Periodic Review 2008:
Recommendation to ORR on
changes to the regime for disruptive possessions

This paper sets out the recommendation of ISG to ORR on a number of outstanding issues following on from its recommendation in January 2008. Separate legal drafting is being finalised to reflect these issues.

1. Sustained Planned Disruption – levels of trigger
2. Treatment of possession overruns (with regard to cost compensation)
3. Restrictions of Use resulting from changes of law
4. Transitional arrangements

1. Sustained Planned Disruption

In its January recommendation, ISG recognised that a sustained high level of planned disruption might lead to a significant difference between actual costs/ losses and formulaic compensation. It considered the various forms that a "Sustained Planned Disruption" mechanism (SPD) might take, and it agreed the following principles:

- the SPD mechanism should allow either party to reopen compensation discussion;
- the measure should be a monetary-based threshold rather than hours-based;
- the measure should be set at both 3 and 7 period timeframes, to pick up different methods of disruptive working;
- a trigger would be required for revenue loss and for costs (in each case a separate figure for 3 and 7 periods);
- the aim of the mechanism would be to capture only the most disruptive possessions i.e. approximately 1% of all possessions.

Table 1.1 SPD principles (as outlined in January 2008 recommendation)

Threshold	Treatment of compensation
Revenue loss compensation > x% or y% of revenue over a defined timeframe of 3 or 7 periods respectively; OR Difference between cost compensation and actuals > £Xm or £Ym over a defined timeframe of 3 or 7 periods respectively.	**Existing Schedule 4 algorithm & cost formula** **Possibility of costs/losses net of benefits for all possessions during defined timeframe** (parties will be able to agree to exclude some possessions where no adverse effect)

The policy group has now carried out further work to agree a recommendation on what the values of the trigger thresholds should be for both revenue loss and cost mechanisms.

Revenue loss trigger

The policy group had already indicated that it expected the revenue loss trigger to be in the range 10-20%, and so carried out analysis within that range to identify how often, historically, the threshold would have been triggered. This analysis was based on actual historical Schedule 4 payments over 2 years, uplifted for the estimated effect of the proposed changes in Notification Factors. The analysis also involved Network Rail's local Delivery Planning teams, who helped to identify the exceptionally disruptive possessions responsible for those instances in which the threshold would have been triggered.

In parallel, Delivery Planning teams also identified all the historical possessions which would have fallen into the "Type 3" definition[1] and where compensation would have been potentially "re-openable" anyway (some of which would have been compensatable under Part G in the existing regime).

Based on this analysis, the policy group agreed that setting the SPD revenue loss thresholds at the following levels would be appropriate, capturing around 0.5% of all possessions during the two years of the sample analysed.

Table 1.2 SPD revenue loss triggers for all operators (by Service Group)

Over 3 periods	Schedule 4 payments > 20% of Service Group revenue
Over 7 periods	Schedule 4 payments > 15% of Service Group revenue

Coupled together with the individual possessions captured by the Type 3 threshold, this means that approximately 1% - 1.5% of all possessions would in effect have been re-opened in 2005/06 and 2006/07 (ignoring any re-opening triggered by cost thresholds under Type 2, Type 3 or SPD arrangements, see below).

The policy group believes that the above thresholds enable the Schedule 4 mechanism to capture broadly the same scale of compensation as under existing Part G and Major Project Notice arrangements.

[1] A Type 3 definition is defined as a single possession greater than 120 hours (including public holidays). See Table 3.1 of January 2008 recommendation for full detail.

As mentioned in the recommendation, the policy group considered further whether a "trailing mechanism" would be required. Under such a provision, once SPD was triggered in respect of a Service Group, it would remain triggered until Schedule 4 compensation passed below a (lower) threshold. However, it appears that this would be of limited use. A common pattern for a series of possessions is a number of preliminary possessions, often spread over a number of months, prior to a final large possession (e.g. for commissioning a new signalling system or replacing S&C). Rather than trying to capture a "tail" of possessions after a large possession, it therefore seems more useful to try to capture the "build-up" of possessions. It was for this reason that a 7-period threshold of 15% is proposed, despite the fact that – based on 2005/06 and 2006/07 – this threshold would not have captured significantly more large possessions than would a 20% threshold (in conjunction with Type 3 and the 3-period threshold).

Cost trigger

The policy group recognised that, even where the revenue loss mechanism is not triggered, sustained disruption could nevertheless lead to instances where costs differ substantially from what is paid by the liquidated sums regime. Given the lack of historical data, less extensive analysis was possible, but it was agreed that the cost trigger should be set at a level where it provides a safety net for any extreme cases.

ISG therefore recommends that the following values should be put in place for the cost trigger, at an operator level. The differentiated approach between small operators and others is to recognise the limited ability of some operators to absorb exceptional costs.

Table 1.3 SPD Cost trigger for small operators (Chiltern, Merseyrail, C2C and open access passenger operators)

Over 3 periods	£250k	Difference between formulaic cost compensation and reasonably incurred actual costs
Over 7 periods	£500k	

Table 1.4 SPD Cost trigger for all other operators

Over 3 periods	£500k	Difference between formulaic cost compensation and reasonably incurred actual costs
Over 7 periods	£1m	

ISG asks ORR to note that the cost trigger is set at an operator level rather than a Service Group level.

2. Treatment of possession overruns

Given the increased role of cost compensation in the revised Schedule 4, the policy group has considered further how costs should be treated in the event of possession overruns.

This further consideration does not extend to compensation for revenue loss. Clearly, in the case of overruns which are not reflected in any timetable, revenue loss compensation will continue to be addressed through Schedule 8, and where an amended timetable is put in place, the revenue loss algorithm of Schedule 4 would apply as it does at present.

The policy group believes that it is consistent that costs should be recovered for any unplanned extension of a Restriction of Use, as well as the planned element of the Restriction of Use. Whilst recognising that Network Rail already has incentives to avoid overruns and put in place amended timetables where appropriate, it believes that putting such a provision in place would increase those incentives.

Recovery of costs should be permitted both for the period of operational disruption during an overrun, as well as any period for which an amended timetable is in place during an overrun. In some cases, both scenarios might occur in succession, and for purposes of recording the number of hours in order to define the categorisation by “Type” of any individual Restriction of Use and thereby determine the appropriate form of compensation treatment [2], the duration of all such disruption should be aggregated.

However, where a Restriction of Use overruns and an amended timetable is not in place (for example, if the overrun is at very short notice), additional cost compensation will always be on a bespoke basis rather than a formulaic approach given that the cost formula is dependent on the operation of S4CS (which compares <u>scheduled</u> timetables).

In terms of how this interacts with the SPD mechanism, for practical purposes any non-formulaic compensation associated with overruns will not feed into the aggregated measure for triggering the SPD threshold (since these relate to formulaic compensation). However, in the case that the SPD threshold is triggered, compensation for the total disruption relating to Restrictions of Use (including any overruns) can be reopened.

It is also intended that where an overrun of a Type 1 possession does not lead to it becoming a Type 2, but nevertheless leads to additional Direct Costs of over £10k (and is at least one hour) then recovery of Direct Costs should be permitted.

[2] See Table 3.1 of January recommendation for the categorisation of RoU “Types”

3. Restrictions of Use resulting from changes of law

The ISG recommendation in January recommended the removal of the distinction between compensation for a Competent Authority RoU and a Network Rail RoU, for purposes of how an operator is compensated. This was to remove doubt over the precise level of the financial obligation of the disrupting party to Network Rail, and to provide greater certainty to operators regarding the compensation they would receive.

The recommendation reflected the discussion about RoUs in relation to Schedule 4 (as opposed to Network Changes resulting from Competent Authority Directions and changes of law as currently provided for in G9 –"Changes imposed by Competent Authorities") – subsequent discussion suggested that this area required further consideration.

Operators believed that it would be consistent for the same principle as described above in relation to Schedule 4 to apply also to Part G Competent Authority Changes. Network Rail was concerned, however, that the extension to Part G of this mechanism would mean a considerable risk transfer to Governments (and possibly Network Rail) compared to the present situation.

The policy group recommends, therefore, that G9 is redrafted to recognise that Network Rail should be obliged to compensate train operators under Schedule 4 for the effects of disruptive possessions resulting from Network Changes attributable to a Competent Authority Direction or changes of law only where, and to the extent, it recovers compensation in respect of that Network Change from a Competent Authority or some other governmental body (the latter in respect of a change of law). Network Rail would be required to use reasonable endeavours to try to secure what the operator would otherwise receive under Schedule 4.

4. Transitional arrangements

ISG recommended that transitional arrangements should be put in place to allow existing compensation arrangements to continue to apply in cases where the compensation itself or the compensation methodology has been agreed prior to the changes to the regime.

More specifically, it is envisaged that the new arrangements should apply with immediate effect from the date of implementation, unless the parties have explicitly agreed, in writing, compensation or a specific compensation methodology prior to the implementation date, in which case compensation can be paid under the existing arrangements, but only for Restrictions of Use taken up to 6 months after the implementation date.