



PR23: Impact assessment on Schedule 4 opt-out mechanism

October 2022

The following impact assessment supports our conclusions on the PR23 framework for Schedule 4, as set out in [this document](#).

Impact assessment on Schedule 4 opt-out mechanism

Policy area	Schedule 4 opt-out mechanism
<p>Background</p>	<p>The Schedule 4 possessions regime compensates rail operators for the financial impacts of planned disruption to rail services. Such disruption occurs when Network Rail restricts access to the network (known as a possession) to, for example, carry out engineering works. The regime has two key functions:</p> <ul style="list-style-type: none"> • to compensate train operators for the financial impact of planned service disruption caused by Network Rail when it takes possession of the network; and • to incentivise Network Rail to reduce the amount of service disruption due to possessions and to provide timely advance notice to users of its network. <p>There are separate arrangements for passenger and freight operators. (There is no Schedule 4 regime for charter operators as engineering possession plans are typically agreed before the majority of charter services are planned.)</p> <p>Publicly-contracted passenger operators receive full Schedule 4 compensation in return for paying an access charge supplement (ACS), which funds passenger Schedule 4 compensation payments.</p> <p>Open access passenger operators can elect to pay the ACS and receive full Schedule 4 compensation. Alternatively, they can choose not to pay the ACS and receive compensation for only the most disruptive possessions. Currently, no open access operators have chosen to pay the ACS.</p> <p>Freight operators receive set levels of compensation and pay no ACS. Freight operators have the option to pay an ACS and receive higher compensation, but no operators currently do so.</p>
<p>Proposed change being considered</p>	<p>Recent changes to rail passenger contracts have resulted in operators having different requirements regarding possession compensation arrangements. Operators on concession-style contracts, which are exposed to fewer financial risks than under</p>

traditional franchise contracts, may decide that they no longer require protection against the financial risks associated with possessions. However, other operators, notably freight and open access operators, continue to be fully exposed to commercial risks and incentives and may seek protection from the impact of possessions on their businesses.

To reflect differing contractual arrangements for operators, and to accommodate further developments such as rail reform, we are proposing to allow operators to opt out of Schedule 4 in CP7.

We intend to limit the option for publicly-contracted operators to opt out of Schedule 4 to a complete opt-out, i.e. covering both the revenue and cost compensation components. This is in the interest of simplicity to avoid having multiple Schedule 4 regimes. It is also expected that GBR is likely to set out its own cost compensation arrangements in contracts with its operators.

Open access operators will have the option, as now, to opt in fully to Schedule 4 (paying an ACS) or receive compensation for only the most disruptive possessions and sustained planned disruption (without an ACS).

Freight operators will also be able to opt out, continue with current levels of compensation or receive higher compensation and pay an ACS.

The decision to opt in or out will last for the whole of CP7, apart from in exceptional circumstances set out in our consultation document.

**(1) Network Rail
(and GBR once
formed)**

Financial impacts of payment flows: while Network Rail's expected costs will reduce as a result of paying out less Schedule 4 compensation (due to operators opting out), this would be expected to be offset by reduced income from the ACS. Overall the expected financial impact would be neutral.

Administrative burden: there being fewer operators within the Schedule 4 regime will reduce the day-to-day administrative burden of the regime on Network Rail, especially the negotiated aspects of Schedule 4.

Commercial impacts: if operators opt out of Schedule 4, this could allow Network Rail/GBR and operators to enter into alternative arrangements relating to possessions compensation.

	<p>Incentives impacts: as a result of no longer making compensation payments to opted-out operators, Network Rail would have reduced financial incentives to plan possessions efficiently and thus minimise disruption.</p> <p>There is a risk that Network Rail could be incentivised to discriminate against operators that have opted out, as it no longer needs to pay these operators compensation.</p> <p>To mitigate any loss of financial incentives on Network Rail and the potential for discrimination, we are working to develop a suite of metrics that will monitor Network Rail's performance across network availability, possession planning and possession efficiency. We expect that these measures will impose strong reputational incentives on Network Rail to plan possessions efficiently.</p> <p>Once publicly-funded operators are contracted by GBR, GBR will face internalised incentives to manage possessions efficiently, since it will be exposed to the revenue impacts of disruptions caused to its own operators.</p>
<p>2) Passenger operators (and commissioning authorities)</p>	<p>Commercial impacts / flexibility: an opt-out mechanism will provide operators with greater flexibility to reflect their own commercial needs in deciding on the most appropriate compensation arrangements for possessions.</p> <p>There is a risk of impacts on operators if, as described above, Network Rail has less effective or perverse incentives on possession planning. However, we expect such risks to be mitigated by greater monitoring of Network Rail.</p> <p>Administrative burden: operators that opt out will no longer need to enter into negotiated sections of Schedule 4, reducing the administrative burden.</p> <p>Funding impacts: to the extent that operators opt out, the arrangements will reduce the degree of 'money go round' whereby DfT (and other franchise bodies) fund publicly-contracted operators for the costs of the ACS, which operators then receive back in Schedule 4 compensation, and effectively pass pack to the franchise body through their terms of their concession-style agreements.</p>
<p>Freight operators</p>	<p>We do not anticipate that any freight operators would wish to opt out of Schedule 4, since it currently provides them with compensation without them having to pay an ACS. However, the option to opt out is available to freight operators, which may be</p>

	attractive if alternative arrangements are made available to them, for example in a future reformed industry. Any opt-out decision would remain at the choice of freight operators.
Recommendation	To introduce a Schedule 4 opt-out mechanism for all operators in CP7
Next steps	<p>We will introduce the opt-out mechanism as part of PR23.</p> <p>In order to assist operators in their decision of whether to opt-out, Network Rail will produce indicative ACS estimates for passenger operators within two months of ORR's PR23 draft determination.</p> <p>All operators (passenger and freight) must inform Network Rail of their decision to opt out within a set number of weeks of being provided with an indicative ACS by Network Rail, well in advance of the start of CP7. We will confirm the timing of decision-points through further correspondence with the industry.</p>



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