



OFFICE OF RAIL AND ROAD

PR18: Schedule 4 - Initial thinking on negotiated compensation arrangements for planned disruption

December 2016

This document has been published alongside [‘Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives’](#).

Policy	Incentives - Schedule 4
Policy area	Schedule 4 - Negotiated compensation arrangements
Background	<p>In return for the payment of an access charge supplement (ACS), franchised passenger operators receive formulaic cost and revenue compensation (based on liquidated sums) for all possessions, but with different compensation available depending on the level and impact of disruption. The Schedule 4 passenger regime operates a tiered structure of possessions defined by the following possession types:</p> <ul style="list-style-type: none">a) type 3 possessions: single possession greater than 120 hours (including public holidays), receive formulaic compensation as default but with the possibility of actual revenue losses and costs (subject to a materiality threshold);b) type 2 possessions: single possession greater than 60 hours, but equal to or less than 120 hours, (excluding public holidays), receive formulaic compensation as default but with the possibility of actual costs (subject to a materiality threshold and in respect of categories of direct costs only);c) type 1 possessions: All other possessions receiving formulaic revenue and cost compensation (subject to the payment of ACS). <p>The sustained planned disruption (SPD) mechanism is designed to protect train operators from instances where there is disruption caused by possessions over a sustained period. Additional compensation for SPD is triggered when the impact of disruption crosses a pre-defined threshold (in terms of revenue lost or increased costs) under which train operators may claim additional revenue / cost compensation above that covered by the liquidated sums payable under Schedule 4.</p> <p>The freight Schedule 4 regime is structured so that there are three levels of compensation depending on the degree of disruption (with</p>

the possibility of compensation for actual losses for severe disruption). Examples of the different categories of possession (referred to in the freight regime as variations to service) are given below.¹ Higher payments are made for late notice possessions.

- a) Category 3 possessions include situations where access to a destination is blocked meaning freight needs to be conveyed by another means.
- b) Category 2 possessions include those resulting in cancellations of affected services.
- c) Category 1 possessions include those resulting in increased journey length or a significant change in arrival/departure time.

Which of the PR18 outcomes does this charge/incentive deliver against?

Outcome: The network is available.

Description of outcome:

Taking effective decisions around possessions, mitigating the overall impact on end users

The impact of delay on operators, passengers and freight customers is minimised

Problem under consideration with the current charge/incentive

Respondents to our November stakeholder letter raised two issues with the current regime:

- 1) The appropriateness of the current SPD thresholds (we have also noted an error in the contractual wording that we are proposing to correct); and
- 2) That the current process for claiming bespoke compensation (for type 2 or 3 possessions or SPD for passenger operators, or for category 3 for freight operators) is costly, time-consuming and difficult to resolve.

¹ A full definition of the different categories can be found in the model freight contract http://orr.gov.uk/_data/assets/pdf_file/0007/2959/model-freight-contract-august-2016.pdf

What is the scale of the issue & who is impacted?

There have been no SPD claims so far in CP5. This appears, at least in part, to be due to the defined thresholds for revenue losses, which appear to be internally inconsistent (with the absolute – not relative – revenue loss threshold over three billing periods being higher than that for seven periods). It is important that the SPD regime is fit for purpose and that in the event an operator faces substantial revenue loss and / or costs due to a period of SPD it is able to recover these.

In addition, both passenger and freight operators have explained that the process for negotiating compensation is lengthy and time-consuming.

The main impacted parties are:

- Parties negotiating bespoke compensation, who may spend longer than needed if the processes do not work well;
- Train operating companies (TOCs) who may not receive appropriate compensation for type 2 and 3 possessions or SPD;
- Freight operating companies (FOCs) who may not receive appropriate compensation for significant disruption; and
- Network Rail who may not have sufficient incentives to reduce the incidence of sustained planned disruption.

Options to be considered

Option 0: Do nothing	<ul style="list-style-type: none">• Revenue thresholds would be updated in line with changes to service group revenues as part of the Schedule 8 recalibration.• Cost thresholds would be updated in line with inflation.• All other contractual wording would remain as is.
Option 1: Changes to SPD revenue thresholds	Amend the wording (proposed changes marked in red and underlined) such that either party may trigger SPD when an operator's formulaic Schedule 4 revenue loss compensation is either: a. Greater than 20% of <u>3/13 of</u> defined service group revenue over 3 consecutive periods; or b. Greater than 15% of <u>7/13 of</u> defined service group revenue over 7 consecutive periods.
Option 2: Review some or all of the thresholds for triggering bespoke compensation	<ul style="list-style-type: none">• Review, and if appropriate amend, the thresholds to ensure they accurately reflect the revenue / cost implications for operators.
Option 3: Review of contractual wording	<ul style="list-style-type: none">• Review the contractual wording and process with a view to making the process less cumbersome and protracted.

Assessment of options

Assessment of option 1: Change to SPD revenue threshold	<ul style="list-style-type: none">• The current wording relating to SPD is such that if the first criteria (a) is satisfied the second criteria (b) is always satisfied. This was not the intention of the original drafting.• It is important that this inconsistency is addressed to ensure the regime works as
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	intended. The change should not prevent any of the other options being taken forward.
Assessment of option 2: Review some or all of the thresholds for triggering bespoke compensation	<ul style="list-style-type: none"> • This should help ensure the benefits to operators of the liquidated damages regime (of reducing administrative burden) are balanced with that of negotiated arrangements (of delivering more accurate compensation). • This should improve the accuracy of the incentive on Network Rail with respect to particularly long / large possessions. • Could have funding implications and increase the ACS charge.
Assessment of option 3: Review of contractual wording	<ul style="list-style-type: none"> • This should help to make the process of claiming simpler and more transparent. • Note: it is important that any improvements to Schedule 4 in this area can be applied, if relevant, to Schedule 8 (notably SPP compensation) and we will consider the contractual wording of both in parallel.
Recommendation	<ul style="list-style-type: none"> • We are proposing to progress all options (although option 1 is the priority) as set out above (as they are complementary).
Next Steps <ul style="list-style-type: none"> • We will work with industry to review the existing SPD thresholds to determine whether they are too high (on the basis that these thresholds should capture the most disruptive possessions, i.e. approx. 1% of all possessions). We also welcome feedback on the proposed correction to the contractual wording. • If the evidence confirms that the thresholds are too high then we will consult on specific adjustments to the levels in the latter half of 2017. • We will also continue to work with industry to understand what improvements it might be possible to make to the process for making bespoke claims. This will be done alongside our work on Schedule 8 to try and ensure consistency across the schemes. 	



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