource Library / Regulatory Documents / Access Charges Review / PR2008 / Review of Possessions Compensation Regime).

2. Existing approach to compensation for possessions

2.1 Train operators receive compensation for possessions and amended timetables through the following components.

- Under Schedule 4, in return for the payment of an Access Charge Supplement, franchised passenger operators receive formula based compensation for revenue losses from planned possessions and, for significant disruption (generally longer than a weekend) or for possessions related to a Major Project, compensation for certain categories of costs (but not any additional revenue loss). Schedule 8 provides formula based revenue compensation for unplanned possessions (including possession overruns).
- Some open access passenger operators have signed up to different parts of the Schedule 4 provisions set out above, whilst others have no Schedule 4 provisions at all.
- For freight operators, Schedules 4 and 8 provide compensation for service variations and cancellations in respect of short-notice/unplanned/overrunning possessions notified after T-12.
- Under Part G, for possessions associated with Network Change most passenger and freight operators can claim for full revenue losses (over and above that receivable under the Schedule 4 formula) and for all reasonable costs net of any benefits.

2.2 The following sections describe the existing possessions compensation regime in more detail and highlight the strengths and weaknesses of the existing regime.

Schedule 4 for passenger operators

2.3 Schedule 4 for franchised passenger operators provides formula based revenue compensation. Such revenue compensation is paid irrespective of whether the possession was taken for maintenance, renewal or enhancement. For Significant Restrictions of Use (see below), compensation is paid for certain categories of "Direct Costs", but not for enhancements or other works falling under Network Change.

Formula based revenue compensation

2.4 The Schedule 4 formula based revenue compensation is based on that provided under Schedule 8, where franchised passenger train operators receive compensation for the delays and cancellations that they experience. Under Schedule 8 compensation is based on the Marginal Revenue Effect (MRE) of the delay, with each franchised passenger train operator's track access agreement containing separate MRE rates for each Service Group. The MRE rates are based on expected revenue impact of the delay and reflect passengers'

response to unplanned delay through the inclusion of a delay multiplier.¹

- 2.5 In Schedule 4, franchised passenger train operators are compensated based on the delays and cancellations that they would experience due to a possession. The impact of the possession is calculated by comparing the timetable that actually operated with the normally expected timetable, with payment rates based on Schedule 8 MRE rates, with a sliding scale of discounts to reflect the level of advance notification of the possession provided by Network Rail. These notification discounts reflect the progressive removal of the unexpected delay multiplier included in the MRE rates based on passengers assumed awareness of the possession. As the delay multiplier varies by type of operator and the passengers that they carry, the notification discount also varies by operator.
- 2.6 Three levels of notification discounts are available:
- First Working Timetable (FWTT) – payment rates range from 15% to 40% of MRE;
 - Informed Traveller Working Timetable (ITWTT - i.e. uploaded to the Train Service Database by T-12 but not in the FWTT) – payment rates range from 48% to 60% of MRE;
 - Applicable Timetable (ATT - i.e. at 22:00 before the day of operation) but not in the ITWTT – payment rates 80% of MRE
- 2.7 In the case of unusual possession profiles, separate compensation calculations may be undertaken for:
- Train-bus-train patterns – where a possession on an intermediate section of track may result in a train-bus-train pattern that would not be picked up by the Schedule 4 formula;
 - High speed diversions – where operators are diverted onto faster routes (and so would not be fully compensated under the Schedule 4 formula) but would still arrive later than originally planned.
- 2.8 The formula based compensation only covers the loss of revenue as, at the time of the last review, it was felt that the inclusion of bus costs would be too difficult and would have a limited impact on Network Rail incentives.
- 2.9 Franchised passenger train operators are required to have a Schedule 4 whereas open access passenger operators can choose whether to have Schedule 4.

¹ The delay multiplier reflects the fact that passengers are more inconvenienced by an unscheduled delay than by a timetabled, advertised increase in journey time. For example, the delay multiplier for most London & South East, and Regional service groups, is 2.5. A full description of the existing Schedule 8 system is given in Review of the Schedule 8 performance regime. This can be accessed at: <http://www.rail-reg.gov.uk/server/show/nav.177>

Significant Restrictions of Use

- 2.10 For Significant Restrictions of Use (SRoUs) – possessions longer than 60 hours (not including public holidays) or associated with a Major Project² – franchised passenger train operators can also claim compensation for certain categories of cost. Compensation is based on estimated costs and is only payable where “Direct Costs” exceed £10,000. The vast majority of possessions (around 97%) fall outside the SRoU definition.

Access Charge Supplements

- 2.11 In return for the ability to claim compensation under Schedule 4, franchised passenger train operators pay an Access Charge Supplement (ACS) to Network Rail. The ACS is based on the efficient level of Schedule 4 expenditure across the control period. Open access passenger operators have the option to have a Schedule 4 and pay an ACS, or not to be compensated under Schedule 4.

Schedule 4 for freight operators

- 2.12 The freight model contract does not contain a Schedule 4 with the sort of possessions compensation regime used by franchised passenger train operators (and some open access passenger operators). Instead, it provides for a liquidated sum to be paid to the freight operator if variations are required to be made to services, for reasons attributable to Network Rail, that result in effects matching or exceeding a list of criteria. These criteria are set out in Schedule 4 and are intended to cover circumstances such as the use of a longer diversionary route or a delayed departure time, which are likely to cause the freight operator significant additional costs.
- 2.13 Freight operators are not required to pay an ACS to be eligible for the service variation sum under Schedule 4. Although the value of the service variation sum (Schedule 4) and cancellation sum (Schedule 8) will vary from freight operator to freight operator, they are generally around £500 and £1,000 respectively.
- 2.14 Freight operators can also propose a bespoke possessions compensation regime of the type used by passenger operators (i.e. to receive compensation for all planned possessions), subject to the payment of an ACS and to criteria set out in ORR’s document “Criteria and procedures for the approval of freight track access contracts” published in May 2006.

Part G of the Network Code

- 2.15 Under Part G of the Network Code, most train operators (franchised passenger, freight and nearly all open access passenger) can claim compensation for possessions associated with Network Change. Under

² Major Project defined in Part D of the Network Code as “any engineering, maintenance or renewal project which requires a possession or series of possessions of one or more sections of track extending over a period of more than one year, or a period which contains two or more Passenger Change Dates”.

Part G, full compensation is available to train operators; that is, train operators are able to claim full revenue losses over and above those compensated through the Schedule 4 formula, and all costs associated with the possession, not just those cost categories that are compensated for Significant Restrictions of Use, net of any benefits. Compensation is payable irrespective of the duration of the possession.

Strengths of the current regime

2.16 The policy group considers that the current regime has a number of strengths, which need to be taken into consideration when considering any changes, namely:

- The passenger Schedule 4 incentive structure is easy to understand and Network Rail is able to incorporate it into its planning processes. Incentives are generally aligned with the timetable production process and the effect of disruption on passengers;
- The formula based approach for revenue compensation significantly reduces transaction costs associated with individual claims;
- Cost compensation is available where costs are likely to be large, i.e. possessions of long duration or those forming part of a series of possessions (currently defined by reference to a Major Project)
- Freight Schedule 4 is easily understood and operated and provides some incentive/compensation to reduce the effect of disruptive short notice possessions.

Concerns with the current regime

2.17 Despite the strengths of the current possessions compensation regime there are a number of concerns that have arisen with its application and impact on incentives, in particular:

- an inconsistent approach to compensating train operators for the effects of possessions. In particular, in most cases train operators receive more, and for freight and open access passenger operators significantly more, compensation for possessions associated with Network Change compared to possessions taken for other purposes;
- issues around the boundaries between Schedule 4 and Part G, with the greater compensation available under Part G providing an incentive for train operators to claim compensation under Part G;
- lack of clarity around the definition of what constitutes a Major Project;
- concerns over the accuracy of compensation arrangements and the resulting economic signals, with concerns over the accuracy of the Schedule 4 revenue compensation formula and the lack of compensation for bus costs for most possessions. This has led to

concerns over whether Network Rail is facing the correct economic signals when taking possessions;

- a lack of transparency in the Part G and Schedule 4 process and unnecessarily high transaction costs, particularly where compensation is agreed through negotiations between train operators and Network Rail.

3. Summary of workstreams

- 3.1 This chapter provides a summary of the findings from the three workstreams listed in the “Method of Work” section of the Introduction. Where consultants have carried out work for the industry, they were provided with a remit to examine cost-disruption relationships and to make recommendations on potential improvements to the existing regimes in the context of incorporating within Schedule 4 all compensation relating to possessions on the network and in light of the issues highlighted in the previous section. They were asked to consider thresholds of possession categorisation for points at which the level of disruption to operators became of greater significance.

Overview of workstreams

Compensation to passenger operators for revenue loss

- 3.2 Steer Davies Gleave (SDG) has undertaken a project to recommend changes to the way in which passenger operators are compensated for revenue loss, bearing in mind the trade-off between accuracy (i.e. compensation reflecting actual revenue loss as accurately as possible) and practicality. The project was based on a review of existing research into the effects of possessions on passenger demand, together with some new analytical work.

Compensation to passenger operators for costs

- 3.3 Faber Maunsell has carried out a project to look at the relationship between cost and disruption. The exercise made use of the following data and data sources based on 80 disruptive possessions during which costs were incurred by six passenger operators:

- Cost compensation information supplied directly by operators and/or Network Rail;
- Data on all parameters of disruption from Schedule 4 Compensation System (S4CS);
- Operational hours, trains and route miles affected from S4CS, passenger timetables or Quail maps;
- Interviews with all six operators;
- Interviews with operational planners and delivery planners in Network Rail.

Compensation to freight operators

- 3.4 Freight operators, Network Rail and ORR formed a freight working group to consider jointly how the compensation mechanism for freight might be developed.

Compensation to passenger operators for revenue loss

- 3.5 SDG's remit was based on the assumption that, under a revised Schedule 4, compensation for revenue loss would be structured broadly as follows:

- For most possessions, compensation would have to be determined by a formulaic approach (such as the existing Schedule 4 algorithm). This is because, for most possessions, the sums involved are relatively small compared with the transaction costs of any alternative approach.
- For some "large" possessions (to be defined), with potentially very material effects on passenger operator revenue, there would need to be provision for passenger operators to claim any revenue losses over and above that provided by the formula.

- 3.6 In this context, SDG was asked to consider:

- Whether the existing Schedule 4 algorithm should be modified.
- Whether there is a case for an "intermediate" approach, for "medium" sized possessions, whereby compensation would be calculated based a model such as MOIRA. The idea was that this might improve the accuracy of compensation, by using a model that should be more accurate than the Schedule 4 algorithm, but without incurring the transaction costs associated with a claim process.
- How the boundaries between the different mechanisms for determining compensation should be defined.

- 3.7 SDG's work was based partly on existing research into the effect of possessions on demand, and partly on a number of pieces of new analysis. In particular, SDG:

- compared for a sample of possessions the revenue loss predicted by Schedule 4 with that predicted by MOIRA;
- compared the demand profiles in MOIRA with passenger counts data on relative demand at different times of day and on different days of the week; and
- re-analysed existing survey data to gain a better understanding of the extent to which passengers are aware of possessions in advance of travelling.

3.8 The key conclusions from SDG's work were that:

- For individual possessions, the existing Schedule 4 algorithm can give estimates of revenue loss that differ significantly from that estimated by MOIRA. However, over a sample of possessions, the two methods appear to give results of a similar order of magnitude; there is no evidence to suggest that Schedule 4 systematically under- or over- estimates revenue loss compared to MOIRA.
- The notification factors in the existing Schedule 4 algorithm should be modified to more accurately reflect levels of passenger awareness, and hence revenue loss (see below).
- The mechanistic use of MOIRA to estimate revenue loss, for "medium" sized possessions, is not recommended. This is because any advantages in terms of accuracy (compared to the Schedule 4 algorithm) would be outweighed by the practical difficulties of contractualising the use of MOIRA.
- Thresholds should be defined, based on duration of possession(s), above which compensation should be based on a claim (as in the current Part G arrangements) rather than just the Schedule 4 algorithm (see below).
- There may be merit in establishing a "Possessions Compensation Guide", setting out best practice in estimating revenue loss due to possessions. It would not be obligatory for operators or Network Rail to follow the Guide in estimating revenue loss for any particular possession. However, a Guide could enable most claims to be settled more quickly, and to reduce transaction costs.

Notification factors

- 3.9 The notification factors in the Schedule 4 algorithm are intended to reflect the level of passenger awareness at different stages of the timetabling process. SDG provides new evidence on passenger awareness and suggests that consideration be given to amending notification factors.
- 3.10 The Schedule 4 algorithm currently assumes, for possessions notified before the First Working Timetable (FWTT), that all passengers (and potential passengers) are aware of the possession. SDG's research suggests that this is not the case, and furthermore that the level of awareness among passengers at later stages of the timetabling process is actually higher than currently indicated by the Schedule 4 notification factors.
- 3.11 In addition, it was shown that changes in traveller behaviour in recent years mean that over 90% of tickets are now booked only within a month of travel. With this in mind, SDG suggested that whilst the key

stages in the timetable development process remain well-defined points to use as “breakpoints” in the notification structure itself, there is also an argument for introducing a fourth level of notification factor closer to the date of travel at some point between the Informed Traveller Working Timetable (ITWTT) at T-12. This would provide Network Rail with an incentive to inform passenger operators before the Applicable Timetable (ATT) at T-0, even when it has missed the current medium discount.

- 3.12 SDG proposes amendments to the notification factors to reflect this evidence. The table below shows two options for a Service Group with a delay multiplier of 2.5 (most London and South East and Regional Service Groups). The first option (“Compensation Regime”) shows the notification factors recommended by SDG based purely on levels of passenger awareness. There is little difference between the notification factors at different stages of the timetable development process, which reflects SDG’s findings that passenger awareness of a possession is only weakly correlated with when a possession is notified.
- 3.13 SDG recognises that this would significantly reduce the financial incentives on Network Rail to notify possessions as early as possible. SDG have therefore proposed a second option (shown as “Incentive Regime” in the table below), in which the notification factors are adjusted so as to provide more of an incentive for early notification.

Table 3.1 Possible revised notification factors proposed by SDG

Illustration of notification factors (for a Service Group with delay multiplier of 2.5)		By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors		40% of MRE	60% of MRE		80% of MRE
Proposed new notification factors	Compensation Regime	60% of MRE	63% of MRE	66% of MRE	70% of MRE
	Incentive Regime	60% of MRE	65% of MRE	70% of MRE	80% of MRE

- 3.14 Alternative notification factors for other Service Groups, on a basis consistent with SDG’s proposals above, are shown in Annex A.

Thresholds for possession categorisation

- 3.15 SDG was asked to identify a point at which passenger operators should be able to claim for full revenue losses (net of benefits) if there is evidence to suggest that they may otherwise be undercompensated using the traditional Schedule 4 algorithm (incorporating any agreed amendments to notification factors, as discussed above).
- 3.16 In order to define where these boundaries might be set, SDG’s work considered possessions which are both long in duration as well as those which are "serial possessions", which might affect demand more than the corresponding number of independent possessions.
- 3.17 Three categories of possession were proposed, as shown below:

Table 3.2 Categorisation of possessions for revenue compensation (consultants’ proposal)

	Definition	Compensation for revenue loss
“Normal”	(all other possessions)	Schedule 4 algorithm only
“Larger”	A single possession of over 120 hours; or where a given Service Group is affected by possessions in a particular location with a cumulative duration of 300 hours over any consecutive 3 periods	Schedule 4 algorithm by default Bespoke calculation if there is evidence that the algorithm is likely to underestimate the level of revenue loss (likely to use MOIRA and/or historical revenue data)
“Largest”	where a given Service Group is affected by possessions in a particular location with a cumulative duration 700 hours over any consecutive 7 periods	Bespoke calculation by default

- 3.18 SDG felt that the distinction between “Larger” and “Largest” would preserve flexibility, by encouraging use of the simpler, formulaic method when there was no strong case to move away from it in the case of “larger” possessions. Based on a sample of five periods of possessions, SDG estimated that approximately 0.5% of all

possessions would fall into the “Larger” category, and that approximately 0.25% of possessions would fall into the “Largest” category.

- 3.19 The full SDG report is available at the Network Rail website from 1 October 2007 (www.networkrail.co.uk / Resource Library / Regulatory Documents / Access Charges Review / PR2008 / Review of Possessions Compensation Regime).

Compensation to passenger operators for costs

Proposed cost formula

- 3.20 Faber Maunsell (FM) was asked to:

- examine the relationship between different types of costs and measures of disruption;
- consider the feasibility of a formulaic approach to cost compensation;
- identify and define appropriate thresholds at which different levels of compensation might apply (including minimum and maximum bounds within which it should operate).

Rail replacement bus costs

- 3.21 FM established at an early stage of the consultation that rail replacement bus costs are the dominant cost category, around 90% of all costs.
- 3.22 From the information provided, FM did not observe robust correlations between rail replacement bus costs and different types of disruption e.g. duration, volumes of passengers, Schedule 4 revenue compensation.
- 3.23 The consultants developed a new measure called “Estimated Bus Miles” (EBMs), a parameter which would reflect the impact of the possession compared with the train service that would normally operate. It takes into account the quantity of trains operating over the section of the network affected by the possession. However, it also takes into account the level of rail replacement bus provision required, which depends on the availability of an alternative diversionary route, or the presence of an alternative parallel operator such as LUL.

Table 3.3 Formula for Estimated Bus Miles

<p>Estimated Bus Miles (EBMs) = Length of route where train services affected x Number of trains x Weighting</p>

3.24 The weighting is designed to reflect the level of rail replacement services provided for the length of route between which train services are affected by the possession. This would fall into three categories:

Table 3.4 Weighting for Estimated Bus Miles

Full provision of bus services where all passengers travelling over the route affected by the possession must transfer to buses.	100% weighting
No provision of bus services where all passengers use the train services which use a diversionary route, or transfer to a parallel operator such as LUL;	0% weighting
Partial provision of bus services where some passengers use the train services which use a diversionary route, or transfer to a parallel operator, but where some buses are needed to serve intermediate stations.	50% weighting

3.25 FM felt that, through analysis of the relationship between EBMs and rail replacement bus costs, a reasonably good linear relationship exists.

3.26 The FM report goes on to state that the parameter of EBMs requires further development, but could be agreed upfront by route section in each operator's contract. Compensation could then be calculated through multiplication by a network-wide rate per mile. FM also envisages a period of shadow running to explore the practicality and suitability of the EBMs parameter and to refine the outputs from the original analysis by collecting further sample cost data.

3.27 In conjunction with this FM recommends that system issues are investigated to test the level of automation that is feasible. This would include in the short-term:

- Development of prototype system; and
- Population of the proposed lookup table for one or more train operators to assess feasibility.

- 3.27 Further detail of the proposal on EBMs is provided in Annex B.

Costs through changes in train mileage

- 3.28 Costs or savings caused by adjusted train mileage are already taken into account by the existing bespoke compensation mechanisms. Given that the change in train miles is a parameter easily available through S4CS, FM proposes that this aspect could also be compensated on a formulaic basis, calculated using an average compensation rate per train mile – this would be operator-specific (or possibly Service Group specific) derived from a suitably sized sample of historical data (and forecast data where appropriate) on variable track access charges, EC4T, capacity charge and fuel.

“Other Costs”

- 3.29 The consultants also carried out some preliminary work to investigate a formulaic approach for compensating “Other Costs” such as publicity and train planning.³

Thresholds for possession categorisation

- 3.30 FM considered that there might be a lower threshold below which, as now, no cost compensation would be offered, in order to reduce transaction costs. If a lower threshold were set, FM’s analysis suggests that a 24 hour threshold would allow 87% of costs to be recovered, and that an 8 hour threshold would allow 91% of costs to be recovered.
- 3.31 FM was asked to identify an upper threshold above which train operators or Network Rail could make a case for compensation to be based on full costs and losses (net of benefits). It was proposed that this boundary might be set at 60 hours, consistent with the existing Significant Restriction of Use duration threshold.
- 3.32 In order to align with the upper boundaries in revenue compensation, FM also proposed that the definition of a series of possessions from the envisaged “Larger” and “Largest” categories could also be incorporated into the upper threshold.
- 1.19 The full FM report is available at the Network Rail website from 1 October 2007. (www.networkrail.co.uk / Resource Library / Regulatory Documents / Access Charges Review / PR2008 / Review of Possessions Compensation Regime).

³ The policy group does not intend to consult on that work, as it felt that it would introduce too great a level of complexity at this stage, being dependent on the development of a further new mileage parameter in addition to “Estimated Bus Miles”, which might cause confusion.

Compensation to freight operators

- 3.33 Freight operators and Network Rail agreed at an early stage of the freight work that the work would concentrate on designing a compensation regime that would provide costs and losses net of benefits for “extremely disruptive” possessions. There was no intention to change the existing “Service Variation & Cancellation” provisions within freight Schedule 4 and Schedule 8 which would continue to compensate operators for disruption for possessions advised after T-12.
- 3.34 The freight working group discussed that there could be two main building blocks for developing a mechanism within freight Schedule 4, in order to create a single compensation mechanism which replaces the existing provisions in Part G, each of which is set out more fully below.
- Definition of a new set of thresholds for “extremely disruptive” possessions which trigger compensation
 - Linking compensation to the non-availability of agreed key routes and diversionary routes

Option 1: Trigger thresholds for extreme disruption⁴

- 3.35 The objective would be to set suitable thresholds of “extreme disruption”, against which the actual disruption is measured. Initial values were suggested for where the trigger thresholds might be set.
- 3.36 In order to assess the appropriateness of these suggested thresholds, a period of shadow running would be necessary, perhaps for a period of up to six months. After one month of data collection, it would become clearer as to whether the proposed thresholds are set at broadly the right levels (although the remainder of the shadow running period would be used to monitor and, if necessary, refine them).
- 3.37 It is expected that both the shadow running and the actual implementation could be managed in the same way as currently works for service variations and cancellations (“SV&C”), namely that freight operators provide and submit the claim to Network Rail, who then verifies it.

⁴ It should be noted that the adoption of trigger thresholds would be a feature common to both options 1 and 2. However, the levels at which thresholds are ultimately set may be dependent on whether the diversionary route element of Option 2 is adopted, see below

Option 2: Identification of diversionary routes (combined with trigger thresholds for those cases where diversionary routes not available)

- 3.38 An alternative option considered was to identify and agree where suitable diversionary routes exist for freight traffic and to offer compensation only where these are not available, again subject to any necessary overarching criteria and the trigger thresholds identified through the same process as described in Option 1 (although the actual levels of the thresholds may be different under Options 1 and 2).
- 3.39 The working group considered possibilities of how suitable diversionary routes might be identified and agreed, investigating a number of other workstreams currently being undertaken by Network Rail which might provide the necessary data within acceptable timescales.

4. Proposals of the policy group and issues for consultation

- 4.1 The policy group has considered the emerging findings from the three workstreams described above and has discussed which of these should be taken forward for consultation with the wider industry.
- 4.2 ORR's remit envisages that changes are made to Schedule 4 of Track Access Agreements which enable compensation for disruptive possessions to be removed from Part G. This proposal for reform sets out proposed amendments to the existing regimes within Schedule 4 of track access agreements (and Schedule 8 of freight access agreements) and identifies a number of options for implementation timing, particularly in light of the required amendments to Part G.
- 4.3 This chapter now provides full details on the policy group's proposals concerning the possessions compensation regime and sets out the reasons underpinning these conclusions.

Overview

Franchised passenger operators

- 4.4 The proposal sets out:
- A tiered structure for different types of compensation to reflect different levels of disruption, and a revised categorisation of possessions to incorporate the above findings;
 - A proposal for the formulaic compensation for rail replacement costs and identification of the continuing work for assessing the practicability of this option;
 - A possible revision of notification discounts in the existing Schedule 4 structure to reflect new evidence about passengers' awareness of possessions;
 - Options for implementation.

Open access passenger operators

- 4.5 The proposal sets out how the above changes will affect open access passenger operators.

Freight operators

- 4.6 The proposal sets out the methodology for agreeing new compensation thresholds in the coming months to reflect the boundaries of extreme disruption.

Part G

- 4.7 The proposal is for Part G to be amended to exclude compensation relating to disruptive possessions (including amended timetables).

Consultation questions

1. Consultees are invited to comment on the appropriateness of the current compensation mechanisms (i.e. through Schedule 4 and Part G of the Network Code) and whether or not the high level proposals set out above would improve the way in which compensation is identified and paid.

2. Consultees are also invited to propose any other alternative approaches that you feel would be more appropriate along with your reasoning for supporting such proposals.

3. Consultees are asked to comment on whether there are other changes to Part G or Schedule 4 which the policy group should consider.

Franchised passenger operators

Tiered structure for compensation

- 4.8 The policy group has considered the various proposed boundaries for different levels of compensation and how to incorporate them into a single transparent structure. It agrees that a tiered structure along the lines of those recommended by the consultants with all compensation for possession in one place (Schedule 4) would be beneficial and should be adopted.
- 4.9 The current proposal being considered by the group as a tiered structure is set out below, and is discussed further in the subsequent paragraphs.

Table 4.1: Tiered structure for different types of compensation

Possession type	Threshold	Cost	Revenue
Type 4	<p>Single possession >120 hours; OR “Series” of possessions</p> <ul style="list-style-type: none"> • X hours over 3 periods in a Service Group; or • Y hours over 7 periods in a Service Group⁵ <p>(includes public holidays)</p>	<p>Existing Schedule 4 algorithm & cost formula</p> <p>Possibility* of costs/losses net of benefits (where possible to be based on forecast actuals)</p> <p><i>* Where either party believes that the total formulaic compensation will under or overcompensate by more than £10k</i></p>	
Type 3	<p>Single possession > 60 hours (formerly SRoU duration threshold)</p> <p>(excludes public holidays)</p>	<p>Cost formula</p> <p>Possibility* of Direct Costs net of benefits (where possible to be based on forecast actuals)</p> <p><i>* Where either party believes that the cost formula will under or overcompensate by more than £10k</i></p>	<p>Existing Schedule 4 algorithm</p>
Type 2	<p>Single possession > 24 hours</p>	<p>Cost formula</p>	
Type 1	<p>Single possession < 24 hours</p>	<p>None</p>	

⁵ X and Y to be agreed following further analysis, described as “Threshold 1” and “Threshold 2” respectively in the discussion in paragraphs 4.19 onwards. In some cases, these may be measured over a sub-Service Group – see below for details.

4.10 Further work is needed to test the specific implications of the recommendations, The policy group considers that this work can be completed to allow for implementation by April 2009.

Reasons for the tiered structure proposal

4.11 There is general recognition across the industry that it is appropriate for there to be different types of compensation to reflect the scale and impact of different levels of disruption. The proposal in Table 4.1 above takes this into account.⁶

4.12 The policy group believes that “duration of possessions” (singularly or cumulatively) represents the clearest and most transparent way of agreeing the boundaries, reflecting the actual disruptive impact on the operators and their customers. For this reason, it is agreed that it is beneficial for references to Major Projects and Network Change not to be included in any definitions of boundaries.

Revenue boundaries

4.13 The policy group agrees that revenue loss compensation should generally be formula-based by default because it believes that:

- whilst the answer may over predict in some cases and under predict in others, a formulaic approach has low transaction costs and appears to give realistic results in most cases; and
- a more predictable level of compensation incentivises Network Rail by providing the right price signals for it to plan its possessions effectively. This would be the scenario in possessions **Types 1-3**.

4.14 However, it is recognised that for large possessions or “serial possessions”, any under prediction of losses may be significant and there should be the possibility for operators to claim costs and losses net of benefits.⁷ In practical terms it is likely that these would be based

⁶ The actual classification into Types 1-4 is believed to represent a more neutral language for categorising possessions than using titles such as “Large” or “Significant”.

⁷ Where “costs and losses net of benefits” would reflect the definitions in Conditions G2.2 and G2.3 of the Network Code as:

“the amount of compensation ...equal to the amount of the costs, direct losses and expenses (including loss of revenue) which can reasonably be expected to be incurred by the Train Operator...[taking into account]... the benefit (if any) to be obtained or likely in the future to be obtained by the Train Operator as a result, and the ability or likely future ability of the Train Operator to recoup any costs, losses and expenses from third parties including passengers and customers”

on either modelling using MOIRA, or on analysis of outturn actual revenue. This is the rationale behind proposing the **Type 4** possession.

- 4.15 The consultants proposed a distinction between “Larger” and “Largest”, the difference being that in the former case the formulaic approach remained theoretically the default, whereas, in the latter case, bespoke costs and losses net of benefits was the default approach. The policy group does not believe that this distinction between “Larger” and “Largest” possessions is appropriate, as there is insufficiently small difference between them to justify the additional contractual provision.
- 4.16 The consultants also suggested that a series of possessions should only be considered at a particular location. The policy group believes that a “series” should be defined in terms of disruption to a passenger market, without reference to a particular location. A passenger market can be severely disrupted by a series of possessions on a particular route, irrespective of whether they occur in the precise same location.
- 4.17 In most cases it is believed that Service Groups, as defined in Schedule 8 of track access agreements, can be used as a reasonable proxy for passenger markets. The policy group therefore proposes that, in general, a passenger market should be defined as being affected by a **Type 4** series of possessions if the total (cumulative) duration of possessions affecting the Service Group, within a given time period, exceeds a given threshold number of hours.
- 4.18 However, there may be some Service Groups that cover such a large geographic area, and serve such a range of distinct markets, that the Service Group should be subdivided in some way for purposes of determining a “series” of possessions. For example, if a single Service Group is made up of entirely distinct services serving distinct markets on several entirely distinct routes, it may be appropriate to apply the thresholds separately for each route. Examples of Service Groups that it might be appropriate to divide in this way might include ScotRail’s Highland Service Group (within which the West Highland line is geographically separated from services centred around Inverness), and the InterCity Cross Country franchise (which is one Service Group for Schedule 8 purposes, though it serves a wide range of markets).
- 4.19 This leaves the question of what threshold(s) should be used to define a **Type 4** series of possessions. The consultants proposed two thresholds, which they estimated would between them capture approximately 0.5% - 1% of possessions:
- A “larger” series of possessions, defined as having a cumulative duration exceeding 300 hours over any 3 consecutive periods; and
 - A “largest” series of possessions, defined as having a cumulative duration exceeding 700 hours over any 7 consecutive periods.

- 4.20 As described above, the policy group does not propose to introduce a distinction between “Larger” and “Largest” series of possessions. The policy group proposes to combine the consultants proposals, so that a Service Group is defined as being affected by a **Type 4** series of possessions if either:
- It is affected by possessions of a cumulative duration exceeding a certain number of hours (“Threshold 1”) over any 3 consecutive periods; or
 - It is affected by possessions of a cumulative duration exceeding a certain number of hours (“Threshold 2”) over any 7 consecutive periods.
- 4.21 However, the policy group does not believe that the numerical thresholds proposed by the consultants are appropriate. These thresholds (300 and 700 hours) were proposed in the context of a “series” of possessions only applying if all the possessions were at the same location. Under the policy group’s proposals, the location of a possession will not generally be relevant. The policy group therefore believes that the thresholds (“Threshold 1” and “Threshold 2” above) will need to be higher than the 300 / 700 hours, in order to avoid a substantial proportion of possessions falling under the definition.
- 4.22 The policy group therefore proposes to do further analysis during the consultation period to inform a judgement as to the appropriate thresholds. The aim would be to capture an appropriate percentage of possessions on a network-wide level (the policy group believes that the 0.5% - 1% figures proposed by the consultants might represent an appropriate range) given the current Major Project definition (but accepting that this will include possessions that would not be associated with a Major Project as it is currently defined).
- 4.23 In recording the cumulative duration of possessions, for measuring against the “serial disruption” threshold(s), possessions which take place solely in white space, and are therefore non-disruptive, should be disregarded. However, if a possession is partly in white space, and partly disruptive, it is proposed that – for simplicity – the entire duration of the possession counts towards the cumulative total. This is to avoid the need to define and record the “disruptive duration” of every possession.
- 4.24 An alternative approach to defining **Type 4** possessions is set out later in this chapter.

Consultation questions

4. Consultees are invited to indicate whether or not they support the continued use of a formula as a default approach to identifying associated revenue loss or, if not, set out the reasons why you do not believe use of a formulaic approach is appropriate and what alternative approach you believe should be adopted.

5. It is recognised that Schedule 4 does not in all cases reflect actual revenue loss. However, the consultants found little evidence of a systematic under- or over-compensation. Consultees are invited to indicate whether or they agree with this, and if not, to provide supporting evidence for the view.

6. Consultees are invited to comment on the proposed thresholds for calculating revenue loss, particularly on the appropriateness and the impact on incentives of a Type 4 possession being defined as one which is over 120 hours or part of a “series” of possessions, based on the cumulative duration of possessions affecting a Service Group over any 3 and/or 7 consecutive periods.

- If the “series” of thresholds is to be designed by reference to cumulative hours over a number of periods, what would consultees consider to be an appropriate threshold?**
- Do consultees agree that, except in a relatively small number of cases, a “series” of possessions should include the cumulative number of hours across a whole Service Group? Which Service Groups might need to be subdivided to reflect distinct passenger markets?**
- Alternatively, do you think that the trigger for a “Type 4” possession should be based on another measure, for example on a percentage of revenue loss as estimated by the Schedule 4 algorithm? (see section on alternative approach below)**

Treatment of long-running Restrictions of Use

4.25 For passenger operators, the current formulaic compensation mechanism ceases to compensate long-running Restrictions of Use after a period of time, because where they are timetabled every relevant day, there ceases to be a Corresponding Day after three years against which to identify their impact. Under the proposed new

arrangements, the impact of repeated regular short possessions may not trigger the thresholds for Type 2, 3 or Type 4 possessions. A mechanism may therefore need to be developed (possibly within Part G) to ensure this long-running impact continues to be fairly compensated. Consideration will also need to be given to the treatment of long-running Restrictions of Use which may not trigger relevant thresholds but nevertheless involve a change to the operation of the network.

Consultation question

7. Consultees are invited to comment on the treatment of long-running Restrictions of Use.

Possessions Compensation Guide

4.26 The policy group proposes that a Possessions Compensation Guide should be developed along the lines suggested by the consultants. This would set out best practice in estimating revenue loss due to possessions (and may be informed by guidance issued in 2006 by DfT on the efficient management of possessions). It would not be obligatory for operators or Network Rail to follow such a Guide in estimating revenue loss for any particular possession. However, a Guide could enable most claims to be settled more quickly, and reduce transaction costs.

4.27 It is envisaged that a Guide might include advice on issues such as

- The use of MOIRA in estimating revenue loss due to possessions;
- Adjustments that might commonly be made to MOIRA results, to better reflect specific issues arising as a result of possessions; and
- Best practice in estimating revenue loss directly from analysis of historic revenue data.

Consultation question

8. Consultees are invited to comment on the proposal to develop a Possessions Compensation Guide to facilitate estimation and calculation of revenue losses arising from possessions.

Cost boundaries

- 4.28 **Type 1** possessions represent the possible scenario in which it might be acceptable for operators not to receive any cost compensation. The consultants' analysis suggests that a lower threshold (of between 8 and 24 hours) would allow approximately 90% of costs to be recovered. Having a lower threshold might reduce transaction costs. However, having a lower threshold might also introduce scope for dispute and perversely increase transaction costs as both parties engage resources in "monitoring" the boundary.
- 4.29 The introduction of a **Type 1** possession boundary depends largely on the outcome of the further work to examine the feasibility of the cost formula. If it is concluded that the formula is robust and that it can be fully automated, then it is arguable that a lower threshold is superfluous and that all possessions will receive cost compensation through a formula.
- 4.30 Notwithstanding the ongoing investigation of the appropriateness of a lower threshold, **Type 2** possessions would then introduce compensation through the proposed cost formula (for rail replacement bus costs and the net effect on costs of changes in train mileage). It would apply up to the 60 hour duration threshold (excluding public holidays), consistent with the duration threshold in the "Significant Restriction of Use" definition.
- 4.31 The policy group supports the principle of this formula-based approach to compensation because it believes that a more predictable level of compensation incentivises Network Rail by providing the right price signals for it to plan its possessions effectively.
- 4.32 For the purposes of calculating compensation, Estimated Bus Miles (EBMs) are felt to incorporate the busyness, or intensity of track use better than simply possession duration or other measures of disruption. They also reflect, through the weighting, the pattern of rail replacement buses provided given the availability of diversionary routes or parallel services. Clearly, additional work is required to establish the exact rules, which ought to be straightforward to implement and where the risk to both parties is agreed to be low. Further information is provided below (and in Annex C) on how this mechanism will be further developed and tested.
- 4.33 **Type 3** possessions occur when the 60 hour duration threshold is triggered, representing the point at which either party has the option to request that costs and losses net of benefits are calculated on a bespoke basis (subject to the formulaic cost compensation under or

over compensating by more than £10k), on the basis that disruption becomes more significant above this level.

- 4.34 Putting the boundary at this level also helps to reduce any issues around Clause 18.1 / Schedule 9 of agreements between franchised passenger operators and DfT, as it is consistent with the existing duration threshold for SROUs.
- 4.35 For **Type 4** possessions, parties have the option to request that costs and losses net of benefits are calculated on a bespoke basis when there is a “series of possessions” (subject to total formulaic compensation under or over compensating by more than £10k). This is to recognise the financial impact that repeated disruption can have on an operator.
- 4.36 The policy group proposes that, for **Type 3** possessions in cases where compensation is being calculated on a bespoke basis, operators are entitled to claim “Direct Costs”⁸ as set out in the existing template Schedule 4 contract in relation to SROUs, whereas in **Type 4** possessions there should be entitlement to claim all costs.

Consultation questions

9. Consultees are invited to indicate whether or not they support, in principle, the use of a formula as a default approach to calculating cost compensation for rail replacement bus costs and costs or savings resulting from changes in train mileage. If not, set out the reasons why you do not believe use of a formulaic approach is appropriate.

10. Consultees are invited to comment on the proposed thresholds for when it would be appropriate to claim any costs associated with the taking of a possession, particularly:

- **Is it appropriate to have a lower threshold below which cost compensation could not be claimable? If so, why do you think a threshold is appropriate and at what level do you think it should be applied? Would a lower threshold be**

⁸ “Direct Costs” defined in Schedule 4 of track access agreements as the aggregate amount of:

- (a) bus and taxi hire costs;
- (b) publicity costs;
- (c) train planning and diagramming costs; and
- (d) costs directly related to the organisation and management of the Train Operator's response to a Restriction of Use,

incurred by the Train Operator as a result of a Restriction of Use, adjusted by:

- (i) adding any increase in costs which results from increases in train mileage; and
- (ii) deducting any decrease in costs which results from decreases in train mileage.

appropriate even if the calculation of cost compensation could be automated?

- **Should a formula based approach apply in all cases (above a notional lower threshold) or should there be an upper threshold beyond which it becomes the default option but not mandatory?**
- **If thresholds are appropriate, where do you think they should be set and why?**
- **Should the definition of Direct Costs also apply to Type 4 possessions?**

Type 4 possessions – an alternative approach

4.37 The trigger being proposed for a Type 4 possession, or series of possessions, is based on the duration of the possession (or, in the case of a series of possessions, the cumulative duration over a given time period). An alternative would be to base the definition of a Type 4 possession on the impact of the possession on passenger operator revenue, as estimated by the Schedule 4 algorithm. For example, a possession might be treated as a Type 4 possession if the revenue loss, as estimated by the Schedule 4 algorithm, exceeded a defined percentage of Service Group revenue. Similarly, a Service Group could be defined as being affected by a Type 4 “series” of possessions if, over a number of consecutive periods, the revenue loss as estimated by the Schedule 4 algorithm exceeded a defined percentage of Service Group revenue.

4.38 Such an approach might ensure that a single highly disruptive possession, or a brief but highly disruptive series of possessions, is treated under “Type 4”, with the potential for operators to recover costs and revenue losses in excess of formulaic compensation. Such an approach would also be consistent with the “Sustained Poor Performance” threshold in Schedule 8. However, it would suffer from the disadvantage that, if the Schedule 4 algorithm gave very little compensation – for whatever reason – for what was in fact a very disruptive series of possessions, the “series” definition would not be triggered. It would also be more difficult to predict when the trigger would be hit in advance of the possessions in question.

Development of the cost formula proposal

- 4.39 The policy group supports the principle of the proposed cost formula which uses the new parameter Estimated Bus Miles (EBMs) to calculate rail replacement bus costs, and also incorporates costs or savings resulting from changed train mileage, although recognises that further work is required to test and refine the proposed mechanism and provide confidence to the industry. In particular it would like to validate the analysis and conclusions on the EBM element, using new data from a greater sample size.
- 4.40 More extensive cost data will be needed before 'shadow running' to derive the compensation rates. In conjunction with this, the policy group recommends that system issues are investigated to test the level of automation that is feasible. This would include in the short-term:
- Development of prototype system; and
 - Population of the proposed lookup table for one or more Train Operators to assess feasibility.
- 4.41 This proposed mechanism will need stakeholder review and buy-in if it is to be used effectively. The policy group agrees with the consultants recommendations that a programme of workshops and training would be needed in advance of implementation.
- 4.42 Further training of users at the ground-level would be needed in advance of implementation. This may best occur at the same time as the population of the proposed EBM lookup table for each Train Operator.
- 4.43 The policy group proposes the incorporation of a mechanism into Schedule 4 to allow either party to make adjustment to the data required for the cost formula, if it can demonstrate a material change in circumstances.
- 4.44 The policy group envisages that all unit cost rates within the cost formula will be indexed annually by RPI.
- 4.45 Further detail on the envisaged process for implementation of the cost formula is offered in Annex C.

Consultation questions

11. Consultees are invited to comment on the proposed approach to use 'Estimated Bus Miles' to calculate rail replacement bus costs. Do you believe that this is a practicable way forward and would be easy to apply? What practical issues

would such an approach raise?

12. Consultees are invited to comment on the appropriateness of using a formula based approach for the costs or savings resulting from changes in train mileage? Do you consider that the Faber Maunsell recommendations are appropriate? If not what alternative approaches do you recommend?

13. Consultees are asked to comment on the proposed method of implementation of this formula based approach. Please also refer to Annex C.

Process and timescales for agreeing compensation

4.46 Regarding the process and timescales for when operators and Network Rail should agree compensation for Type 3 and Type 4 possessions, the policy group proposes a process along the lines of the current process in the SROU provisions of Schedule 4. This obliges Network Rail and operators to work together to identify the eligible possessions and to agree compensation in advance.

4.47 This process would apply to those possessions which trigger the duration threshold, as well as those which are part of a “series” of possessions, to the extent that this can be foreseen in advance.

Consultation question

14. Consultees are invited to comment on the proposed process and timescales by which compensation is agreed.

Notification factors

4.48 The policy group would like to consult further on the possibility to adapt the structure and level of Schedule 4 notification factors to more accurately reflect the impact of passenger awareness on revenue loss whilst continuing to provide incentives on Network Rail to notify early.

Passenger awareness

- 4.49 The policy group is proposing that changes to notification factors are considered, in order to better reflect passenger awareness and thereby the actual revenue losses experienced by passenger operators.
- 4.50 The consultants proposed two options for revision of notification factors. The first option was to base notification factors purely on levels of passenger awareness. In the second option, the notification factors are adjusted so as to still provide more of an incentive for early notification. These are described in more detail in chapter 3 and are illustrated in full in Annex A.
- 4.51 The policy group is keen to revise notification factors in such a way that Schedule 4 compensation becomes more cost reflective of the actual impact of disruption but it also wants to maintain strong incentives for Network Rail to plan its possessions early and efficiently. The policy group therefore would like to consult the wider industry on the “incentive regime” option. The table below illustrates the change for a Service Group with a delay multiplier of 2.5.
- 4.52 Adopting the “incentive regime” option would leave the notification factor for amended timetables unchanged in all cases, which would also have the benefit of reducing the complexity of settlement under Clause 18.1/ Schedule 9 of the franchise agreement between franchised passenger operators and DfT. Any other Clause 18.1/ Schedule 9 calculations could be done on a mechanistic basis.
- 4.53 Schedule 4 also provides compensation where timetables have been amended in response to an emergency or short-term disruption. Where amended timetables are put in place at very short notice (for example the day before), the full financial effects of the amended timetable on passenger demand will be close to those described in Schedule 8. However, it is believed that the late notice notification factor in the “incentive regime” option provides a sufficient incentive for Network Rail to provide advance notice for amended timetables.
- 4.54 There would be few additional transaction costs from introducing the above changes to notification factors, as it would simply be a matter of changing data within S4CS.

Intermediate notification factors

- 4.55 The policy group would also like to consult the industry on the possibility of introducing an intermediate notification factor between ITWTT (T-12) and ATT (T-0), to reflect the consultants’ findings that changes in traveller behaviour in recent years mean that over 90% of tickets are now booked only within a month of travel. The existing

stages in the timetable development process remain well-defined points to use as “breakpoints” in the notification structure itself, but a fourth level of notification factor could be put in closer to the date of travel.

- 4.56 There are practical issues with this approach which require further consideration, but the policy group agrees that, in principle, an intermediate notification factor level would provide greater incentive for Network Rail to inform operators even where the inclusion in the ITWTT at T-12 notification is not achieved.
- 4.57 To allow passenger operators to notify passengers at T-4 (namely, one month before) this would require a new Network Rail timetable to be issued at T-6. This would incur some additional costs both from Network Rail from issuing the new timetable and from operators in terms of assessing its impact. We consider that Clause 18.1 / Schedule 9 transaction costs are likely to be small as any changes would be mechanistic. We consider that the benefits of more closely reflecting passenger awareness of possessions, and improved Network Rail incentives, are likely to outweigh the additional costs of the changes.

Overview of proposed changes to notification factors and structure

- 4.58 The table below illustrates what the change would be to a Service Group with a delay multiplier of 2.5

Table 4.2 Proposed revision of notification factors

Illustration of notification factors (for a Service Group with delay multiplier of 2.5)	By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors	40% of MRE	60% of MRE		80% of MRE
Proposed new notification factors (“incentive regime” option)	60% of MRE	65% of MRE	70% of MRE	80% of MRE

Consultation questions

15. Consultees are invited to comment on the proposals to change the notification factors as indicated:

- **Do you believe that the proposed approach will better align compensation paid with associated revenue loss?**
- **Does the “incentive regime” proposal strike the appropriate balance between being cost reflective and providing the right incentives, and if not, what other factors should be taken into consideration?**

16. Consultees are invited to comment on the appropriateness of introducing a new point for notification at an interim point such as T-6 weeks. Are there practical issues that make such a notification point difficult and if so is there another point where a threshold would be more appropriate?

Implementation issues for franchised passenger operators

- 4.59 The DfT and Transport Scotland have confirmed that implementation of the proposal for franchised passenger operators will be subject to the application of Clause 18.1/ Schedule 9 of franchise agreements. These provisions apply a change mechanism which, in differing manners, provides protection to train operators under existing franchises for the impacts, and a pass through to the DfT of the gains, consequent on the changes to Schedule 4 and Part G made as part of an access charges review.
- 4.60 The policy group has taken account of the application of these arrangements and has concluded that two main approaches should be consulted upon, one involving introduction of all the proposals with effect from 1 April 2009 (the "immediate implementation proposal") and the other phasing the introduction of separate elements of the proposals (the "phased implementation proposal").
- 4.61 The immediate implementation proposal would involve implementation of all aspects of the proposal with effect from 1 April 2009. Short term transitional arrangements would need to be considered in respect of Significant Restrictions of Use and Network Changes which have already been notified before that date.

- 4.62 The phased proposal would involve implementing the elements of the proposals relating to revised notification factors and formulaic compensation for bus costs and adjusted train mileage with effect from 1 April 2009. However, the balance of the changes to Part G and compensation for Significant Restrictions of Use would be phased in on a franchise by franchise basis as new franchises were awarded. In these circumstances, Clause 18.1 / Schedule 9 adjustments would be unlikely to be applicable.
- 4.63 The advantages and disadvantages of the options are set out below, although these assume that a one-off deal between operators and DfT is not possible (or at least would be worse than incurring any ongoing transaction costs). Costs would be reduced if a deal could be struck. Whilst this has taken time to achieve, such deals have been struck in the past in relation to changes made to regimes at previous access charges reviews.
- 4.64 The advantages of the immediate implementation proposal include the following:
- The removal of the distinction, for compensation purposes, between Network Change and non-Network Change possessions as between Network Rail and train operators thereby removing any disincentive to pursue an efficient mix of renewal and enhancement work.
 - Improved clarity between Network Rail and train operators in respect of when bespoke compensation can be claimed and therefore improved working relationships and reduced transaction costs between the parties.
 - The provision of improved cost signals to Network Rail in respect of the costs of possessions for which it does not currently pay cost compensation.
- 4.65 The disadvantages of the immediate implementation proposal include the following:
- Cost compensation for Major Projects and Network Change compensation for possessions would still need to be calculated for the purposes of the operation of Clause 18.1/ Schedule 9. (requiring the ongoing categorisation of possessions in relation to Major Projects, other Significant Restriction of Use categories and Network Change) and therefore transaction costs between DfT/TS and operators are likely to increase. It should be noted that, apart from the West Coast franchise where special provisions apply, the number of Part G claims is small, particularly where Schedule 4 is not used to calculate revenue compensation. Any further increase in transaction costs will be temporary (until franchise renewal) and will be at least partially offset by the reduction in transaction costs between franchised passenger operators and Network Rail.

- The operation of Clause 18.1/ Schedule 9 will mean that franchised passenger operators will, until franchises are replaced, still perceive the old regime. This will maintain the economic incentives on franchised passenger operators to claim Network Change or Major Projects status for possessions. This means that there will still be some otherwise avoidable transaction costs that remain.
- Given that DfT/TS will have less knowledge in this area than Network Rail, this increases the risk of the possibility of increased administrative costs (although it should be noted that for large possessions the level of compensation paid by DfT/TS is likely to be similar to that paid under the new regime).

4.66 The advantages of the phased implementation proposal include the following:

- The elements of the proposals (revised notification factors and formulaic costs compensation) which are more easily processed through clause 18.1/ Schedule 9 can still be implemented immediately.
- The elements of the proposals which would otherwise give rise to the most significant clause 18.1/ Schedule 9 issues (chiefly exclusion of Major Projects from Significant Restriction of Use treatment and the changed test for full revenue and costs compensation) are aligned with franchise replacement, so that existing franchises are not required to address these changes and new franchises will be awarded on the basis of the new proposals.
- Train operators and Network Rail continue to operate the established Major Projects and Network Change categorisations until the time of franchise change, avoiding the need for any shadow process between train operators and DfT/TS.

4.67 The disadvantages of the phased implementation proposal include the following:

- Continuation of the existing Major Projects and Network Change categorisation leaves in place an inconsistent approach in terms of compensation between Network Rail and train operators for possessions for differing purposes (in particular, a differentiation between a possession taken for a renewal and a possession for an enhancement would remain).
- Different operators would be on different regimes which may increase transaction costs and the parties may face inconsistent incentives according to such regimes.
- The advantages of clearer compensation costs would not be achieved.

- It will take some time for the new arrangements to be fully introduced (see Annex E for a full list of franchise renewal dates).

4.68 Another option, given the potential Clause 18.1 issues associated with Part G changes, would be for operators and Network Rail to agree to Part G changes through the C5 process and then similarly to agree to the Schedule 4 changes to track access agreements under the Section 22 process. However, it is recognised that this would change the risk profile for franchised passenger operators and may have implications for government funding which would need to be considered. This option could be explored further depending on the response to the consultation.

Consultation questions

17. Consultees are asked to indicate, if the proposed changes are adopted, whether, and if so, to what extent you anticipate difficulties in netting off the effects of the changes through Clause 18.1 / Schedule 9 of the franchise agreement and what measures could be pursued to mitigate this.

18. Consultees are asked to express a preference from the approaches set out above, and to identify any alternative approach to implementation which they may prefer.

19. DfT has indicated that it would expect to apply the arrangements in franchise agreements which ensure financial neutrality to franchised passenger operators where such changes arise from a Regulatory Review and have emphasised the importance of any proposal allowing the financial neutrality arrangements in the franchise agreements to be calculated reliably and to the satisfaction of all parties involved. Consultees are invited to comment on the implications of this in their response.

Open access passenger operators

- 4.69 In order to enable the correct incentivisation for Network Rail and to avoid unreasonable levels of disruption to open access operators as well as to facilitate a more consistent approach across the network, the policy group considers that the revised compensation regime should also apply in the case of open access passenger operators.
- 4.70 The proposal is therefore that the existing provisions for compensation for disruption possessions are removed from Part G and that any reference to Major Projects is removed from Schedule 4. In respect of compensation for possessions, open access passenger operators would be able to elect to have either:
- the full regime as set out above, for which an Access Charge Supplement would be payable; or
 - the ability to only claim costs and losses net of any benefits in the case of Type 4 possessions in accordance with the boundaries set out in the tiered structure above. In this case, they would not participate in any of the components of the regime below the Type 4 boundary (for revenue loss or costs) and no Access Charge Supplement would be payable.

Consultation question

20. Consultees are invited to comment on the proposal above for open access passenger operators.

Freight operators

Thresholds for extreme disruption

- 4.71 The policy group recommends that the current provisions for compensation for disruption caused through possessions which have not been notified in all material respects by T-12 (Service Variations & Cancellations – “SV&C”) will remain in place and will be unaffected by this review.
- 4.72 The proposal to identify and agree key routes and diversionary routes was examined in some detail. Network Rail believed that if feasible, such an approach would provide an incentive for core routes or a valid

diversionary route to be available at all times and that this would therefore form the backbone of a freight compensation regime.

- 4.73 Whilst freight operators welcomed the initiative to formalise the necessary information on diversionary routes, concern was expressed at how appropriate it would be to combine this aspect with a compensation mechanism at this stage. It was felt that the suitability of routes would be specific to each freight operator and that incorporating this work into a compensation regime could lead to additional bureaucracy and provide more ground for disputes. Freight operators also argued that, even on an operator-specific basis, almost every route could be considered to be a “key” route for at least some of their customers and that the identification of key routes would hence be problematic.
- 4.74 The policy group therefore recommends that the compensation for extremely disruptive possessions set prior to T-12 will be based on a new set of trigger thresholds to be examined and agreed. Where possessions exceed these thresholds, freight operators will be entitled to claim actual costs and losses (net of benefits). The thresholds are expected to apply equally to all freight operators.
- 4.75 Initial values have been suggested for where the trigger thresholds might be set. In order to assess the appropriateness of these suggested thresholds, a period of shadow running will be necessary, described in further detail in the section on implementation. The objective will be to set the thresholds so that they are only triggered when “extreme disruption” is captured. The suggested threshold is when any of the following occur:
- (i) the affected service is cancelled
 - (ii) the affected service commences its journey from an alternative origin
 - (iii) the affected service has to operate to an alternative destination
 - (iv) the planned departure time differs from that of the original service by more than ‘X’ minutes⁹
 - (v) the planned arrival time at destination differs from that of the original service by more than ‘X’ minutes
 - (vi) the affected service is diverted over a route [of] which the train operator has no route knowledge
 - (vii) the imposition of any more demanding length, weight or gauge restrictions for the affected service
 - (viii) the use of at least one additional locomotive on the affected service or use of a diesel locomotive as a substitute for an electric locomotive
 - (ix) the operation of the affected service requires additional resources to be provided (but only where the FOC could

⁹ Both 60 and 120 minutes have been suggested as possibilities, and the shadow running will proceed on the basis of both.

demonstrate that the additional costs it will be exposed to will exceed £250 per train)

- 4.76 It is expected that both the shadow running and the actual implementation could be managed in the same way as currently works for “SV&C”, namely that freight operators would produce and submit the claim to Network Rail, who would then verify it.

Implementation issues for freight operators

- 4.77 As set out above, shadow running will be necessary to test and refine the suggested thresholds (see Annex F for further information on the proposed shadow running).
- 4.78 Without prejudice to discussions on the timing of implementation for the proposals for the passenger operators, the intention is that the shadow running will gauge the suitability of the initial proposed thresholds, with refinement where necessary. The aim is that a new regime could be implemented for the beginning of Control Period 4 for inclusion into Schedule 4 (in place of compensation for possessions through Part G).

Consultation questions

21. Consultees are invited to comment on the proposed criteria for determining compensation for freight operators. Do you believe that this would cover all situations where losses would occur? If not, what other factors should be incorporated?

22. Consultees are asked to comment on whether or not the identification of diversionary routes would add value to a possession compensation regime for freight operators and, if so, how would you envisage that this concept could be incorporated into the regime?

23. Consultees are invited to comment on the proposals set out in Annex F concerning the way in which the compensation regime for freight operators is intended to be shadow run, including any practicalities or problems with collecting and producing the data.

Access Charge Supplements

- 4.79 Currently an Access Charge Supplement (ACS) in respect of Schedule 4 compensation is payable by franchised passenger operators. The network-wide aggregated total of all ACSs is equal to the forecast level of efficient Schedule 4 payments across the control period, as determined by ORR at each access charges review. Based on the total, each franchised passenger operator's ACS is set in proportion to its share of the fixed charge.
- 4.80 Open access passenger operators pay an ACS in those cases where they opt to include Schedule 4 provisions in their track access contract. In each case this is currently calculated by pro-rating the above network-wide aggregated total (for franchised passenger operators) on a mileage basis.
- 4.81 The current arrangements provide a transparent incentive to Network Rail at a national level, because if it becomes more efficient in planning possessions it will spend less than the allowance made through the ACS. However, as a cost to operators the ACS is not transparent as it is unlikely to align precisely with the Schedule 4 payments any individual operator will receive. The ACS does not therefore provide operators with a reliable price signal, nor does it provide Network Rail with incentives at an operator-specific level.
- 4.82 There are two options for changing the ACS:
- continue to calculate the cost of Schedule 4 to Network Rail at a network-wide level, but absorb it into the fixed track access charge for franchised passenger operators; or
 - develop a methodology which is more reflective of the operator-specific impact, so that the ACS paid by operators would be more closely aligned to the expected payments received through Schedule 4 over the control period.
- 4.83 The first option leaves the current network-wide level incentive in place on Network Rail to improve its planning of possessions, and the additional sum to be included in the fixed charge is relatively straightforward to calculate.
- 4.84 The second option appears to offer greater transparency and clearer incentives at an operator-specific level. However, it is currently unclear how to accurately forecast operator-specific costs of Schedule 4 for all operators for the whole control period. Further consideration is needed to identify how this would work in practice.
- 4.85 The policy group recognises that there are advantages and disadvantages of both approaches and will continue to give further consideration to this question during the consultation process.

- 4.86 Whether through a separate ACS or absorbed into the fixed charge, the policy group will also consider whether the funding allowance for Network Rail for Schedule 4 should be subject to adjustment where traffic levels change materially.
- 4.87 For open access passenger operators choosing to have the full Schedule 4 (see previous section on open access passenger operators) an ACS would still be payable as a contribution to the cost of the overall compensation scheme.¹⁰
- 4.88 The policy group intends that the current proposals for freight operators are designed to capture only exceptionally disruptive possessions to replace the existing provisions under Part G and on that basis does not propose that freight operators should pay an ACS.

Consultation questions

24. Consultees are invited to comment on the proposed options for the future treatment of the ACS.

- **Is there advantage in retaining the current arrangement, where each franchised passenger operator pays, and has visibility of, a separate ACS for formulaic Schedule 4 compensation?**
- **If a separate Schedule 4 ACS is retained, how would consultees propose to make it more cost reflective to individual operators?**
- **If absorbed into the fixed charge, how would a Schedule 4 ACS be calculated for open access operators who opted into the formulaic components of the regime?**
- **In any event, do you agree that it should be subject to adjustment during the control period where traffic levels change?**

¹⁰ As noted earlier, if an open access passenger operator chooses to only have Type 4 possessions compensation, an ACS would not be payable.

5. Next steps

- 5.1 In parallel with the consultation, the policy group will continue to consider all issues of practicality and feasibility, particularly taking into account the likely implications for transaction and set-up costs of all options.

Shadow running

- 5.2 The first stages of shadow running will run in parallel with the consultation period. This will allow:
- assessment of the appropriateness of the suggested thresholds of disruption caused by possessions advised before T-12 for the freight operator compensation regime;
 - further review of the practicability of the proposed formulaic approach for calculating compensation for some cost categories for the passenger operator compensation regime.

Timescales

- 5.3 Consultees will be given 8 weeks to consider the proposals and to respond to the consultation by Friday 23 November. The consultation questions are asked throughout the text and are listed together in Annex G of this consultation paper.
- 5.4 Final recommendations will be submitted to ORR by the end of January 2008.

Annex A: Notification factors

This annex shows:

- the existing notification factors in Schedule 4;
- alternative notification factors, if these were to be based entirely on evidence of how passenger awareness of a possession varies according to the time at which the possession is notified (“Compensation Regime”); and
- alternative notification factors, based in part upon evidence of passenger awareness, but adjusted to retain a stronger financial incentive on Network Rail for early notification (“Incentive Regime”). These are the notification factors proposed by the Schedule 4 Policy Group in this consultation paper.

The notification factors differ according to the “delay multiplier” used to calculate the Network Rail payment rate in Schedule 8, as follows:

- Delay Multiplier = 2.5: London & South East and Regional Service Groups (except those primarily serving airport markets)
- Delay Multiplier = 5.1: Long Distance Service Groups
- Delay Multiplier = 6.5: Service Groups primarily serving airport markets

**Table A1: Existing and proposed notification factors:
Service Groups with delay multiplier = 2.5**

		By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors		40% of MRE	60% of MRE		80% of MRE
Proposed new notification factors	Compensation Regime	60% of MRE	63% of MRE	66% of MRE	70% of MRE
	Incentive Regime	60% of MRE	65% of MRE	70% of MRE	80% of MRE

**Table A2: Existing and proposed notification factors:
 Service Groups with delay multiplier = 5.1**

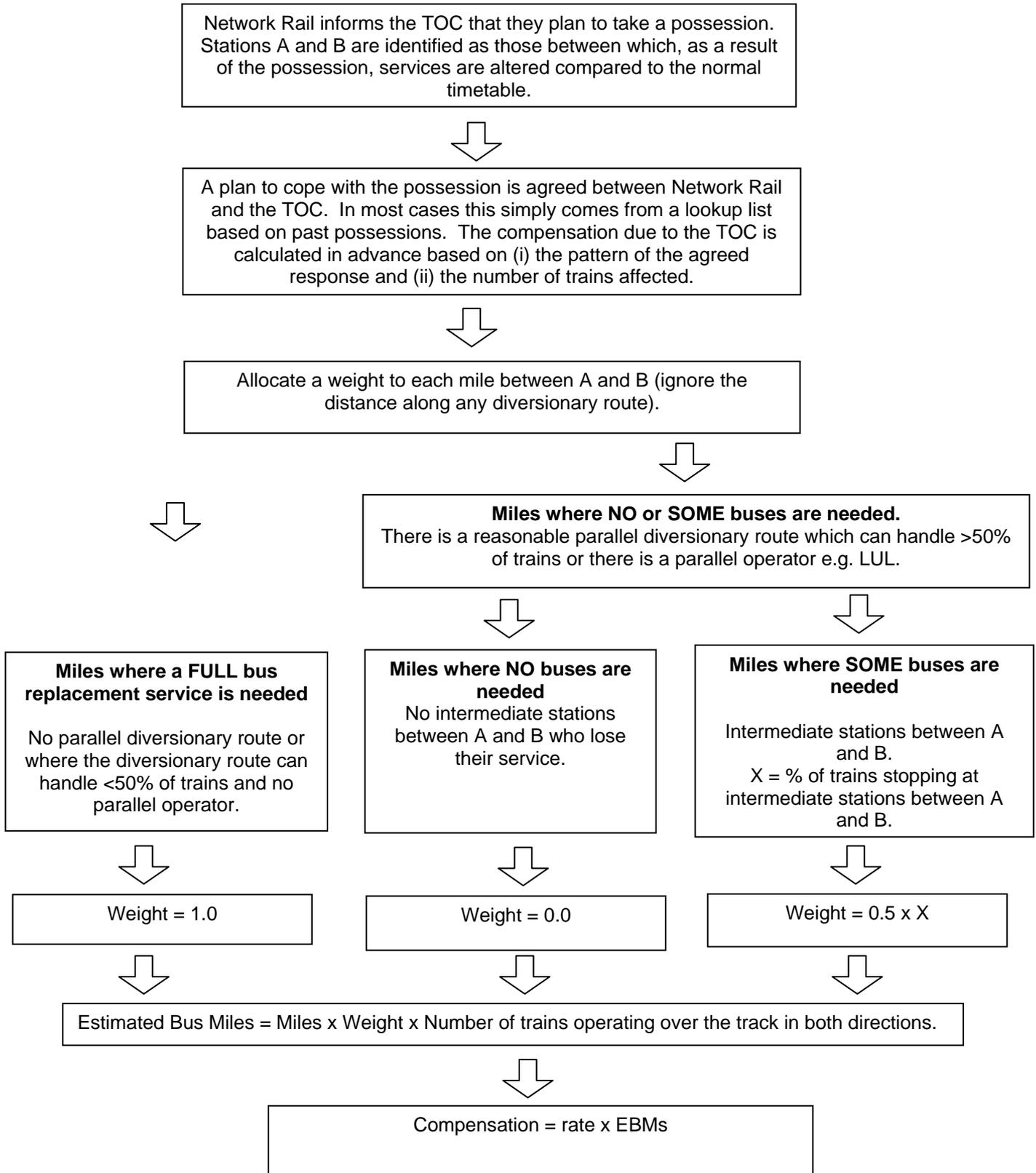
		By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors		19% of MRE	50% of MRE		80% of MRE
Proposed new notification factors	Compensation Regime	45% of MRE	50% of MRE	55% of MRE	60% of MRE
	Incentive Regime	45% of MRE	55% of MRE	65% of MRE	80% of MRE

**Table A3: Existing and proposed notification factors:
 Service Groups with delay multiplier = 6.5**

		By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors		15% of MRE	48% of MRE		80% of MRE
Proposed new notification factors	Compensation Regime	40% of MRE	45% of MRE	50% of MRE	55% of MRE
	Incentive Regime	40% of MRE	50% of MRE	65% of MRE	80% of MRE

Annex B: Estimated Bus Miles

This annex is taken from the FM report (page 72) to demonstrate how the Estimated Bus Miles (EBM) value would be calculated in practice. Please refer to the FM report for full detailed information.



Annex C: Envisaged process for implementation of the cost formula

Source: Letter from Faber Maunsell 18 September 2007

Short-Term Measures

1. Presentation of the proposals to the wider potential user group at a workshop, to support industry consultation.
2. Collecting and analysing a further sample set of possessions, to test the proposed mechanism and provide confidence to the industry. This should help the industry to address the outstanding issues of principle set out in the final FM report.
3. Population of a proposed lookup table for one passenger train operator to validate feasibility and confirm timescales.
4. Development of a prototype system for calculating compensation.

Longer-Term Implementation of the Proposed Mechanism

Ensuring the process is operational before June 2008 would require significant work across the wider industry. The key stages are outlined below along with the people who would need to be involved.

It is clear that the major element of work would be in populating the lookup tables for all passenger train operators.¹¹

1. The principles of the proposals would need to be explained to Network Rail account teams [and delivery planning teams] and passenger train operators' Track Access Managers. This might involve 3 to 4 workshop sessions being run at locations around the country.
2. Collecting more extensive cost data would need to start very soon to derive the compensation rates used for CP4. This would involve getting the support of Track Access Managers (perhaps on the back of the workshop sessions above). This would need to occur soon so that, at the very least, accurate cost data could be collected for possessions occurring over the next six months. This process should be supported through analysis of data to ensure accuracy and reliability, and to feedback any data quality issues immediately to passenger train operators.
3. A period of shadow-running in advance of full operation. This would allow the method to be refined and amended so that when the approach is formally adopted by Control Period 4, users will have had the opportunity to work with and understand the method. This process may need some support to deal with unexpected issues.

¹¹ This would apply to open access operators if and where necessary.

4. Population of lookup table for all passenger train operators. We anticipate that it would involve a number of sessions for each operator, involving both the Track Access Manager and the relevant Network Rail Customer Relationship Executive and / or Customer Manager. Our estimate of the effort involved is as follows:
 - a. Network Rail's Constant Traffic Sections (CTSs) represent the very smallest level at which response to a possession would normally be planned and operated. The sum of all CTSs operated over by all Train Operators is 4,900; giving the maximum number of entries that would need to be populated in such a table.
 - b. In practice significant numbers of CTSs with only one or two users could probably be assessed in relation to EBM weights, using past possessions and other sources of data such as contingency plans, just within the individual TOCs, with a process for Network Rail validation; the range of admitted options is only limited. Consideration of complex multi-user CTSs might require some multi-lateral deliberations,
 - c. If it were assumed that it took around 10 minutes to assess each CTS; this would imply a total effort of around 110 person days across all Train Operators, (with proportionate validation effort from Network Rail Account Teams). Averages are meaningless but across the 19 TOCs this would range from 1.5 to perhaps 7 person days. This is of course a once for all input to create a framework that would then need only detail tweaking over the rest of the Control Period.
 - d. We anticipate that this process would need some significant support in the early stages, with a reduced level of independent assistance to 'hold the ring' as participants became more familiar with the process. In particular, resolution of hard cases raising issues of principle will probably require some external input.
5. Involvement in populating the lookup tables would provide many in the user community with necessary knowledge and understanding of the system. However, there would also need to be further training for other users, such as Network Rail's possession planning teams. If the compensation mechanism is to send the right messages to those managing engineering plans, they need to be able to understand and operate the system.

Finally, development of a system (based on the proposed prototype) would need to occur in advance of June 2008. We suggest that those involved with the S4CS revenue compensation system should be kept closely involved with this process.

Annex D: Legal issues for passenger regime

This annex outlines drafting amendments that could be made to Schedule 4 of the Track Access Agreement and Part G of the Network Code to implement the recommendations of the Schedule 4 policy group if such recommendations are accepted.

The drafting amendments set out below have been prepared upon the assumption that the Schedule 4 and Part G amendments are implemented in relation to all train operators on the same date. If implementation is phased on an operator by operator or some other basis, some further amendments will be required.

Categorisation of Possessions

Creation of either three or four categories of possession:

- (a) Type 1 Restriction of Use - The Restriction of Use is for a period of time which falls below the minimum threshold. The Train Operator would not be entitled to any costs compensation and revenue loss would be calculated in accordance with the existing Schedule 4 algorithm. The suggested threshold is 24 hours although a lower threshold, possibly 8 hours or even no threshold, could be considered if the shadow running that is due to take place shows that automation of the calculation and notification process is possible.
- (b) Type 2 Restriction of Use- The Restriction of Use is for a period of between 24 hours (or whatever is finally decide as the Type 1 threshold) and 60 hours or anything under 60 hours if there are no Type 1 Restriction of Use (with the 60 hours threshold aligning with the Type 3 minimum threshold). Revenue loss would be calculated in accordance with the existing Schedule 4 algorithm. The Train Operator would be entitled to costs compensation in accordance with the cost formula (which would include compensation for rail replacement bus costs (using a new formula for "Estimated Bus Miles") and would take into account the net effect on costs of changes in train mileage).
- (c) Type 3 Restriction of Use - The Restriction of Use is for a period of over 60 hours but less than a period of 120 hours (public holidays will be excluded). Revenue loss would be calculated in accordance with the existing Schedule 4 algorithm.

The Train Operator would be entitled to costs compensation in accordance with the cost formula as set out in (b) above. If either the Train Operator or Network Rail believes that the cost formula

is under or overcompensating by a specified de minimis, compensation would be calculated on a bespoke basis and would be Direct Costs (as are presently compensated in respect of Significant Restrictions of Use) net of benefits. The suggested de minimis level is £10,000 but there will be a specific consultation question in relation to the appropriate de minimis level.

- (d) Type 4 Restriction of Use - The Restriction of Use is for a period of over 120 hours or where there is a series of Restrictions of Use that result in a Service Group (or specified sub-Service Group) (public holidays will be included) being subject to more than a certain number of hours of restricted use in a specified time period. It is currently envisaged that there may be two thresholds; one in relation to a three month period and one in relation to a seven month period.

See paragraph 2 (*Type 4 Thresholds*) below and Table 4.1 in the document for a more detailed explanation of the thresholds referred to above.

Cost compensation will be the same as available for a Type 3 Restriction of Use, see (c) above. The Train Operator would be entitled to revenue compensation in accordance with existing Schedule 4 algorithm.

If either the Train Operator or Network Rail consider that the Train Operator is being over or under compensated, in relation to the total formulaic revenue loss and cost compensation, by a specified de minimis then revenue and cost compensation will be costs, direct losses and expenses (including loss of revenue) net of benefits. The suggested de minimis level is £10,000 but there will be a specific consultation question in relation to the appropriate de minimis level. There will be further drafting over the processes to be followed to activate this measure of compensation.

Further consideration will be given to the scope of benefits to be taken into account for Type 3 and Type 4 Restrictions of Use.

Where a Restriction of Use starts before and/or ends after a White Period, the entire length of the Restriction of Use shall be taken into account when counting the cumulative total hours. Where a Restriction of Use starts and ends in the same White Period, the Restriction of Use shall not count towards the cumulative total hours (Mechanisms are expected to help identify what constitutes a single Restriction of Use).

Further consideration will have to be given to the extent to which possession overruns are addressed in Schedule 4.

Amended timetables introduced by Network Rail will continue to be categorised as Restrictions of Use and compensated accordingly under Schedule 4 on the same basis as possessions.

To reflect the above principles, the following drafting changes would need to be made:

- (a) Definitions for Type 1 Restriction of Use, Type 2 Restriction of Use, Type 3 Restriction of Use and Type 4 Restriction of Use would need to be inserted. Each definition would be defined by reference to the thresholds. Drafting will need to take into account the fact that a Restriction of Use could start as one type of Restriction of Use and becoming a second type, for example due to a subsequent amendment or a cumulative threshold being passed;
- (b) Clauses 2.6 (*Notification of Significant Restriction of Use*) and 2.8 (*Changes to Significant Restriction of Use*) would have to be deleted;
- (c) Clauses 2.4 (*Network Rail Payments*) and 2.7 (*Compensation arrangements*) would need to be rewritten to reflect the above regime;
- (d) The revenue loss formula and mechanics will remain substantially as currently drafted;
- (e) New clauses will need to be inserted to deal with costs compensation in relation to Type 2 Restrictions of Use and Type 3 Restrictions of Use;
- (f) New clauses will need to be inserted to deal with the various Type 4 Restriction of Use issues, including cost and revenue compensation when not calculated in accordance with the formula and the relevant thresholds; and
- (g) New clauses will need to be inserted to cover arrangements for agreeing compensation and resolving failures to agree. The drafting will need to incorporate the process, including timescales, by which Train Operators and Network Rail can agree compensation in relation to Type 3 and Type 4 possessions. This process would apply to those possessions which trigger the duration threshold, as well as those which are part of a "series" of possessions (to the extent that this can be foreseen in advance).

The consultation document proposes a process similar to the process for Significant Restrictions of Use in the current Schedule 4.

The process for the notification of claims and the necessary evidential requirements will need to be incorporated into the above drafting issues once a decision has been made as to the appropriate requirements. Processes for payments will need to be developed which include the facility in the case of Type 4 Restrictions of Use for payments to be made in appropriate cases in advance of the restriction in respect of the costs of preparatory activity.

Clause 2.3 (c) currently states that a Train Operator does not receive compensation in relation to a Restriction of Use that relates to a Network Change proposed by that Train Operator. Whilst Clause 2.3 (c) would need to be removed to ensure separation of Schedule 4 and Part G, Clause 2.3 (b) (which prevents a Train Operator receiving compensation in relation to a Restriction of Use it requests) will still operate to prevent a Train Operator receiving compensation in relation to a Restriction of Use that relates to a Network Change proposed by that Train Operator.

Type 4 Restriction of Use thresholds

Restrictions of Use become a Type 4 Restriction of Use when a Service Group (or specified sub-Service Group) is affected by more than a certain number of hours of restricted use in a specified time period. As an alternative being consulted, account may be taken of the relative size of the formulaic compensation for loss of revenue.

The intention of this is to recognise the fact that a continuing number of small Restrictions of Use over an extended period of time can have a greater detrimental effect than the amount of compensation paid separately in relation to each Restriction of Use.

To redress the balance it was felt that a Train Operator (or Network Rail) should have the opportunity to ask for cost and revenue compensation to be calculated on the basis of total costs and losses net of benefits received as opposed to by the cost and revenue formulae.

As Restrictions of Use in a number of locations, such as at the start and end of a journey, have a cumulative effect on the customer, it has been decided that the cumulative effect of Restrictions of Use on a Service Group (as defined in Schedule 8 of each Train Operator's Track Access Agreement), each of which is in effect an individual market, should be considered. As the intention of the cumulative thresholds is to reflect

disruption to a market, certain Service Groups which have a number of distinct markets within them will be sub-divided and the number of hours of restricted use relating to each sub-group will be considered when deciding whether the thresholds have been breached. There is a specific consultation question as to which Service Groups should be sub-divided.

When deciding whether a Type 4 Restriction of Use has occurred, the length all Restrictions of Use reflected in the timetable that affect a Service Group will be added together and if the relevant thresholds are exceeded, a Type 4 Restriction of Use will be treated as occurring.

Upon the occurrence of a Type 4 Restriction of Use, the Train Operator or Network Rail can ask for the total compensation in relation to the Restrictions of Use that contribute to the breaching of the threshold to be calculated on a bespoke basis (costs, direct losses and expenses (including loss of revenue) net of benefits) if it considers that there has been an over or under compensation by more than the de minimis level.

Either party will be able to refer the calculation of compensation to dispute in accordance with the Access Dispute Resolution Rules.

There are specific consultation questions relating to:

- (a) whether a compensation guide should be drafted and if one is, what status it should have; and
- (b) whether a Restriction of Use should become a Type 4 Restriction of Use if the amount of compensation payable is above a certain threshold.

Notification Factors

Amendment of the notification factors and the introduction of a fourth notification level, possibly at T-6. Proposed amended figures are:

Illustration of notification factors (for a service group with delay multiplier of 2.5)		By FWTT	By ITWTT	New intermediate threshold	By ATT
Existing notification factors		40% of MRE	60% of MRE		80% of MRE
Proposed new notification factors	Compensation Regime	60% of MRE	63% of MRE	66% of MRE	70% of MRE
	Incentive Regime	60% of MRE	65% of MRE	70% of MRE	80% of MRE

Possible drafting amendments are:

- (a) Clause 4 to be amended to refer to the new fourth notification level;
- (b) Annex A Part 3 to be amended to reflect the new fourth notification level and the amended figures; and
- (c) A mechanism will need to be inserted to allow identification of changes to the timetable between ITWTT and the new intermediate threshold and the new intermediate threshold and ATT and generally to ensure consistency with available processes;
- (d) Further clarification of what counts as notification and of the associated processes; and
- (e) Consideration as to whether any changes are required to Part D of the Network Code to the extent that a new timetable is to be issued at T-6.

Indexation

Schedule 4 to state that the cost formula, including Estimated Bus Miles and the net effect on costs of changes to train mileage, are to be indexed in relation to RPI (unless a more appropriate listed index is agreed upon). As Access Charges, which make up part of the calculation in relation to the net effect on costs of changes in train mileage, are already subject to indexation, a base year in relation to the net effect on costs of changes in train mileage will need to be agreed upon.

Amendments to Part G

There are a number of possible amendments that can be made to:

- (a) ensure that Restrictions of Use are only compensated under Schedule 4, while preserving the application of Part G in relation to the other effects of Network Change, while also making provision for the proper compensation (without double counting) of measures and effects which may be partly related to a Restriction of Use and partly related to the ongoing consequences of a Network Change;
- (b) to reinforce the boundaries between Schedule 4 and Part G (that possessions and associated possession overruns are compensated via Schedules 4 and 8). Consideration needs to be given as to how to deal with a Restriction of Use that last for over six months and becomes a Network Change; and
- (c) increase the transparency between Schedule 4 and Part G.

The following drafting changes could be made to Part G to achieve the above:

- (a) Conditions G2.2 (*Amount of Compensation*) and G4.2 (*Amount of Compensation*) to be amended by inserting “(but excluding any costs, direct losses or expenses incurred by a Train Operator as a consequence of any Restriction of Use (as defined in Schedule 4 of the Train Operator’s Track Access Agreement))”after “(including loss of revenue)”after “(including loss of revenue)” in both conditions. Whilst most Open Access Operators will have a Schedule 4 that contains a definition of Restriction of Use, there is a possibility that certain Open Access Operators will not, although the expectation (subject to further discussion) is that these operators will want at least Type 4 Restriction of Use compensation and therefore such definition will be added;

- (b) A mechanism to address the fact that there may be no Corresponding Day to enable the calculation of formulaic revenue compensation when a Restriction of Use has lasted for more than three years. Consideration will need to be given to the treatment of long-running Restrictions of Use which may not trigger Type 4 thresholds but nevertheless involve a change to the operation of the network;
- (c) Amending Conditions G2.3 (a) and G4.3 (a) to ensure that there is consistency of wording between Conditions G2.3 (*Benefits to be taken into account*) and G2.2 (*Amount of Compensation*) and G4.3 (*Benefits to be taken into account*) and G4.2 (*Amount of Compensation*). This could be achieved by the deletion of “result of the proposed Network Change” from Conditions G2.3 (a) and 4.3 (a) and the insertion of “consequence of the implementation of the change” in place of the deleted wording; and
- (d) Inclusion of wording in Conditions G2 and G4 to exclude compensation received under Schedules 4 and 8 when assessing compensation payable under Part G.

Competent Authority related issues

Further consideration needs to be given to how Restrictions of Use related to a Competent Authority (in both Schedule 4 and Part G) are dealt with and whether any changes are needed.

Removal of Major Project Notices

Removal of the concept of Major Project Notices from Schedule 4. The following drafting changes would be required to achieve this:

- (a) Deletion of the definition of “Major Projects”; and
- (b) Clause 2.6 (c) (ii) which states that a Restriction of Use becoming a Significant Restriction of Use if the Restriction of Use is in connection with a Major Project Notice (other than one where compensation is payable under Part G) will be deleted (see paragraph 1 (*Categories of Possession*) above).

The Possession Strategy Notice structure in Part D will continue, but without any direct relevance for the Schedule 4 process.

Amendments in relation to Estimated Bus Miles

If any information for the operation of formulaic compensation of costs is not able to be compiled before implementation, a process will be required to govern its compilation, agreement and approval by the ORR

(including the resolution of any disputes). The arrangements will also need to clarify the timescales for the work to be completed and the allocation of costs in relation to the process.

The information once provided by Train Operators and Network Rail in relation to Estimated Bus Miles will need to be updated from time to time to capture changes to the timetable and ensure the accuracy of the compensation calculations. To allow these changes to be made, a change mechanism needs to be inserted into Schedule 4. This mechanism will only allow changes to factual information that is used in relation to the calculation of Estimated Bus Miles.

The following drafting changes would need to be made:

- (a) The insertion of a paragraph stating that either party would be able to propose a change to the information used to calculate Estimated Bus Miles by serving a notice of proposed change upon the other party.
- (b) The insertion of a paragraph detailing the procedure for the proposed change which would:
 - (i) set out the amount of notice required to be given by the part proposing the change;
 - (ii) require the proposing party to specify both the date that the proposed change is to come into effect and, as far as possible, the party's proposed amendment;
 - (iii) state that if the parties fail to reach agreement as to the nature of the change within a specified time period (or if the parties agree that they will not reach agreement within such time period), that either party may refer the matter for expert dispute resolution in accordance with Part D of the Access Dispute Resolution Rules. This clause could contain certain specific amendments to Part D of the Access Dispute Resolution Rules; such as a shorter time frames within which the experts opinion must be delivered;
 - (iv) state that the amendments only take effect either once approved by the ORR under section 22 of the Act or notified to the ORR.
- (c) The insertion of a paragraph dealing with any apportionment of costs between the parties.

The above drafting changes will need to reflect the results of the shadow running and the further work to be carried out by the consultants appointed by the Working Group.

Implementation issues

- (a) Some notices in relation to a Network Changes and Significant Restrictions of Use will have been served before the implementation of the amendments to Schedule 4 and Part G and the agreement of the related compensation arrangements will be at varying stages of development. Will Restrictions of Use that occur after the implementation of the amendments but relate to a notice of Network Change or a notified Restriction of Use served before the implementation be compensated under the new regime or the current regime?
- (b) If phased implementation occurs, there will be a period of time where there are two parallel regimes in operation. In this event, it is anticipated that there would be a single form Part G, with individual operators' Schedule 4 arrangements applying or dis-applying elements as appropriate.
- (c) Agreement will need to be reached as to how to deal with the issues arising from Clause 18.1 and Schedule 9 if phased implementation occurs. An all party agreement may be required to deal with these issues.

Annex E: Franchise renewal dates

Franchise	Earliest Renewal	Latest Renewal
South Central	September 2009	
TPE	January 2011	January 2013
Greater Anglia	March 2011	
Scotrail	October 2011	October 2014
West Coast Main Line	March 2012	
Southeastern	First quarter 2012	First quarter 2014
Thameslink/GN	First quarter 2012	First quarter 2015
Northern	March 2013	
Great Western	March 2013	March 2016
East Coast Mainline	October 2013	March 2015
New Cross Country	October 2013	March 2016
South West Trains	February 2014	February 2017
East Midlands	October 2014	September 2015
West Midlands	September 2015	
London Rail Concession	March 2016	To be confirmed
Wales	December 2018	
Chiltern	December 2021	
Merseyrail	June 2028	

Annex F: Shadow running of the proposed freight regime

It is envisaged that shadow running would analyse data covering a 6 month period, and that the monitoring of affected services would work along similar lines to the existing process for managing claims for Service Variations and Cancellations in that the FOC would be expected to produce and submit a claim to Network Rail, who then would verify it. However, in order to gain a preliminary view of how many services are likely to be affected, it is proposed to carry out an initial review of results after analysing one month's data.

The process for assessing the likely scale of compensation involved would be a new process, requiring FOCs to provide detailed and transparent assessment of the financial effect of the different types of disruption experienced (see part 2 below).

How shadow running would work

Part 1: Monitoring of number of possessions affected:

Each FOC would manually submit a list of all services affected by possessions advised prior to T-12, identifying those that trigger the suggested criteria. This could be carried out on a weekly basis or over an agreed historical period where the data might already exist. To recap, the suggested criteria are as follows:

- (i) the affected service is cancelled
- (ii) the affected service commences its journey from an alternative origin
- (iii) the affected service has to operate to an alternative destination
- (iv) the planned departure time differs from that of the original service by more than 'X' minutes¹²
- (v) the planned arrival time at destination differs from that of the original service by more than 'X' minutes
- (vi) the affected service is diverted over a route [of] which the train operator has no route knowledge
- (vii) the imposition of any more demanding length, weight or gauge restrictions for the affected service
- (viii) the use of at least one additional locomotive on the affected service or use of a diesel locomotive as a substitute for an electric locomotive
- (ix) the operation of the affected service requires additional resources to be provided (but only where the FOC could demonstrate that the additional costs it will be exposed to will exceed £250 per train)

¹² Both 60 and 120 minutes have been suggested as possibilities, and the shadow running will proceed on the basis of both.

* In the cases of (iv) and (v), the actual number of minutes would be recorded, which would allow an impact assessment of both of the possible suggested thresholds, as well as others if appropriate.

If carried out on a weekly basis, this might need to be submitted in the same week as the corresponding SV&C claim, in order to help verify that there is no overlap between pre T-12 and claims which would have been made anyway.

The format for collecting the data would be similar in structure to the existing claim submissions for SV&C, and would therefore be familiar to users on both the FOC and Network Rail side.

Using the existing SV&C process as a benchmark for the number of services affected in an average week, Network Rail currently envisages that it would be able to resource its parts in such a process, but the first month's results should provide greater clarity to all parties involved on the numbers of services affected.

It is currently unclear, however, how Network Rail would be able to verify the numbers of services which were affected by a need for new route knowledge (vi) or additional resource (ix), and we would welcome further discussion on this.

Part 2: Likely scale of compensation involved:

Whereas existing SV&C provisions work on the basis of a liquidated sum payment (cancellation approximately £1,000, service variation approximately £500), in this case compensation would reflect the actual costs (to be) incurred. Network Rail therefore needs to understand the cost implications for FOCs of each individual criterion being triggered, which will vary on a case by case basis.

The exact numbers of trains affected would determine whether the cost implications could be assessed for all affected trains or just for a representative sample. This decision could be made after analysing one month's data.

For each train entry in Appendix 2 where a claim would be valid (or for an agreed representative sample), FOCs would need to supply a detailed and transparent assessment of the costs [resulting against each individual criterion], supported by the appropriate detail corresponding to all criteria e.g. in the case where there is a change of origin or destination and an extra loco, we would expect the FOC to be able to show how the differing train mileage leads to the resulting additional fuel costs / driver costs, as well as the costs associated with an extra loco.

To aid clarity of analysis, a template is being developed for the presentation of the cost claim information.

Part 3: Sample audit of information:

The shadow running relies both on operators fully identifying services that would trigger a claim and quantifying the costs thereof, and on Network Rail fully challenging the information provided. Further discussion is needed as to whether it would be possible for ORR or another independent body to do a sample audit of both the completeness and accuracy of the information provided through this shadow running exercise.

Annex G: Consultation questions

General questions

1. Consultees are invited to comment on the appropriateness of the current compensation mechanisms (i.e. through Schedule 4 and Part G of the Network Code) and whether or not the high level proposals set out above would improve the way in which compensation is identified and paid.
2. Consultees are also invited to propose any other alternative approaches that you feel would be more appropriate along with your reasoning for supporting such proposals.
3. Consultees are asked to comment on whether there are other changes to Part G or Schedule 4 which the policy group should consider.

Revenue boundaries

4. Consultees are invited to indicate whether or not they support the continued use of a formula as a default approach to identifying associated revenue loss or, if not, set out the reasons why you do not believe use of a formulaic approach is appropriate and what alternative approach you believe should be adopted.
5. It is recognised that Schedule 4 does not in all cases reflect actual revenue loss. However, the consultants found little evidence of a systematic under- or over-compensation. Consultees are invited to indicate whether or they agree with this, and if not, to provide supporting evidence for the view.
6. Consultees are invited to comment on the proposed thresholds for calculating revenue loss, particularly on the appropriateness and the impact on incentives of a Type 4 possession being defined as one which is over 120 hours or part of a “series” of possessions, based on the cumulative duration of possessions affecting a Service Group over any 3 and/or 7 consecutive periods.
 - If the “series” of thresholds is to be designed by reference to cumulative hours over a number of periods, what would consultees consider to be an appropriate threshold?
 - Do consultees agree that, except in a relatively small number of cases, a “series” of possessions should include the cumulative number of hours across a whole Service Group? Which Service Groups might need to be subdivided to reflect distinct passenger markets?
 - Alternatively, do you think that the trigger for a “Type 4” possession should be based on another measure, for example on a percentage of revenue loss as estimated by the Schedule 4 algorithm?

Long-running Restrictions of Use

7. Consultees are invited to comment on the treatment of long-running Restrictions of Use.

Possessions Compensation Guide

8. Consultees are invited to comment on the proposal to develop a Possessions Compensation Guide to facilitate estimation and calculation of revenue losses arising from possessions.

Cost boundaries

9. Consultees are invited to indicate whether or not they support, in principle, the use of a formula as a default approach to calculating cost compensation for rail replacement bus costs and costs or savings resulting from changes in train mileage. If not, set out the reasons why you do not believe use of a formulaic approach is appropriate.

10. Consultees are invited to comment on the proposed thresholds for when it would be appropriate to claim any costs associated with the taking of a possession, particularly:

- Is it appropriate to have a lower threshold below which cost compensation could not be claimable? If so, why do you think a threshold is appropriate and at what level do you think it should be applied? Would a lower threshold be appropriate even if the calculation of cost compensation could be automated?
- Should a formula based approach apply in all cases (above a notional lower threshold) or should there be an upper threshold beyond which it becomes the default option but not mandatory?
- If thresholds are appropriate, where do you think they should be set and why?
- Should the definition of Direct Costs also apply to Type 4 possessions?

Development of the cost formula proposal

11. Consultees are invited to comment on the proposed approach to use 'Estimated Bus Miles' to calculate rail replacement bus costs. Do you believe that this is a practicable way forward and would be easy to apply? What practical issues would such an approach raise?

12. Consultees are invited to comment on the appropriateness of using a formula based approach for the costs or savings resulting from changes in train mileage? Do you consider that the Faber Maunsell recommendations are appropriate? If not what alternative approaches do you recommend?

13. Consultees are asked to comment on the proposed method of implementation of this formula based approach. Please also refer to Annex C.

Process and timescales for agreeing compensation

14. Consultees are invited to comment on the proposed process and timescales by which compensation is agreed.

Notification factors

15. Consultees are invited to comment on the proposals to change the notification factors as indicated:

- Do you believe that the proposed approach will better align compensation paid with associated revenue loss?
- Does the “incentive regime” proposal strike the appropriate balance between being cost reflective and providing the right incentives, and if not, what other factors should be taken into consideration?

16. Consultees are invited to comment on the appropriateness of introducing a new point for notification at an interim point such as T-6 weeks. Are there practical issues that make such a notification point difficult and if so is there another point where a threshold would be more appropriate?

Implementation issues for franchised passenger operators

17. Consultees are asked to indicate, if the proposed changes are adopted, whether, and if so, to what extent you anticipate difficulties in netting off the effects of the changes through Clause 18.1 / Schedule 9 of the franchise agreement and what measures could be pursued to mitigate this.

18. Consultees are asked to express a preference from the approaches set out above, and to identify any alternative approach to implementation which they may prefer.

19. DfT has indicated that it would expect to apply the arrangements in franchise agreements which ensure financial neutrality to franchised passenger operators where such changes arise from a Regulatory Review and have emphasised the importance of any proposal allowing the financial neutrality arrangements in the franchise agreements to be calculated reliably and to the satisfaction of all parties involved. Consultees are invited to comment on the implications of this in their response.

Compensation to open access passenger operators

20. Consultees are invited to comment on the proposal above for open access passenger operators.

Compensation to freight operators

21. Consultees are invited to comment on the proposed criteria for determining compensation for freight operators. Do you believe that this would cover all situations where losses would occur? If not, what other factors should be incorporated?

22. Consultees are asked to comment on whether or not the identification of diversionary routes would add value to a possession compensation regime for freight operators and, if so, how would you envisage that this concept could be incorporated into the regime?

23. Consultees are invited to comment on the proposals set out in Annex F concerning the way in which the regime is intended to be shadow run, including any practicalities or problems with collecting and producing the data.

Access Charge Supplements

24. Consultees are invited to comment on the proposed options for the future treatment of the ACS.

- Is there advantage in retaining the current arrangement, where each franchised passenger operator pays, and has visibility of, a separate ACS for formulaic Schedule 4 compensation?
- If a separate Schedule 4 ACS is retained, how would consultees propose to make it more cost reflective to individual operators?
- If absorbed into the fixed charge, how would a Schedule 4 ACS be calculated for open access operators who opted into the formulaic components of the regime?
- In any event, do you agree that it should be subject to adjustment during the control period where traffic levels change?