

## **PR18: Schedule 4 and 8 Re-calibration Working Group**

### **Meeting 3: Note of the freight operator Re-calibration Working Group meeting held on 28 April 2017 at ORR's London offices**

#### **The purpose of the note**

1. This note summarises the actions and key decisions agreed in the freight operator meeting of the Schedule 4 and 8 Re-calibration Working Group (hereafter: the Working Group) meeting held on 28 April 2017.
2. In the meeting the group discussed: (i) the payment rates in Schedule 8 regime; (ii) the re-calibration of benchmarks in Schedule 8; (iii) the re-calibration of Schedule 4; and (iv) the forward agenda for the next re-calibration Working Group.
3. The slides ORR presented in the meeting are available on the ORR website<sup>1</sup>.

#### **Payment rates in Schedule 8**

##### **4. Points of clarification**

- Following on from the discussion on Schedule 8 payment rates in the previous freight Working Group meeting, ORR confirmed that in order to approve a revision of the Network Rail payment rates, freight operators will need to supply robust evidence on the financial impacts of delay. In the absence of such evidence the CP6 rates will be based on the CP5 rates (uplifted for inflation).
- It was noted that two freight operators provided data on the cost categories that the payment rates should reflect (following an action taken at the previous meeting). ORR reviewed these submissions with a view to collating them but did not find significant overlaps with the cost categories put forward. ORR stated that it is not well placed to continue the work of determining which cost categories are sensitive to delay.
- ORR confirmed – in the light of concerns from freight operators about the possibility that new evidence would be rejected - that the best way to ensure that new evidence could be approved for use in the calculation of payment rates

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<sup>1</sup> [http://orr.gov.uk/\\_data/assets/pdf\\_file/0014/25520/slides-on-schedule-8-recalibration-benchmarks-in-the-freight-regime-28-april-2017.pdf](http://orr.gov.uk/_data/assets/pdf_file/0014/25520/slides-on-schedule-8-recalibration-benchmarks-in-the-freight-regime-28-april-2017.pdf)

[http://orr.gov.uk/\\_data/assets/pdf\\_file/0015/25521/slides-on-schedule-4-recalibration-28-april-2017.pdf](http://orr.gov.uk/_data/assets/pdf_file/0015/25521/slides-on-schedule-4-recalibration-28-april-2017.pdf)

was by ensuring that ORR was consulted throughout the process of producing the evidence.

- RDG confirmed that any work to improve the evidence base for the Network Rail payment rate would need to be approved by ORR by early September 2017.
- Network Rail confirmed that if freight operators put forward a robust proposal that they think will produce useful results they are willing to contribute towards the cost of consultancy work to revise the Network Rail payment rate.
- ORR explained that work is already underway to produce evidence for the relationship between passenger operator revenue and unplanned disruption. ORR will consider how this work should be used to inform the re-calibration of the Network Rail payment rates in the passenger regime, which feed into the freight operator payment rate.
- ORR agreed that it was important for freight operators to understand the basis of the calculation of freight operator payment rates.
- ORR explained that it is difficult to provide a comprehensive teach-in for freight operators on how the Network Rail payment rates are calculated in the passenger operator Schedule 8 regime, due to their complexity.
- ORR noted that the Halcrow reports from PR13 explain much of the methodology of the calculation of Network Rail payment rates for passenger operators (which affect the freight operator payment rates). It was suggested that freight operators consult these first and then teach-ins on specific areas could be arranged at a later stage.

## **5. Concerns raised**

- Freight operators are unclear on why ORR did not accept the evidence in the L.E.K work that they funded in PR13 to revise the Network Rail payment rate. As a result there is a concern about commissioning new work to establish evidence which could be used in the re-calibration of the Network Rail payment rate if this could happen again.
- Freight operators are concerned with the lack of transparency on the calculation of the payment rates in the passenger operator Schedule 8 regime – in particular freight operators were interested whether the model had been compared against actual historical passenger operator revenue losses.
  - ORR stated that there was no direct way to establish actual historical losses because estimating the losses requires estimating what would have happened if delay had been lower but all other factors remained the

same – it is not a case of simply looking at what happened to passenger operator revenue over the period. ORR noted that the current PDFH econometric study would serve as an alternative source of evidence on revenue losses from delay.

- Freight operators raised concerns about paying for modelling work to be undertaken, especially given the large costs this would involve. They noted that unlike the Network Rail passenger payment rate there was no existing model to base the Network Rail freight payment rate upon and it would need considerable investment to produce a model from scratch that would calculate future lost revenue.
- The freight operators were also concerned that the impact of efficiency (i.e. operating trains with on average more freight per train) would not be taken into account if the Network Rail freight payment rate was adjusted solely by RPI.
  - ORR noted that they would require evidence on what the impacts are in order to approve any change to the rates.

## 6. Actions

- **ORR** to circulate the section of the PR13 final determination that sets out why the L.E.K work was not considered robust enough to use to re-calibrate the Network Rail payment rate.
- **Freight operators** to reply with further queries if the explanation given in the final determination is unclear.
- **Network Rail** to check with PDFC that it can share the consultancy proposal for the study looking at the relationship between unplanned disruption and operators' revenues with the group. If this agreed to, Network Rail will circulate it to the group.
- **ORR** to circulate links to the Halcrow PR13 reports on the re-calibration of Schedule 8.
- **Freight operators** to review the Halcrow reports and identify areas of the calculation of the Network Rail payment rates that they want greater understanding of.
- **Freight operators** to consider next steps on whether and how to develop new evidence on the financial impact of delay on freight operators.

## Re-calibration of benchmarks in Schedule 8

### 7. Points of clarification

- Network Rail and operators clarified that the Network Rail benchmark for CP5 was not calculated on the basis of past performance – it was set on the basis of the Network Rail benchmark in the last year of CP4 (note that Network Rail’s CP4 benchmarks had a performance improvement trajectory applied).
- ORR agreed to consider the following additional criteria for use in its assessment of the Schedule 8 benchmark: “the benchmark must be consistent with the funding that Network Rail receives”.
- Network Rail raised the point that if the current annual traffic adjustment for the freight operator benchmark is retained for the CP6 the congestion factor will have to be re-calculated even if the capacity charge is removed.
- ORR noted that they are keen to incentivise Network Rail to reduce Delays Per Incident (DPI) and are looking at the differences between DPI for Network Rail and operator caused incidents.
- It is Network Rail and freight operators’ role to propose the re-calibration period to be used for CP6, and that could involve selecting a longer re-calibration period. ORR’s role is to consider and approve the proposal.

### 8. Concerns

- Network Rail was expressed concerns that there would be an inconsistency in Schedule 8 if the capacity charge were to be removed in CP6 but the freight operator benchmarks continued to be adjusted annually for changes in traffic on the network. It was also noted that re-calibrating the congestion factor for the traffic adjustment would require a significant amount of work.

### 9. Actions

- **ORR** to consider policy on the adjustment to reflect congestion on the network in light of proposals on the capacity charge.

## Re-calibration of Schedule 4

### 10. Points of clarification

- ORR noted that some of the issues raised by freight operators in response to the December consultation could be considered re-calibration issues but others fell within the policy development workstream (see slides for details).

- ORR explained that the issue of the funding available for the freight Schedule 4 regime would need to be discussed between operators, funders and Network Rail.
- ORR indicated that the base case for the re-calibration of the Schedule 4 freight regime would involve:
  - updating the freight Schedule 4 budget and payment rates for inflation to deliver broadly the same level of compensation as in CP5; and
  - identifying any issues with contractual wording and if straightforward address.
- Freight operators clarified that for bespoke compensation claims the issue they are concerned about is the ease of making claims as well as ensuring they are adequately compensated.

## 11. Concerns raised

- Freight operators raised the concern that the current Schedule 4 payment rates do not incentivise Network Rail to plan their possessions in the most efficient way. It was suggested that Network Rail could make savings through more efficient possession planning if the freight Schedule 4 payment rates were higher (that might more than offset the increase in Schedule 4 costs). Freight operators also highlighted the role the System Operator might play in ensuring diversionary routes remain available when primary routes are blocked, particularly when the diversionary route is on another Network Rail Route.
- One freight operator raised a question around the use of diversionary routes. In particular around what should be considered to be the 'original' route where an operator makes changes in anticipation of possessions.
- Freight operators also sought clarity on the procedures around possessions switching from category 1 or 2 to category 3.
- Network Rail flagged that it had some concerns with some specific aspects of Schedule 4 that might possibly be considered when looking at contractual wording issues.

## 12. Actions/Next steps

- ORR will engage with RDG, Network Rail and freight operators to try and reach agreement on who will lead the re-calibration work post June.

- The majority (but not unanimous) view of the group was that the basecase was (subject to any separate discussions on funding) an acceptable basis for the re-calibration.
- Parties agreed to flag any concerns with contractual wording (ORR to supply a log)
- ORR and Network Rail to discuss specific contractual wording issues outside of this Working Group.

## Forward agenda

### 13. Points of clarification

- ORR noted that the previously discussed Schedules 4 & 8 'mini-consultation' may not take the form of a consultation if there are no policy decisions that need consulting on. Instead the ORR will publish a letter or memorandum making clear any substantive policy or re-calibration decisions agreed by the Working Group.
- It was confirmed that next freight Working Group meeting will be the last led by ORR. Future Working Group meetings will be led by RDG. Although ORR will continue to attend.

### 14. Points of agreement

- It was agreed that at the next meeting ORR will re-cap on the key decisions and points of agreement arrived at in Working Group meetings to date.
- It was also agreed that the key topics for discussion in future Working Group meetings should be discussed.
- On Schedule 4 it was agreed that contractual wording should be discussed.

## Attendees

Name	Organisation
Greg March	Colas
Nigel Oatway	DBS Cargo
Bethan Stokes	DfT
Rob Whittleston	DfT
Norman Egglestone	DRS
Lindsay Durham	Freightliner
Danny Matthews*	GBRf
Alexis Streeter	Network Rail
John Thomlinson	Network Rail
Nick Coles	Network Rail
Peter Swatridge	Network Rail
Deren Olgun	ORR
Joe Quill*	ORR
Joel Moffat	ORR
Sheona Mackenzie	ORR
Yasmine Ghozzi	ORR
Caitlin Scarlett	RDG

\* Joined the meeting by phone.