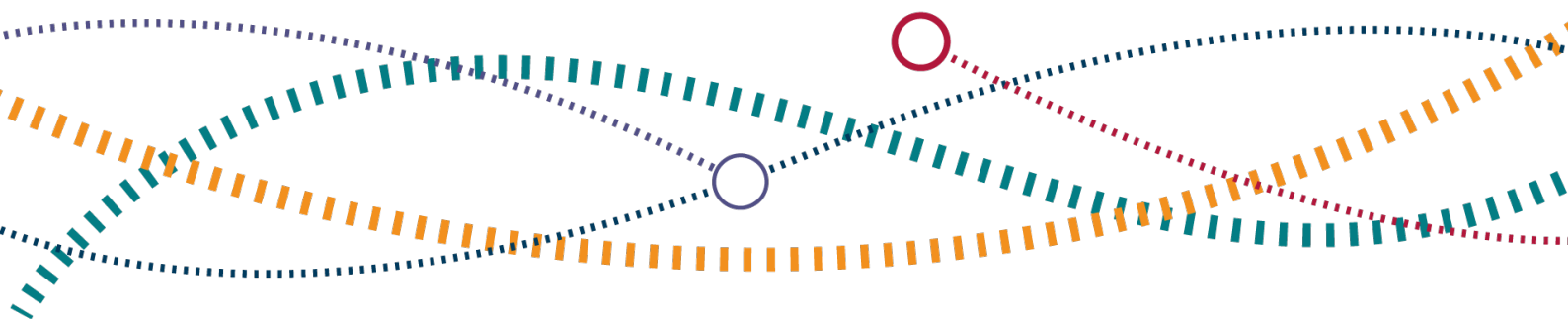




PR23: Impact assessment on provision to allow for recalibration of Schedule 8 within control periods

15 June 2023

This impact assessment supports our draft decision on the PR23 framework for Schedule 8, as set out in our PR23 draft determination: [policy position on the schedules 4 and 8 incentives regimes](#).



<p>Background</p>	<p>The Schedule 8 performance regime places incentives on Network Rail and train operators to limit the disruption they cause and, therefore, to improve network performance. Through the regime, train operators receive compensation when Network Rail's performance is worse than its benchmark and pay Network Rail a bonus when it performs better than its benchmark. Schedule 8 is calibrated to be 'financially neutral on expectation', meaning that Network Rail and operators would not make or receive payments if prior expectations were met in terms of train performance.</p>
<p>Proposed change being considered</p>	<p>Schedule 8 parameters are fixed for the duration of a control period. This can mean, for example, that benchmarks do not respond during the control period to external shocks such as changes to traffic volumes. This potentially means that the regime is not accurately calibrated if circumstances change during the control period, which could result in large and volatile payment flows between parties.</p> <p>Currently, there is only limited scope to update Schedule 8 parameters during the control period, provided for in the passenger regime by Schedule 8, paragraph 17 (this provision is not present in the freight and charter regimes). Through this provision, train operators and Network Rail can request updates to their parameters. However, due to its bilateral nature, this provision is not well-suited to recalibrating in a co-ordinated way across multiple operators and does not permit ORR to initiate recalibration.</p> <p>We are therefore proposing to include a provision within Schedule 8 to allow ORR to initiate updates to Schedule 8 parameters, to introduce more flexibility into the regime. The provision would only be used if there were clear benefits to the industry from recalibrating, and if it was clearly justified by a material change in circumstances that diverged from the assumptions made in the PR23 recalibration. We would not recalibrate as a result of poor performance that was under the control of industry parties. Circumstances would need to be likely to lead to a sustained change in realistic performance expectations in future years of the control period.</p>

	<p>We are proposing that the ability for ORR to initiate recalibration within the control period should be included in the passenger, freight and charter regimes (the freight and charter regimes are calibrated at the industry level, so a change to benchmarks or payment rates would affect all operators).</p>
<p>Impacts on Network Rail and train operators (passenger, freight and charter)</p>	<p>We assess the impacts of the proposal at an industry level, as the impacts affect Network Rail and train operators in very similar ways.</p> <p>Financial impacts: If there is a material change in circumstances during the control period, this could result in significant Schedule 8 net payment flows in favour of Network Rail or train operators. These payments may be out of step with expected performance or the expected financial impacts of disruption. In such circumstances, under this new provision, ORR may initiate recalibration of Schedule 8. If such a recalibration is triggered, financial flows for both Network Rail and operators are more likely to reflect reasonable expectations of performance and the financial impacts of disruption. This could benefit industry parties by reducing the volatility of budgets (for operators that are ‘held neutral’ to Schedule 8 by their franchise bodies, these benefits would be felt by the franchise bodies rather than the operators.)</p> <p>Administrative burden: There would be administration costs associated with any mid-period recalibration. These costs would reflect the scope and methodology for the recalibration – for example, whether it included all operators and updated both performance benchmarks and payment rates. Recalibration of Schedule 8 is a complex and potentially costly exercise – for example, the PR23 recalibration exercise is spanning around a year in length and is requiring specialist consultant resources to carry out the calculations, in addition to staff time from ORR and the industry. While the PR23 recalibration models are being built in such a way to be readily updateable any recalibration will still come at a material cost in industry resources.</p> <p>Incentive impacts: There are benefits to fixing Schedule 8 parameters over time. Schedule 8 payments are often used in business cases for initiatives that improve performance, providing parties with an opportunity for financial benefit if performance outcomes are improved. Fixing Schedule 8 parameters provides</p>

	<p>industry parties with clear incentives to improve performance in the knowledge that performance gains will not be immediately 'clawed back' through an updated recalibration. For this reason, ORR only intends to use the new provision when there is a material change in circumstances that requires it. In such circumstances, a recalibration that reflected updated industry circumstances would mean that incentives are calibrated to more accurately reflect performance expectations and the financial impacts of disruption. (We note, however, that parties are always incentivised to improve train performance, regardless of where the benchmark is set, given the linearity of Schedule 8's incentives.)</p> <p>There may be a negative effect on a party's incentives in a situation where it becomes clear that a recalibration is likely due to the observance of a material change in circumstances. In the intervening period, there may be less incentive for the party to improve its performance as this would translate into more challenging benchmarks following the recalibration.</p>
<p>Draft decision</p>	<p>To introduce a provision within Schedule 8 to allow ORR to initiate recalibration of Schedule 8 within the control period, and to include this provision in the passenger, freight and charter regimes. We will mitigate potentially adverse incentive impacts by only using this provision if there is a material change in circumstances.</p>
<p>Next steps</p>	<p>We intend to include new clauses that will enable recalibration within the control period in our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.</p>



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