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<Name and address  
of track access manager,  
or equivalent, in each  
train operating company>

## **BY E-MAIL**

**Dear Sir/Madam,**

### **Schedule 4 Sustained Planned Disruption: confirmation of values for defined service group revenue for CP4**

#### *Sustained planned disruption*

1. The purpose of this letter is to set out the values for “defined service group revenue” which are needed to determine whether sustained planned disruption (SPD) has occurred. This follows my earlier letter, of 26 October 2010, in which I proposed values, and subsequent bilateral correspondence. **The values are set out in Appendix A to this letter.** This letter also provides more general information regarding SPD.
2. Under Schedule 4 of ORR’s model passenger track access contract, operators are entitled to receive compensation for revenue loss resulting from restrictions of use in return for the payment of an access charge supplement. Operators receive compensation based on a three tiered structure underpinned by compensation formulae.
3. In addition to this, under part 3 of Schedule 4, if SPD is deemed to have occurred, compensation can instead be calculated on the basis of actual (rather than formulaic) revenue losses and costs. In order for SPD to be triggered, an operator’s revenue loss compensation must be either<sup>1</sup>:
  - greater than 20% of defined service group revenue over 3 consecutive periods; or
  - greater than 15% of defined service group revenue over 7 consecutive periods.

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<sup>1</sup> SPD may alternatively be triggered by reasonable incurred costs exceeding certain thresholds.



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4. Please note that these thresholds are defined with respect to the amount of compensation determined under Schedule 4<sup>2</sup>, rather than an operator's actual revenue loss. When calculating 3 and 7 period thresholds, it should be assumed that one period of defined service group revenue is equal to one thirteenth of the annual defined service group revenue.

*Defined service group revenue*

5. Our aim is that the defined service group revenue is defined on a consistent basis to that of the Schedule 4 formulaic revenue loss compensation; in particular we have sought to use the same assumptions regarding total revenue and journeys for both measures.
6. The Schedule 4 revenue loss compensation calculation<sup>3</sup> is a function of Network Rail payment rates, also referred to as Network Rail Marginal Revenue Effect (MRE), which is specified in column C to Appendix 1 of Schedule 8.
7. We calculated Schedule 8 values and consulted on these during the 2005 performance regime review. The MRE values for most service groups have not been recalibrated subsequent to the 2005 review, other than to adjust for RPI or to reflect franchise remapping. For these service groups, for consistency, we have determined the defined service group revenue on the basis of 2004-05 revenue (again, adjusted for RPI).
8. In some cases, the definition of service groups has changed in the intervening periods, and we have reallocated revenue associated with particular service codes to reflect these changes. In other cases, MRE have been recalibrated since 2005 (typically to take account of new services) and we have sought to reflect these changes.
9. The defined service group revenue is calculated using the information given in Table 1 of Appendix A. Where there are differences between the proposed values and these confirmed values, we note this in the appendix.
10. The table lists the proposed SPD ratio for each service group. The defined service group revenue is the product of the SPD ratio and the Network Rail payment rate (the "MRE") for the same service group, as defined in Appendix 1 of Schedule 8.

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<sup>2</sup> The revenue loss compensation calculation is set out in paragraph 3.4 of schedule 4 of the model track access contract (passenger services). The model contract can be accessed on our website: <http://www.rail-reg.gov.uk/server/show/nav.202>.

<sup>3</sup> See paragraph 3.4 of schedule 4 of the model track access contract (passenger services).

**11.** We have chosen to define the defined service group revenue as a function of the SPD ratio, because the SPD ratio does not require adjustment for RPI, and is less sensitive to service changes, so we consider the administrative burden of keeping it updated is less than that of defining the service group revenue directly.

*Discussion on the SPD mechanism*

**12.** In their responses to my earlier letter, some operators have raised issues and concerns regarding the design of the SPD.

**13.** There was concern that the trigger was set at too high a level. We note that the SPD mechanism was designed to apply to sustained high levels of planned disruption, in effect approximately 1% of all possessions. We have received some evidence from operators that the triggers have been set at such a level that fewer than anticipated possessions will be categorised as SPD. This is a concern to us and something we will revisit as part of our periodic review.

**14.** The other main concern raised was on the choice of metric used for the trigger. In particular, an operator argued that actual revenue loss, rather than estimated revenue loss, should be used as the metric. Again, we have noted this concern (and note that this alternative metric has disadvantages, such as complexity, as well as advantages). Some discussion regarding the choice of metric is given in Appendix B.

**15.** Certain operators have suggested changing the design for the mechanism within the current Network Rail control period (CP4). Our perspective on this is as follows:

- Schedule 4 of the model contract was determined as part of the periodic review 2008 (PR08). Change to the mechanism within the control period would require a large degree of consensus – from Network Rail and others – and is unlikely to be feasible with respect to the particular issues outlined.
- The SPD mechanism was designed in PR08 with a large degree of proactive industry involvement and consultation. However, on the basis of feedback received during our consultation on defined service group revenue values, we have identified SPD as a mechanism that is important for us to scrutinise as part of the next periodic review.

**16.** We therefore do not propose to change the mechanism for the current control period.

**17.** Some information on the process used for establishing the SPD mechanism is set out in Appendix B to this letter.

**18.** If you have other points you wish to raise with us regarding Schedule 4 or related matters, you will be given the opportunity to do so as part of the periodic review process – through workshops, consultations and other means. The first such opportunity will be in May this year, when we launch the 2013 periodic review and conduct a three month consultation. In the meantime we are happy to hear your views on an informal basis.

**19.** I am sending this letter to representatives of all franchised train operating companies but with a bespoke Appendix A which contains confidential information relevant to each company separately.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Emily Bulman', with a stylized flourish at the end.

**Emily Bulman**

## Appendix A – SPD Confirmed values for CP4

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## Appendix B – SPD BACKGROUND INFORMATION

1. The SPD mechanism is set out in our final determination for PR08<sup>4</sup>. In the Track Access Passenger Model Contract<sup>5</sup>, paragraphs 2.10 and 8 of Part 3 of Schedule 4 details the SPD mechanism and payments.
2. The mechanism was introduced to permit bespoke compensation – representing actual revenue losses and costs - for a sustained high level of planned disruption where overall there might be a significant difference between actual costs/losses and formulaic compensation. The SPD mechanism was designed to apply to only the most disruptive possessions and, in effect, approximately 1% of all possessions<sup>6</sup>.
3. An SPD event can be triggered by a revenue loss trigger as well as a cost trigger. The revenue loss trigger levels are defined with respect to compensation levels rather than the levels of actual revenue lost. The compensation levels are a function of the MRE payment rates, which in turn are based on expected revenue impact of the delay. They reflect passengers' response to unplanned delay through the inclusion of a delay multiplier.
4. On the subject of the metric used to define the trigger, the ISG<sup>7</sup> stated:

*“Having considered both options set out in the consultation document, ISG recommends that a revenue-based trigger is more appropriate than an hours-based trigger, being more effective at identifying high impact planned disruption in relation to*

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<sup>4</sup> Periodic review 2008: Determination of Network Rail's outputs and funding 2009-14 document: <http://www.rail-reg.gov.uk/upload/pdf/383.pdf>.

<sup>5</sup> <http://www.rail-reg.gov.uk/server/show/nav.202>

<sup>6</sup> This is set out in the Industry Steering Group's (ISG) recommendation to ORR on changes to the regime for compensating disruptive possessions: [http://www.rail-reg.gov.uk/upload/pdf/pr08-poss-recs\\_comp\\_regime\\_310108.pdf](http://www.rail-reg.gov.uk/upload/pdf/pr08-poss-recs_comp_regime_310108.pdf).

<sup>7</sup> January 2008 recommendation to ORR.

*passengers and considerably less complex to implement. The revenue-based mechanism would be triggered if, over a number of consecutive periods, the formulaic compensation relating to revenue loss as estimated by the Schedule 4 algorithm exceeded a defined percentage of Service Group / Operator revenue.*

5. The thresholds for the revenue loss trigger were proposed by the Industry Steering Group - economic and contractual framework – (ISG) and were based on analysis carried out using actual historical Schedule 4 payments over 2 years<sup>8</sup>.
6. The ORR set out the proposals for the mechanism in its consultation documents and received responses from the industry. Some of the respondents expressed concern regarding the definitions of the thresholds as well as other aspects of the SPD mechanism. ORR, however, accepted ISG's proposed thresholds, and the mechanism was implemented as per the ISG's recommendations.

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<sup>8</sup> This is set out in the Industry Steering Group's March 2008 document, Recommendations to ORR on changes to the regime for disruptive possessions: [http://www.rail-reg.gov.uk/upload/pdf/pr08-rcmd\\_flwup\\_290208.pdf](http://www.rail-reg.gov.uk/upload/pdf/pr08-rcmd_flwup_290208.pdf).