



# PR18: Schedule 8 – Final impact assessment on effectiveness of the Sustained Poor Performance (SPP) regime

June 2017

This impact assessment supports conclusions following our December 2016 consultation ['Improving incentives on Network Rail and train operators: A consultation on changes to charges and contractual incentives'](#) (henceforth referred to as the 'consultation'). The assessment of the options contained within this document has been updated to reflect points raised in response to the consultation.

Policy	Incentives Schedule 8
<b>Policy area</b>	Schedule 8 – Sustained Poor Performance (SPP)
<b>Background</b>	<p>The SPP mechanism under Schedule 8 is designed to provide protection to passenger operators if Network Rail's performance falls to such a level that the payments they receive under the liquidated damages element of Schedule 8 are materially less than the actual financial impact of poor performance.</p> <p>The rationale for this mechanism is that it is generally considered that operators' costs of delay rise more rapidly when the level of disruption to their services exceeds a certain threshold. The standard Schedule 8 payment rates do not account for this as they assume that the financial impact of delay rises at a constant rate.</p>
<b>Which of the PR18 outcomes does this charge/incentive deliver against?</b>	<p>Outcome: The network is reliable</p> <p>Description of outcome:</p> <ul style="list-style-type: none"> <li>• Network Rail delivers the optimal level of reliability for every service</li> <li>• The impact of delay on operators, passengers and freight customers is minimised</li> </ul>

### **Problem under consideration with the current charge/incentive**

In response to our November 2015 stakeholder letter, several operators expressed concerns that the current process for making SPP claims is costly, time-consuming and difficult to resolve. In particular, operators stressed the difficulty of proving revenue losses in SPP claims. Revenue losses are uncertain and hard to estimate, making them subject to dispute. In contrast, it was generally agreed that costs were easier to establish and consequently far less subject to dispute. It seems likely that the uncertainty and consequent dispute will persist in any SPP regime that includes revenue losses.

The cost of making claims may be dis-incentivising operators from doing so. This would limit both the effectiveness of the incentive that the SPP provisions provide to Network Rail to improve its performance, and the extent to which operators are held neutral to the additional losses arising from sustained poor performance.

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

Industry has provided us with several case studies to demonstrate the high costs associated with making and resolving a SPP claim. Several of the claims in the case studies were initiated several years ago and are still unresolved; such claims have cost Network Rail and operators in excess of £100,000 in legal expenses.

Since the start of CP5 no operator has initiated a SPP claim despite half of all operators being eligible to make a claim. This could be because these operators have been deterred by the resource intensive process of making a claim.

### **Options to be considered**

Option 0: Do nothing

- The current mechanism is triggered if Network Rail's performance is at least 10% worse than benchmark over 13 consecutive periods (one year).
- After it has been triggered, passenger operators can decide to make a claim for 'all relevant losses' resulting from worse than benchmark performance.

Option 1: Only include cost recovery

- Under this option operators would only be able to claim for compensation for the costs that they incur as a result of Network Rail's worse than SPP threshold performance, rather than all relevant losses. That is, operator claims would and could no longer include revenue losses (and the revenue losses would instead be covered under the liquidated damages regime).

**Assessment of options**

Assessment of option 1 (Only include cost recovery)

- This option would remove the difficulties associated with operators having to demonstrate revenue losses. In turn the process for operators to make SPP claims would be simpler, which would likely increase the number of claims made.
- If operators made more SPP claims Network Rail would have a more effective incentive to ensure their performance did not fall below the SPP threshold.
- However, in their responses to the consultation several operators raised concerns that lower SPP claims would weaken Network Rail's incentives to improve performance.
- Operators' also explained in their responses that during prolonged periods of poor performance, revenue losses can significantly increase above the amount recovered through the liquidated damages regime. Operators are concerned that excluding revenue losses from SPP claims would mean they are not appropriately compensated when Network Rail's performance falls below the SPP threshold, the principal purpose of the SPP regime.

**Recommendation**

- Since these SPP provisions exist principally for the benefit of passenger operators, in light of their concerns with our proposal, we do not plan to pursue it further.

**Next Steps**

- Although ORR is not pursuing any changes to the SPP provisions we are willing to consider any options developed by industry to simplify the process for making and resolving SPP claims.
- We will be working with industry to improve the clarity of the contractual wording of the SPP provisions, where necessary, and to review a re-calibrated threshold, if appropriate.



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