



PR18: Schedule 4 - Initial thinking on incentives created by notification discount factors (NDFs)

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 – notification discount factors
Background	<p>Network Rail is incentivised to plan possessions early as it gets a discount on Schedule 4 revenue compensation it pays to franchised passenger operators for early notification of restriction of use. The amount of discount for passenger Schedule 4 revenue compensation is determined by notification discount factors (NDFs), which reflect the reduced impact on operators’ revenues when passengers receive early notice of service disruption. This is because passengers are considered to be less affected by disruption when they know about it in advance.</p> <p>The NDFs are based on assumed levels of passenger awareness of planned disruption prior to travelling. In particular, for the proportion that is unaware of the disruption prior to travel, the compensation is equivalent to that for unplanned disruption under Schedule 8. However, for the proportion that is aware of disruption, the compensation is calculated on the assumption that additional journey time and / or inconvenience is broadly equivalent to a planned part of their journey.</p> <p>The NDFs vary according to three levels of notice known as notification discount thresholds. These reflect different levels of passenger awareness associated with the length of notice given.</p> <p>The value of NDFs also differs according to passenger market segments, which are each assigned a ‘delay multiplier’. These</p>

variations occur because some market segments (for example passengers destined for airports) are assumed to be more inconvenienced by unplanned disruption than others. The table below summarises NDFs applied at each notification threshold and delay multiplier. The NDFs are applied to the equivalent Schedule 8 rate (i.e. the marginal revenue effect (MRE), which represents the impact of a minute's lateness on fare revenue over time).

In the table below, NDFs are expressed as percentages of MRE payable. This means if a particular NDF is, for example, 60% , Network Rail pays 40% of MRE.

Passenger Schedule 4 CP5 notification discount factors and thresholds by late time multiplier

Average late time multiplier	By New Working Timetable ¹	By 22 Weeks Before Possession ²	By Applicable Timetable ³
4.3 or higher	40% of MRE payable	63% of MRE payable	85% of MRE payable
3.4 to 4.2	45% of MRE payable	65% of MRE payable	85% of MRE payable
2.8 to 3.3	50% of MRE payable	68% of MRE payable	85% of MRE payable
2.7 or less	55% of MRE payable	70% of MRE payable	85% of MRE payable

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

¹ The version of the timetable issued 26 weeks before it comes into operation. It broadly reflects the earliest operators are able to inform passengers of planned disruption.

² Notification by this point allows the possession to be reflected in the informed traveller timetable.

³ The timetable for any day as issued at 10pm the previous night.

Problem under consideration with the current charge/incentive

Responses to our November 2015 stakeholder letter (“the November 2015 letter”) about the effectiveness of Schedule 4 suggested the incentives created by NDFs as part of the Schedule 4 regime could be improved. Stakeholders expressed concerns that NDFs may no longer reflect the current levels of passenger awareness and therefore may not incentivise good possession planning. For example, some argued that the current structure incentivises Network Rail to book planned possessions too far in advance in order to benefit from the discount. This then leads to some of these possessions being cancelled or changed later in the process.

As part of its review of charges, RDG has also highlighted a strong case for reforming NDFs, which we last updated in PR08. In addition, we think there is value in reviewing NDFs as a result of possible changes in passenger awareness levels due to changes in two key areas:

- How and when passengers source travel information, notably through increasing use of the internet (including via smart phones); and
- The significant increase in the use of advance-purchase and dedicated tickets. For example, there has been a significant growth in the sale of advance purchase tickets, from 7.3% in 2003/04 to 17.7% in 2012/13⁴.

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

The scale of the issue depends on the extent to which passenger awareness about planned disruption and how passengers plan and book their rail journeys have changed since we last updated NDFs. As mentioned above, we have reasons to believe that passenger behaviour has changed since NDFs were last reviewed in PR08. Based on stakeholder feedback, we think there is significant scope to improve the incentive properties of NDFs and associated notification thresholds to better reflect the impact of planned disruption on passengers. This could also support improvement in Network Rail’s possession planning practices leading to potentially lower levels of booked and subsequently cancelled possessions.

Options to be considered

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|-------------------------|---|
| Option 0: Do nothing | • Maintaining the CP5 levels of NDFs and notification thresholds. |
| Option 1: Reformed NDFs | • Review NDFs and notification thresholds to determine whether they remain appropriate. |

Assessment of options

⁴ ORR, 2014, *Retail Market Review Consultation*.

<p>Assessment of option 1 (Reformed NDFs)</p>	<p>If new evidence shows the current NDFs and associated thresholds are inaccurate, updating them would have the following benefits:</p> <ul style="list-style-type: none"> • It would incentivise Network Rail to plan possessions more efficiently (e.g. fewer possessions booked too early prior to proper planning and then subsequently cancelled, with associated benefits to operators through less lost revenue); • If passenger awareness has increased since PR08, this could increase the current levels of NDFs to reflect lower impact on revenue loss being paid (i.e. Network Rail would get a higher discount on Schedule 4 compensation it pays to franchised passenger operators); • If this is the case (i.e. higher NDFs), this could reduce an access charge supplement (ACS). Franchised passenger operators pay ACS in return for a full Schedule 4 compensation. The charge is set to reflect the amount Network Rail is expected to pay out in Schedule 4 compensation; and • As franchised passenger operators are protected by funders from changes in ACS during the duration of their franchise, a lower ACS would deliver better value for money for taxpayers. <p>Updating NDFs and associated thresholds could have the following costs:</p> <ul style="list-style-type: none"> • Some transitional costs to Network Rail and operators to update any relevant possession planning processes; and • There may be some costs to franchise authorities to update their in-franchise models as a result of changes to NDFs.
<p>Recommendation</p>	<ul style="list-style-type: none"> • We plan to carry out research into passengers' awareness of planned disruption and if appropriate update NDFs and notification thresholds.
<p>Next Steps</p>	<p>We are commissioning a market research study into passenger awareness levels to inform our review of NDFs:</p> <ul style="list-style-type: none"> • The aim of this research is to update our understanding of passenger awareness of planned service disruption including how and when passengers become aware of possessions; and to derive robust estimates of passenger awareness levels of planned disruption; • We will also seek industry's views of the strengths and weakness of the current possession planning processes to inform how changes to the NDFs and thresholds might impact on Network Rail's and operators' existing possession

planning processes;

- We will use our market research and stakeholder evidence to inform our review of NDFs and notification thresholds; and
- We will consult on a fully developed option(s)/specific proposals on NDFs in 2017.



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