



# **Guide to the route-level efficiency benefit sharing (REBS) mechanism in CP5**

Version 2.0

31 March 2016

# Contents



	Feedback .....	3
<b>1.</b>	<b>Purpose of this document .....</b>	<b>4</b>
	Who should read this guide? .....	4
<b>2.</b>	<b>Introduction .....</b>	<b>5</b>
	What is REBS? .....	5
	Related documents .....	5
	What did operators need to do at the start of CP5? .....	6
	Opting out of REBS .....	7
	Material alliances.....	8
<b>3.</b>	<b>Key features of REBS .....</b>	<b>9</b>
	Introduction to this chapter .....	9
	Overview of REBS.....	9
	Setting REBS baselines .....	11
	Retaining the costs and benefits from REBS .....	11
	Impact of material alliance performance on REBS payments .....	12
<b>4.</b>	<b>REBS Calculations .....</b>	<b>14</b>
	Calculating REBS performance .....	14
	Calculating REBS payments.....	16
	Example 1: Outperformance payment from Network Rail to operators.....	17
	Example 2: Underperformance payment from operators to Network Rail .....	17
	Adjusting REBS performance for under-delivery of required outputs and asset sustainability....	18
<b>5.</b>	<b>Answers to common questions .....</b>	<b>19</b>
	<b>Annex A: Approach to assessing Network Rail’s total REBS performance.....</b>	<b>27</b>
	<b>Annex B: Impact of cumulative approach to measuring REBS performance .....</b>	<b>29</b>
	<b>Annex C: Adjusting Network Rail’s financial performance for under-delivery of outputs and asset sustainability.....</b>	<b>33</b>
	Example: PPM under-delivery output adjustment.....	35

# Version history

Version	Date	Summary of changes
v1.0	31 March 2014	Original version of REBS guide
v1.1	16 April 2014	Correction made to the explanation of how REBS payments are allocated to operators based on variable usage charge income (Chapter 3); clarification of how the REBS opt-out works for new franchises (Chapter 3 and 4); and other minor wording changes.
v2.0	31 March 2016	<p>We issued a draft to Network Rail, Transport Scotland, the Department for Transport and operators for comment on 30 July 2015 and held a workshop on 3 August 2015.</p> <p>We have restructured the order of the text. We have also further clarified the calculation for adjustments to route performance for non-delivery of outputs, asset sustainability and civils volumes variances. We have also clarified the allocation of route-level performance to REBS participants and payment apportionment approaches for full-year and part-year REBS participants.</p>

## Feedback

If you have any questions or feedback in relation to the content of this guide, please contact:

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# 1. Purpose of this document

## Who should read this guide?

- 1.1 We have developed this guide to explain the key features of the route-level efficiency benefit sharing (REBS) mechanism and to provide examples of how REBS will work in practice during control period 5 (CP5), which runs from 1 April 2014 to 31 March 2019. We also outline our tests for “material alliances”.
- 1.2 This guide is aimed at operators (franchised passenger, open access and freight), who are within the scope of REBS. Charter operators are not within the scope of REBS. This guidance may be of general interest to other industry participants who want to understand the impact that this regulatory incentive may have on Network Rail and operators.
- 1.3 The focus of this document is on the workings of REBS in CP5 and so we do not provide a detailed coverage of policy considerations<sup>1</sup>, such as the underlying rationale, the potential benefits and costs, and the reasons for our decisions in relation to individual elements of the mechanism.
- 1.4 We will update this guide from time to time to include new information and to reflect feedback from stakeholders. If we do make changes to this guide, we will publish the updated guidance on our website (setting out clearly in the guide the changes that we have made) and send it to operators (franchised, open access and freight) and Network Rail.
- 1.5 Key changes between versions are shown in the version history on page 3.

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<sup>1</sup> We have previously set out the reasons for our decisions on REBS in Chapter 19 of our [PR13 final determination](#) and in our consultation document, [Aligning incentives: decisions on route-level efficiency benefit sharing \(REBS\) and operator exposure to Network Rail's costs at a periodic review](#).

## 2. Introduction

### What is REBS?

- 2.1 In our 'Periodic Review 2013: Final determination of Network Rail's outputs and funding for 2014-19', we explained that in CP5 we would replace the CP4 efficiency benefit sharing mechanism (EBSM) with a route-level incentive mechanism. The route-level efficiency benefit sharing (REBS) mechanism encourages Network Rail and operators (franchised passenger, open access and freight) to work together and allow both to share in Network Rail's efficiency gains or losses on an annual basis. REBS strengthens the alignment of incentives between Network Rail and operators in order to support greater co-operation and drive down industry costs.
- 2.2 We see REBS as a default mechanism for those operators that do not want to enter into direct commercial agreements with Network Rail (including alliances), as well as being a stepping stone to the development of more commercial relationships within the industry. As our preference is for more commercial arrangements, we would be content to see operators opting out of REBS to pursue their own commercially negotiated risk and reward sharing agreements with Network Rail, provided such arrangements are transparent and non-discriminatory.
- 2.3 Throughout the 2013 periodic review (PR13) we consulted extensively on our proposals for REBS and in developing REBS we have taken into account the feedback we have received from the industry.

### Related documents

- 2.4 This guide draws together information from a number of different sources:
- (a) our PR13 final determination (Chapter 19)<sup>2</sup>;
  - (b) the version of Schedule 7 contained within operators' track access contracts that will apply for CP5<sup>3</sup>;
  - (c) Network Rail's draft CP5 delivery plan<sup>4</sup>;
  - (d) Network Rail's final CP5 delivery plan<sup>5</sup>; and
  - (e) our CP5 regulatory accounting guidelines (RAGs)<sup>6</sup>.

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<sup>2</sup> ORR, [Periodic Review 2013: final determination of Network Rail's outputs and funding for 2014-19](#), October 2013

<sup>3</sup> ORR, [PR13 legal notices](#)

<sup>4</sup> Network Rail, [CP5 draft delivery plan](#)

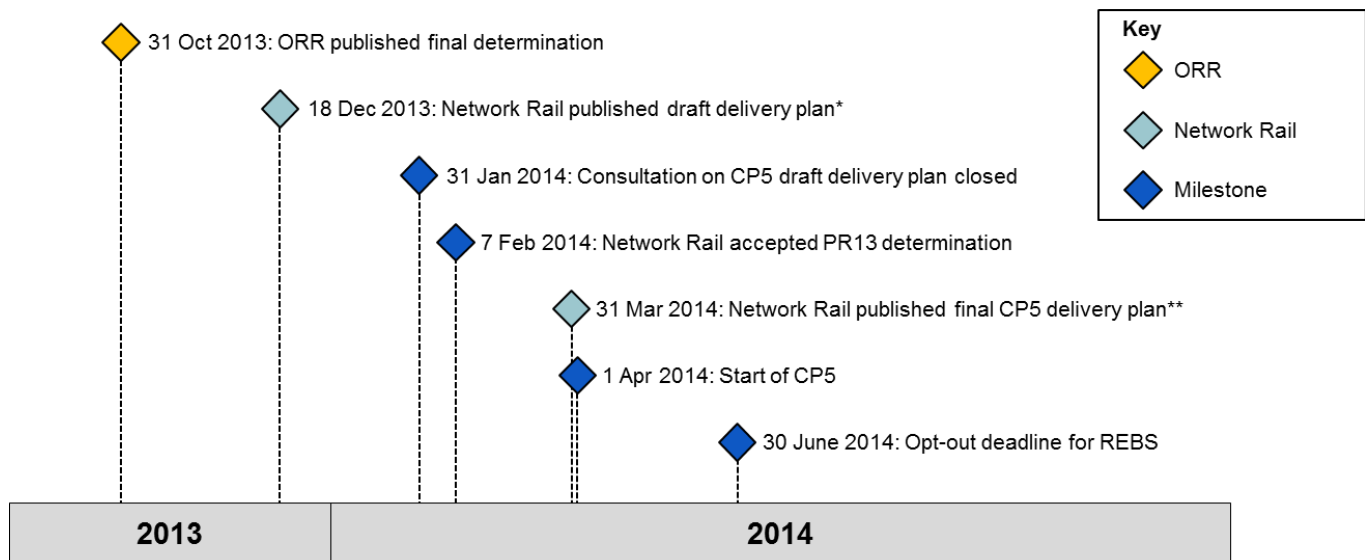
<sup>5</sup> Network Rail, [CP5 final delivery plan](#)

<sup>6</sup> ORR, [CP5 regulatory accounting guidelines](#)

## What did operators need to do at the start of CP5?

2.5 Operators were able to opt out of REBS on one or more routes at the start of CP5. In Figure 2.1, we show the timetable for the key activities and milestones in relation to REBS up to the opt-out deadline on 30 June 2014.

Figure 2.1: Key activities and milestones in relation to REBS



\* CP5 draft delivery plan supporting information included draft CP5 REBS baselines.

\*\* CP5 final delivery plan supporting information included final CP5 REBS baselines.

2.6 Operators had an opportunity to comment on the CP5 draft REBS baselines<sup>7</sup> as part of Network Rail's draft delivery plan consultation, which closed on 31 January 2014. Following this consultation, Network Rail published its final CP5 delivery plan<sup>8</sup>, including finalised REBS baselines on 31 March 2014<sup>9</sup>.

2.7 Operators had three months from the start of CP5 to decide whether to participate in REBS for CP5, i.e. whether to exercise their right to opt out of the mechanism. To opt out at the start of CP5, operators had to send an opt-out notice<sup>10</sup> to Network Rail by 30 June 2014. **Operators that did not opt out were automatically 'opted-in' to REBS for the whole of CP5.** However, there are some circumstances where operators can opt out of REBS within CP5.

<sup>7</sup> Network Rail's consultation related only to the England & Wales routes. This is because we have a separate determination for Scotland and so, for Scotland, our CP5 determination REBS baselines act as the final REBS route baselines for Scotland.

<sup>8</sup> Network Rail, [CP5 final delivery plan](#)

<sup>9</sup> Network Rail, [CP5 delivery plan REBS baselines](#)

<sup>10</sup> An opt-out notice is a letter from an operator to Network Rail, stating that it is choosing to exercise its right to opt out of REBS in CP5. A template opt-out notice is provided in Appendix 7B of Schedule 7 of the franchised passenger operator model track access contracts and Appendix 2 of Schedule 7 in the freight operator model track access contract. The opt-out notice allows the operator to opt out of one or more routes.

## Opting out of REBS

- 2.8 Schedule 7 in operators' CP5 track access contracts sets out the circumstances where an operator is able to opt out of REBS on one or more routes. We have summarised the relevant provisions below. Schedule 7 also provides the template opt-out notice to be served on Network Rail, with a copy to ORR.
- 2.9 Operators had the right to opt out of REBS at the start of CP5, when there is a new operator on a route, when a new franchise is awarded, or when a new material alliance is formed. This is explained further below:
- (a) **at the start of CP5** (on or before 30 June 2014). Operators could have informed Network Rail within three months from the start of CP5 that they did not want to participate in REBS. This 'opt-out' applied to individual routes, i.e. operators can choose not to participate in one or more operating routes (called REBS routes in track access contracts); and
  - (b) **during CP5, when:**
    - (i) **an operator begins operating services on a new route or is awarded a new franchise.** This applies to new franchised or open access operators, or to existing operators that start operating services on a route where they have not previously operated. Also, where a new franchise is awarded to the incumbent franchisee (either through competition or direct award), we treat this as a new franchise. A new opt-out notice would be required if the operator wishes to opt out of REBS<sup>11</sup>. A new franchisee will not be bound by the decision of the previous incumbent on REBS or by its previous decision if it was the incumbent. Essentially the opt-out decision resets for a new franchise so unless the new franchised operator opts out of REBS, it is automatically 'opted-in'; or
    - (ii) **a new material alliance<sup>12</sup> agreement is made between Network Rail and one or more operators for a route.** This opt-out applies where Network Rail has notified us and the affected operators (i.e. those operators that operate on that route) that it has entered into a new agreement and we agree that this agreement is a material alliance agreement. Network Rail will normally serve notice on ORR within 14 days of entering into a material alliance. The material alliance partner and other operators on the material alliance route will be able to serve an opt-out notice only in relation to the material alliance route. They will also be able to opt out of other routes if any of the other provisions in 2.9(b)(i) above applies<sup>13,14</sup>.

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<sup>11</sup> In these circumstances an opt-out may be served only in respect of the route on which the operator starts operating those services.

<sup>12</sup> Track access contracts define a material alliance as "...an agreement between Network Rail and one or more operators establishing an alliance in which those parties work jointly to carry out or otherwise share the risk of activities on a part of the network".

<sup>13</sup> For the avoidance of doubt, even if Network Rail has not notified us of an alliance that we would otherwise consider to be material, this does not prevent us from determining that the alliance is a material alliance agreement.

For 'within control period' opt-outs, an opt-out notice must be served within two months after the date on which the operator starts operating new services or after the date of receipt of our confirmation that we have determined an alliance agreement to be 'material'.

- 2.10 Once an opt-out has been exercised, whether under the new operator/new franchise provision (i.e. para 2.9(b)(i) above) or because of a new material alliance (i.e. paragraph 2.9(b)(ii) above), the opt-out cannot be reversed. If a material alliance ends, there is no mechanism to opt back into REBS on that route.

## Material alliances

- 2.11 Network Rail will normally serve notice on ORR within 14 days of entering into a material alliance.
- 2.12 We have not set out any specific rules for determining a material alliance agreement as we will consider each alliance agreement on a case-by-case basis. However, in our assessment, we will consider the following criteria:
- i. the scope of Network Rail's route income and expenditure covered by the alliance;
  - ii. the time period of the alliance agreement;
  - iii. the alliance partner's share of traffic on the route;
  - iv. the extent to which the alliance is expected to impact existing route expenditure plans;
  - v. the degree of shared control within the alliance;
  - vi. the degree of shared resources within the alliance; and
  - vii. the nature of risk sharing within the alliance.

We will work with Network Rail, as soon as possible after it has entered an alliance, to determine the information that we will require to assess the financial impact on a REBS route baseline from a new alliance.

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<sup>14</sup> For the avoidance of doubt, this provision does not apply to immaterial alliance agreements or material alliances in existence prior to CP5.



# 3. Key features of REBS

## Introduction to this chapter

- 3.1 This chapter covers the following:
- (a) overview of REBS;
  - (b) setting REBS baselines;
  - (c) retaining the costs and benefits from REBS; and
  - (d) impact of material alliance performance on REBS payments.

## Overview of REBS

- 3.2 REBS is intended to strengthen the incentives on Network Rail and operators (both passenger and freight) to work together, in order to drive down industry costs, by allowing operators to share in Network Rail's efficiency gains or losses at a Network Rail operating route level, each year within CP5. The operating routes are those as at our PR13 determination and for our purposes will not change in CP5 due to Network Rail reorganisations. The routes are: Anglia, East Midlands, Kent, London North East, London North West, Scotland, Sussex, Wales, Wessex and Western.
- 3.3 This means that where Network Rail has financially outperformed against the agreed route baseline, i.e. Network Rail's net expenditure (including elements of income) is less than the baseline, operators will receive a 25% share of this financial outperformance in the form of a cash payment from Network Rail. However, where Network Rail has financially underperformed, i.e. Network Rail's net expenditure (including elements of income) is greater than the baseline, operators will share 10% of this underperformance by making a payment to Network Rail<sup>15</sup>. The percentages in this paragraph are the shares, before the caps are applied.
- 3.4 REBS has some key differences to the EBSM in control period 4 (CP4), which ran from 1 April 2009 to 31 March 2014. In particular, REBS:
- (a) operates at a Network Rail operating route level, rather than at a national level;
  - (b) provides operators with both upside (25% share) and downside (10% share) exposure to Network Rail's cumulative financial performance, rather than just upside;

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<sup>15</sup> Our calculation of REBS performance will include any adjustments for under-delivery of Network Rail's required PR13 outputs, including train performance and where Network Rail has not maintained the sustainability of the network appropriately. Please refer to Annex C of this guide or to the CP5 regulatory accounting guidelines (RAGs) for further information.

- (c) has payments that are capped in relation to the level of REBS performance (capped at 10% of REBS outperformance and 10% of REBS underperformance)<sup>16</sup>;
- (d) provides operators with an opt-out from the mechanism (by route) at the start of CP5 and in certain circumstances during CP5; and
- (e) reflects the incentives that Network Rail faces in relation to its renewals expenditure, i.e. that under the 'RAB roll forward' policy, it retains only 25% of any efficient renewals underspend and bears 25% of any efficient overspend on renewals<sup>17</sup> (see para 5.1(k) for further details).

3.5 The following elements of Network Rail's income and expenditure are included within the REBS calculation:

- (a) support costs;
- (b) Rail Safety and Standards Board (RSSB) and British Transport Police (BTP) costs;
- (c) network operations costs;
- (d) network maintenance costs;
- (e) renewals (excluding renewals under the spend-to-save mechanism<sup>18, 19</sup>);
- (f) schedule 4 and 8 costs;
- (g) property income (excluding telecoms property income and non-periodic review income);
- (h) variable usage charge (VUC) income;
- (i) capacity charge income; and
- (j) electrification asset usage charge (EAUC) income.

For the avoidance of doubt, the REBS calculation **does not** include any other Network Rail income and expenditure. For example, REBS does not include Network Rail's enhancements expenditure.

<sup>16</sup> Caps were calculated in relation to financial outperformance and underperformance against the CP5 REBS baselines and are fixed at the start of CP5. The calculation of the caps is explained further in para 5.1(j).

<sup>17</sup> For the avoidance of doubt, this 25% figure is different to the 25% sharing rule for REBS outperformance. The 25% rule applied to the assessment of renewals performance is also taken into account when calculating the REBS payment caps referred to in 3.4 (c), above.

<sup>18</sup> The spend to save mechanism allows Network Rail, in certain situations, to spend money on capital schemes that were not funded as part of PR13. These schemes are promoted by Network Rail and either generate additional income or reduce costs. For example, the spend to save mechanism applies to expenditure on information management renewals.

<sup>19</sup> Due to the separate treatment of the renewal of civil structures in PR13, we will exclude the changes to civils volumes from REBS performance. We have also excluded changes in civils volumes from our calculation of total financial performance for CP5 because civils scope was an area of significant uncertainty during PR13. Changes in civils unit costs are still included in the calculation. This treatment is consistent with our CP5 regulatory accounting guidelines.

## Setting REBS baselines

- 3.6 Our PR13 final determination income and expenditure assumptions for England & Wales and Scotland provide the total baselines for the calculation of REBS payments. However, Network Rail was able to set the REBS route baselines for each of the nine England & Wales operating routes, providing that these baselines reconcile, on a line-by-line and year-by-year basis<sup>20</sup> to our national England & Wales PR13 income and expenditure assumptions. As we had a separate determination for Scotland, our PR13 final determination income and expenditure assumptions provided the REBS route baselines for Scotland.
- 3.7 Network Rail published its draft REBS baselines and upside/downside caps for the nine England & Wales routes on 18 December 2013, as part of the supporting information to its draft CP5 delivery plan. Network Rail then finalised the REBS baselines in the supporting information to its final CP5 delivery plan, published on 31 March 2014. Network Rail is not able to make adjustments to REBS route baselines after the start of CP5.
- 3.8 REBS baselines, cumulative performance and upside/downside caps will be adjusted annually for inflation. See para 5.1(f) for more details.

## Retaining the costs and benefits from REBS

- 3.9 During CP4, the majority of franchised operators were not contractually eligible to retain payments under EBSM because the governments in England & Wales and in Scotland did not waive the Clause 18.1 / Schedule 9 (no net loss, no net gain) provisions in their pre-CP4 franchise agreements. However, for franchises competitively let in CP4 the Department for Transport (DfT) agreed to waive this provision.
- 3.10 We asked the Department for Transport and Transport Scotland to provide information on whether they would allow franchised operators to retain the costs and benefits of REBS in CP5. We have summarised their responses below.
- 3.11 For DfT the position in CP5 is:
- (a) **Pre-CP4 franchises.** If a franchisee, with a franchise let before CP4, does not opt out of REBS in CP5, DfT will recover any REBS payments received by the franchisee by adjusting franchise payments but the franchisee will be on risk for any REBS payments that it is required to pay to Network Rail;
  - (b) **CP4 franchises.** Franchisees will bear the costs and retain the benefits of REBS in CP5. However, this means that franchisees will be on risk for any REBS payments that they have to make to Network Rail. For CP4 franchises, DfT will not adjust franchise payments for REBS;

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<sup>20</sup> Paragraph 19.35 of our PR13 final determination refers to the requirement for REBS baselines to reconcile back to our final determination on a line-by-line basis. Since publishing our final determination, we have clarified with Network Rail that this reconciliation also extends to our year-by-year assumptions. We have set this constraint so that the CP5 baselines for total financial performance and REBS performance are set on a consistent basis.

- (c) **New competitively let franchises.** The DfT position will be decided on a case by case basis. The franchise agreement will generally require the franchisee to obtain the Secretary of State's consent prior to exercising the REBS opt-out in the track access contract and will specify whether the franchisee is able to retain any benefits<sup>21</sup>; and
- (d) **Direct award franchises.** These are new franchises, even when awarded to an incumbent. The DfT position will be decided on a case by case basis. Under the track access contract, an operator wishing to opt out would need to serve a new opt-out notice within two months of the franchise start. This is separate from any requirements set out in the franchise agreement.

- 3.12 Operators should note that where track access contracts are assigned, novated or transferred, a new opt-out notice would be required if the novation, assignment or transfer is due to a new franchise agreement (including direct awards or integration of franchises).
- 3.13 Transport Scotland is supportive of alliancing as a vehicle for greater industry collaboration, to optimise performance, delivery of franchise obligations and drive down unit costs.
- 3.14 If you require further information on the position of franchising authorities in relation to REBS, then please contact DfT and Transport Scotland directly.

## Impact of material alliance performance on REBS payments

- 3.15 REBS performance includes the efficiency gain (or loss) from any **material alliances** that Network Rail has entered into on a route. Therefore, REBS payments include the financial consequences of any alliance payments, i.e. REBS payments will be calculated after any financial transfers between Network Rail and the alliance partner(s). This means that on operating routes where material alliance agreements are in place, REBS performance (and therefore REBS payments) is impacted by the performance of Network Rail's material alliances.
- 3.16 For example, if Network Rail has financially outperformed a REBS baseline by £10m, excluding alliance payments, but has then paid £1m to the alliance partner, REBS outperformance will be £9m.

Alliance payments example £m 2016-17 prices	Route A	Route B	Route C
REBS performance before material alliance payments	15	(10)	10
Network Rail material receipts	n/a	5	0
Network Rail material alliance payments	n/a	(2)	(1)
<b>REBS performance</b>	<b>15</b>	<b>(7)</b>	<b>9</b>

<sup>21</sup> See clause 3 of Schedule 6.2 in the [InterCity East Coast franchise agreement](#), dated 9 December 2014 as an example.

- 3.17 We expect Network Rail to be transparent about the impact of alliance agreements on its financial performance. We require Network Rail, in its regulatory financial statements, to set out (by operating route) the financial consequences of payments between Network Rail and operators from its material alliances.
- 3.18 Some elements of material alliance payments may relate to areas of income and expenditure that are not included in REBS baselines, e.g. operators' income. However, for simplicity, and to avoid incentives for the alliance to make and book alliance performance to particular areas of income and expenditure, REBS performance will include all elements of alliance payments in relation to a particular REBS route.

# 4. REBS Calculations

## Calculating REBS performance

- 4.1 Every year, after Network Rail has produced its annual regulatory financial statements (normally published in July), we will carry out an assessment of Network Rail's total financial performance for England & Wales and Scotland and at a route level. At the same time, we will also assess Network Rail's performance against the REBS baselines.
- 4.2 In CP5, we plan to issue our annual efficiency and finance assessment in early autumn, following the end of the relevant financial year. However, the speed with which we can finalise our assessment will depend on the quality of information provided in Network Rail's regulatory financial statements.
- 4.3 Our assessment of REBS performance will be based on Network Rail's cumulative financial performance, compared to REBS route baselines, for the control period up to the latest year of each assessment, i.e. our assessment considers REBS performance for the control period to date, rather than just the REBS performance in one year.
- 4.4 The approach to calculating REBS performance each year, for Scotland and each of the nine England & Wales operating routes, will be as follows:
- (a) identify the subset of Network Rail's income and expenditure that is included within REBS;
  - (b) calculate the variance between Network Rail's actual cumulative income and expenditure and the cumulative REBS baselines, for that subset of Network Rail's income and expenditure<sup>22</sup> (Step 1);
  - (c) where appropriate, adjust REBS performance for any deferral or acceleration in Network Rail's renewal programme and significant changes to Network Rail's route cost allocations (Step 2);
  - (d) adjust the renewals element of REBS performance to reflect how Network Rail is incentivised on capital expenditure, i.e. the RAB roll forward policy – this is explained later in this guide (Step 3); and
  - (e) assess whether Network Rail has delivered its regulatory requirements ('required outputs')<sup>23</sup> and where it has not delivered its required outputs, make adjustments to REBS performance in line with our CP5 regulatory accounting guidelines (Step 4).
- 4.5 We have set out below an example of how REBS performance will be calculated. Please note that all numbers in the example below are purely illustrative.

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<sup>22</sup> The variance is calculated net of any "material alliance" payments.

<sup>23</sup> These outputs are set out within Chapter 3 of our PR13 final determination.

## Step 1: Variance analysis

£m 2016-17 prices	Actual 2016-17	REBS baseline	Variance
<b>Cumulative</b>	<b>(A)</b>	<b>(B)</b>	<b>(B-A)</b>
Support costs	84	91	7
RSSB and BTP	18	17	(1)
Network operations	125	108	(17)
Network maintenance	180	248	68
Renewals	200	480	280
Schedule 4 and 8 costs	41	41	0
<b>Total expenditure</b>	<b>648</b>	<b>985</b>	<b>337</b>
Property income	(60)	(50)	10
VUC income	(55)	(61)	(6)
Capacity charge income	(120)	(117)	3
EAUC income	(5)	(5)	0
<b>Total income</b>	<b>(240)</b>	<b>(233)</b>	<b>7</b>
<b>Net total expenditure</b>	<b>408</b>	<b>752</b>	<b>344</b>

**Step 2: Where appropriate, adjust REBS performance for any deferral or acceleration in Network Rail's renewal programme and significant changes to Network Rail's route cost allocations**

£m 2016-17 prices	Variance	Acceleration / (deferral) of work	Outperformance (before RAB roll forward)
Income and expenditure excluding renewals	64	-	64
Renewals	280	(285)	(5)
<b>Total</b>	<b>344</b>	<b>(285)</b>	<b>59</b>

**Step 3: Adjust REBS performance for the impact of the RAB roll forward policy**

£m 2016-17 prices	Outperformance (before RAB roll forward)	Impact of RAB roll forward policy	Outperformance (before adjustments)
Outperformance excluding renewals	64.00	N/A	64.00
Renewals outperformance	(5.00)	75% x (5.00)	(1.25)
<b>Cumulative REBS outperformance (before output adjustments)</b>			<b>62.75</b>

## Step 4: Adjust REBS performance for Network Rail's under-delivery of its required outputs

Adjustments (£m, 2016-17 prices)	Outperformance
REBS performance before output adjustments	62.75
Missed train performance	(2.15)
Missed asset management milestones	(4.60)
Other adjustments (see Annex C)	-
<b>Total cumulative REBS performance to end of 2016-17</b>	<b>56.00</b>

## Calculating REBS payments

- 4.6 Network Rail and operators that have not opted out of REBS are contractually required to make REBS payments within 56 days after the date that we publish REBS payments as part of our annual efficiency and finance assessment of Network Rail. The publication of REBS payments will normally be in the early autumn but was delayed in the first year of CP5.
- 4.7 Network Rail will calculate payments to and from individual operators as follows:
- apply REBS sharing rules (25% of outperformance and 10% of underperformance) to cumulative REBS performance (Step 5);
  - deduct any potential REBS payments (uncapped) from previous years (Step 6);
  - check whether the total calculated potential REBS payment exceeds the value of the REBS upside or downside cap (as relevant) for that route (Step 7). The caps are published in Network Rail's CP5 delivery plan, as adjusted for inflation; and
  - for operators participating in REBS for a full year of CP5, allocate the total potential REBS payments for that route to operators based on their share of total VUC income for the year being assessed for that route (Step 8). For operators participating in REBS for less than a full year of CP5, see para 5.1(r) for the calculation method. Payments are exclusive of any VAT due on them.
- 4.8 We have set out below two examples of the approach that Network Rail will take to calculate payments between itself and operators in each year of CP5. The numbers presented below are purely illustrative.



## Example 1: Outperformance payment from Network Rail to operators

Step 5, 6 and 7: Apply REBS sharing rules to cumulative REBS outperformance, deduct any uncapped potential REBS payments from previous years and check against caps

£m 2016-17 prices	Outperformance
Total cumulative REBS performance to end of 2016-17	56.0
Cumulative REBS performance after applying 25% <sup>24</sup> sharing rule (£56m x 25%)	14.0
Adjust for: uncapped potential REBS payments from prior years	(2.0)
Uncapped potential REBS payments for 2016-17	12.0
Compare to REBS route upside cap	9.8
<b>Resulting total route potential REBS payments (lower of £12.0m and £9.8m)</b>	<b>9.8</b>

Step 8: Allocate total potential REBS payments to operators according to their share of VUC income (for full year participants)

£m 2016-17 prices	Potential REBS payments	Opt-out exercised?	Payments to operators
<b>Total route REBS payments</b>	<b>9.80</b>		<b>6.37</b>
TOC 1 (40% )	3.92	x	3.92
TOC 2 (25% )	2.45	✓	-
TOC 3 (15% )	1.47	x	1.47
FOC 1 (10% )	0.98	✓	-
FOC 2 (10% )	0.98	x	0.98

## Example 2: Underperformance payment from operators to Network Rail

Step 5, 6 and 7: Apply REBS sharing rules to cumulative REBS underperformance, deduct any uncapped potential REBS payments from previous years and check against caps

£m 2016-17 prices	Underperformance
Total cumulative REBS performance to end of 2016-17	20.0
Cumulative REBS performance after applying 10% sharing rule (£20m x 10%)	2.0
Adjust for: uncapped potential REBS payments from prior years	(1.0)
Uncapped potential REBS payments for 2016-17	1.0
Compare to REBS route downside cap	2.0
<b>Resulting total route potential REBS payments (lower of £2.0m and £1.0m)</b>	<b>1.0</b>

<sup>24</sup> For the avoidance of doubt, this adjustment is not the same as the RAB-roll forward adjustment, which has already been taken into account in this example when calculating net REBS outperformance for 2016-17 in Step 3 above, and in calculating the REBS payment caps.

**Step 8: Allocate total potential REBS payments from operators to Network Rail, according to their share of VUC income (for full year participants)**

£m 2016-17 prices	Potential REBS payments	Opt-out exercised?	Payments from operators
TOC 1 (40% )	0.40	x	0.40
TOC 2 (25%)	0.25	✓	-
TOC 3 (15%)	0.15	x	0.15
FOC 1 (10%)	0.10	✓	-
FOC 2 (10%)	0.10	x	0.10
<b>Total route REBS payments</b>	<b>1.00</b>		<b>0.65</b>

## Adjusting REBS performance for under-delivery of required outputs and asset sustainability

- 4.9 In CP5, Network Rail’s total financial performance is adjusted in respect of under-delivery of its required outputs. During CP5, we will apply the same methodology for adjusting REBS performance for under-delivery of outputs as we do for adjusting Network Rail’s total financial performance.
- 4.10 From November 2013 to March 2014, we carried out a joint programme of work with Network Rail to determine a framework for adjusting our assessment of Network Rail’s financial performance in CP5 where Network Rail has not delivered its required outputs.
- 4.11 Following this work, we set out the method for calculating these adjustments (and how they are allocated to routes), as far as possible, in our CP5 regulatory accounting guidelines<sup>25</sup>. We have further clarified some aspects of our approach in Annex C of this guidance, including how we adjust REBS performance in CP5 if Network Rail does not deliver required asset sustainability and outputs.

<sup>25</sup> ORR, [CP5 regulatory accounting guidelines](#)

## 5. Answers to common questions

5.1 In this chapter we have included answers to some of the questions that we have been asked in relation to REBS over the course of PR13 and in subsequent discussions.

### General

- (a) **Question:** *What will happen to the Efficiency Benefit Sharing Mechanism (EBSM) from CP4?*

**Answer:** EBSM will no longer apply for CP5. However, we have retained the provision on the 'Efficiency Benefit Share' within Schedule 7 of passenger and freight track access contracts so that operators are able to receive any EBSM payments in relation to the final year of CP4 as we had not determined whether there was a payment under EBSM for 2013-14 before the start of CP5.

- (b) **Question:** *What types of income and expenditure are included within the high-level category descriptions?*

**Answer:** The following elements of Network Rail's CP5 income and expenditure are included within REBS baselines:

**Support costs:** all support costs (e.g. finance, human resources, information management, insurance and group strategy) in Statement 7a of the regulatory financial statements.

**Industry costs:** RSSB and BTP costs in Statement 7a of the regulatory financial statements.

**Network operations:** all network operations and customer services signalling and non-signalling costs in Statement 7a of the regulatory financial statements.

**Network maintenance:** all network maintenance costs (e.g. including track, structures, signalling, telecoms, electrification, plant and machinery and operational property) in Statement 8a of the regulatory financial statements.

**Renewals:** all renewals costs (e.g. including track, structures, signalling, telecoms, electrification, plant and machinery and operational property) in Statement 9a of the regulatory financial statements, but excluding renewals under the spend-to-save mechanism (information management renewals are spend-to-save schemes).

**Schedule 4 and 8 costs:** all Schedule 4 & 8 costs in Statement 10 of the regulatory financial statements.

**Property income:** includes advertising income, retail income, concessions income, other property income, property sales and developments and property operating costs but excludes telecoms property income and non-periodic review income, in Statement 6b of the regulatory financial statements.

**Variable usage charge income:** all variable usage charge income from passenger and freight operators, including default charge income, in Statement 6b of the regulatory financial statements.

**Capacity charge income:** all capacity charging income in Statement 6b of the regulatory financial statements.

**Electrification asset usage charge income:** all electrification asset usage charge income in Statement 6b of the regulatory financial statements.

## Measuring performance

- (c) **Question:** *What happens if a year of cumulative REBS outperformance is followed by a year of REBS underperformance?*

**Answer:** REBS performance is calculated on a cumulative basis but payments are made on an annual basis. Therefore, depending on the level of underperformance and outperformance in a particular year, one year's outperformance could be offset, fully or partially, by the next year's underperformance. Please see Annex B for examples of how payments are impacted by the cumulative approach to calculating REBS performance.

- (d) **Question:** *How will we make sure that REBS performance is measured correctly?*

**Answer:** Network Rail has a legal duty to provide information to us that is in all material respects accurate, complete and is fairly presented<sup>26</sup>. Its regulatory financial statements, which form the basis of the calculation of REBS performance, are subject to an external audit, with independent reporters reviewing other technical aspects of Network Rail's estimate of its performance. As part of our annual assessment, we review Network Rail's estimate of its REBS performance and we can make changes to the value of REBS performance before we finalise it in each year.

- (e) **Question:** *What happens if Network Rail defers or accelerates significant levels of work? How does this affect the REBS baselines?*

**Answer:** REBS baselines will not be adjusted in these situations. However, when calculating REBS performance, we will adjust financial performance for the level of deferrals and acceleration. By a deferral, we mean that Network Rail has completed less work than is required so the work that has not been done is a deferral. For example, if Network Rail has deferred £100m of renewals expenditure in the control period to date, we will reduce the initial variance by this amount. By acceleration, we mean that Network Rail has brought forward planned work to an earlier point in time. Further details of how we deal with this issue can be found in the CP5 regulatory accounting guidelines.

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<sup>26</sup> Part D of Network Rail's licence states that: "The licence holder shall maintain all systems of control and other governance arrangements that ensure the information collected and reported to ORR is in all material respects accurate, complete and is fairly presented and that all control and other governance arrangements are kept under regular review by the directors of the licence holder so that they remain effective for this purpose."

(f) **Question:** *How is inflation treated within REBS performance?*

**Answer:** Network Rail's REBS baselines (and baselines for total financial performance) will be adjusted each year for inflation, based on the movement in the November to November RPI CHAW index. REBS performance (and total financial performance) will be reported on a real basis, i.e. in the price base for the year in which the assessment takes place. Inflation uplifts will be applied to all figures carried forward from previous years so that performance is presented in a consistent price base. Further details can be found in the CP5 regulatory accounting guidelines and in Schedule 7 of operators' track access contracts.

(g) **Question:** *What happens if Network Rail's financial performance changes dramatically?*

**Answer:** REBS is designed to limit financial risk to both Network Rail and operators. Operators share in a lower percentage of Network Rail's underperformance than outperformance and there are monetary caps that limit REBS payments each year for both Network Rail and operators.

For certain situations, there are mechanisms (re-openers) that can be used to re-open the price control (i.e. our determination) to allow changes to be made to the revenues that Network Rail is allowed to recover, e.g. where material events have happened that are beyond reasonable management control or could not have reasonably been foreseen. In the event of our PR13 determination being re-opened, we would also review the appropriateness of the existing REBS baselines.

## Calculating payments

(h) **Question:** *How have you calculated REBS financial performance?*

**Answer:** The PR13 Final Determination sets out the following elements of Network Rail's income and expenditure to be included in the REBS calculation, reflecting those that operators are considered able to influence: support, operations, maintenance & renewal costs; Network Rail's share of RSSB and BTP costs; schedules 4 & 8 costs; property income; variable usage charge income; capacity charge income and electrification asset usage charge (EAUC) income. The steps in our calculation are:

- we calculate financial performance by comparing the net of these elements to the baseline after adjusting for deferral and acceleration of expenditure;
- to be consistent with the RAB roll forward policy for renewals, only 25% of renewals financial outperformance or underperformance will be reflected in REBS payments;
- the resulting out/under performance will be further adjusted for any non-delivery of Network Rail's required outputs;
- where these elements net to an upside (i.e. financial outperformance), operators will take a 25% share in this outperformance (before the effect of the caps); and

where these elements net to a downside (i.e. financial underperformance), operators will take a 10% share in this underperformance (before the effect of the caps).

REBS financial performance is cumulative, using the uncapped inflation-adjusted financial performance from all years within CP5, subject to payment caps.

- (i) **Question:** *How will adjustments for the non-delivery of outputs be allocated to routes from the national level?*

**Answer:** In Annex C, we summarise the adjustments that we may make for the non-delivery of outputs in CP5 and how these adjustments will be allocated to routes. Further information is also contained in the CP5 regulatory accounting guidelines.

- (j) **Question:** *How have you calculated the caps in relation to REBS payments?*

**Answer:** In addition to the final CP5 REBS baselines, Network Rail has published REBS caps for each year of CP5 in the supporting information to its CP5 delivery plan. Caps are calculated as follows:

The **upside** cap is calculated as the sum of:

- the element of the cap relating to renewals: baseline renewals expenditure x 25% (share of renewals financial outperformance based on RAB roll forward) and the element of the cap relating to other income and expenditure, all multiplied by 25% (share of outperformance) and by 10% (upside cap);

The **downside** cap is calculated as the sum of

- the element of the cap relating to renewals: baseline renewals expenditure x 25% (share of renewals financial outperformance based on RAB roll forward) and the element of the cap relating to other income and expenditure, all multiplied by 10% (share of underperformance) and by 10% (downside cap);

Please note that, as with the calculation of the payments themselves, the cap on REBS payments applies at the total baseline level and not on a line-by-line basis for each element of income and expenditure.

- (k) **Question:** *What is the RAB roll-forward policy and how does this impact on REBS payments?*

**Answer:** The RAB roll forward policy is the process for updating the value of Network Rail's regulatory asset base in each year of the control period, e.g. for inflation, additional efficient capital expenditure, under-delivery of required outputs and amortisation. An explanation of the process can be found in our CP5 regulatory accounting guidelines and in Chapter 12 of our PR13 final determination.

To reflect the 25% RAB roll forward pain/gain sharing mechanism, REBS performance will include 25% of any underspend or generally 25% of an overspend on renewals

expenditure that is eligible for a RAB addition and 100% of any renewals expenditure not eligible for a RAB addition.

(l) **Question:** *When will you declare REBS payments each year?*

**Answer:** For each year of CP5, Network Rail will report its estimate of REBS performance by route in its regulatory financial statements, which are normally published in July. We will then review Network Rail's analysis and set out our own assessment in our annual finance and efficiency assessment, normally published in early autumn. Our annual efficiency and finance assessment will act as the final assessment of REBS performance. Network Rail will calculate individual payments to or from REBS participants based on our assessment.

(m) **Question:** *What happens if I do not agree with the REBS payment that has been calculated?*

**Answer:** There are essentially three stages in calculating REBS payments where operators could challenge the assessment of REBS performance and REBS payments:

- i. Network Rail's estimate of route REBS performance in its regulatory financial statements;
- ii. our own assessment of REBS performance in our annual efficiency and finance assessment; and
- iii. Network Rail's calculation of REBS payments (based on our assessment of REBS performance).

The publication of Network Rail's regulatory financial statements will provide an opportunity for operators to raise any issues they have with us before we finalise our assessment of REBS performance in our annual efficiency and finance assessment. If operators think that there has been an error in Network Rail's calculation of REBS payments, then they should raise any issues with Network Rail in the first instance.

### **Within-control period changes**

(n) **Question:** *What happens if there is a significant change to the structure of the industry?*

**Answer:** Generally, we will not change CP5 REBS baselines or make any adjustments to REBS performance as a result of changes in industry structure, unless they lead us to re-open our PR13 determination. However, if a change in industry structure leads to significant changes to Network Rail's methodology for allocating costs between operating routes, we will consider making adjustments to REBS performance (see next question for further details).

- (o) **Question:** *What is the impact on REBS if Network Rail makes changes to its route boundaries or changes to its approach to allocating costs to routes?*

**Answer:** REBS baselines are fixed at the start of CP5. This means that if Network Rail changes the scope of its operating routes, e.g. if it merges two routes, then it will still have to report against the baselines and operating routes that it set at the start of CP5.

However, where Network Rail makes material changes to the methodology for allocating costs between operating routes, we will consider the impact of these changes and we may make adjustments to REBS performance to reflect these changes, where appropriate. For example, if during CP5, Network Rail decides to allocate more costs to one route and less to another, compared to its CP5 REBS baselines, we may adjust REBS performance in those routes to reflect that some of the underspend or overspend in those routes is not reflective of true outperformance or underperformance.

- (p) **Question:** *Although you have included a summary of potential output adjustments in this guide, do you expect to agree additional adjustments within the control period?*

**Answer:** We consider that the type of adjustments set out in our CP5 regulatory accounting guidelines will cover the majority of the adjustments to total financial performance and to REBS performance that may be needed in CP5. However, over the next five years there may be circumstances where we need to make other adjustments to Network Rail's total financial performance, that are not currently set out in the CP5 regulatory accounting guidelines.

- (q) **Question:** *If a new franchise is awarded during the control period, is that new franchised operator bound by the decision of the previous franchise holder to opt in or opt out of REBS?*

**Answer:** No. A new franchisee will not be bound by the decision of the previous incumbent on REBS. Essentially the opt-out decision resets for a new franchise, i.e. unless the new franchised operator opts out of REBS, it is automatically 'opted-in'. The new franchised operator then has an opportunity to opt out of REBS within two months after the date on which it starts operating the new services. As mentioned above, where a new franchise is awarded to the incumbent franchisee, we also treat this as a new franchise and the operator would need to serve a new opt-out notice if it wishes to opt out of REBS. Otherwise it will be opted in.

Paragraph 1.4 of Part 3 of Schedule 7 to the track access contract sets out the circumstances where an opt-out notice may be served. For the avoidance of doubt, the intention of our policy in this area is that the award of a new franchise means that ***the new operator is automatically opted in unless it opts out.***

- (r) **Question:** *If an operator starts a franchise part-way through a year, and does not opt out of REBS, will that operator be subject to REBS payments for that year?*



**Answer:** Maybe. Operators in REBS for a full year will have their REBS payments for a given route calculated based on their share of VUC charges on that route. For operators starting part-way through the year, the track access contract has a time test for whether a period is or is not included:

Period day	Track access contract expires	Track access contract commences
On or before 14 <sup>th</sup> day	Period not included	Period included
On or after 15 <sup>th</sup> day	Period included	Period not included

If an operator is in REBS for part of a year, its REBS payments are not calculated with reference to only its own VUC charges. The full year's VUC charges for the continuous franchise are divided by 13 periods and then multiplied by the number of periods that the operator is participating, in accordance with the table above and the period dates<sup>27</sup>. As a check, if there are two operators running a franchise, their respective shares should sum to 13 periods. This proportion of the franchise VUC is then used to calculate the REBS payment.

- (s) **Question:** *What happens if an operator is on a default variable usage charge (VUC) rate and this is then changed to a new VUC rate?*

Default VUC rates are set high, so as to incentivise operators to identify their vehicle characteristics fully as quickly as possible when they introduce new rolling stock. When actual vehicle characteristics are submitted to Network Rail for the calculation of a variable usage charge and, after ORR consent, operators move onto an agreed new VUC rate<sup>28</sup>.

A change in VUC rate will have a dual effect because the calculation of REBS performance uses route-level VUC and the payment share calculation uses an individual operator's share of VUC on that route. However, since the change is not likely to be material, VUC rate changes will only be applied prospectively. This is consistent with accounting standards, which generally only allow retrospective restatement if changes are material.

Any adverse effects for an operator changing rate will be probably mitigated by their having a lower share of VUC charges in the calculation of REBS payments. Also an operator's entitlement to a VUC rebate after the operator moves from the default VUC rate to an agreed VUC rate will not change.

<sup>27</sup> There are 13 railway periods in each year, starting on 1<sup>st</sup> April. Period dates are [here](#)

<sup>28</sup> The process for submitting vehicle characteristics is set out in guidance published by Network Rail: [Control Period 5 \(CP5\) Variable Usage Charge \(VUC\) guidance document](#), 20 April 2015, version 1.1

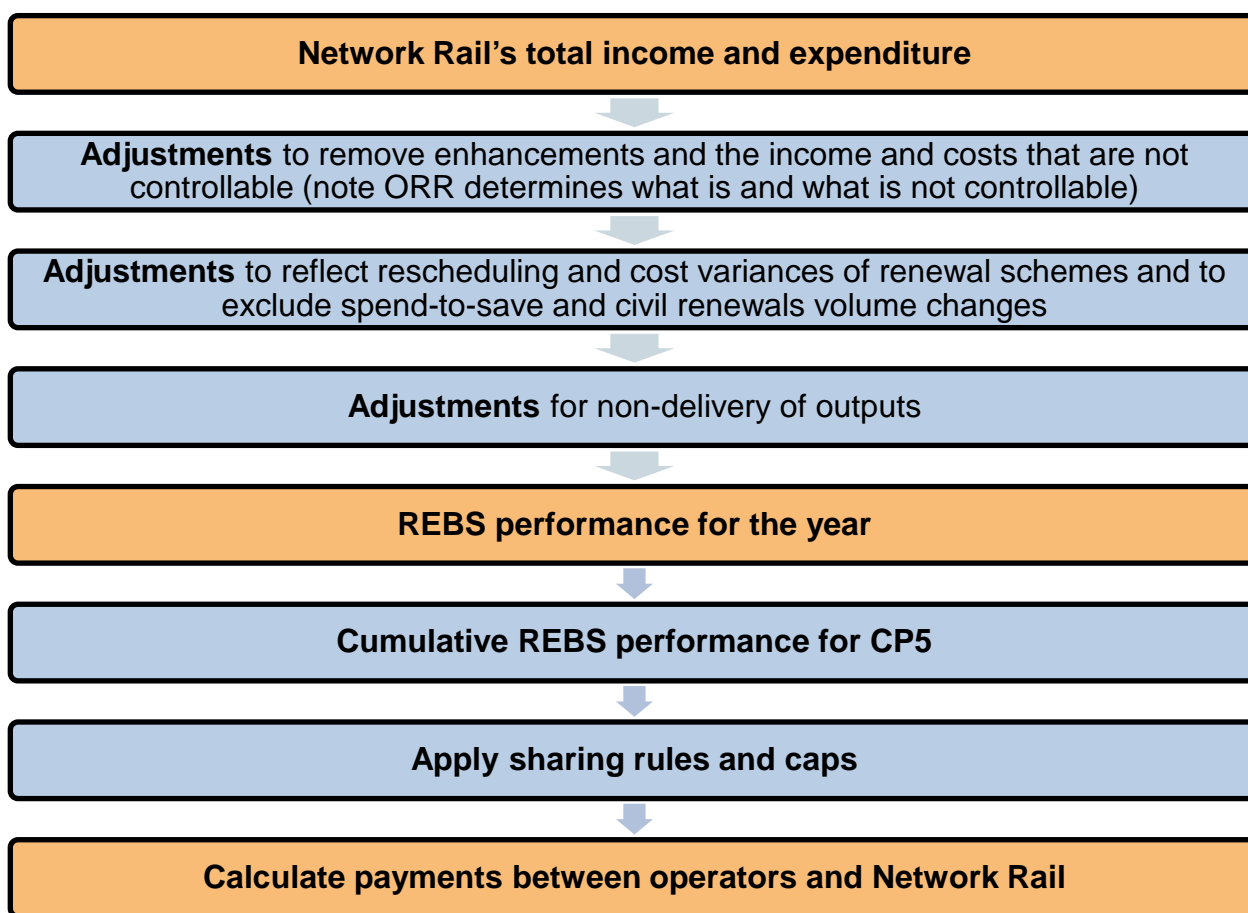
(t) **Question:** *What happens if an operator only incurs a small amount of VUC on a route?*

If an operator has not opted out of a route and has incurred a small amount of VUC on a route (e.g. if on a diversionary route), then it would be for Network Rail to consider setting a *de minimis* amount and to decide whether to waive any rights to the amount.

# Annex A: Approach to assessing Network Rail's total REBS performance

- A.1. Working with Network Rail, we have developed a new measure for reporting financial performance in CP5, which more clearly links Network Rail's reporting to the financial assumptions included in our PR13 determination. This is explained in more detail in our CP5 regulatory accounting guidelines.
- A.2. The approach to calculating REBS performance, is shown below in Figure A.1 and in the CP5 regulatory accounting guidelines.

Figure A.1: Approach to calculating total financial performance in CP5



- A.3. In Table A.1, we show an example of how Network Rail's total financial performance will be calculated in CP5. All numbers are purely indicative. As this is an example of Network Rail's total financial performance, this includes elements of income and expenditure that are not included within REBS baselines.

**Table A.1: Example statement of total financial performance**

£m, 2016-17 prices	Actual	PR13	Variance to PR13	Less:	Variance not included in total financial performance	Variances in volume of work	Other adjustments to PR13	Final Variance	Financial out / (under) performance	Notes
	A	B	C: Favourable/ (Adverse)		D	E	F	G = C - D - E - F	H = G or H = G*25%	
<b>Income</b>										
Grant income	4,900	4,970	-70		-70	-	-	-	-	-
Fixed charges	560	572	-12		-12	-	-	-	-	-
Variable charges	3,500	3,555	-55		-50	-	-	-5	-5	-5
Other single till income	3,000	2,667	333		30	-	-	303	303	303
Opex memorandum account	30	-	30		-	-	-	30	30	30
<b>Total income</b>	<b>11,990</b>	<b>11,764</b>	<b>226</b>		<b>-102</b>	<b>-</b>	<b>-</b>	<b>328</b>	<b>328</b>	
<b>Expenditure</b>										
Network operations	1,200	1,232	32		-	-	-	32	32	32
Support costs	1,300	1,330	30		-	-	-	30	30	30
Industry costs and rates	263	274	11		10	-	-	1	1	1
Reporter's fees	30	17	-13		-	-	-	-13	-3	=[G]*25%
Network maintenance	3,030	3,198	168		-	-	30	138	138	138
Traction electricity	155	100	-55		-50	-	-	-5	-5	-5
Schedule 4 costs	650	611	-39		-	10	-	-49	-49	-49
Schedule 8 costs	50	40	-10		-	-	-	-10	-10	-10
Renewals	6,000	7,560	1,560		-	780	-	780	195	=[G]*25%
PR13 Enhancements	7,500	8,448	948		50	50	150	698	175	=[G]*25%
Non PR13 Enhancements	102	-	-102		-102	-	-	-	-	-
Financing Costs	1,200	1,215	15		15	-	-	-	-	-
Financial penalties	10	0	-10		-	-	-	-10	-10	-10
Corporation Tax	50	0	-50		-	-	-	-50	-50	-50
<b>Total expenditure</b>	<b>21,540</b>	<b>24,025</b>	<b>2,485</b>		<b>-77</b>	<b>840</b>	<b>180</b>	<b>1,542</b>	<b>504</b>	
<b>Total</b>	<b>-9,550</b>	<b>-12,261</b>	<b>2,711</b>		<b>-179</b>	<b>840</b>	<b>180</b>	<b>1,870</b>	<b>832</b>	
<b>Total financial out / (under) performance before adjusting for under-delivery of outputs and adjustments for other matters</b>									<b>832</b>	
<i>Less adjustments for under-delivery of outputs and reduced sustainability</i>										
Under-delivery of train performance requirements									-50	
Missed enhancement milestones									-60	
Asset management sustainability									-70	
<b>Total adjustment for missed outputs</b>									<b>-180</b>	
<i>Less adjustments for other matters</i>										
Inadequate explanation to support financial outperformance									-50	
<b>Total other adjustments</b>									<b>-50</b>	
<b>Total financial out / (under) performance to be recognised</b>									<b>602</b>	

## Annex B: Impact of cumulative approach to measuring REBS performance

- B.1 In this annex, we provide four indicative examples of total REBS payments over CP5 under the following scenarios:
- (a) hitting CP5 baselines over CP5 in total: underperformance in the first half of the control period followed by outperformance in the second half of the control period;
  - (b) hitting CP5 baselines over CP5 in total: outperformance in the first half of the control period followed by underperformance in the second half of the control period;
  - (c) outperformance over CP5: underperformance at the beginning of the control period more than offset by outperformance towards the end of the control period; and
  - (d) underperformance over CP5: outperformance at the beginning of the control period more than offset by underperformance towards the end of the control period.
- B.2 In the examples below, we have not allocated REBS payments to individual operators and instead show only total annual payments relating to the indicative route. For simplicity we have not assumed any output adjustments or deferral of expenditure over CP5.
- B.3 These four examples help to illustrate the impact of the cumulative assessment of REBS performance on REBS payments, i.e. our assessment considers Network Rail's performance for the control period up to and including the year we are assessing, rather than just considering Network Rail's in-year performance. For a brief example, see Table B.1.

**Table B.1: Cumulative and annual REBS payments**

£m 2012-13 prices	2014-15	2015-16	2016-17	2017-18	2018-19	CP5 total
Cumulative REBS payments	(5)	5	3	(4)	2	2
Annual REBS payments	(5)	10	(2)	(7)	6	n/a

- B.4 In the notes to Table B.2, we explain the calculation of the cumulative variance and also the calculation of annual potential REBS payments. Also, in the notes to Table B.3, we explain the impact of the caps on annual potential REBS payments.
- B.5 Please note that in the tables below, a negative REBS payment value is a payment from operators to Network Rail and a positive payment value is a payment from Network Rail to operators.

**Table B.2: REBS payments under Scenario (a)**

£m 2012-13 prices	2014-15	2015-16	2016-17	2017-18	2018-19	CP5 total
Cumulative baseline	323.0	668.0	1,043.0	1,370.0	1,628.0	1,628.0
Cumulative actuals	348.0	718.0	1,093.0	1,395.0	1,628.0	1,628.0
Cumulative variance	(25.0)	(50.0)	(50.0)	(25.0)	-	-
Cumulative variance (including renewals adjustment for RAB roll forward)	(17.7) <sup>1</sup>	(35.8)	(35.8)	(18.2)	-	-
Cumulative potential payments	(1.8) <sup>2</sup>	(3.6)	(3.6)	(1.8)	(0.0)	-
Annual potential payments (uncapped)	(1.8)	(1.8)	-	1.8 <sup>3</sup>	1.8	-
<i>Upside cap</i>	4.7	4.7	4.8	4.2	3.4	21.7
<i>Downside cap</i>	(1.9)	(1.9)	(1.9)	(1.7)	(1.4)	(8.7)
<b>Annual potential payments (capped)</b>	<b>(1.8)</b>	<b>(1.8)</b>	<b>-</b>	<b>1.8</b>	<b>1.8</b>	<b>-</b>

**Notes:**

- <sup>1</sup> As an example of how this would work, the cumulative variance (including renewals adjustment for RAB roll forward) of -£17.7m for 2014-15 is calculated as follows: £2.3m variance in relation to renewals expenditure (this is 25% of the £9.1m renewals expenditure variance) + £15.5m variance on other income and expenditure.
- <sup>2</sup> The cumulative potential payment of £1.8m is calculated as follows: the cumulative variance (including renewals adjustment for RAB roll forward) at the end of 2014-15 of £17.7m, multiplied by the sharing factor of 10%, i.e. £17.7 x 10% = £1.8m.
- <sup>3</sup> The annual (uncapped) payment of £1.8m is calculated as follows: cumulative potential payments at end of 2017-18 (£1.8m) less cumulative potential payments at end of 2016-17 (-£3.6m), i.e. -£1.8m - -£3.6m = £1.8m.

**Table B.3: REBS payments under Scenario (b)**

<b>£m 2012-13 prices</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>CP5 total</b>
Cumulative baseline	323.0	668.0	1,043.0	1,370.0	1,628.0	1,628.0
Cumulative actuals	298.0	618.0	993.0	1,345.0	1,628.0	1,628.0
Cumulative variance	25.0	50.0	50.0	25.0	-	-
Cumulative variance (including renewals adjustment for RAB roll forward)	17.7	35.8	35.8	18.2	-	-
Cumulative potential payments	4.4	8.9	8.9	4.5	-	-
Annual potential payments (uncapped)	4.4	4.5	-	(4.4)	(4.5)	-
<i>Upside cap</i>	4.7	4.7	4.8	4.2	3.4	21.7
<i>Downside cap</i>	(1.9)	(1.9)	(1.9)	(1.7)	(1.4)	(8.7)
<b>Annual potential payments (capped)</b>	<b>4.4</b>	<b>4.5</b>	<b>-</b>	<b>(1.7)<sup>1</sup></b>	<b>(1.4)</b>	<b>5.9</b>

**Notes:** <sup>1</sup> In 2017-18, the annual potential payment (capped) of -£1.7m is calculated as the lower of the downside cap for that year (-£1.7m) and the annual potential payment (uncapped) in the same year (-£4.4m).

**Table B.4: REBS payments under Scenario (c)**

<b>£m 2012-13 prices</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>CP5 total</b>
Cumulative baseline	323.0	668.0	1,043.0	1,370.0	1,628.0	1,628.0
Cumulative actuals	338.0	698.0	1,073.0	1,364.0	1,600.0	1,600.0
Cumulative variance	(15.0)	(30.0)	(30.0)	6.0	28.0	28.0
Cumulative variance (including renewals adjustment for RAB roll forward)	(10.6)	(21.5)	(21.5)	3.1	19.5	19.5
Cumulative potential payments	(1.1)	(2.1)	(2.1)	0.8	4.9	4.9
Annual potential payments (uncapped)	(1.1)	(1.1)	-	2.9	4.1	4.9
<i>Upside cap</i>	4.7	4.7	4.8	4.2	3.4	21.7
<i>Downside cap</i>	(1.9)	(1.9)	(1.9)	(1.7)	(1.4)	(8.7)
<b>Annual potential payments (capped)</b>	<b>(1.1)</b>	<b>(1.1)</b>	<b>-</b>	<b>2.9</b>	<b>3.4</b>	<b>4.2</b>

**Table B.5: REBS payments under Scenario (d)**

<b>£m 2012-13 prices</b>	<b>2014-15</b>	<b>2015-16</b>	<b>2016-17</b>	<b>2017-18</b>	<b>2018-19</b>	<b>CP5 total</b>
Cumulative baseline	323.0	668.0	1,043.0	1,370.0	1,628.0	1,628.0
Cumulative actuals	298.0	628.0	1,003.0	1,366.0	1,646.0	1,646.0
Cumulative variance	25.0	40.0	40.0	4.0	(18.0)	(18.0)
Cumulative variance (including renewals adjustment for RAB roll forward)	17.7	28.6	28.6	4.0	(12.4)	(12.4)
Cumulative potential payments	4.4	7.1	7.1	1.0	(1.2)	(1.2)
Annual potential payments (uncapped)	4.4	2.7	-	(6.1)	(2.2)	(1.2)
<i>Upside cap</i>	4.7	4.7	4.8	4.2	3.4	21.7
<i>Downside cap</i>	(1.9)	(1.9)	(1.9)	(1.7)	(1.4)	(8.7)
<b>Annual potential payments (capped)</b>	<b>4.4</b>	<b>2.7</b>	<b>-</b>	<b>(1.7)</b>	<b>(1.4)</b>	<b>4.1</b>



# Annex C: Adjusting Network Rail’s financial performance for under-delivery of outputs and asset sustainability

- C.1 Table C.1 is a high level summary of the adjustments to total financial performance in CP5 if Network Rail under delivers against its required outputs. Adjustments to REBS performance will be consistent with adjustments to total financial performance.
- C.2 Further details on the approach to adjusting Network Rail’s performance are set out in the CP5 regulatory accounting guidelines<sup>29</sup>.

**Table C.1: High level summary of the adjustments to total financial performance and REBS performance**

Regulated output/ licence condition	Approach
Sustainability	<p>Where sustainable delivery has not been achieved, financial performance will be adjusted based on the cost of work not done.</p> <p><b>Route-level adjustments:</b> Sustainability applies at asset group level and at route level. Therefore, any adjustments to route performance will reflect the route-specific assessment of sustainability for each asset group.</p>
Asset management	<p><i>Asset Management Excellence Model (AMEM):</i> A total monetary value is assigned to the six AMEM categories on the basis of the improvement from Network Rail’s CP4 exit positions (PR13 strategic business plan (SBP)) to their positions at the time that the PR18 SBP is submitted. The maximum adjustment is £20m if there is no improvement between CP4 exit and PR18 SBP.</p> <p><i>Data Quality:</i> A total monetary value is assigned to the improvement from Network Rail’s PR13 data quality grades (based on the Arup assessment in May 2013, as updated for missing scores) to its position at 31 March 2017. The maximum adjustment is £20m if there is no improvement between CP4 exit and PR18 SBP.</p> <p><i>ORBIS:</i> Given the importance of this programme, for each of its nine milestones, where a milestone is not achieved an adjustment of one ninth of the programme value in current prices will be made to financial performance. Each missed milestone has an impact of 1/9 of the total programme value in CP5.</p> <p><b>Route-level adjustments:</b> Adjustments for AMEM, data quality and ORBIS will be made in proportion to the relative size of each route. The total Great Britain adjustment would be divided between operating routes using the proportion of train miles attributable to that route.</p>

<sup>29</sup> ORR, [CP5 regulatory accounting guidelines](#)

Regulated output/ licence condition	Approach
Train performance	<p>We will adjust financial performance for the under-delivery of the national outputs for train performance. Adjustments will be based on the value of lost time to passengers or freight users.</p> <p>Adjustments will be made separately for each output: Public Performance Measure (PPM), Cancellations and Significant Lateness (CaSL) and the Freight Delivery Metric (FDM).</p> <ul style="list-style-type: none"> <li>• PPM (England and Wales) - £30m per 1% shortfall</li> <li>• PPM (Scotland) - £2.5m per 1% shortfall</li> <li>• CaSL (England and Wales) - £30m per 1% shortfall</li> <li>• FDM - £1m per 1% shortfall</li> </ul> <p>Passenger operators' performance is assessed relative to the PPM and CaSL assumptions in the CP5 delivery plan. The national adjustment for financial underperformance (as above) is then shared only among underperforming operators, based on their contribution to the national level of underperformance.</p> <p>This will be calculated by multiplying the financial underperformance of that operator (relative to the delivery plan) by the proportion of trains that have run in the year concerned by that operator relative to the total number of non-charter passenger trains that have run.</p> <p>There is no "financial benefit" for outperformance and therefore outperforming operators and routes are eliminated from the allocation of adjustments.</p> <p>Performance plan targets for PPM and CaSL are set to 1 decimal place, in accordance with the statistics Memorandum of Understanding between ORR and Network Rail. We assume that all other decimal places are zero. Calculations of actual performance against those targets are to 2 decimal places only, to give sufficient precision to calculations without being affected by very minor revisions to train punctuality figures in subsequent periods.</p> <p><b>Route-level adjustments:</b> The operator-level underperformance will be allocated to routes based on that operator's net Schedule 8 payments by route, on an accruals basis. Operator-level net payments by route will then be summed to give an overall route performance. Where a route is found to be financially outperforming, that route's performance will be set to nil. The remaining (underperforming) routes will share the total underperformance in proportion to that route's share, such that the total route-level underperformance adjustment matches the national adjustments for underperformance,</p> <p>Any adjustment in respect of freight performance will use the Freight Delivery Metric and a similar approach (Schedule 8 for freight). See the example below.</p>

Regulated output/ licence condition	Approach
Network Availability	<p>Our PR13 determination gave CP5 exit targets for the Passenger Disruption Indices for Passengers and Freight (PDI-P and PDI-F). We are using a value-based approach to adjusting financial performance for under-delivery of the PR13 network availability requirements. The adjustments are £15m per 0.1 shortfall for PDI-P and £1m per 0.1 shortfall for PDI-F.</p> <p><b>Route-level adjustments:</b> Network Rail is making changes to the way it produces and reports PDI-P and PDI-F that will enable it to report values by operating route by the end of CP5. Network Rail will therefore be able to make a direct comparison to the target without the need for allocation assumptions.</p>
Network Capability	We do not propose to make any adjustment in addition to the existing compensation arrangements for network capability. However, if there is a material reduction in Network capability this could be revisited.

### Example: PPM under-delivery output adjustment

**Table C.1: PPM variances against PR13 (national) and DP14 (TOC)**

PPM %	PR13	DP14	Actual	Variance
England & Wales	92.0		91.0	(1.0)
TOC A		92.0	90.0	(2.0)
TOC B		92.0	88.0	(4.0)
TOC C		92.0	91.0	(1.0)
TOC D		92.0	89.0	(3.0)
TOC E		92.0	95.0	3.0

Overview: This table calculates the variance of actual PPM at national level for England & Wales against the determination. It also calculates the variance for individual TOCs between their actual performance and their DP14 targets.

Negative variances are adverse.

With an output adjustment of £30m per 1% missed PPM target, the total adjustment for E&W is £30m.

**Table C.2: Allocation of underperformance adjustment to underperforming TOCs**

	Trains run	Share of trains run (%)	Variance (from above)	Weighting	Allocation of adjustment (£m)
TOC A	100	9.1	2.0	0.18	(3.5)
TOC B	200	18.2	4.0	0.73	(14.1)
TOC C	100	9.1	1.0	0.09	(1.8)
TOC D	200	18.2	3.0	0.55	(10.6)
TOC E	500	45.5	outperformed	-	-
<b>Total</b>	<b>1,100</b>	<b>100.0</b>		<b>1.55</b>	<b>(30.0)</b>

Overview: This £30m is allocated to underperforming operators based on their share of trains run because PPM is a measure of the proportion of trains that have run on time.

There is no allocation to TOCs that have outperformed their PPM target.

The weighting is the share of trains run by that TOC multiplied by the variance from the TOC's delivery plan target.

The £30m adjustment is then allocated in proportion to the weightings.

**Table C.3: Schedule 8 payments by TOC and route**

Net Schedule 8 receipts / (payments) by Network Rail (£m)	Route 1	Route 2	Route 3	Route 4	Total
TOC A	0	30	0	(40)	(10)
TOC B	0	0	0	(20)	(20)
TOC C	(10)	0	(20)	0	(30)
TOC D	(1)	(1)	(1)	(1)	(4)
TOC E	(2)	-	10	-	8
<b>Total</b>	<b>(13)</b>	<b>29</b>	<b>(11)</b>	<b>(61)</b>	<b>(56)</b>

Overview: Network Rail's schedule 8 receipts and (payments) are summed by route for each TOC.

No allocation of the £30m adjustment is made at this stage.

"Outperforming" TOCs are not removed at this stage.

**Table C.4: Apportionment of underperformance adjustments to underperforming routes**

<b>Output adjustment (£m)</b>	<b>Route 1</b>	<b>Route 2</b>	<b>Route 3</b>	<b>Route 4</b>	<b>Total</b>
TOC A	0	10.59	0	(14.12)	(3.53)
TOC B	0	0	0	(14.12)	(14.12)
TOC C	(0.59)	0	(1.18)	0	(1.77)
TOC D	(2.65)	(2.65)	(2.65)	(2.65)	(10.60)
TOC E <i>outperformed</i>	-	-	-	-	-
<b>Initial apportionment</b>	<b>(3.24)</b>	<b>7.94</b>	<b>(3.82)</b>	<b>(30.88)</b>	<b>(30.00)</b>
<b>Remove outperforming routes</b>	<b>(3.24)</b>	<i>outperformed</i>	<b>(3.82)</b>	<b>(30.88)</b>	<b>(37.94)</b>
<b>Re-apportion to balance</b>	<b>(2.56)</b>	-	<b>(3.02)</b>	<b>(24.42)</b>	<b>(30.00)</b>

Overview: The £30m in total PPM output adjustments (from Table C.2) are then initially apportioned to routes based on net Schedule 8 payments by TOC (from Table C.3).

In this example, Route 2 has outperformed.

Based on the apportionment, outperforming routes are then removed, resulting in the total adjustment being too high (£37.94m). The adjustment is then re-apportioned among the underperforming routes to give a total of £30m, e.g. for route 1  $(3.24) \times (30.00) / (37.94) = (2.56)$ .

The effect of this is that all the underperforming routes have smaller levels of underperformance than after the initial apportionment.



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