PR23 final determination:

Policy position – Schedules 4 and 8 incentives regimes

31 October 2023

About this document

This Schedules 4 and 8 incentives regimes final policy document is one of five policy positions documents of our final determination for the 2023 periodic review (PR23).

PR23 determines what the infrastructure manager for the national rail network, Network Rail, is expected to deliver with respect to its operation, support, maintenance and renewal (OSMR) of the network during control period 7 (CP7), which will run from 1 April 2024 to 31 March 2029, and how the available funding should be best used to support this.

This strongly influences:

- the service that passengers and freight customers receive and, together with taxpayers, ultimately pay for; and
- the charges that Network Rail's passenger, freight and charter train operator customers pay to access its track and stations during CP7.

Our final determination sets out:

- our decisions on Network Rail's outcome delivery and its planned expenditure to secure the condition and reliability of the network;
- changes to access charges and the incentives framework; and
- relevant policies on the financial framework, managing change and holding to account.

In addition to **this document**, we have also published as part of our final determination:

Document type	Details
Summary of conclusions and overviews	Our decisions on what Network Rail will need to deliver and how funding should be allocated: • Summary of conclusions and overview for England & Wales • Summary of conclusions and settlement for Scotland

Document type	Details
Consolidated decisions	A summary of our final decisions across Great Britain
Introduction	An overview of PR23 and background to our final determination
Settlement documents	Detailed final decisions for the System Operator and each of Network Rail's regions in England & Wales: • Eastern region • North West & Central region • Southern region • Wales & Western region See our summary of conclusions and settlement document for detailed information for Scotland.
Supporting documents	Technical assessments of: • Health and safety • Outcomes • Sustainable and efficient costs • National Functions • Other income
Policy positions	How we intend to regulate Network Rail during CP7 in relation to: • Financial framework • Access charges • **Schedules 4 and 8 incentives regimes** • Managing change • Holding to account With the exceptions of managing change and holding to account, our policy position documents include our assessment of stakeholder views on our proposals. Stakeholder views for managing change and holding to account are published in a separate document.

Document type	Details
Impact assessments	A consolidated set of assessments of the impact of our final policies on access charges and contractual incentives on affected parties.

Next steps

We will now implement our final determination. Implementation is the process through which we amend operators' track and station access contracts to give effect to new access charges and incentives (such as Schedule 8 benchmarks and payment rates) determined through the periodic review. We expect to issue our review notices in December 2023 and, subject to Network Rail's acceptance, issue notices of agreement and review implementation notices in time for CP7 to commence from of 1 April 2024.

We expect Network Rail to publish a delivery plan for CP7 that is consistent with our final determination. We have published a notice alongside our final determination which sets out expectations for the scope and timing of the delivery plan.

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Executive summary

Network Rail's possessions and performance regimes compensate train operators for financial impacts arising from planned and unplanned service disruption. The possessions and performance regimes are contained within Schedules 4 and 8 of track access contracts. Schedule 4 places incentives on Network Rail to plan possessions efficiently so as to minimise disruption, and Schedule 8 places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance.

We have reviewed the Schedule 4 and 8 incentive regimes as part of PR23 and concluded that the regimes will remain in place for CP7, with their essential structures unchanged. We are making incremental and proportionate changes and introducing flexibility to respond to changing circumstances.

We are introducing an opt-out mechanism for Schedule 4 in CP7, which provides train operators with the flexibility to adjust to industry reform in line with their commercial circumstances. Passenger operators, following receipt of indicative access charge supplements, are now deciding whether to opt in or out of Schedule 4 in CP7. We are also introducing flexibility to Schedule 8. In CP7, we will allow for the removal of relevant Schedule 8 payments between Great British Railways (GBR) and its contracted operators, if GBR is established, if there is sufficient legislative change to permit the removal of payments and provided that there is a sufficiently robust incentive framework in place.

We will allow for the update of Schedule 8 parameters during the control period, and we now expect to carry out a recalibration of the Schedule 8 passenger regime in advance of year 3 of CP7. This will allow the regime to adjust during the control period to better reflect industry conditions, such as changes to revenue and performance.

The Schedule 4 and 8 regimes are being recalibrated as part of PR23, to reflect updated industry data. Draft outputs have been shared with the industry, and we will finalise parameters shortly after the final determination.

In the calculation of Network Rail payment rates in the Schedule 8 passenger regime, we have applied a transitional adjustment which moderates the size of the decrease in rates, from an average fall of around 75% in draft rates (compared with control period 6 (CP6) levels) to around 45% in near-final results. We will review the evidence underpinning payment rates as part of the planned recalibration ahead of year 3 of CP7.

In the calculation of the operator benchmark in the Schedule 8 freight regime, we are implementing an adjustment, in light of uncertainty about whether operators will be able to return performance to the levels seen in the period used to calculate the draft benchmark. This adjustment moderates the change in the benchmark by setting it midway between the 2018 periodic review (PR18) and PR23 calculated levels.

Recalibration will be completed shortly after this final determination. Finalised Schedule 4 and 8 parameters will be issued in review notices in December 2023, and will take effect from the start of CP7 in April 2024.

1. Introduction

1.1 Network Rail's possessions and performance regimes compensate train operators for financial impacts arising from planned and unplanned service disruption. The possessions and performance regimes are contained within Schedules 4 and 8 of track access contracts. Schedule 4 places incentives on Network Rail to plan possessions efficiently so as to minimise disruption, and Schedule 8 places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance. In a vertically separated railway, which has multiple different operators, these regimes provide benefits by encouraging Network Rail and train operators to factor in the costs of disruption that they impose on other parties.

1.2 The regimes are calibrated to be largely 'financially neutral on expectation', meaning that Network Rail and operators would not make or receive payments if prior expectations are met in terms of possessions management (for Schedule 4) and train performance (for Schedule 8). An access charge supplement (ACS) is payable in return for full Schedule 4 compensation. Schedule 8 does not have an ACS and instead works on the basis of performance benchmarks – payments are made or received when a party's performance is worse or better than these benchmarks.

1.3 As part of PR23, we have been reviewing the framework for these regimes. We published initial consultations in June 2021 (Schedule 8) and September 2021 (Schedule 4), followed by a combined April 2022 'preferred options' consultation. In October 2022, we published our Schedule 4 & 8 conclusions on the framework for the regime in CP7, which also included a consultation on outstanding matters. Our draft decisions were then summarised in the PR23 draft determination policy position document on Schedules 4 and 8 incentives, published on 15 June 2023. All decisions are also stated in this final determination document.

1.4 We decided in the October 2022 conclusions document to retain the essential structure of Schedules 4 and 8 and not to carry out more wide-ranging reforms. This was in the context of rail reform potentially more fundamentally changing the structure of the industry. We are though proceeding with a small number of proportionate changes to the regime during CP7. This document summarises decisions made in respect of Schedule 4 and Schedule 8, and updates on recalibration of the regimes for CP7.

1.5 Recalibration work has been ongoing and will conclude shortly after the final determination. Recalibration working groups comprising Network Rail and train operators have supported the recalibration process, with separate groups for the passenger and freight & charter sectors. The groups have typically met monthly to discuss points of methodology, with final decisions being made by ORR where required.

1.6 We have taken our decisions on the CP7 incentives framework based on the existing legal requirements, while also ensuring the framework can be applied under different industry reform scenarios, for example if GBR is formed as an integrated rail body. While we refer in this document primarily to Network Rail, our decisions are also relevant if GBR takes on responsibility as infrastructure manager.

1.7 In July 2023, we published a consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'. This consulted on the track access contract terms that will give effect to policy decisions confirmed in this final determination. Changes to legal drafting that result from that consultation will be applied in updated model track access contracts and PR23 review notices, and we expect to publish conclusions to the consultation in February 2024.

Summary of responses to the draft determination

1.8 **Network Rail** agreed with the decision to proceed with the Schedule 4 opt-out mechanism and a mechanism to allow for the removal of Schedule 8 payments between GBR and its contracted operators. Network Rail agreed with our proposal to allow for recalibration of Schedule 8 during CP7, albeit that it sought flexibility for more frequent changes. On recalibration of the passenger Schedule 8 regime, Network Rail strongly disagreed with ORR's decision, made shortly after the draft determination, to make a transitional adjustment to moderate the reduction in Network Rail payment rates, saying it went against the best available evidence. On recalibration of the freight Schedule 8 regime, Network Rail has favoured proceeding with a standard recalibration methodology without ad hoc adjustments to parameters.

1.9 **Passenger operators** offered qualified support regarding the measures to bring greater flexibility to Schedule 8 in CP7. Regarding the Schedule 4 opt-out mechanism and the potential switch-off of Schedule 8 payments for GBR's contracted operators, Rail Partners and train operating companies (TOCs) typically recognised the reasons for the changes, but were concerned about impacts on Network Rail's behaviours from the loss of financial incentives. Some passenger operators were in favour of the ability to recalibrate Schedule 8 during the control period, but noted that the right balance must be struck between flexibility and stability. Most passenger operators were in favour of a transitional adjustment to moderate the reduction in Network Rail payment rates, out of concerns regarding the underlying evidence base and the potential performance impacts of Network Rail facing lower payment rates.

1.10 **Freight operators**, in their responses to the draft determination, were typically not in favour of policy changes to introduce greater flexibility, stressing the value to the sector of greater stability. On Schedules 4 and 8, they were in favour of the regimes applying at all times to all operators, to maximise the strength of system-wide incentives. Freight operators expressed caution and concern at the prospect of recalibration of Schedule 8 within the control period, saying that this creates uncertainty as to the benchmarks and payment rates that will apply in CP7. On Schedule 8 recalibration, freight operators objected strongly to a transitional adjustment to moderate the reduction in Network Rail payment rates in the passenger regime. This is because it has the effect of also moderating the reduction in freight operator payment rates. Freight operators also objected to the setting of several freight regime parameters – the freight operator benchmark, the Network Rail performance benchmark, and the Network Rail freight cancellation threshold – as being unrepresentative or being accepting of poor Network Rail performance.

Summary of changes since the draft determination

1.11 We outline here the changes made between the draft and final determinations.

Schedule 4 opt-out mechanism

1.12 We have made some small changes to the Schedule 4 opt-out mechanism. Most notably, we have added to the circumstances under which operators can change their opt-out status, to allow for a change in decision if there is a recalibration of Schedule 4 access charge supplements during the control period. See paragraphs 2.5 to 2.7.

Adding flexibility to Schedule 8 in CP7

1.13 We are now committing to recalibrate the passenger Schedule 8 regime ahead of year 3 of CP7. This will allow the regime to adjust during the control period to better reflect industry conditions, and will reflect any changes which ORR makes to Network Rail’s performance trajectories. The recalibration will include a review of the econometric evidence used to derive Network Rail payment rates. See paragraphs 3.22 to 3.26.

Network Rail payment rates in the passenger Schedule 8 regime

1.14 Network Rail payment rates in the passenger Schedule 8 regime had been recalibrated to be on average 75% lower in draft results, due to lower industry revenues (accounting for 15 percentage points of the fall) and a new methodology and estimates for the passenger revenue response to disruption, known as elasticities (accounting for 60 percentage points). In line with an incremental and proportionate approach to PR23, we have made a transitional adjustment which halves the impact of the new elasticities. This took the average reduction in Network Rail payment rates to 45% in near-final results. See paragraphs 3.41 to 3.48.

Freight operator benchmark in the freight Schedule 8 regime

1.15 We are now implementing an adjustment to the operator benchmark in the freight Schedule 8 regime, in light of uncertainty about whether freight operators will be able to return performance to the levels seen in the period that was used to calculate the draft benchmark. This adjustment moderates the change in the benchmark by setting it midway between the PR18 and PR23 recalibrated levels. See paragraphs 3.54 to 3.55.

Next steps

1.16 The recalibration of the Schedule 4 and 8 regimes is nearly complete, and we expect to issue near-final parameters very shortly after this final determination. Chapters 2 and 3 provide more information on the timescales for Schedules 4 and 8 respectively. Finalised parameters will be implemented in track access contracts through review notices in December 2023, and will take effect from the start of CP7 in April 2024.

2. Schedule 4

Summary

Network Rail has nearly completed its recalibration of the Schedule 4 parameters for CP7.

We are proceeding with an opt-out mechanism for Schedule 4 in CP7, which provides train operators with the flexibility to adjust to industry reform in line with their commercial circumstances. Train operators, following receipt of their indicative ACSs, are now deciding whether to opt in or out of Schedule 4 in CP7 – this document provides information on response deadlines and the default positions for operators.

We will include a provision within Schedule 4 to cover the potential need to reopen the Schedule 4 ACS calculation during CP7. This may be activated in the event of a within-control period recalibration of Schedule 8 (see Chapter 3).

Summary of decisions

2.1 The table below summarises decisions made during the PR23 review of Schedule 4, and we are confirming them as part of our final determination. In some cases, decisions relate to initial proposals for change that have not been taken forward – in the table these are phrased as decisions 'not to' change policy. Decisions that were concluded upon prior to our draft determination (for example in the October 2022 document) are unchanged from the draft determination unless stated otherwise.

Table 2.1 Schedule 4 decisions

Decision	Consultation reference	Decision reference
To introduce an opt-out mechanism to Schedule 4	Proposed in our September 2021 Schedule 4 consultation (paragraph 3.2). Consulted on in our April 2022 Schedules 4 & 8 consultation (paragraph 1.21).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (paragraph 1.11). Further information provided in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraphs 2.2 to 2.14).
To increase monitoring of Network Rail's possessions management to maintain its incentive to minimise disruption[1]	Proposed in our September 2021 Schedule 4 consultation (paragraph 4.2 and 4.21). Consulted on in our April 2022 Schedules 4 & 8 consultation (paragraphs 2.14 and 2.25).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (paragraph 1.25).
Not to develop a method for settling compensation claims for lengthy possessions and periods of sustained planned disruption	Proposed in our September 2021 Schedule 4 consultation (paragraph 4.8). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 4, paragraph 10).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex A, A.8).
Not to develop a tool to estimate Schedule 4 formulaic compensation	Proposed in our September 2021 Schedule 4 consultation (paragraph 4.23). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 4, paragraph 19).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex A, A.11).
Not to review the methodology for calculating the access charge supplement for open access operators	Proposed in our September 2021 Schedule 4 consultation (paragraph 4.29). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 4, paragraph 29).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex A, A.17).

[1] This work is being taken forward through the PR23 final determination: supporting document on outcomes. See Chapter 11, 'Network availability and possession management'.

Decision	Consultation reference	Decision reference
Not to update freight compensation rates	Proposed in our September 2021 Schedule 4 consultation (paragraph 5.2). Consulted on in our April 2022 Schedules 4 & 8 consultation (paragraph 2.33).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex A, A.20).

Schedule 4 opt-out mechanism

Background

2.2 We are introducing a Schedule 4 opt-out mechanism for CP7. We consider that the opt-out mechanism provides operators with the flexibility to adjust to industry reform in line with their commercial circumstances. Our decision is supported by an impact assessment.

2.3 Passenger operators have now received indicative Schedule 4 access charge supplements, and they have until 3 November 2023 to inform Network Rail of their decision on whether they want to opt in or out of the Schedule 4 regime for CP7. We will give effect to each operator's decision in track access contracts through review notices that implement PR23.

Publicly contracted operators

2.4 Publicly contracted operators that have chosen to opt out will not receive any compensation for planned possessions nor pay the ACS which funds passenger contract Schedule 4. Publicly contracted operators that wish to opt out of Schedule 4 must do so completely, i.e. both from the revenue and cost compensation components[2] for the entirety of the control period (except in limited circumstances set out below). This is in the interest of simplicity and stability.

2.5 All operators' decisions to opt in or out will last for the entirety of CP7, except in a limited set of circumstances. Following the draft determination, some operators raised the concern that, if a within-control period recalibration of Schedule 8 leads to a significant change to the ACS, operators should have the ability to reopen their decision on whether to remain opted in or out of Schedule 4. We have therefore widened the circumstances in which operators can review their Schedule 4 decision, to reflect where a Schedule 8 recalibration results in a

[2] Passenger Schedule 4 has two compensation components: revenue loss compensation to compensate operators for lost revenue due to service disruption, and cost compensation due to additional operating costs of managing service disruption, e.g., the costs of operating rail replacement bus services.

change in the ACS. In such circumstances, operators will have a window of time to decide if they want to opt in or out of Schedule 4. This will allow operators to take account of the changed circumstances, ensuring the incentive for Network Rail to plan possessions efficiently remains in place.

2.6 We have also updated the circumstances under which publicly contracted operators can change their decision to opt in or out during the control period, following responses to our consultation on implementation.

2.7 In summary, publicly contracted operators can change their decision to opt in or out following the events listed below:

(a) award of a franchise agreement following re-tendering of the services in the agreement;

(b) a direct award of a franchise agreement;

(c) change of ownership of a franchise agreement that involves significant changes in service levels;

(d) a change to the franchising authority that is a party to the operator's franchise agreement; or

(e) a change to the level of access charge supplements that results from a recalibration of Schedule 8.

Open access operators

2.8 Open access passenger operators will retain the choice to fully opt in (and pay an ACS) or continue to receive limited Schedule 4 compensation (only for the most disruptive possessions and sustained planned disruption, while paying no ACS). Open access decisions will be for the entirety of CP7, except in the case of a change to the ACS that results from a recalibration of Schedule 8, as discussed at paragraph 2.5 above.

Freight operators

2.9 Freight operators can choose to remain in Schedule 4 and receive current levels of compensation or opt out completely – these decisions will last for the entirety of CP7. Freight operators currently do not pay a Schedule 4 ACS. There remains the option, as in CP6, for freight operators to request additional Schedule 4 compensation in return for an ACS, but our understanding is that no freight operators have requested this.

2.10 The table below summarises the opt-out mechanism for operators by sector.

Table 2.2 Schedule 4 opt-out mechanism

Operator type	Current position	Decision to opt out	Decision to opt in
Publicly contracted passenger operators	Receive full Schedule 4 compensation, and pay an ACS.	Receive no Schedule 4 compensation. No payment of ACS.	N/A
Open access passenger operators	Receive limited Schedule 4 compensation (for the most disruptive possessions and sustained planned disruption). No payment of an ACS.	N/A	Receive full Schedule 4 compensation and pay an ACS.
Freight operators	Receive standard freight Schedule 4 compensation. No payment of an ACS.	Receive no standard freight Schedule 4 compensation. No payment of an ACS.	N/A

How the Schedule 4 opt-out mechanism works

2.11 Network Rail provided operators with indicative ACSs to inform their decision on whether to opt in or out for CP7 on 15 September 2023. Operators have until 3 November 2023 to notify Network Rail of their decisions. Those publicly contracted operators that do not state their decision by this date will be deemed to have decided to remain in the Schedule 4 regime.

2.12 Open access operators have also been provided with indicative ACSs, and alongside freight operators will have the same timeframe to decide to opt in or out. Open access operators that do not state a position within the timeframe to respond will remain in receipt of the baseline levels of Schedule 4 compensation currently applicable in their track access contracts. Freight operators that do not state a position within this timeframe will continue to receive Schedule 4 compensation as currently.

2.13 Network Rail will inform ORR of all operators' decisions shortly after the 3 November 2023 deadline. Operators' decision will then be implemented in track access contracts through our PR23 review notices.

2.14 In the case of a new public service operator, open access operator or freight operator, that comes into existence during the control period, the operator will have the choice whether to opt in or opt out when it enters into its track access contract with Network Rail.

Potential changes to Schedule 4 within CP7

Timetabling process changes: reopener provision

2.15 Before our draft determination, Network Rail had proposed changing the timetabling process, following consultation with the industry. Under the proposed process, known as Better Timetabling for Passengers and Freight (BTPF), Network Rail would be able to make up to three timetable changes per year. This would have a significant impact on Schedule 4 as described in our draft determination.

2.16 We had initially proposed incorporating provisions within Schedule 4 to address how any changes to the timetabling process might impact on the operation of Schedule 4. However, Schedule 10 of track access contracts provides ORR with powers to make changes to Schedule 4 within control periods as a result of changes to the Network Code (which codifies the timetabling process). Given the existence of this power, we do not need to include an additional reopener provision within the Schedule 4 contract.

Reopener for consequential changes to Schedule 4 following within-control period changes to Schedule 8

2.17 We have included a new provision to allow for a within-control period recalibration of Schedule 8 (see Chapter 3 below). Schedule 8 parameters are used in the calculation of Schedule 4 revenue loss payments, and thereby affect the required ACS, and there are other linkages such as calculation of defined service group revenues and notification factors. It is therefore necessary to include a reopener provision to recalculate elements of Schedule 4 in the case of a significant change to Schedule 8 parameters during CP7. This will be implemented through new wording in Schedule 4, following our July 2023 consultation on ‘Implementing PR23: Consultation on drafting changes to access contracts’.

Recalibration of Schedule 4

Notification factors

2.18 Notification factors are used to calculate the level of discount Network Rail receives on the amount of revenue loss compensation it pays, the earlier it notifies operators about forthcoming possessions. The earlier it notifies, the greater the discount.

2.19 We stated in our draft determination that changing the way Schedule 8 payment rates are calculated would require us to revise the way in which notification factors are calculated. Schedule 8 Network Rail payment rates are being calculated using a 'semi-elasticity' approach (see paragraph 3.43), in a way that does not require the use of delay multipliers.

2.20 Following this, we have devised a new methodology that has been discussed with a sub-group of our passenger recalibration working group and on which we are notifying the wider working group. This brings the methodology for notification factors closer to that used for the calculation of Schedule 8 payment rates.

Sustained planned disruption revenue thresholds

2.21 As part of the Schedule 4 recalibration we have reviewed the sustained planned disruption (SPD) revenue loss thresholds as a result of the change in Schedule 8 payment rates. This is because the reduction in Schedule 8 payment rates will lead to a fall in the amount of revenue loss compensation paid. The aim of the review was to ensure lower compensation does not change the likelihood of operators triggering an SPD claim. The review is resulting in a change in the percentage of defined service group revenue, over the 3 and 7 month assessment periods, required to trigger an SPD claim. We are notifying changes to the passenger recalibration working group and changes will be enacted through the review notice process.

3. Schedule 8

Summary

The recalibration of Schedule 8 is nearly complete. This chapter summarises the process and outlines the key decisions that have been made to update Schedule 8 parameters for CP7. These include a transitional adjustment to moderate the size of the fall in Network Rail payment rates in the passenger Schedule 8 regime, and an adjustment to the operator benchmark in the freight Schedule 8 regime to limit the change between CP6 and CP7.

In CP7, we will allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, if GBR is established, if there is sufficient legislative change to permit the removal of payments and provided that there is a sufficiently robust incentive framework in place.

We will also allow for the update of Schedule 8 parameters during the control period, and we now expect to carry out a recalibration of Schedule 8 in advance of year 3 of CP7. This will allow the regime to adjust during the control period to better reflect industry conditions.

Summary of decisions

3.1 The table below summarises decisions made during the PR23 review of Schedule 8. In some cases, decisions relate to initial proposals for change that have not been taken forward – in the table these are phrased as decisions 'not to' change policy. Decisions that were concluded upon prior to our draft determination (for example in the October 2022 document) are unchanged from the draft determination unless stated otherwise.

Table 3.1 Schedule 8 decisions

Decision	Consultation reference	Decision reference
To retain the link between Network Rail's benchmarks and forward-looking performance trajectories	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 3.10). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 7).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.7).

Decision	Consultation reference	Decision reference
Not to update benchmarks annually	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 3.14). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 18).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.18).
Not to share allocation of some types of delay within Schedule 8	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 3.24). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 29).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.27).
Not to change how TOC-on-TOC delay is handled within Schedule 8	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 4.2). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 37).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.33).
Not to change the allocation of delay within Schedule 8 for unidentified incidents	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 4.22). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 48).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.38).
Not to change Schedule 8 compensation to more fully reflect financial impacts of delay (e.g. passenger compensation costs)	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 4.30). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 57).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.45).
To retain the sustained poor performance (SPP) mechanism for franchised passenger operators	Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 58).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.46).

Decision	Consultation reference	Decision reference
Not to update the evidence base underpinning the freight and charter Network Rail payment rates	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 5.5). Consulted on in our April 2022 Schedules 4 & 8 consultation (paragraph 3.7).	Concluded in our October 2022 Schedule 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.50 & B.51).
Not to revisit the structure of freight caps	Proposed in our June 2021 Schedule 8 train performance regime consultation (paragraph 5.8). Consulted on in our April 2022 Schedules 4 & 8 consultation (Annex 5, paragraph 65).	Concluded in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (Annex B, B.57).
To implement a mechanism that may switch off Schedule 8 payments for GBR's future operators in the event of legislative change	Proposed in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (paragraph 2.8).	Concluded in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.5).
To create a new provision to allow for ORR to initiate within-control period recalibration of Schedule 8, and to use this provision to recalibrate the Schedule 8 passenger regime ahead of year 3 of CP7	Proposed in our October 2022 Schedules 4 & 8 conclusions and consultation on outstanding matters (paragraph 2.27).	Concluded in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraphs 3.17 and 3.22).
To extend the sustained poor performance mechanism to open access operators	Proposed in PR23 draft determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.44).	Concluded in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.37).
To remove the prolonged disruption sum from the freight Schedule 8 regime	Proposed in PR23 draft determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.55).	Concluded in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.58).

Decision	Consultation reference	Decision reference
To remove the freight and charter incident cap option for a 30% exposure level to delay minutes beyond the cap	Proposed in PR23 draft determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.56).	Concluded in PR23 final determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.59).

Scope of application of Schedule 8

Background

3.2 In our draft determination policy position (paragraphs 3.8 to 3.17), we presented a draft decision to allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, in the event that there is sufficient legislative change to permit this. We refer to this as the 'switch-off' mechanism. It could simplify financial arrangements under GBR should the UK Government proceed with rail reform plans to create GBR as a new body. We said we would consider whether certain conditions had been met before giving effect to this new provision – these include the need for sufficient developments in rail reform and changes in industry structure to justify it, and for there to be a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance. Schedule 8 would continue unchanged for non-GBR operators, and delay attribution would continue across the system. Contractual wording for the new provision was included in our consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

3.3 This clause would take effect if (1) the legal requirements for a performance scheme in the 2016 Regulations[3] are changed, and (2) ORR issues a notice confirming that the relevant new paragraphs within Schedule 8 shall take effect.

3.4 Responses to the draft determination made similar points to those expressed in earlier consultations. Network Rail agreed with ORR's draft decision, highlighting that the 'switch-off' mechanism will simplify incentives and enable the successful transfer of operator contracts to GBR. By contrast, freight operators and some train operators expressed concerns that, if most operators are no longer subject to Schedule 8 payments, the incentives on GBR will be reduced. Operators want to

[3] A train performance scheme which encourages parties to minimise disruption is a requirement of the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 ('the 2016 Regulations'). Network Rail meets this requirement through Schedule 8. The legal framework was explained in our April 2022 consultation, paragraphs 1.7 to 1.8.

see what incentive regime will take the place of Schedule 8. Annex A provides a more detailed summary of responses.

Our decision

3.5 Our decision is to proceed with this proposal. We have reviewed responses to our draft determination, and our view remains that, if implemented (in the event of the creation of GBR and sufficient legislative change), the proposal will simplify financial and incentive arrangements for GBR's future operators. This is consistent with our intention for the PR23 settlement to be adaptable to the outcomes of rail reform. The Department for Transport (DfT) and Great British Railways Transition Team (GBRTT) have said that switching off Schedule 8 payments is a necessary step for GBR to be formed as an integrated rail body and for existing concession-style contracts to be transferred to GBR as the franchising body. Our decision is supported by an impact assessment. The mechanism will be applied to those operators currently contracted by DfT.

3.6 We note concerns expressed by some operators that the 'switch-off' mechanism could have adverse impacts on performance incentives. We do not expect this to be the case. If rail reform proceeds, we expect ORR to have a role holding GBR to account across infrastructure management and train services. Given its receipt of passenger revenues, GBR will have its own commercial incentives to run a high-performing railway, so as to attract and retain passengers. Further, GBR will be exposed to Schedule 8 payments in respect of non-GBR operators, so there will be a strong financial incentive for GBR to limit the disruption caused by both its infrastructure and contracted train services. In this respect, we note the UK Government's intentions for incentives on train operators as stated in its response to our April 2022 consultation: "The Government is strongly committed to ensuring that contracts between Great British Railways and operators include strong performance incentives."

3.7 We do though recognise that there is still a degree of uncertainty as to the future regulatory structure in respect of GBR. Therefore, as stated in paragraph 3.12(b), we will require that there is a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance before we issue a notice to give effect to the new sub-paragraphs.

3.8 The contractual changes would have the effect, for GBR's contracted operators, of stopping the main regular Schedule 8 payments, known as 'Performance Sums' (as per Schedule 8 of passenger track access contracts, paragraphs 9 and 10), as well as payments under Sustained Poor Performance provisions (Schedule 8, paragraph 18). It would leave intact some limited payments relating to adjustments to previous payments (Schedule 8, paragraph 6.3), the resolution of disputes (Schedule 8, paragraph 12.2) and the costs of assessing and implementing any amendments to Schedule 8 Appendix 1 and the Performance Monitoring System (Schedule 8, paragraph 17.4).

3.9 We confirm that a notice can only be issued by ORR at or after the start of CP7. Should it be necessary to issue a notice with retrospective effect, this would, at the earliest, only be backdated to the date from which the amended 2016 Regulations came into force. If there is such a change to the 2016 Regulations, we would engage with the industry in order to provide clarity about our intentions.

3.10 The clauses will include a new Schedule 8 paragraph 12.5 which will enable Schedule 8 payments to be 'switched back on'. This could be required in the event of a further change to an operator's commercial contractual model – for example, the re-adoption of revenue risk that may result in a requirement for Schedule 8 protections. Any notice issued in accordance with paragraph 12.5 would not apply retrospectively.

3.11 The UK Government has not yet brought forward legislation that would amend the 2016 Regulations. If legislation prohibits performance scheme payments between GBR and its operators, then we would expect to issue a notice to trigger the 'switch-off' mechanism and meet this requirement. If legislation provides discretion on whether payments between GBR and its operators under a performance scheme should apply, we would make a decision on whether to issue a notice under the new Schedule 8 paragraph 12.3(b) taking into account our duties. This includes the duty to promote improvements in railway service performance.

3.12 We would therefore consider the following points:

(a) We will consider whether the 2016 Regulations have indeed been amended in such a way as to allow the removal in Schedule 8 of the requirement for the majority of performance scheme payments between GBR and its contracted operators.

(b) We will need to be satisfied that there are sufficient developments in rail reform and changes in industry structure to justify issuing a notice – the combining of infrastructure manager and franchise authority within the same organisation is likely to be consistent with this requirement. There needs to be a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance.

(c) We must be satisfied that there is no reduction in the financial protection offered through Schedule 8 to non-GBR operators such as freight and open access operators that remain fully exposed to payments under Schedule 8.

3.13 In relation to the position in Scotland, there has been no indication from the UK Government that legislation would remove non-GBR operators from the legal requirement for a performance scheme, so we do not yet see a justification for the new clauses to be applied to non-GBR operators. However, if legislative amendments removed the requirement for a performance scheme from Transport Scotland's operators, GBR and each Transport Scotland operator could seek to jointly agree a change to their track access contract to include the 'switch-off' mechanism. This would be subject to ORR's approval, in accordance with section 22 of the Railways Act 1993. We would apply similar conditions as we intend to use for GBR operators in issuing a notice to give effect to the 'switch-off' mechanism (paragraph 3.12), such as a sufficient robust regulatory and incentive framework being in place.

Adding flexibility to Schedule 8 in CP7

Background

3.14 In our draft determination policy position (paragraphs 3.28 to 3.42), we presented a draft decision to include a provision in Schedule 8 to allow for the update of Schedule 8 parameters during the control period. This was intended to add flexibility to Schedule 8 to address the current situation where parameters are set for the whole control period and do not respond at a system-wide level to external shocks such as significant changes to traffic volumes.

3.15 We stressed that the power would only be used in the event of a material change in circumstances. We noted in particular that it may be appropriate to consider within-control period recalibration during CP7 if uncertainties about recovery from the pandemic mean that parameters turn out to have been inaccurately determined. This had been a key concern raised by Network Rail and many train operators during the recalibration process.

3.16 In response to the draft determination, Network Rail expressed support for the draft decision to include a provision to allow for ORR to initiate recalibration of Schedule 8 during the control period. However, Network Rail sought clarifications and assurances on how the need for recalibration will be monitored, and how recalibrations will be initiated and carried out in practice. Rail Partners and some passenger operators expressed support, but highlighted the need for a balance between flexibility and stability. Freight operators were concerned that the proposal could create uncertainty, and stated that the threshold for recalibration should be set at a high level and only used in unforeseen circumstances. Annex A provides a more detailed summary of responses.

Our decision

Summary

3.17 Our decision is to proceed with this new provision to allow for the update of Schedule 8 parameters during the control period. Our decision is supported by an impact assessment. The proposal offers potential benefits in allowing parameters to adjust during the control period to better reflect industry conditions. This would reduce the extent of any 'windfall' payments that are the result of exogenous factors.

3.18 The new provision will be implemented through clauses in model track access contracts. We consulted on the contractual wording through our consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'. Any changes to the wording will be explained in our conclusions to that consultation.

3.19 We will include the new provision in Schedule 8 for the passenger, freight and charter sectors. We noted in our draft determination document that the case for the provision is strongest in the passenger regime, which has less stable underlying data than the freight and charter regimes and faces the greatest uncertainty about future demand and traffic volumes. However, external shocks do also impact the freight and charter markets, including through the knock-on effects of changes in passenger traffic volumes which may affect performance in freight and charter. In addition, the calibration of each sector regime uses inputs from the other sector regimes, for example Network Rail payment rates, which helps to keep the Schedule 8 'star model'[4] in balance. This may justify an update to one sector regime as the consequence of an update to another sector's regime.

3.20 The existing passenger Schedule 8 paragraph 17 provision, which allows Network Rail and each passenger operator to request changes to the operator's parameters, will remain in place.[5] (This provision is not present in the freight and charter regimes.) The existing paragraph 17 provision should continue to be used in TOC-specific circumstances such as service changes or franchise remapping.

[4] Under the star model, all Schedule 8 payments are made bilaterally between Network Rail and operators, with no payments flowing directly between operators. The star model is calibrated so as to leave Network Rail financially neutral based on expectations of disruption caused by operators to one another.

[5] In passenger contracts, this paragraph 17 will be amended so as to implement the new power for ORR to initiate within-control period recalibration of Schedule 8.

ORR will only initiate recalibration under the new provision where the existing provision does not suffice. This is likely to be where there is a material change in circumstances that affects multiple operators, where coordinating multiple contractual changes under paragraph 17 would be burdensome.

3.21 Any change to Network Rail payment rates in Schedule 8 will feed through into revenue compensation formulae in Schedule 4 (in line with paragraph 3.4 of Schedule 4 in the passenger model contract). This may mean that Schedule 4 ACSs are inaccurately calculated, with Network Rail's ACS income no longer being in line with expected Schedule 4 compensation. In such circumstances, Schedule 4 ACSs are likely to need to be recalculated. For this purpose, we are including a new provision in Schedule 4 to allow for ACSs to be recalculated during the control period – see paragraph 2.17.

Recalibration ahead of year 3 of CP7

3.22 We are now committing to recalibrate the passenger Schedule 8 regime ahead of year 3 of CP7. This is in addition to the provision that allows for ORR to initiate a recalibration of Schedule 8 following a material change in circumstances.

3.23 As explained in our PR23 final determination: supporting document on outcomes (Chapter 3), we consider that it is appropriate to reset Network Rail's passenger train performance trajectories ahead of year 3 of CP7. The Schedule 8 passenger regime will be recalibrated at the same time as this reset. Network Rail benchmarks in the passenger regime will be updated to reflect changes in performance trajectories, and we also expect to update TOC benchmarks, Network Rail payment rates and TOC payment rates. The update of Network Rail payment rates will include a review of the econometric evidence used to calculate the rates (see paragraphs 3.41 to 3.48 regarding the PR23 recalibration). The Schedule 8 recalibration will be based on the policy framework determined through PR23, and it will not provide an opportunity to make policy changes or alter the wider terms in contracts.

3.24 The reset of performance trajectories ahead of year 3 of CP7 will not change freight trajectories, and we do not intend to recalibrate the freight or charter Schedule 8 benchmarks at this time. However, the recalibration of the passenger regime may mean that changes to freight and charter operator payment rates are required in order to retain system-wide balance. We expect that changes to the freight and charter regimes will be limited to these necessary updates.

3.25 We expect that any update would be limited to Schedule 8 parameters as per the contractual appendices[6]. The update would be based on the policy framework determined through PR23, and it would not provide an opportunity to make policy changes or alter the wider terms in contracts.

3.26 We will work with the industry after the completion of PR23 to decide upon the detailed scope, methodology, roles, responsibilities and resourcing for the planned recalibration of the passenger Schedule 8 regime ahead of year 3 of CP7.

Recalibration due to a material change in circumstances (outside the recalibration ahead of year 3 of CP7)

Using the new provision under a material change in circumstances

3.27 Aside from the commitment to recalibrate Schedule 8 in advance of year 3 of CP7, we remain of the view that Schedule 8 should only be subject to an additional update in CP7 in the event of a material change in circumstances. The provision will only be used if there are clear benefits to the industry and performance outcomes from recalibrating.

3.28 A material change in circumstances will be significantly different from the circumstances assumed in the PR23 recalibration or, subsequently, the recalibration in advance of year 3 of CP7. Any decision as to whether there has been a material change in circumstances rests with ORR. A material change in circumstances is unlikely to be the result of performance that is under the control of industry parties. In addition, the circumstances would need to be likely to lead to a sustained material change in realistic expectations in future years of the control period, rather than be a short-lived change or one with limited effects. We do not intend to set quantitative thresholds that will ‘trigger’ recalibration, and will instead make a judgement based on the full set of relevant considerations, including metrics such as traffic and passenger volumes. We expect to be able to reach a better overall judgement by looking at changes in the round rather than based on a limited set of quantitative triggers. The emergence of significant net financial payments may be indicators that a material change in circumstances has occurred, but will not in themselves be a reason to recalibrate.

3.29 Aside from the commitment to recalibrate Schedule 8 in advance of year 3 of CP7, the provision will only be used if there are clear benefits to the industry from recalibrating. We will consider whether there is sufficiently high-quality evidence on which to base the calculations. We will also consider factors such as the time

[6] The relevant appendices are as follows: in the passenger regime Appendices 1 and 3; in the freight regime Appendix 1; and in the charter regime Appendix 8A.

and resources available to carry out a recalibration. Any recalibration would be likely to require support from specialist consultants, which would need to be funded by the industry.

Scope of recalibration under a material change in circumstances

3.30 The scope of any recalibration will be decided at the time, based on the nature of the material change in circumstances. The decision on scope will cover the following:

(a) The sectors within scope – i.e. whether the passenger, freight and charter sector schemes are each within scope.

(b) The operators within scope – this will be decided by the scope of the change in circumstances. It seems likely that any material change in circumstances would affect operators across different regions, and across different passenger market segments, but it will be assessed at the time whether the change is more contained.

(c) The parameters within scope – this will be decided based on the nature of the change in circumstances, e.g. whether it affects performance (in which case benchmarks could be within scope), revenue (in which case payment rates could be within scope) or both. Additionally, we would expect the Schedule 8 parameters with the greatest impact on payment flows to be most likely to be within scope of any recalibration during the control period.

3.31 In addition, in each decision on scope, retaining balance in the ‘star model’ will be a consideration.

Updates to Network Rail’s benchmarks under a material change in circumstances

3.32 Network Rail’s Schedule 8 benchmarks are being calibrated to be consistent with the baseline performance trajectories set through ORR’s PR23 final determination. Benchmarks could be based on newer trajectories in circumstances where ORR has agreed for Network Rail’s baseline performance trajectories to be adjusted. This will help to retain consistency between benchmarks and our regulatory expectations of Network Rail. We otherwise expect the benchmarks to remain consistent with the baseline trajectories in our final determination or, subsequently, the recalibration in advance of year 3 of CP7.

3.33 ORR’s PR23 final determination: policy position on managing change sets out the principles governing change in Network Rail’s baseline trajectories. It states: “Changes to success measure baseline trajectories will only be made following a material change in circumstances" (paragraph 3.15 of the 'managing change' document). These circumstances are "those unforeseen in Network Rail's forecasts or ORR baseline trajectories and are likely to be outside of Network Rail's control and lead to a sustained change in realistic performance expectations in future years of the control period". The policy adds that "ORR does not expect consulted changes to be made frequently" (paragraph 3.8). The policy also states that a change in baseline trajectories could be initiated by Network Rail or ORR (paragraph 3.16).

3.34 Following an update to baseline trajectories, benchmarks may be updated, but this may not automatically follow. We will take into account factors such as the time and resources available to carry out a recalibration.

3.35 Network Rail's benchmark in the freight regime is linked to a trajectory determined by ORR for freight cancellations and lateness (FCaL), without the cancellations element. FCaL is not itself a success measure, but the FCaL trajectory has been calculated using the same methodology as for the freight cancellations success measure. The FCaL trajectory and Network Rail freight benchmark could be updated during the control period in a recalibration that follows a material change in circumstances.

Other Schedule 8 policy matters

Sustained poor performance and open access operators

3.36 The sustained poor performance (SPP) mechanism provides for additional compensation to be payable to a train operator when lateness and cancellations attributable to Network Rail reach a specified threshold, beyond which the standard Schedule 8 formula may significantly undercompensate the operator. The mechanism is contained in the model contract for public service operators (Schedule 8 paragraphs 18 and 19 and Appendix 3), but it has not yet been made available to open access operators. Our understanding is that this is because these operators had previously benefited instead from 'local output commitments', but these have fallen into disuse.[7]

3.37 In our draft determination, we put forward a proposal from Network Rail that the sustained poor performance mechanism should be extended to open access operators in CP7. We agreed that this would have benefits, as it would extend a

[7] Local output commitments (LOCs) are covered in Part L of Network Rail's Network Code. For franchised operators they were replaced with Schedule 8 sustained poor performance provisions as part of ORR's 2005 Review of the Schedule 8 performance regime, but were retained for open access operators.

financial protection to open access operators and remove a potential source of discrimination between different types of passenger operators. Network Rail confirmed in its draft determination response that it agrees with ORR's proposal. Other responses generally did not comment on the proposal, but open access operators have told us that they support the inclusion of the mechanism. The model contract for open access operators will therefore include new paragraphs containing the SPP mechanism, for adoption in CP7.

Recalibration of Schedule 8

3.38 Our recalibration programme has been updating the Schedule 8 regime's parameters for CP7. In PR23, ORR has led on the recalibration of Schedule 8 for passenger operators, and Network Rail has led on the recalibration of Schedule 8 for freight and charter operators. The recalibration working groups mentioned in Chapter 1 have met monthly since April 2022 in support of the recalibrations to discuss and agree points of methodology, with final decisions being made by ORR where required. The most significant decisions, which we have made through consultation with the recalibration working groups, are summarised below.

Recalibration of the passenger Schedule 8 regime

Background

3.39 As set out in Table 3.1, we are not making significant policy changes to the Schedule 8 regime. However, during the PR23 recalibration we have made important choices, in consideration of the impact of the pandemic and the availability of new evidence on how passengers respond to service disruption. These choices affect payment rates and performance benchmarks.

3.40 In the passenger regime recalibration, the recalibration timeframe – the historical period from which data is taken to recalibrate the regime – is 2021-22 period 8 to 2022-23 period 7 (roughly October 2021 to October 2022). This was chosen as being a recent full year of data that limits the direct impacts of the pandemic on data, while capturing some of the post-pandemic changes to services, performance and passenger demand. The approach taken in PR18, to take two full years of data, was not appropriate in PR23 as the relevant years (2020-21 and 2021-22) would have been highly impacted by the pandemic.

Network Rail payment rates

3.41 In the calculation of Network Rail payment rates, initial draft results in May 2023, which were described in the draft determination, showed a substantial (circa 75%) fall from PR18 levels. Following consultation with the industry, we have made a transitional adjustment to the calculation which moderates the size of the fall in CP7, to an average 45% fall from PR18 levels in near-final results. Below we describe the main components driving the reduction in payment rates.

3.42 One key input to Network Rail payment rates is operator service group revenue, calculated using data from the recalibration timeframe. An adjustment has been made to this revenue data to account for the adverse impact of the pandemic and industrial action on revenues. This has raised the revenue in the adversely impacted periods to the percentage rate of revenue recovery seen in unimpacted periods (as compared with pre-pandemic levels). We consider that this gives a better representation of likely revenue levels during CP7. While this raises payment rates above the pre-adjustment level, the effect is more than counteracted by the overall fall in operator revenues from pre-pandemic levels. The net impact in initial draft results was to reduce average Network Rail payment rates by around 15 percentage points.

3.43 Another key input to Network Rail payment rates is the set of estimates of the elasticity of passenger revenue to performance, which is used to quantify the revenue impact of disruption. Since PR18, new studies have been commissioned by the Rail Delivery Group (RDG) from Steer (2019) and SYSTRA (2022), which directly estimate the relationship between revenue and performance (using pre-pandemic data)[8]. These studies build on an earlier study from Oxera (2017) which directly estimated this relationship for flows in London and the South East and which was adopted in the PR18 recalibration for these flows. The PR18 recalibration had, for flows outside London and the South East, indirectly estimated the relationship between revenue and delay through evidence on how demand responds to changes in generalised journey time.

3.44 In the PR23 recalibration's initial draft results, we used the results from the Steer and SYSTRA studies in full to estimate the relationship between revenue and delay. This followed a recommendation from a sub-group of the recalibration working group and specific recommendations from Steer on how to combine the Steer and SYSTRA studies. The estimates showed that demand is less responsive to disruption than had previously been estimated. In initial draft results, lower demand elasticities drove a material fall in Network Rail payment rates of

[8] The studies were commissioned by the Passenger Demand Forecasting Council (PDFC), part of RDG. PDFC maintains the Passenger Demand Forecasting Handbook (PDFH), which summarises research on rail demand forecasting for a variety of industry purposes such as investment appraisal. The Steer (2019) and SYSTRA (2022) studies are available to industry subscribers to PDFH.

around 60 percentage points on average. In combination, the effect of lower revenues and lower demand elasticities resulted in an average fall of 75%.

3.45 In advance of the final determination, we have made a transitional adjustment to Network Rail payment rates by taking the midway point between the CP6 implied elasticities and the CP7 calculated elasticities. This adjustment reduces the impact of the new methodology from a 60 percentage point fall to a 30 percentage point fall. When combined with the effect of lower industry revenues, which contributes a 15 percentage point fall, the overall average fall in near-final results is 45%.

3.46 The adjustment followed concerns raised by passenger operators that the larger reduction undermined incentives and was not in line with an incremental and proportionate approach to PR23. Network Rail and freight operators strongly favoured the initial draft results which they saw as being in line with the latest methodology and evidence.

3.47 It remains our view that the PR23 methodology used to estimate demand elasticities is an advancement on the PR18 methodology, but there is clearly a margin of error in estimation. The true value and impact of disruption is not directly observable and so can only ever be estimated. We recognise that the latest evidence implies a substantially different value on performance and full implementation of the recalibrated payment rates would be a large change to make in a single step. With any large change of this nature there is also the risk of unintended consequences.

3.48 In the recalibration ahead of year 3 of CP7, we will work with the industry to review the evidence base on industry revenues and demand elasticities, and will also consider whether there have been any adverse effects of the initial reduction in Network Rail payment rates.

Benchmarks

3.49 In the calculation of Network Rail and operator benchmarks, we are not adjusting benchmarks for the direct impact of industrial action. While industrial action affected train service volumes in the latter part of the recalibration timeframe, the impact on TOC performance benchmarks would be limited. This is because performance is measured against the reduced timetable, and recalibration takes the proportion of on-the-day services delayed or cancelled across the whole year, so days of industrial action carry little weight in the calculation.

3.50 We have also made a decision not to adjust benchmarks in response to high levels of TOC cancellations. Network Rail has stated that TOCs’ cancellations of their own services ('TOC on Self cancellations') were unusually high during the latter part of the recalibration timeframe. It said that this created a risk that, if TOCs beat the cancellation element of their benchmarks in CP7, Schedule 8 would become imbalanced and leave Network Rail financially exposed. However, in order for the recalibration to be workable to necessary timescales, we have set a high threshold for making adjustments to the recalibration data, and were not persuaded that the risk was material enough to depart from the standard methodology. There is some uncertainty as to whether TOC performance will materially improve from levels in the PR23 recalibration timeframe, and the recalibration ahead of year 3 of CP7 provides an opportunity to adjust TOC benchmarks for changes in performance. This would limit the impact of any imbalance in Schedule 8 during the control period.

Completion of the recalibration

3.51 The work to recalibrate the passenger Schedule 8 regime is nearly complete, and is being independently quality assured before finalisation. The recalibration has taken place in three phases, as summarised below. The recalibration is now completing Phase 3 parameters, and these will be provided to Network Rail and operators shortly after publication of this final determination. After a short period for industry review, we will confirm all sets of parameters in a letter to the industry, and implement parameters for CP7 through PR23 review notices. We will also publish a full methodology report for the recalibration, including details for the recalibration of each set of parameters.

Table 3.2 Timings for Schedule 8 passenger recalibration

Phase	Parameters	Key dates
Phase 1	Monitoring points, monitoring point weightings and cancellation minutes	Initial industry agreement in January 2023; provided with draft parameters in September 2023; finalised in November 2023
Phase 2	Network Rail payment rates	Initial draft results in May 2023; updated draft results in September 2023; finalised in November 2023
Phase 3	Network Rail benchmarks, TOC benchmarks, TOC payment rates and sustained poor performance thresholds	Initial draft results in September 2023; finalised in November 2023

Recalibration of the freight and charter Schedule 8 regimes

3.52 We wrote to members of the freight and charter recalibration working group in March 2023 on the expected methodology and assumptions for the PR23 recalibration of Schedule 8. This letter stated that the PR23 recalibration would follow a similar methodology to the PR18 recalibration. For example, most financial parameters in the freight regime, e.g. the Network Rail payment rates and cancellation sums are, as in PR18, uplifted for consumer price index (CPI) inflation.[9]

3.53 The recalibration timeframe, the historical period from which recalibration data is taken to recalibrate some of the regime's parameters, is 2015-16 to 2019-20. This period was chosen on the basis of it being a continuous five-year period (the length of time that has been used in previous freight and charter recalibrations), and that it largely avoids the disrupted data that resulted from the pandemic. Data from this timeframe is the starting point for parameters such as the freight and charter operator benchmarks.

3.54 The draft operator benchmark in the freight regime was recalibrated based on the agreed recalibration period, 2015-16 to 2019-20, and also reflecting an adjustment for expected changes in traffic volumes. This resulted in a lowering in the benchmark from the PR18 to the PR23 recalibration, from 3.10 to 2.39 minutes of delay per 100 miles. Network Rail was content with this operator benchmark, as reflecting the agreed calculation methodology. However, freight operators raised significant concerns, in particular that, when compared with performance data over the past 18 months, the proposed benchmark was in their view unrealistically low. If this was the case, freight operators would risk paying performance penalties against the benchmark during CP7. We therefore considered a proposal from freight operators to make an adjustment to the freight operator benchmark to make it more representative of anticipated conditions in CP7.

3.55 After consideration, consistent with our duties, including our duty to protect the interests of users of railway services, we are now implementing an adjustment to the freight operator benchmark. This moderates the change in the benchmark by setting it midway between the PR18 and PR23 recalibrated levels, resulting in a

[9] We decided in our October 2022 Schedule 8 conclusions (paragraphs B.50-B.51) that the respective Network Rail payment rates for freight and charter operators would not be subject to a full recalibration using new evidence. The industry felt there was insufficient time available to generate the evidence required. Instead, the existing rates will be uplifted for inflation.

benchmark of 2.74 minutes of delay per 100 operator miles.[10] This adjustment is in light of uncertainty about whether freight operators will be able to return performance to the levels seen in the recalibration period, noting the time that has elapsed since that period. It also reflects the likelihood of recovery in network traffic volumes during CP7 and the risk of adverse impacts on performance.

3.56 Network Rail's benchmark in the freight regime is recalibrated to be consistent with a forecast for freight cancellations and lateness (FCaL), without the cancellations element. The FCaL forecast used in draft results applied a four-year historical average of Network Rail's performance in 2017-18, 2018-19, 2019-20 and 2021-22, with a further 5% stretch applied (consistent with trajectory set in the draft determination). The FCaL forecast used in near-final results follows the methodology used for the final determination freight cancellations trajectory: the same four-year historical period as in the draft determination but without the additional 5% stretch. The PR23 final determination: supporting document on outcomes (Chapter 3) sets out how we consider the freight cancellations trajectory to be ambitious yet realistic.

3.57 The recalibration working group was unable to reach agreement on the calibration of the freight cancellation threshold (which relates to Network Rail cancellations of freight services). This threshold sets a level of cancellations, above which freight operators receive a higher rate of compensation for each service cancellation for which Network Rail is responsible. ORR was asked by the recalibration working group to decide on the setting of the threshold. In PR18, the threshold was calculated as the percentage of FOCs' services that were cancelled during the PR18 recalibration timeframe (2012-13 to 2016-17), resulting in a threshold of 0.40%. For CP7, the threshold has been calculated in a similar way, using the PR23 recalibration timeframe, resulting in a threshold of 0.56%. This has allowed the threshold to reflect changing circumstances while retaining consistency with the approach used in previous recalibrations.

3.58 During the recalibration process, Network Rail noted that the 'prolonged disruption amount' has not been used for the past nine years. When a prolonged track closure takes place, with no alternative route available, Network Rail now issues a restriction of use and provides short notice possession compensation under Schedule 4. The recalibration working group agreed that the prolonged disruption amount should not be recalibrated in PR23, and that the Schedule 8 clauses

[10] The charter operator benchmark has been more stable between the PR18 and PR23 recalibrations, and therefore there have not been the same questions as to whether it is being recalibrated at a realistic level of performance. Therefore, we are not adjusting benchmarks in the charter regime.

relating to the calculation of the prolonged disruption sum should therefore be removed. We proposed in the draft determination incentives document (paragraph 3.55) that this step would help to simplify the freight regime, and we are confirming this change now. The required changes to contractual wording are therefore being implemented in PR23.

3.59 The working group also agreed to a simplification of 'incident caps' in the freight and charter sectors. There is currently an incident cap option that offers a 30% exposure level of delay minutes beyond the cap, but this has not been taken up by any operator in CP6. Therefore, the group has proposed that, for the benefit of simplifying the freight and charter regimes, the cap with a 30% exposure option will not be included in CP7, and the only option should be the cap above which operators have 0% exposure. We proposed in the draft determination incentives document (paragraph 3.56) that this step would help to simplify the freight and charter regimes, and we are confirming this change now. The required changes to contractual wording are therefore being implemented in PR23.

3.60 Network Rail's work to recalibrate the freight and charter regimes is nearly complete, and is being independently quality assured before finalisation. The work has taken place in three phases, as summarised below. Network Rail has provided recalibrated phase 1 and 2 parameters to operators. It is now completing phase 3 parameters, and these will be provided to operators shortly after publication of this final determination. After a short period for industry review, we will confirm all sets of parameters in a letter to the industry, and implement parameters for CP7 through PR23 review notices.

Table 3.3 Timings for Schedule 8 freight and charter recalibrations

Phase	Parameters	Completion date
Phase 1	Inflation uplifts to financial parameters (cancellation sums etc.)	June 2023
Phase 2	Annual liability caps (small/new operators only), freight and charter operator benchmarks, Network Rail's benchmark in the charter regime and the freight cancellation threshold	August 2023
Phase 3	Network Rail's benchmark in the freight regime, adjusted freight operator benchmark, freight and charter operator payment rates, incident liability cap levels and supplements	November 2023 (upcoming)

Annex A: Responses to the draft determination

Schedule 4

Schedule 4 opt-out mechanism

Responses to the draft determination

A.1 On the Schedule 4 opt-out mechanism, Network Rail remained supportive of the policy overall, and supports ORR's proposal to introduce an additional circumstance under which operators can opt out or back into the regime (i.e. if the franchising/contracting authority changes). Network Rail noted that this approach provides flexibility for industry reform. Alongside this, Network Rail agreed that the opt-out decision should be maintained for the entirety of the control period.

A.2 Several train operating companies (TOCs) expressed qualified support for the opt-out mechanism. West Midlands Trains and Greater Anglia, while supporting the opt-out mechanism, voiced concerns about the potential dilution of incentives from this proposal, and the importance of ensuring that Network Rail plans possessions efficiently. While generally supportive, Arriva UK Trains and Govia Thameslink Railway highlighted the need to ensure this proposal was balanced with a strong enough incentive for Network Rail to take timely and efficient possessions. They asked for ORR to provide more detail about how these incentives will be replaced in the case of multiple opt-outs.

A.3 MTR Elizabeth Line and c2c did not support an opt-out mechanism, raising the issue that, absent Schedule 4 incentives, the alternative measures for incentivising Network Rail and DfT-contracted operators will be insufficient. They also noted that the opt-out mechanism could increase late possessions and extended engineering works that are not communicated well to passengers.

A.4 Freight operators generally did not support an opt-out mechanism. GB Railfreight echoed similar concerns about the dilution of overall Schedule 4 payments which could lead to Network Rail not being incentivised to minimise disruption to freight operators and their end-customers. DB Cargo cited an understanding for the rationale for the Schedule 4 opt out but was concerned about the impacts on incentives. DB Cargo stressed the need for ORR to explain how the incentive properties of Schedule 4 will be replaced.

A.5 On the Schedule 4 'reopener' provisions, Network Rail supported the two provisions proposed by ORR in the draft determination. Network Rail strongly agreed that 'Better Timetabling for Passengers and Freight (BTPF)' will require a reopening of Schedule 4 including notification factors and access charge supplements (ACSs). Finally, Network Rail also strongly agreed with the need for a Schedule 4 reopener, to change ACSs, if Schedule 8 is recalibrated during the control period.

ORR decisions

A.6 See paragraphs 2.2 to 2.14 for ORR's decisions on the Schedule 4 opt-out mechanism, and paragraphs 2.15 to 2.17 regarding reopener provisions.

A.7 Overall we consider that the opt-out mechanism provides operators with the flexibility to adjust to industry reform in line with their commercial circumstances. The decision is for each train operator to make, and each operator can remain opted in if it considers this will result in the best outcomes for management of possessions. We acknowledge that, if large numbers of operators opt out from Schedule 4, this will reduce financial incentives on Network Rail on possessions management. However, ORR is taking forward a set of steps to increase monitoring of Network Rail's possessions management to maintain its incentive to minimise disruption – see the PR23 final determination: supporting document on outcomes, Chapter 11 on 'Network availability and possession management'.

Schedule 4 recalibration

Responses to the draft determination

A.8 Network Rail noted that it continues to lead on the recalibration of Schedule 4 and has already shared final Schedule 4 cost parameters with passenger operators, and all Schedule 4 parameters with freight operators. Network Rail highlighted that the methodology used to calculate each operator's ACS is the same as that used at PR18, and reflects the methodology set out in ORR's draft determination.

A.9 In response to the Schedule 4 recalibration, London North Eastern Railway (LNER) voiced concerns that the revised payment rates from the Schedule 8 recalibration would under-compensate for planned engineering works and not incentivise improved performance or efficiency in engineering access. LNER also made comments in relation to the cost of rail replacement being index linked to inflation, and it highlighted that fuel prices have increased by greater than the rate of inflation. It said that this will be reflected in LNER rail replacement costs but not in the compensation they receive. Northern also noted the significantly reduced revenue compensation payable under Schedule 4. Northern said that the future formulaic compensation payable for Type 1 possessions would not properly compensate the TOC for lost revenue.

ORR decisions

A.10 Regarding train operators' comments on Network Rail payment rates, these are covered in the section on 'Recalibration of the passenger Schedule 8 regime' below. Regarding the cost compensation provided by Schedule 4, these parameters were recalibrated in full in PR18, and we decided in PR23 it was proportionate to uplift for CPI inflation (which we note has been significant over the course of CP6).

Schedule 8

Scope of application of Schedule 8

Responses to the draft determination

A.11 In response to the Schedule 8 switch-off mechanism for GBR operators, Network Rail agreed with ORR's decision to proceed with the mechanism which would 'switch off' Schedule 8 payments where legislative change permits. It said that this is aligned with GBRTT's view. Network Rail highlighted that the ability to turn off the majority of Schedule 8 payments between GBR and its future contracted operators will enable the successful transfer of operator contracts to GBR, whilst simultaneously simplifying the incentives that GBR-specified operators face.

A.12 There was limited support from TOCs, with MTR Elizabeth Line, Transport for London and c2c opposing this proposal, with concerns about the proposed suspension of Schedule 8 payments following the transfer of operator contracts to GBR. They said that Schedule 8's financial flows incentivise good performance and this should not be lost, or replaced with less direct incentives. Rail Partners, on behalf of passenger operators, said that the proposal should be clearer on how this regime will function in practice. Heathrow Airport Limited (HAL) showed support for this proposal, but sought further understanding of how the mechanism will work in practice.

A.13 In the freight sector, DB Cargo, Railfreight Group and GB Railfreight all opposed the 'switch-off' mechanism. A main area of concern related to incentives, with concerns that if most operators are no longer part of the Schedule 8 regime in CP7, then the financial incentives on Network Rail would be reduced. The freight industry requested information on how this behavioural and incentive effect will be replaced. Other freight areas of concern related to the necessity for an effective regime with appropriate incentives to ensure that freight operators can have certainty over the control period, and plan accordingly.

ORR decisions

A.14 See paragraphs 3.5 to 3.13 for ORR's decisions on the Schedule 8 'switch-off' mechanism for GBR's future operators.

A.15 We remain of the view that, if implemented, the proposal would simplify financial and incentive arrangements for GBR's future operators, which is consistent with our intention for the PR23 settlement to be adaptable to the outcomes of rail reform. We explain in paragraph 3.6 that we would not expect the mechanism to have an adverse impact on performance incentives, due to the existence of other financial and non-financial incentives in the system, in addition to ongoing Schedule 8 payments for non-GBR operators. We will require that there is a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance before we issue a notice to give effect to the mechanism.

Adding flexibility to Schedule 8 in CP7

Responses to the draft determination

A.16 Network Rail strongly supported ORR's proposal to include a provision in the track access contract which allows ORR to initiate an in-control period recalibration, and said that this should cover all operators. Network Rail asked for clarifications and assurances from ORR on how the need for in-control period recalibrations of Schedule 8 will be monitored, and how in-control period recalibrations will be initiated and carried out in practice. Additionally, Network Rail requested that ORR recalibrates in the event of a reduction in TOC-caused cancellations back to longer term levels, and highlighted potential risks of financial imbalances if this materialises.

A.17 Transport Scotland said it would welcome further clarifications relating to within control period updates, including on the interpretation of material change.

A.18 There was broad support from TOCs for the proposal. Greater Anglia and MTR Elizabeth Line supported this provision, especially given the current industry uncertainty. Rail Partners also recognised the rationale for a within control period recalibration of Schedule 8 but highlighted the need for a balance between greater flexibility and the benefits of a stable regime. Rail Partners said that the threshold should be set high to limit uncertainty and avoid deterring investment in performance improvement schemes.

A.19 There was limited support from FOCs for this proposal. Typically, FOCs expressed the view that recalibration would create uncertainty for freight, and increase complexity in customer and supplier contracts which base some contractual terms on assumed Schedule 8 values. GB Railfreight noted that currently Schedule 8 encourages good practice from industry, and this should not be diluted by frequent recalibration. Freightliner said that the threshold for a recalibration should be set high to ensure that recalibrations are only used to adjust for external factors that could not be foreseen during the periodic review.

ORR decisions

A.20 See paragraphs 3.17 to 3.35 for ORR's decisions on the new provision to allow for the update of Schedule 8 parameters during the control period. We are proceeding with the provision and, in addition, we are now committing to recalibrate the passenger Schedule 8 regime ahead of year 3 of CP7. We consider that the new provision offers potential benefits in allowing the regime to adjust during the control period to better reflect industry conditions.

A.21 We agree that it is important to strike a balance between flexibility and stability. We consider that this balance is successfully struck by committing to recalibrate ahead of year 3, providing the industry with clarity on when to expect change to occur, and otherwise only recalibrating in the event of a material change in circumstances. We recognise the freight sector's preference for stability and predictability; recalibration ahead of year 3 will apply only to the passenger sector, with limited consequential changes to the freight and charter regimes.

Recalibration of the passenger Schedule 8 regime

Responses to the draft determination

A.22 Network Rail supported the fall in the draft Network Rail payment rates, and strongly disagreed with ORR's decision not to fully implement the lower payment rates. Network Rail said that the decision disregarded the latest evidence and the cross-industry agreed methodology. Network Rail said this will result in train operators being overcompensated for delays caused by Network Rail, freight, and charter operators. Furthermore, Network Rail said it is unclear on the rationale for ORR's decision not to implement the reduction in payment rates in full.

A.23 The majority of TOCs disagreed with the initial proposal to significantly reduce Network Rail payment rates. TOCs expressed concern for the recalibration results based upon the methodology and they remain unconvinced that the rates represent the true impact of poor performance. TOCs were concerned that the new reduced rates would not incentivise performance effectively, and that there will be a loss of incentives for Network Rail. For example, Northern highlighted concerns for both the results from the new evidence and the technical assumptions used for the semi elasticity methodology. Additionally, Govia Thameslink Railway noted concern around the time period used for the recalibration. TOCs also said that the significant reduction in payment rates was inconsistent with ORR's position to make limited, proportional changes during PR23.

A.24 Based upon the above concerns, TOCs were supportive of ORR's decision to moderate the reduction in payment rates.

A.25 In response to the proposal on Network Rail payment rates in the passenger regime, FOCs strongly disagreed with ORR's decision not to implement the lower rates in full. Rail Partners, on behalf of the freight industry, noted that it was freight operators' preference for the TOC payment rates to be implemented in full. Rail Freight Group supported the full reduction in the passenger payment rates, and was very concerned about a moderation, which they argue conflicts with the available evidence and will have a negative impact on the freight industry. Freightliner had a similar view, saying that this will lead to freight operators overpaying for the cost of the delays that they cause, and payment rates should be established using the available evidence. Freight operators were also concerned about higher costs for incident cap access charge supplements.

ORR decisions

A.26 See paragraphs 3.39 to 3.51for ORR's decisions on recalibration of the Schedule 8 passenger regime, and in particular paragraphs 3.41 to 3.48 on Network Rail payment rates.

A.27 We have made a transitional adjustment to Network Rail payment rates, which reduces the CP7 impact of the new methodology for estimating demand elasticities. It remains our view that the PR23 methodology used to estimate demand elasticities is an advancement on the PR18 methodology. However, there is a margin of error in estimation, and full implementation of the recalibrated payment rates would be a large change to make in a single step, with the risk of unintended consequences. This is the basis of the decision to moderate the fall in rates in CP7. In the recalibration ahead of year 3 of CP7, we will work with the industry to review the evidence base on industry revenues and demand elasticities, and will also consider whether there have been any adverse effects of the initial reduction in Network Rail payment rates.

Recalibration of the freight and charter Schedule 8 regimes

Responses to the draft determination

A.28 In response to the fall in FOC benchmarks, and the increase in the Network Rail cancellation threshold, FOCs have said that this change will have a financial impact on the freight industry, and result in a weakening of incentives on Network Rail to minimise cancellations to freight services. FOCs said there should be an adjustment to freight parameters such as the FOC benchmark and the Network Rail cancellation threshold, and drew parallels with adjustment decisions in the passenger recalibration. Rail Partners similarly said that it was necessary to make adjustments in the freight recalibration. Rail Freight Group noted the complexity of the recalibration but highlighted that parameters should be assessed holistically, and should ensure that the freight sector has certainty across the control period.

A.29 In response to the Network Rail performance target, Rail Partners and Freightliner said that the proposed CP7 Freight Cancellations and Lateness (FCaL) trajectory should have been set at a lower level. FOCs said that the proposed Network Rail trajectory and benchmark in CP7 is inconsistent with industry ambitions for a high-performing and reliable railway. FOCs therefore considered that it is necessary for the Network Rail benchmark to be adjusted accordingly.

ORR decisions

A.30 See paragraphs 3.52 to 3.60 for ORR's decisions on recalibration of the Schedule 8 freight regime.

A.31 Following the draft determination, we have made an adjustment which moderates the freight operator benchmark by setting it midway between the PR18 and PR23 recalibrated levels. This reflects uncertainty about whether freight operators will be able to return performance to the levels seen in the recalibration period. We consider that other parameters, such as the freight cancellation threshold, have been set in a reasonable way and will provide appropriate incentives.

A.32 Regarding the performance trajectory that supports the Network Rail freight benchmark, we consider that the trajectory for Freight Cancellations, on which the FCaL trajectory is based, is ambitious yet realistic. This is explained further in Chapter 3 of the PR23 final determination: supporting document on outcomes.

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