



OFFICE OF RAIL REGULATION

John Thomas
Director of Competition and Regulatory Economics
Telephone 020 7282 2025
Fax 020 7282 2044
E-mail john.thomas@orr.gsi.gov.uk

8 April 2008

Dear consultee

Periodic Review 2008: Train Operator Compensation from Possessions – consultation on changes to the compensation regime for passenger operators and Part G of the Network Code for all operators

1. Train operators currently receive compensation for possessions through Schedule 4 of their track access agreement and / or through Part G of the Network Code.
2. 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 response to our request the industry has put forward proposals for changes to Schedule 4 of passenger train operators track access agreements and Part G of the Network Code (for both passenger and freight train operators). Further recommendations for changes to freight train operators' Schedule 4 are expected in July.
3. Taking the industry's proposals, this letter consults on the changes that we intend to make to Schedule 4 of passenger train operators' track access agreements and Part G of the Network Code (which applies to both passenger and freight operators). We will conclude on these changes in our draft determinations in June 2008. We intend to consult on changes to freight train operators' Schedule 4 in July, and recognise that this may further impact on the drafting of Part G – if this is the case any further changes to Part G will also be consulted on in July.
4. Details of our proposals are included in the Annex to this letter.

Consultation responses

5. We would welcome views on the issues raised in the document, in particular on:
 - (a) Our proposed changes to the transitional arrangements put forward by the industry;
 - (b) Our proposals for implementation of the new regime, in particular on implementation as part of the Periodic Review on 1st April 2009 and our proposed implementation of Part G changes through the C8 mechanism; and

(c) Our proposed changes to the legal drafting of Schedule 4 and Part G proposed by the industry.

6. We also welcome responses more generally on the industry's proposals for changes to Schedule 4 and Part G.

7. Please can you send your views on the issues we have raised in electronic format (or if not possible, in hard-copy format) by Wednesday 7 May 2008 to:

Ekta Sareen
Assistant Economist
Competition and Regulatory Economics
Office of Rail Regulation
1 Kemble Street
London WC2B 4AN
Tel: 020 7282 2164
Email: ekta.sareen@orr.gsi.gov.uk

8. We also be happy to discuss any of the issues raised in this letter. In the first instance please contact Tim Griffiths on 0207 282 2163 or email at: tim.griffiths@orr.gsi.gov.uk.

9. If you send a written response, you should indicate clearly if you wish all or part of your response to remain confidential to ORR. Otherwise we would expect to make it available in our library and on our website and potentially to quote from it. Where your response is made in confidence please can you provide a statement summarising it, excluding the confidential information that can be treated as a non-confidential response. We may also publish the names of respondents in future documents or on our website, unless you indicate that you wish your name to be withheld.

10. Copies of this letter can be found in the ORR library and on the ORR website (www.rail-reg.gov.uk).

Yours faithfully

A handwritten signature in black ink that reads "J.R. Thomas". The signature is written in a cursive style with a horizontal line above the first part of the name.

John Thomas
Director, Competition and Regulatory Economics

Annex – Our proposals for changes to the compensation regime for passenger operators and Part G of the Network Code

Structure of this annex

1. This annex sets out our proposals for changes to the possessions compensation regime for passenger operators and Part G of the Network Code. The annex is structured as follows:

- Brief summary of current possessions compensation arrangements and concerns raised by industry;
- Industry proposals for changes to possessions compensation;
- Our draft conclusions for changes to possessions compensation;
- Our proposals for implementing changes to Part G of the Network Code; and
- Next steps.

Current arrangements for possessions compensation

2. 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 (and in each case not related to Network Change), 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 costs, direct losses and expenses (including loss of revenue), net of any benefits.

Concerns with the current regime

3. We understand from Network Rail and train operators that although the current regime has strengths it also has a number of weaknesses, namely:

- issues around the boundaries between Schedule 4 and Part G;
- an inconsistent approach to compensating train operators for the effects of possessions;
- concerns over the accuracy of compensation arrangements and the resulting economic signals;
- a lack of transparency in the Part G and Schedule 4 process; and
- unnecessarily high transaction costs.

4. The National Audit Office in a review of the modernisation of the West Coast Main Line also voiced concerns over the consistency, predictability and transparency of compensation arrangements¹.

Industry proposals for changes to possessions compensation

5. Partly in response to these concerns we asked the industry to undertake a review of possessions compensation. One of the key outputs that we sought from this review was

¹ See paragraph 22 of *The modernisation of the West Coast Main Line*, National Audit Office, November 2006. This document can be accessed at:
http://www.nao.org.uk/publications/nao_reports/06-07/060722.pdf

the incorporation of all possessions compensation in Schedule 4². Our remit to the industry stated that:

- (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 in addressing compensation taken 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; and
- (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.

6. Our covering letter to the above remit noted the need to take into account in making changes to the 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

² Our letter and remit for the industry is given in *Train operator compensation for possessions*, Office of Rail Regulation, January 2007. This document can be accessed at: http://www.rail.gov.uk/upload/pdf/pr08-toc_comp.pdf

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

7. To undertake the review the industry set up a Possessions Compensation Policy Group (the Policy Group) made up of industry representatives (including Network Rail, train operators, government and ORR (as observer)). The Policy Group developed an initial set of recommendations that it consulted on in September 2007³. Taking into account the consultation responses and further work, the Policy Group provided its formal recommendations to us on 31 January 2008. Further industry recommendations on a limited number of specific issues were received on 14 March 2008.

Passenger regime

8. The main industry recommendations are on the passenger regime. These centre on the development of a tiered structure of compensation in Schedule 4, providing formulaic cost and revenue compensation for all possessions, but with additional compensation available depending on the level and impact of disruption. In return for this Part G compensation for possessions would be withdrawn. The table below outlines the characteristics of each of the proposed tiers. In summary:

- Type 1 possessions would receive formula based revenue and cost compensation;
- Type 2 possessions would receive formula compensation as default but with the possibility of actual costs (subject to a materiality threshold and in respect of categories of direct costs only) mirroring existing Significant Restrictions of Use arrangements; and
- Type 3 possessions would receive formula compensation as default but with the possibility of actual revenue losses and costs (subject to a materiality threshold).

³ *Consultation on the possessions compensation regime*, Schedule 4 Policy Group, September 2007. This document can be accessed at: http://www.rail-reg.gov.uk/upload/pdf/cnslt_poss_comp_regime_270907.pdf

Table 1: Industry recommended structure of Schedule 4 passenger compensation regime

Possession Type	Threshold	Cost	Revenue
Type 3	Single possession > 120 hours (includes public holidays)	Existing Schedule 4 revenue algorithm & new cost formula (as Type 1) Possibility of actual costs/losses (including revenue losses) net of benefits (if formulaic compensation will under or over compensate by greater than £10K)	
Type 2 (mirroring existing significant restrictions of use arrangements)	Single possession > 60 hours (excludes public holidays)	New cost formula (as Type 1) Possibility of direct costs net of benefits (if formulaic compensation will under or over compensate by greater than £10K)	Existing Schedule 4 revenue algorithm
Type 1	Any other single possession	New cost formula	

9. In addition to this it is also proposed to compensate for Sustained Planned Disruption, which will be triggered:

Threshold	Cost	Revenue
Revenue loss compensation over 3 consecutive periods > 20% of defined Service Group revenue or over 7 consecutive periods > 15% of defined Service Group revenue OR Difference between formulaic cost compensation and reasonably incurred costs > £0.5m over 3 consecutive periods or £1m over 7 consecutive periods (apart from Chiltern, Merseyrail C2C and open access operators where values of £0.25m and £0.5m respectively are used to reflect the limited ability of smaller operators to absorb exceptional costs).	Existing Schedule 4 algorithm & cost formula Possibility of actual costs/losses (including revenue losses) net of benefits	

10. The aggregate of all types of possessions would be taken into account in deciding whether or not Sustained Planned Disruption was triggered and would lead to the relevant possessions being treated as if they were Type 3 possessions. We have noted industry assurances in the course of development of the proposals that:

- (a) in practice parties will focus their attention on possessions causing material additional costs and losses; and
- (b) where major possessions are anticipated, Network Rail will discuss in advance with train operators likely impacts and prospects for mitigation, including where appropriate agreeing compensation arrangements in advance.

11. One of the main industry recommendations is the development of a cost formula. This would provide compensation for bus and train mileage costs resulting from possessions. These costs make up around 95% of the costs associated with small possessions. The cost formula would be based on two elements:

- Rail replacement bus costs – based on a new Estimated Bus Miles (EBM) parameter which takes into account the number of trains operating, the mileage affected and through weightings the actual impact on the service;
- Net effect on costs of changes in train mileage – taking into account track access charges, fuel costs etc.

12. EBM requires the development of weightings for each section of track to reflect the typical level of bus substitution. This has been undertaken for one TOC and is currently being developed for other operators. Different compensation rates per EBM will apply for London and South East and Intercity/regional operators to reflect their differential cost base .

13. The industry also recommends changing the notification discounts used in the existing revenue compensation algorithm to reflect better the way passengers perceive possessions. This increases the notification discount factors (increasing the amount of revenue compensation). The proposed changes to the notification factors are listed below:

	By First Working Timetable	By Informed Traveller Timetable	By Actual Timetable
Existing notification discount factors for a Service Group with delay multiplier 2.5	40% of MRE payable	60% of MRE payable	80% of MRE payable
Proposed new notification factors	55% of MRE payable	70% of MRE payable	85% of MRE payable
Existing notification discount factors for a Service Group with delay multiplier 5.1/6.5	19%/15% of MRE payable	50%/48% of MRE payable	80%/80% of MRE payable
Proposed new notification discount factors for Service Groups with delay multipliers 5.1/6.5	45% of MRE payable	65% of MRE payable	85% of MRE payable

14. The industry also consulted on the inclusion of an additional notification factor between T-12 and T-0 to provide an additional incentive on Network Rail to notify disruption. However, consultation responses were against the proposal, citing a potential dilution of the incentive to comply with T-12. This option has not therefore been included as part of the industry recommendation.

15. In view of the inclusion of cost compensation and the increase in the notification discount factors, the industry also recommends that costs should be recovered from any unplanned extension of a restriction of use (i.e. a possession overrun) as well as a planned restriction of use. This would allow costs to be recovered both during the period of operational disruption during an overrun and during the period where an amended timetable is in place during an overrun.

16. The industry recommends that the regime for franchised passenger operators should continue to be funded through an access charge supplement paid by each operator. Network Rail has refined the calculation of the access charge supplement for individual operators to ensure that it is more cost reflective and provides parties with a more reliable price signal, further details of which are included in Network Rail's April Strategic Business Plan update and provided in Appendix 1. **We welcome comments on these calculations.**

17. The industry recommends that open access passenger operators would be able to claim Type 3 and Sustained Planned Disruption compensation, i.e. compensation for significant disruption, but would need to pay an access charge supplement (like franchised operators) to have access to compensation for Type 1 and Type 2 possessions.

Freight regime

18. The industry recommends that, in return for foregoing Part G compensation, freight operators would receive compensation for extreme disruption. It is envisaged that the mechanism would operate in a similar way to the existing service variation mechanism in that operators would identify services which trigger the disruption criteria, and this is then verified by Network Rail. The industry intends that the level of compensation for extreme disruption is similar to that currently received under Part G. The industry has developed initial recommendations for the proposed criteria for extreme disruption, largely a tighter version of the existing service variation definition, with the intention that these are refined during a period of shadow running. The industry has committed to confirming its recommendations on freight compensation for possessions by 1 July 2008.

Competent authority possession

19. The industry recommends that compensation for Competent Authority possessions which do not result from Network Change should be made through the Schedule 4 possession regime - leaving it to Network Rail to recover associated costs directly from Competent Authorities rather than each Access Party recovering their own costs, as is currently the case. This will increase the certainty about the recovery of costs as the possessions regime will be more transparent.

20. However, the policy group has recommended that Network Rail should only be obliged to compensate train operators for the effects of disruptive possessions resulting from Network Change attributable to a Competent Authority direction or change in law where, and to the extent that, Network Rail recovers compensation from the Competent Authority or some other governmental body, and then share the compensation recovered amongst the relevant parties. Network Rail would be obliged to use reasonable endeavours to try to secure the compensation the operator would otherwise receive under

Schedule 4. In these cases where no compensation is able to be recovered, then losses would lie where they fall.

21. Although this recommendation is not consistent with objective (b) set out in paragraph 5, it was driven by a concern that to do otherwise would result in a considerable risk transfer to Government, and potentially Network Rail, compared with the present situation. Given this we are giving further consideration as to whether we should remove the change of law charge, which we consulted on through our February 2008 Update on the framework for setting outputs and access charges and strategic business plan assessment⁴. Whilst we are not proposing any change to the drafting put forward by the policy group, this is an area where we would welcome comment from consultees.

Transitional arrangements

22. The industry recommends that transitional arrangements should be put in place to allow existing compensation arrangements to continue where the compensation itself or the compensation methodology has been agreed prior to the changes to the regime. This would apply to restrictions of use taken up to 6 months after the implementation date.

Implementation

23. The one area where the industry has not reached agreement is around implementation, with ATOC preferring a phased (at franchise renewal) rather than one-off implementation of the new regime.

Further details of industry's recommendations

24. Further details of the industry's recommendations are given in *Periodic review 2008: recommendation to ORR on changes to the regime for disruptive possessions*, January 2008⁵ and *Periodic review 2008: recommendation to ORR on changes to the regime for disruptive possessions*, March 2008⁶.

⁴ *Periodic review 2008: Update on the framework for setting outputs and access charges and strategic business plan assessment*, Office of Rail Regulation, February 2008. This document can be accessed at: <http://www.rail-reg.gov.uk/upload/pdf/351.pdf>

⁵ *Periodic review 2008: Recommendation to ORR on changes to the regime for disruptive possessions*, Schedule 4 Policy Group, January 2008. This document can be accessed at: http://www.rail-reg.gov.uk/upload/pdf/pr08-poss-recs_comp_regime_310108.pdf

⁶ *Periodic review 2008: Recommendation to ORR on changes to the regime for disruptive possessions*, Schedule 4 Policy Group, March 2008. This document can be accessed at: http://www.rail-reg.gov.uk/upload/pdf/pr08-rcmd_flwup_290208.pdf

Our draft conclusions on changes to possessions compensation

25. We welcome the recommendations made by the industry. The recommendations seem well-founded and have broad industry support. We therefore do not intend to make large-scale changes to the recommendations and only intend to recommend changes where there has been no agreement or where we consider changes would be more consistent with our section 4 duties. Our draft conclusion is therefore to implement the changes recommended by the industry apart from the following two areas:

- (a) Implementation (where the industry has been unable to reach agreement)
- (b) Transitional arrangements (where we are not yet persuaded by the industry recommendation and wish to invite further evidence and comment)

Our draft conclusions on implementation

26. As we noted above the only area where the industry could not agree is around implementation. DfT, Network Rail and some train operators prefer a one-off implementation on 1 April 2009 (when the rest of the periodic review will be implemented). Other train operators and ATOC prefer a phased approach where revised notification factors and formulaic compensation for bus costs and adjusted train mileage take effect from 1 April 2009, but phased in changes to Part G and SRoUs on a franchise by franchise basis as new franchises are awarded. The phased approach has largely arisen out of concerns around the application of Clause 18.1/Schedule 9, where changes resulting from a periodic review are passed through from train operators to DfT/Transport Scotland.

27. The industry recommendations highlighted a number of concerns with one-off implementation, incorporating:

- Cost compensation for major projects and network change would still need to be calculated for the purposes of Clause 18.1/Schedule 9 and therefore transaction costs between DfT/Transport Scotland are likely to increase. The recommendations did note that the number of network change possessions is small. We further note that for large possessions (Type 3 or sustained planned disruption) full cost compensation is likely to be available under the new regime. This suggests that there is unlikely to be any material changes to compensation for major projects and network change compared with the existing basis for compensation under Part G of the Network Code;
- The operation of Clause 18.1/Schedule 9 will mean that franchised passengers operators will, until franchises are replaced, still perceive the old regime and so current economic incentives will remain, for example to claim possessions are

associated with network change or a major project. We believe that this position will be worse if implementation is delayed through phasing;

- Given that DfT/Transport Scotland will have less knowledge in this area than Network Rail this carries the risk of increased administration costs.

28. The industry recommendations do note that the disadvantages of a one-off deal would reduce if a deal around Clause 18.1/Schedule 9 arrangements can be struck between DfT/Transport Scotland and train operators. The industry recommendations note that similar deals have been struck in the past.

29. As part of the work stream to develop the most efficient method for applying Schedule 9/Clause 18.1 arrangements following the Periodic Review, DfT are reviewing various implementation options to address the issues outlined above. It is proposed that these would be agreed with TOCs as part of the Schedule 9 revised financial model input discussions. DfT recognise that a different bespoke approach may be required for those TOCs with old style Franchise Agreements that include Clause 18.1. We consider that it would be possible for a deal between train operators and DfT/Transport Scotland to be struck or at the very least the administrative burden on DfT/Transport Scotland to be minimised. DfT have stated that associated changes to Part G will be considered as part of a Charges Review for the purposes of Clause 18.1/Schedule 9.

30. There are a number of advantages to one-off implementation in terms of improved cost signals to Network Rail, reduced transaction costs (between Network Rail and train operators) and greater transparency (as outlined in the industry recommendations). **We therefore consider that changes to Schedule 4/Part G should be implemented on 1 April 2009. We welcome consultation responses on this issue.**

Our draft conclusions on transitional arrangements

31. The one area where we are considering amending the industry recommendations is on transitional arrangements. The industry recommends there should be transition provisions to preserve any existing bespoke compensation arrangements for a 6 month period after the new arrangements take effect. However, Network Rail has advised that it is not aware of any such bespoke compensation arrangements with a duration of more than 6 months. Given the long notice of these proposals, we are not yet persuaded that any transition provisions are needed. Absent such transition provisions, the new arrangements would take effect in full on 1 April 2009 and bespoke arrangements negotiated in advance of that date could be negotiated against the background of the new arrangements.

32. Consultees are therefore urged to make us aware during the consultation, in confidence if desired, of any bespoke compensation arrangements which will or may extend beyond 1 April 2009 so that we can take their existence into account when preparing our conclusions. If we do not receive evidence of bespoke arrangements that will or may extend beyond 1 April 2009 we intend to remove the transitional arrangements from the industry recommendations and introduce all changes from 1 April 2009. We consider that this would ensure that all possessions are compensated on the same basis ensuring transparency and equity.

Legal drafting

33. We have also made some minor changes to the legal drafting of Schedule 4 proposed by the industry. These include changes to improve its clarity and function and also to reflect further proposed amendments to the drafting received by Network Rail on Friday 4 April 2008. These changes are marked up in the draft of Schedule 4 at Appendix 2 and have been discussed with both ATOC and Network Rail.

34. An outstanding issue raised by Network Rail on 4 April 2008 is whether indexation should apply to the Sustained Planned Disruption thresholds. Whilst ORR agrees, in principle, with Network Rail that this should be the case we welcome suggested changes to the legal drafting to achieve this and to deal with the practicalities of its calculation.

35. Network Rail has also provided some proposed legal drafting for the Schedule 4 for non-franchised passenger operators. This is included as Appendix 3 with the differences to the franchised passenger operator Schedule 4 marked up. We welcome views on this proposed drafting.

Our proposals for implementing changes to Part G of the Network Code

36. Changes to Part G of the Network Code will affect both passenger and freight operators. The drafting changes to Part G which we propose are attached at Appendix 4. These are largely as proposed by the industry but without the phased implementation wording. The main effect of the proposed changes is to exclude Part G compensation being payable by Network Rail to train operators in respect of any costs, direct losses or costs incurred by the train operator as a consequence of any Restriction of Use in connection with the implementation of a proposed change. The drafting changes also cover proposed changes to the treatment of Competent Authority compensation as discussed in paragraph 19-21.

37. The Network Code cannot be amended directly through an Access Charges review. Therefore one of the two change mechanisms within the Network Code need to be applied to amend the Network Code:

(a) C5 modification process

In summary, this process involves an access party or ORR putting forward a proposal for change (PfC) to the Network Code to the Class Representative Committee for its consideration and for it to vote whether or not to accept the proposal. Normally at least six committee representatives must vote in favour of the proposal for it to be carried. In addition, Network Rail and any two of the Class Representatives of the Franchised Passenger Class has an ability to veto a proposal for change.

(b) C8 modification process

In summary, the C8 process sets out the procedure by which ORR can require changes be made to the network code. The requirements and detail of this process are as follows:

- (i) We can only make changes to the Network Code using the C8 mechanism if we issue a notice stating that we are satisfied on reasonable grounds that either or both of the following conditions have been satisfied:
 - (1) the modification in question is or is likely to be reasonably required to promote or achieve the objectives specified in section 4 of the Act; and
 - (2) the interests of any relevant person or persons would be unfairly prejudiced if the modification in question were not made, and the need to avoid or remedy such unfair prejudice outweighs or is likely to outweigh any prejudice which will or is likely to be sustained by any other relevant person or persons if the modification is made, having due regard to the need to enable relevant persons to plan the future of their businesses with a reasonable degree of assurance.
- (ii) A C8 modification shall not have effect if its effect would, if made, be:
 - (1) to prevent to a material extent the Train Operator or Access Option Holder exercising, or receiving the benefit of, a protected right; or
 - (2) materially to increase any protected obligation of the Train Operator or Access Option Holder.
- (iii) Before we can issue the C8 notice we must consult on the proposed modification and we have to consult the Secretary of State, Network Rail and the Class Representatives Committee, together with all Class Members

(Train Operators) and any other persons to which we believe ought to be consulted.

- (iv) In the consultation we must make available such drafts of the proposed modification as we shall consider is necessary and give the consultees the opportunity to make representations in relation to the proposed modification.
- (v) The C8 notice can only come into effect on a date which is at least 180 days after the date of the notice.
- (vi) Access Parties have 45 days from the issue of a C8 notice to give notice that the modification, if made, would have an effect as set out above (see (b)(ii) above). If so, the matter is referred to arbitration under the Access Dispute Resolution Rules and a determination must be made within 180 days of referral.

38. We have considered the strengths and weaknesses of both implementation options at length. While we would prefer to implement changes through the C5 mechanism as this would ensure cross industry buy-in to the proposals we are concerned that there is a risk that, despite the broad support to the industry's recommendations, the proposal would not gain the necessary votes required from the Class Committee Representatives under the C5 process (see 35(a) above concerning requirement for agreement via this mechanism). This is particularly a risk regarding our intended one-off implementation of the proposed changes as train operators were split in their support for this. If the PfC is not accepted, then because of the lead-time in progressing the proposal for change we would only discover this after we had issued our final determination on the shape of Schedule 4. This could result in duplicate mechanisms in Schedule 4 and Part G.

39. Because of the risk that the necessary agreement may not be reached, we highlighted that we may need to make a change to the Network Code using the C8 modification process when we originally remitted the industry.

40. We consider that we should implement the changes via the C8 mechanism, but this should be conditional on the changes to Schedule 4 simultaneously taking effect. We consider that we satisfy the criteria needed for a C8 change in that:

- (a) The changes (to both Part G and Schedule 4) are likely to be reasonably required to promote or achieve the objectives specified in section 4 of the Act. We consider that the proposed changes provide a more transparent process, reduce the industry's administrative burden, and therefore contribute to furthering a number of our Section 4 duties, including:

- (i) promoting efficiency and economy on the part of persons providing railway services – as, for example, it will ensure that Network Rail takes into account the full costs of a possession on a consistent basis irrespective of the reason for that possession. The use of a formula based approach for compensation for Type 1 possessions and as the default for other possession types would reduce transaction costs and increase transparency;
- (ii) promoting improvements in railway service performance by ensuring that Network Rail takes into account train operator costs of possession overruns. This would improve economic signals and would be difficult to achieve if possessions were still compensated through Part G; and
- (iii) enabling persons providing railway services to plan the future of their businesses with a reasonable degree of assurance by the increase in transparency from the removal of the distinction between Network Change and other possessions and the provision of formula based cost and revenue compensation for less disruptive possessions.

We do not consider that there are any section 4 duties that would preclude us from making the proposed changes.

- (b) Given the whole industry benefit that would be delivered by the proposals and the broad support that they have received we consider that the interests of train operators and Network Rail would be unfairly prejudiced if the changes were not made. We consider that the benefits of implementing these changes are likely to outweigh any prejudice which might be suffered by other relevant persons. For example, we acknowledge that one off implementation could increase the transaction costs of Clause 18.1/Schedule 9 negotiations between DfT/Transport Scotland and train operators. We also note that the basis of compensation for the most disruptive possessions, Type 3 possessions and SPD (where network change compensation is typically claimed), will be unchanged from the current treatment. However we consider that these costs will be far outweighed by the benefits of ensuring all operators are on the same regime with Network Rail facing the same incentives for all operators. Further we consider that any increase in transaction costs will be small if agreement on Clause 18.1/Schedule 9 treatment can be reached between government and train operators up-front. We consider that using the C8 process will enable relevant persons to plan the future of their businesses with a reasonable degree of assurance by ensuring that all operators have the same regime from 1 April 2009. If the C8 mechanism is not used and changes to Part G are not made then train operators would continue to have two different compensation mechanisms for network change restrictions of use in the next

control period. We do not consider that this would be in the interests of train operators or Network Rail.

- (c) We do not consider that the changes would:
- (i) prevent to a material extent the Train Operator or Access Option Holder exercising, or receiving the benefit of, a protected right; or
 - (ii) materially increase any protected obligation of any Train Operator or Access Option Holder.

41. In relation to the proposed Part G changes, the consultation undertaken now and in July 2008 with regards the freight regime and any further associated changes to Part G will constitute the consultation required under Condition C8.4 of the Network Code. Following the consultation in July, if ORR still considers that implementing the changes to Part G is appropriate we will issue the notice required under Condition C8.1. We welcome any comments from consultees on ORR's proposed use of the C8 process and on the proposed changes which we are proposing to implement by this method.

Next steps

42. Our proposed next steps on reviewing possessions compensation are set out below.

Date	Action
W/c 7 April 2008	Issue letter to industry consulting on changes to possessions compensation for passenger operators and changes to the Network Code for all operators
7 May 2008	Closing date for industry responses on changes to passenger operator possession compensation and changes to the Network Code for all operators
5 June 2008	Conclusions on changes to possessions compensation for passenger operators and changes to the Network Code included as part of draft determinations
1 July 2008	Industry makes recommendations for changes to possessions compensation for freight operators
W/c 14 July 2008	Issue letter to industry consulting on changes to possessions

Date	Action
	compensation for freight operators and any further associated changes to Part G.
W/c 4 August 2008	Closing date for industry responses on changes to freight operator possession compensation
W/c 11 August 2008	Conclusions on possessions compensation for freight operators and changes to Part G. Issue of C8 notice

