

**Joanna Whittington**

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13 November 2015

Dear Sir or Madam,

### **PR18 Reviews of Schedules 4 and 8 of track access contracts**

The purpose of this letter is to invite your input into preparation for reviews of Schedules 4 and 8 of track access contracts (the possessions and performance regimes, respectively), for the 2018 Periodic Review of Network Rail (PR18).

The Schedule 4 (“possessions”) regime compensates train operators for the financial impact of planned possessions – where operators cannot access the network because Network Rail is carrying out engineering work. The Schedule 8 (“performance”) regime compensates train operators for unplanned service disruption caused by Network Rail and other train operators.

We invite responses to this letter by **Friday 15<sup>th</sup> January 2016**. Please see annex 1 for details.

To discuss the regimes, we will be holding a **stakeholder event on Friday 27<sup>th</sup> November 2015**. If you would like to attend this event, please register through this [link](#), by Friday 20th November 2015.

### **Why are we raising this with you now?**

We are seeking views at this early stage because:

- we know from discussions with operators and from stakeholders’ contributions to RDG’s “Review of Charges” that many industry participants think both that these regimes are important and that there is significant scope for their improvement;
- we want to ensure that there is time for research to be commissioned and for any relevant findings to be incorporated into the regimes; and
- both regimes interact strongly with other parts of PR18, notably with requirements for outputs, the structure of charges and the programme of delivery: ensuring that these different components are consistent with and complement each other requires early planning.

### **What are we seeking views on, and how will we use your responses?**

We are looking for views (together with any evidence that you are able to provide) of

*the effectiveness of the current regimes, including aspects that are working well, the scale of any potential problem, and what the priority areas for improvement should be.*

To help inform and structure responses to these questions we provide, in annexes 2 and 3, more information about the current regimes and headings for stakeholders who may wish to contribute more detailed responses.

We will use your responses to help us identify priorities for the review of Schedules 4 and 8, including potential options for addressing some key issues. In doing this, we will also take account of the work on Schedules 4 and 8 undertaken by the Rail Delivery Group (RDG) as part of its review of charges<sup>1</sup>.

### **Why are we holding a stakeholder event?**

We are holding a stakeholder event on Friday 27<sup>th</sup> November 2015. Its purpose is to give stakeholders an opportunity to ask questions, discuss problems with the existing possessions and performance regimes and hear other people's views, to help inform their own responses to this letter.

The event will consist of a session on the performance regime and a session on the possessions regime, with separate discussions being held for the passenger regimes, and the freight and charter regimes.

<b>Timing</b>	<b>Passenger operators</b>	<b>Freight &amp; charter operators</b>
09:00 to 09.30	Coffee	
09:30 to 10:00	Introductions	
10:00 to 13:00	Schedule 8	Schedule 4
13:00 to 13:30	Lunch	
13:30 to 16:30	Schedule 4	Schedule 8

If you would like to attend, then please register by Friday 20<sup>th</sup> November 2015 here: <https://secure.jotformpro.com/form/52813026569963> .

### **How does this stakeholder engagement fit with other PR18 work?**

We will shortly be consulting on high level options for the structure of charges (options that that exclude treatment of Schedules 4 and 8). We know from RDG's work, however, that industry participants are also keen to contribute at an early stage to reviews on Schedules 4 and 8, and this letter provides an opportunity to do so.

We are also working with industry, through the National Task Force and other bodies, to develop performance and availability metrics, and it is important that developments in those areas fit well with developments to Schedules 4 and 8.

### **Responding to the letter**

To respond to this letter, please go to annex 1, which sets out our policy on publication, and next steps.

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<sup>1</sup> RDG "Phase 2b: Assessment of the current charges and incentives regime", May 2014, <http://www.raildeliverygroup.com/what-we-do/our-work-programme/contractual-regulatory-reform/review-of-charges.html>

If you plan to submit a detailed response, it would be helpful if you also look at annexes 2 and 3, which each consist of high level description and an overview of different aspects of the regime, for Schedules 8 and 4 respectively.

We look forward to receiving your response.

Yours faithfully,



Handwritten signature of Joanna Whittington in blue ink.

**Joanna Whittington**

## **Annex 1: How to respond to the letter, our policy on publication and next steps**

We would like any responses to this letter by Friday 15<sup>th</sup> January 2016. Please submit your response, in electronic form to [PR18.Schedules4and8@orr.gsi.gov.uk](mailto:PR18.Schedules4and8@orr.gsi.gov.uk) .

If you plan to submit a detailed response, it would be helpful if you could read annexes 2 and / or 3 on this letter, which set out categories of issues.

We will use your responses, together with RDG's Review of Charges, to help us identify priorities for the review of Schedules 4 and 8, including potential options for addressing some key issues.

We expect to publish responses within 12 weeks of the deadline for submissions. We explain our policy on publication here.

Information provided in response to this consultation, including personal information, may be subject to publication or release to other parties or to disclosure in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). If you want information, including personal data that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.

Please note that, in order to meet our standards of accessibility, when sending documents to us in electronic format that will be published on our website, we would prefer that you email us your correspondence in Microsoft Word format or similar, as opposed to a scanned copy of your response.

## **Annex 2: Schedule 8, the Performance Regime**

This annex is divided into two sections. The first outlines the current regime. The second provides a list of topics, should you find it useful to structure your responses along those lines. In the second section, we also note links to issues with Schedule 8 that RDG has identified in its phase 2b report as part of its Review of Charges<sup>2</sup>.

### **High level description of Schedule 8**

Schedule 8 is described in chapter 20 of our PR13 final determination<sup>3</sup>. The text in this section consists primarily of excerpts of that chapter.

The possessions and performance regimes (Schedules 4 and 8) in track access contracts perform the following functions:

- compensate train operators for the financial impact of planned and unplanned service disruption attributable to Network Rail and other train operators;
- help align incentives between Network Rail and train operators, so the impact of service disruption on revenue and/ or costs is incurred by the organisation who cause the disruption, rather than the train operator that faces the disruption; and
- provide appropriate signals so as to drive the decision-making in relation to performance and possession management, for example, in relation to where to make investments, or to give an indication to Network Rail on whether it is better to have a short possession but with higher engineering costs or take a longer possession.

#### *Passenger operators*

The regimes for franchised and open access passenger operators are very similar. They are both benchmarked regimes, where payments are made when Network Rail's or a train operator's performance diverges from a benchmark number of minutes of lateness.

There are separate benchmarks and payment rates for Network Rail and train operators. These are unique to each train operator's service groups (collections of train services).

The Network Rail payment rate sets the basis for compensation payments from Network Rail to train operators when Network Rail's performance is worse than benchmark, and bonus payments to Network Rail from train operators when Network Rail's performance is better than benchmark. Network Rail payment rates are set at a level to reflect the impact over time of performance on fare revenue. Schedule 8 is not designed to compensate passengers for poor performance (nor to reflect or reimburse any passenger

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<sup>2</sup> RDG "Phase 2b: Assessment of the current charges and incentives regime", May 2014, <http://www.raildeliverygroup.com/what-we-do/our-work-programme/contractual-regulatory-reform/review-of-charges.html>

<sup>3</sup> [http://orr.gov.uk/\\_\\_data/assets/pdf\\_file/0015/465/fd-chapters-15-20.pdf](http://orr.gov.uk/__data/assets/pdf_file/0015/465/fd-chapters-15-20.pdf)  
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compensation). Instead this type of compensation is available to passengers through passenger compensation schemes such as delay repay.

### *Freight and charter operators*

Schedule 8 has benchmarks and payment rates that are common across all freight operators. The Schedule 8 freight operator benchmark is measured in minutes of delay per 100 miles, rather than average minutes of lateness, used in Schedule 8 for passenger operators.

Similarly, Schedule 8 has benchmarks and payment rates that are common across all charter operators. And the Schedule 8 charter operator benchmark is measured in minutes of delay per 100 miles.

### **Headings for more detailed responses**

We are seeking your views (together with any evidence that you are able to provide) on any aspects of the Schedule 8 regime you wish to raise. It would be particularly helpful if stakeholders could comment on:

*the effectiveness of the current regime, including aspects that are working well, the scale of any potential problem, and what the priority areas for improvement should be.*

While some stakeholders may wish to respond briefly to this letter, others may wish to give more detailed responses. We welcome detailed comments on any aspects of the regimes, and invite respondents to structure their responses using some or all of the following headings.

#### **1. The purpose of Schedule 8**

See the high level description of Schedule 8, above. We are interested in stakeholders' views of what the purpose of Schedule 8 should be and of this particular wording.

#### **2. Network Rail payment rates**

Network Rail payment rates for passenger operators are calculated at a service group level and are intended to reflect the long-run revenue losses arising from poor performance.

Network Rail payment rates are the same for all freight operators and services. Similarly, they are the same for all charter operators and services. They are intended to reflect both costs and long-run revenue losses.

#### *Relevant gaps already identified by RDG:*

- *Under Feature 8.4: "The regime should support the industry in making trade-offs between performance, traffic growth and higher expenditure."*

- *Under Feature 6.1: “End-user compensation is not linked to the regime, resulting in the operators potentially being left ‘out-of-pocket’ for end-user compensation mechanisms (e.g. Delay Repay) in some situations.”*

### **3. Network Rail benchmarks**

Benchmarks are currently set on the basis of average performance in a given base year; with performance improvement trajectories laid on top. They are re-calculated for all operators at the start of each control period.

### **4. Sustained poor performance (SPP)**

The SPP regime is intended to provide additional compensation to a train operating company (TOC) when lateness and cancellations attributable to Network Rail reach a specified threshold, beyond which it is considered the liquidated sums nature of Schedule 8 could start significantly to undercompensate the TOC. That additional compensation is measured in relation to the benchmark level of Network Rail’s performance.

### **5. Operator payment rates and the star model**

Passenger operator payment rates are calculated at a service group level and they reflect the modelled financial impact of delays caused by that service group to other operators. The passenger operator payment rates are calculated for each service group by modelling the impact of that service group’s performance on other service groups. Those impacts are then combined with the Network Rail payment rates for each of the impacted service groups, to give the modelled total financial impact of lateness caused by that service group. The modelled financial impact per minute of lateness caused by a given service group is the operator payment rate for that service group.

Freight and charter operator payment rates are the same across all freight and charter operators and services. They are calculated by taking the Network Rail payment rates (for passenger operators) and weighting them by the amount of third party freight operator delay affecting each service group.

### **6. Operator benchmarks**

Benchmarks are currently set on the basis of average performance in the re-calibration period.

Freight and charter operator benchmarks are adjusted over the control period to reflect changes in traffic on the network.

## **7. Treatment of cancellations**

For passenger operators, cancellations are treated as a specific number of “deemed minutes late”; the amount of minutes late that a cancellation is deemed to be worth varies between service groups. The deemed minutes late are then incorporated into Network Rail outturn performance against its benchmarks (and likewise for operators against their benchmarks), which is the basis on which Schedule 8 payments are made.

For freight operators, Network Rail makes compensation payments for each cancellation it makes. These payments require funding and do not necessarily provide full compensation.

Similarly, Network Rail compensates charter operators for cancellations.

## **8. Liability caps**

The regime has a number of liability caps including incident liability caps and annual liability caps for freight operators.

Both freight operators and, separately, charter operators may choose to select from a menu of options to pay an access charge supplement for a cap on the amount they are required to pay in relation to a single incident.

There are reciprocal caps on the maximum annual Schedule 8 liability freight operators and Network Rail can face in relation to a particular track access contract. These are usually agreed by Network Rail and freight operators, and approved by us.

## **9. Interaction with regulated outputs and franchise obligations**

Network Rail is financed for Schedule 8 on the assumption that it performs at benchmark. Network Rail also has performance targets set by ORR and Government. Franchised operators have separate performance requirements set by their relevant franchise authorities.

We are working with the industry to consider potential alternative measures for punctuality, in response, in particular, to concerns about the public performance measure (PPM).

Relevant gaps already identified by RDG:

- *Under Feature 4.13: “The regime is often considered to frustrate the delivery of industry outputs”*
- *Under Feature 8.1: “The performance regime is not well aligned in terms of metrics used.”*

## **10. Perverse incentives and unintended consequences**

Stakeholders may want to comment on any perverse incentives and unintended consequences of the regime (together with any evidence that you are able to provide).

Relevant gaps already identified by RDG:

- *Under Feature 6.3: “The regime is not always aligned with ‘doing the right thing’ for the end-user.”*
- *Under Feature 8.2: “The current performance regime is focused on services and not end-users, so it measures the impact of delays and cancellations on specific services, but not on a passenger’s end-to-end journey”*
- *Under Feature 8.3: “The performance regime does not encourage joint working”*

## **11. Other aspects of the regime**

There may be other aspects of the regime which you wish to comment on.

## **Annex 3: Schedule 4, the Possessions Regime**

This annex is divided into two sections. The first outlines the current regime. The second provides a list of topics, should you find it useful to structure your responses along those lines. In the second section, we also note links to issues with Schedule 4 that RDG has identified in its phase 2b report as part of its Review of Charges<sup>4</sup>.

### **High level description of Schedule 4**

Schedule 4 is described in chapter 20 of our PR13 final determination<sup>5</sup>. The text in this section consists of excerpts of that chapter.

As already set out in annex 2, the possessions and performance regimes (Schedules 4 and 8) in track access contracts perform the following functions:

- compensate train operators for the financial impact of planned and unplanned service disruption attributable to Network Rail and other train operators;
- help align incentives between Network Rail and train operators, so the impact of service disruption on revenue and/ or costs is incurred by the organisation who cause the disruption, rather than the train operator that faces the disruption; and
- provide appropriate signals so as to drive the decision-making in relation to performance and possession management, for example, in relation to where to make investments, or to give an indication to Network Rail on whether it is better to have a short possession but with higher engineering costs or take a longer possession.

The possession regimes for passenger and freight operators are different, as outlined below. There is no Schedule 4 regime for charter operators. This is because possession plans are typically agreed before the majority of charter services are planned.

#### *Passenger operators*

Schedule 4 compensates franchised passenger operators for service disruption due to planned possessions. In return for this compensation passenger operators pay a pre-determined access charge supplement (ACS) to cover the estimated efficient cost to Network Rail of the Schedule 4 regime. This reflects the fact that Network Rail is expected to require a certain number of possessions and can be seen as analogous to the performance benchmark in Schedule 8.

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<sup>4</sup> RDG "Phase 2b: Assessment of the current charges and incentives regime", May 2014, <http://www.raildeliverygroup.com/what-we-do/our-work-programme/contractual-regulatory-reform/review-of-charges.html>

<sup>5</sup> [http://orr.gov.uk/data/assets/pdf\\_file/0015/465/fd-chapters-15-20.pdf](http://orr.gov.uk/data/assets/pdf_file/0015/465/fd-chapters-15-20.pdf)

Open access passenger operators only receive full formulaic Schedule 4 compensation, consistent with that available to franchised passenger operators, if they opt to pay an ACS. Currently no open access passenger operators do this.

Both franchised and open access passenger operators may also receive bespoke compensation for very long-lasting possessions or Sustained Planned Disruption (SPD).

### *Freight operators*

The Schedule 4 freight regime is structured so that there are three levels of compensation depending on the degree of disruption (with the possibility of compensation for actual losses for severe disruption) and higher payments made for late notice possessions.

Unlike franchised passenger operators, freight operators do not pay an ACS in order to be able to receive compensation under Schedule 4. The expected costs of freight Schedule 4 are instead funded by the government as part of Network Rail's funding requirement.

### **Headings for more detailed responses**

We are seeking your views (together with any evidence that you are able to provide) on any aspects of the Schedule 4 regime you wish to raise. It would be particularly helpful if stakeholders could comment on:

*the effectiveness of the current regime, including aspects that are working well, the scale of any potential problem, and what the priority areas for improvement should be.*

While some stakeholders may wish to respond briefly to this letter, others may wish to give more detailed responses. We welcome detailed comments on any aspects of the regimes, and invite respondents to structure their responses using some or all of the following headings.

#### **1. The purpose of Schedule 4**

See the high level description of Schedule 4, above. We are interested in stakeholders' views of what the purpose of Schedule 4 should be and of this particular wording.

#### **2. The level of compensation received by operators**

Compensation payments are made by Network Rail to franchised passenger operators on a formulaic basis. Schedule 4 payments are to compensate for a combination of the following:

- (a) the effect of possessions on fare revenue;
- (b) additional costs incurred when running replacement buses; and
- (c) costs or cost savings from a change in train mileage.

Franchised and open access passenger operators receive compensation for very long-lasting possessions or Sustained Planned Disruption (SPD).

Freight operators receive compensation within Schedule 4 based on three tiers of disruption. Flat rate liquidated sums are paid for the first two tiers, with the possibility of additional actual costs / losses available for the most disruptive possessions.

Relevant gaps already identified by RDG:

- *Under Feature 7.1: “Schedule 4 may not always compensate operators for the costs they incur when Network Rail takes a possession.”*
- *Under Feature 7.7: “The regime does not place sufficient incentives on Network Rail to consider the costs of other industry parties.”*

### 3. Notification discount factors

Network Rail receives a discount on the amount of Schedule 4 compensation it pays to franchised passenger operators for early notification of restrictions of use; this is known as the notification factor. The discount reflects the reduced impact on operators’ revenues where customers/passengers receive early notice of service disruption. There are three levels of notice known as notification discount thresholds.

Relevant gaps already identified by RDG:

- *Under Feature 7.6: “Network Rail can be disincentivised from making changes to its possessions plans once it has notified operators.”*
- *Under Feature 7.8: “The regime does not have sufficient flexibility to allow Network Rail to move possessions, at short notice, without undue penalties.”*

### 4. The ACS

Schedule 4 payments to franchised passenger operators are funded through the Access Charge Supplement (ACS) which is paid to Network Rail by franchised passenger train operators in return for receipt of full Schedule 4 compensation.

The ACS is derived on the basis of assumed maintenance and renewals volumes and Schedule 4 unit costs for each asset type and then apportioned pro-rata amongst franchised passenger operators based on historic Schedule 4 compensation payments paid to operators.

The total ACS should reflect the amount Network Rail is expected to pay out in Schedule 4 compensation over the control period – the Schedule 4 regime is designed to be financially neutral provided that Network Rail delivers its baseline plans efficiently.

Relevant gaps already identified by RDG:

- *Under Feature 7.3: "Network Rail has typically over-recovered its Schedule 4 costs through the Access Charge Supplement."*

## **5. The Sustained Planned Disruption mechanism**

The Sustained Planned Disruption (SPD) mechanism is designed to protect passenger train operators from instances where there is severe disruption caused by possessions over a sustained period. Additional compensation for SPD is triggered when the impact of severe disruption crosses a pre-defined level (in terms of revenue lost and increased costs) at which point train operators may claim additional revenue/ cost compensation above that covered by the liquidated sums payable under Schedule 4.

## **6. Interaction with regulated outputs**

In PR13, we set regulated outputs for Network Rail in relation to possessions, in the form of the possession disruption index (PDI) which measures network availability in terms of the extent of planned disruption to passenger and freight services caused by engineering works on the network. This measure is broken down into passenger disruption index (PDI – P) and freight disruption index (PDI – F).

We are working with the industry to consider potential alternative measures for availability, in response to concerns about PDI.

## **7. Perverse incentives and unintended consequences**

Stakeholders may want to comment on any perverse incentives and unintended consequences of the regime (together with any evidence that you are able to provide).

### Relevant gaps already identified by RDG:

- *Under Feature 7.5: "There are examples of circumstances where the current regime incentivises Network Rail to utilise shorter possessions. However, in some cases, a blockade may be a more efficient possessions strategy."*
- *Under Feature 7.4: "The regime considers only the impact of possessions on specific train services, and not on the end-user experience."*

## **8. Other aspects of the regime**

There may be other aspects of the regime which you wish to comment on.