



# Schedule 4 re-calibration

Passenger operator  
Working Group

15 May 2017

# Purpose of these sessions

- To agree the detailed scope of the re-calibration work by June to enable industry deliver the work needed.
- The focus is on re-calibration not policy i.e. it's about the specific numbers in the formula and detailed methodology rather than reviewing principals or fundamental aspects of the methodology.



# The current approach

**The aim:** Should reflect the amount Network Rail is expected to pay out in Schedule 4 compensation resulting from maintenance & renewals under the liquidated damages regime over the control period.

**The calculation:**

- Assumed maintenance and renewals volumes (from the Strategic Business Plan (SBP) submitted during the price control); and
- Schedule 4 unit costs for each asset type are apportioned pro-rata amongst operators based on historic Schedule 4 compensation payments paid to operators.

**Issues with this approach**

- Actual levels of maintenance and renewals are likely to differ from forecast
- There is a concern that setting the charge based on the SBP has resulted in an ACS higher than appropriate due to, for example, deferral of renewals into CP6.

# Options considered

Option	Consultation responses
<p>1. Use the delivery plan (which is produced immediately before the start of the control period) rather than the SBP.</p>	<ul style="list-style-type: none"> <li>- Less support than the other options</li> <li>- NR think the link to the SBP/FD must be maintained to ensure consistency across the settlement package</li> </ul>
<p>2. More frequent (probably annual) recalculations to adjust the baseline Schedule 4 cost based on the most recent business plan (or potentially for ex-post variations in the volume of renewal and maintenance activity) during the control period.</p>	<ul style="list-style-type: none"> <li>- Some support</li> <li>- Some felt fixing ACS for 5 year period is too long</li> <li>- Alternative suggestion of a wash up process instead of a full recalculation</li> <li>- NR suggest this would be like reopening the settlement each year (and would be inconsistent with rest of settlement)</li> <li>- NR believe annual assessment of financial performance already takes account of deferrals</li> </ul>
<p>3. Make a high-level adjustment to the total ACS needed (for example on the basis of historical over-recovery) at the start of CP6.</p>	<ul style="list-style-type: none"> <li>- Some support</li> <li>- NR think this would weaken the incentive</li> </ul>
<p><b>Other points made</b></p> <ul style="list-style-type: none"> <li>- One respondent suggested route level ACS</li> </ul>	

# Next steps on policy work

## ■ We are doing some further thinking and analysis

- If we do make a change it needs to be consistent with the rest of the settlement and support the Schedule 4 incentives
- If there is a proportionate way of improving the incentive and/or avoiding a windfall gain.
- We will consult further in September but will engage with NR and RDG ahead of that.

## ■ What about the re-calibration

## ■ Are there other things that need to be re-calibrated?

- At a route level – how do we ensure consistency with the final settlement

## ■ Timing of the re-calibration work

- What can happen alongside the ongoing policy work?



# Bespoke compensation

# The current approach

The Schedule 4 passenger regime operates a tiered structure of possessions defined by the following possession types:

- a) Type 3: single possession greater than 120 hours (including public holidays), receive formulaic compensation as default but with the possibility of actual revenue losses and costs (subject to a materiality threshold);
- b) Type 2: single possession greater than 60 hours, but equal to or less than 120 hours, (excluding public holidays), receive formulaic compensation as default but with the possibility of actual costs (subject to a materiality threshold and in respect of categories of direct costs only);
- c) Type 1: All other possessions receiving formulaic revenue and cost compensation (subject to the payment of ACS).

Additional compensation for Sustained Planned Disruption (SPD) is triggered when the impact of disruption crosses a pre-defined threshold (in terms of revenue lost or increased costs) where there is disruption caused by possessions over a sustained period.

## Issues with this approach

- Concern that the SPD thresholds are too high
- Concern that the current process for claiming bespoke compensation (for type 2 or 3 possessions or SPD) is costly, time-consuming and difficult to resolve.



# Options considered

Option	Consultation responses
1. Fix error in SPD threshold formula	<ul style="list-style-type: none"> <li>- No concerns raised</li> </ul>
2. Review thresholds (SPD and/or type 2 and/or type 3)	<ul style="list-style-type: none"> <li>- Specific support from TOCs for looking at SPD threshold (less so for looking at type 2 or 3)</li> <li>- NR noted that a number of bespoke claims for type 2 and 3 claims have been made</li> <li>- NR noted that a lack of SPD claims doesn't mean the thresholds are too high – its intended to only capture the extreme</li> </ul>
3. Review contractual wording with a view to improving the process	<ul style="list-style-type: none"> <li>- Some support from TOCs</li> <li>- NR supportive of looking at this and have better guidance in place</li> </ul>

# Next steps

## ■ We are doing some further thinking and analysis

- Of the SPD thresholds (we think this is a policy rather than a recalibration issue) and plan to consult on a minded-to position in September
- We support Network Rails suggestion of improving the guidance;
- We will consider any specific issues raised (either in response to this consultation or by this group). ORR will lead on these and engage with industry on the detail in due course

## ■ What does that mean for the re-calibration?

- We don't think there is a strong case for recalibrating type 2 and 3 thresholds – do you agree?



# Contractual wording

# Contractual wording

- We've circulated a form for raising issues
- Please include as much detail as you can when raising an issue – and it would be helpful (but not essential) if you have a suggested solution
- Note: it may not be possible to resolve all issues raise – providing information on the scale of the issue will be helpful
- Please raise any issues by 9<sup>th</sup> June 2017
- ORR will lead on these and engage with industry on the detail in due course