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OFFICE OF **RAIL REGULATION**

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Chairmen, Network Code Industry Steering Group
Paul Plummer Esq
Dominic Booth Esq
Graham Smith Esq

Dear Sirs.

Train Operator Compensation from Possessions

1. Train operators currently receive compensation for possessions through Schedule 4 of their track access agreement and / or through Part G of the Network Code.
2. We understand from discussions with Network Rail and train operators that the current compensation mechanisms for possessions are not working as effectively as they should, in particular due to:
 - (a) issues around the boundaries between Schedule 4 and Part G;
 - (b) an inconsistent approach to compensating train operators for the effects of possessions;
 - (c) concerns over the accuracy of compensation arrangements and the resulting economic signals;
 - (d) a lack of transparency in the Part G and Schedule 4 process; and
 - (e) unnecessarily high transaction costs.
3. To date a complete review of the interrelationship between Schedule 4 and Part G compensation mechanisms has not been undertaken, in part because of the different ways each regime might be amended, i.e.:
 - (a) Schedule 4 can only be amended by ORR as part of an Access Charges Review (unless all parties have agreed to a change);
 - (b) The Network Code, and any part of it (including Part G), can be amended at any time either by a proposal being put forward by an industry party using the Network Code C5 process or by ORR using the C8 process.



INVESTOR IN PEOPLE



4. We agree that there are a number of structural issues with the possession compensation mechanisms which, if rectified, could provide a more transparent process, reduce the industry's administrative burden, and therefore contribute to furthering a number of our Section 4 duties, including:

- (a) promoting efficiency and economy on the part of persons providing railway services;
- (b) promoting improvements in railway service performance; and
- (c) enabling persons providing railway services to plan the future of their businesses with a reasonable degree of assurance.

5. We therefore believe that the compensation mechanisms for possessions contained in Schedule 4 and Part G of the Network Code should be reviewed as part of the periodic review 2008 (PR08). We consider that, in the first instance, a review of Schedule 4 and Part G of the Network Code should be undertaken as an industry review. We therefore propose to remit the Network Code Industry Steering Group (ISG) to lead a review of these compensation mechanisms to achieve the objectives set out in the attached remit.

6. One of the key outputs that we are seeking is the incorporation within Schedule 4 of all compensation relating to possessions on the network. We see this as key in introducing consistency in the approach to providing compensation for disruption to train services caused by possessions. ORR has suggested on a number of occasions previously that there would be merit in having a single compensation regime for possessions.

7. Such a review would need to be completed in time to be taken into account in our conclusions on access charges for Control Period 4 (April 2009 to March 2014). Required timescales for completion are therefore included in the attached remit along with a number of other factors that should be taken into consideration.

8. We recognise that any proposed changes to existing regimes might result in changes to the risk profiles applying to industry parties. Changes would also have implications for the relationship between Schedule 4 and Part G of the Network Code and could have implications for the operation of clause 18.1/Schedule 9 franchise agreement provisions. These impacts, together with other relevant factors, should be taken into consideration when making proposals for change.

9. As we believe that there is significant industry benefit to be gained in consolidating possessions compensation within Schedule 4, we would expect to take steps to introduce such a change as part of PR08 even if ISG is unable to make any recommendations to deliver this.



10. We will provide support to ISG, if required, and would look to participate on any working group established to deliver this work.

11. I am copying this letter to all industry stakeholders for information because of the potential impact that this work will have on them.

Yours sincerely

A handwritten signature in black ink that reads "John Thomas".

John Thomas



Remit to Network Code Industry Steering Group

Review Train Operator Compensation from Possessions

Introduction

This document details the remit for a review by ISG of the arrangements for compensation of train operators for possessions

Possession Compensation Principles

The following principles should be reflected in establishing a compensation mechanism for possessions:

- (a) all compensation for possessions should be made through Schedule 4 of a Track Access Agreement (or its freight equivalent) to the exclusion of Part G;
- (b) a consistent approach should be taken for compensation for possessions for differing purposes i.e. there should be no differentiation between a possession taken for a renewal or an enhancement. Differentiation may however be introduced to reflect the scale and impact of a possession or number of different possessions if this is considered appropriate. Differentiation may lead to different rates and/or approaches to compensation;
- (c) transaction costs should be minimised;
- (d) Network Rail should be incentivised, where possible, to manage the use of possessions efficiently and effectively;
- (e) train operators should receive “fair” compensation for the restriction on contractual rights if these are affected by a possession. A balance should be struck between accuracy and the efficiency of compensation mechanisms;
- (f) a right of appeal should be retained to enable train operators and Network Rail to seek redress if compensation is disputed;
- (g) transparency of costs / benefits to be paid should be established, where possible, so that the risks and impact of disruption caused by possessions can be anticipated;
- (h) there should be a consistent approach for paying compensation to franchised and non-franchised passenger operators and freight operators unless there is a compelling case to take a different approach;



Related Issues

In removing possessions compensation from Part G of the Network Code and channelling this through Schedule 4/8 (Schedule 8 for possessions overruns) there may be a residual role for some compensation to be paid through Part G in respect of the long term impacts (as opposed to disruptive impacts) of the implementation of a Network Change. ISG should consider this and whether the definition of Network Change is appropriate in its current form and whether other changes should be made to Part G.

ISG should consider linkages between Schedule 4, industry planning, timetable development and Part G processes to ensure the achievement of the best whole industry possessions strategy.

The effect of Clause 18.1/Schedule 9 provisions within franchise agreements will need to be taken into account.

Output Required

ISG should produce the following outputs as part of this work:

- (a) agree the compensation structure, setting out:
 - (i) the compensation structure or structures which would apply in any given case;
 - (ii) what compensation will be paid for different types of possessions;
 - (ii) how it is funded;
 - (iii) appeal process;
 - (iv) relevant timings;
- (b) calculation of appropriate compensation rates for revenue losses and additional costs for both passenger and freight. This may involve a mix of liquidated damages or look-up table approach for some possessions and bespoke calculations for more significant possessions. This is likely to require some external support to which we could contribute funding;
- (c) evidence that any proposals put to ORR as recommendations have been appropriately consulted with relevant stakeholders and that their comments have been taken into account;
- (d) proposed drafting changes to Schedule 4 and Part G of the Network Code that are required to give effect to the proposed changes.



Requirement for Stakeholder Involvement

Before putting a recommendation to ORR for consideration in its periodic review all affected parties should have been consulted and their views taken into account. Any recommendations put to ORR for consideration should be accompanied by evidence that appropriate consultation has taken place, accompanied by copies of all consultation responses received and details of the conclusions reached in considering each of the issues raised.

As part of the PR08 process we expect to provide industry stakeholders a further opportunity through our draft conclusions on access charges. This would include proposed Network Code C8 changes to amend Part G of the Network Code, if required.

Timescales

To fit with the access charges review timescales, recommendations should be submitted to ORR by the end of January 2008. To achieve this, we would reasonably expect draft proposals to be put to the industry for consultation no later than the end of September 2007. We will therefore take a view in September 2007 as to whether the industry has made appropriate progress or whether we need to develop our own approach. To allow progress to be monitored we would ask ISG to develop a work programme identifying key milestones to fit with these timescales.