



OFFICE *of*
RAIL REGULATION

REVIEW OF THE SCHEDULE 8 PERFORMANCE REGIME

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Chairman's foreword

1. The Government's White Paper *The Future of Rail*, published in July, set out a blueprint for the industry which recognises rail's status as a public service, specified by Government and delivered by the private sector. As the independent regulator, the Office of Rail Regulation plays a key role in ensuring that this partnership between the public and private sectors operates effectively.
2. In September, ORR published for consultation proposals on its future work programme in the light of the White Paper. Although we are working within an overall implementation programme coordinated by The Department for Transport, ORR must nonetheless ensure that we continue to exercise our functions fully in accordance with the public interest duties set out in the Railways Act.
3. As the White Paper said, one of ORR's responsibilities is 'to help ensure that the railway provides value-for-money for both the fare-payer and the taxpayer, taking into account safety, performance and cost'.
4. This sums up what we seek to achieve in exercising our functions as the independent economic – and in future also the safety – regulator for the rail sector. ORR is an 'umpire', holding the ring between public sector funders and private sector service providers, maintaining a level playing field for different private sector companies, and helping to ensure that the interests of all rail users and of taxpayers are met.
5. To help the industry to operate in the public interest, our approach will include the following:
 - improving understanding of the costs of providing rail services, so that strategic decisions by Government and other funders on services to be supported by public funding and by all operators in planning their service patterns are based on sound and consistent information about the implications of different courses of action;
 - putting in place clear measures of the outputs to be delivered by Network Rail as manager and operator of network assets which are consistent with the outputs to be delivered by train operators and other suppliers, and with a clearly understood mechanism for changing required outputs;
 - establishing appropriate incentives and contractual frameworks for Network Rail and train operators to work in partnership to plan for and deliver these outputs

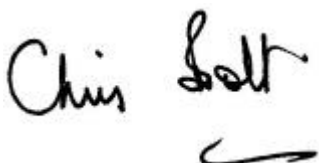
efficiently, so that funders and rail users get the services they expect and companies have the freedom to decide the most effective means of delivery; and

- monitoring delivery of outputs, making the results available to funders and users, and taking proportionate and targeted enforcement action if needed to protect the public interest.

6. In taking forward our proposed work programme, ORR will be publishing a number of reports and consultation papers between now and Christmas. The two being published today are of central importance in ensuring that decisions on service provision are based on sound information about infrastructure costs, and providing appropriate and effective incentives to Network Rail and train operators:

- the Structure of Costs and Charges Review will lead to the development of an infrastructure cost model. This can be used by funders and operators as well as Network Rail and ORR to assess the impact on infrastructure costs of changes in service patterns. This review will allow the structure of charges to be revised to align commercial incentives with the public interest; and
- the Performance Regime Review will consider how the current regime can be changed to ensure that, taken together with other contractual arrangements such as Local Output Commitments, Network Rail has the right incentives to deliver – and indeed exceed – the performance improvements required by the Access Charges Review 2003.

7. Taken together, these documents cover key components of the planning and incentive structure of the rail industry. They will therefore be of major interest to all companies operating in the rail industry, rail users and funders. We look forward to your full involvement in the consultation, both in responding to these documents and in participating in the planned industry seminars and work groups.

A handwritten signature in black ink that reads "Chris Bolt". Below the signature is a small, simple arrow pointing to the right.

Chris Bolt
Chairman, Office of Rail Regulation

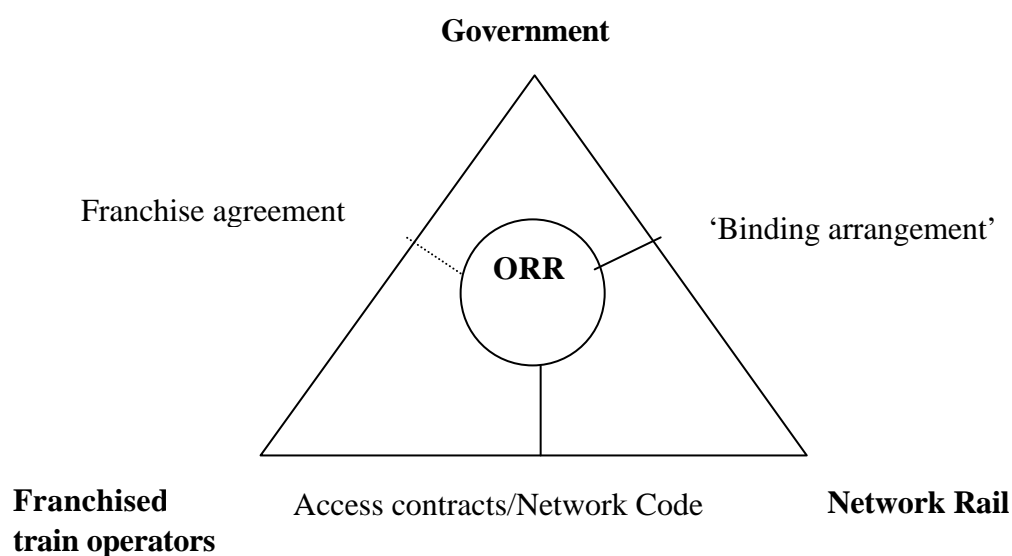
2 November 2004

1. Purpose and context of the review

Introduction

- 1.1 The Government's recent White Paper¹ on The Future of Rail envisages that Network Rail and train operators will work constructively and cooperatively in order to achieve material and sustained improvements in train performance. Network Rail will be accountable for whole industry performance (not just its own), and have the mechanisms in place to support this new responsibility.
- 1.2 In simple terms, the White Paper envisages a strengthening of key industry relationships in order to facilitate improvements in performance. These relationships are shown in Figure 1.1.

Figure 1.1: The industry's key relationships



- 1.3 The key relationships are:
- (a) the 'binding arrangement' between the Government and Network Rail, which sets out the high-level specification of what the Government is prepared to spend on the railways and the key outputs it expects to see delivered by Network Rail;

¹ *The Future of Rail*, Department of Transport, Cm 6233, London, July 2004.

- (b) the franchise agreements between the Government and the franchisees, setting out the outputs that train operators are required to deliver and the corresponding funding arrangements; and
 - (c) the access agreements and Network Code that govern the partnership between Network Rail and the train operators.
- 1.4 This review focuses on the performance regime contained within Schedule 8 of passenger track access contracts but it will need to be aligned, in particular, with the reform of the Network Code and the development of future franchise agreements (see paragraphs 1.18 to 1.25). It will therefore be very important that the separate but closely related workstreams are coordinated.
- 1.5 In addition to the structural changes proposed in the Government's Rail Review, the White Paper highlights a number of perceived problems with the current performance regime:
- (a) poorly focused incentives, which could at times be perverse;
 - (b) a blame culture due to the workings of the delay attribution system that has increased industry costs; and
 - (c) complex interactions within the current compensation regime.
- 1.6 ATOC and Network Rail submitted a paper to the Government prior to the conclusions of the Rail Review (reproduced in Annex C), identifying areas where change to the Schedule 8 performance regime may address some of these perceived problems. These are considered further in Chapter 2.

Purpose of this document

- 1.7 The purpose of this document is to consult upon the effectiveness of the current Schedule 8 performance regime and to discuss possible changes to it.
- 1.8 Annex B provides a description of the key features of the current Schedule 8 performance regime. The regime is designed to fulfil three broad objectives:
- (a) to compensate train operators for the farebox revenue lost in the event of poor performance by Network Rail;
 - (b) to incentivise Network Rail and train operators to maintain and improve operational performance; and

- (c) to set the appropriate signals and provide information so as to drive the decision-making by both Network Rail and the train operators in relation to performance management, *e.g.* investment prioritisation and preparation of business cases for performance improvement schemes.
- 1.9 Although the Access Charges Review 2003 (ACR2003) included some significant changes to the basis of payments within the Schedule 8 performance regime (which, as discussed at paragraph 2.2, have resulted in much lower payments flowing through the regime), its structure was last fully reviewed as part of the 2000 periodic review (PR2000).
- 1.10 It is therefore appropriate to review the regime, both as a result of the proposals in the White Paper and because of the period of time since the structure of the regime was last fully examined .
- 1.11 The focus of this review is on the following questions.
- (a) Do the current objectives of the regime (as set out in paragraph 1.8) remain appropriate?
 - (b) Is the current regime fulfilling its objectives?
 - (c) Does the current regime impose unwarranted bureaucracy and cost in relation to the benefits?
 - (d) What changes (if any) to the regime should be implemented by this review, for example to improve the alignment of incentives with responsibilities in light of the proposals in the White Paper?
- 1.12 ORR is aware of suggestions that incentivising performance improvement could lead to performance being given priority over safety requirements. ORR does not accept that improved performance is achieved at the expense of safety. This is because a good performing railway will be indicative of a well-managed and safe railway. However, in carrying out the review, ORR will have regard to any issue raised in this respect from the Health and Safety Executive (HSE).
- 1.13 There are two broad possibilities regarding change to the existing regime:

- (a) a radical change to the structure, whereby a different performance model to Schedule 8 may be appropriate²; or
 - (b) changes to various parameters which strengthen the effectiveness of the existing Schedule 8 performance regime.
- 1.14 The choice of performance model will depend largely on the objectives of the regime. Within the new industry structure, franchised passenger train operators will generally continue to take some revenue risk. In this case, there is a continuing need for a performance regime to compensate train operators for the effect on their farebox revenue resulting from lateness and cancellations to their trains caused by Network Rail and other train operators.
- 1.15 If such compensation were not to be provided, it is reasonable to assume that performance risks would be factored into franchise bids. This would have the effect of lowering the value of the franchise through a higher level of subsidy being required by the franchisee (or lowering the receipts to Government where the bid for a franchise is in the form of a premium payment).
- 1.16 The consequence of this is that many of the performance models existing in other industries which focus primarily on incentivising desired behaviour rather than compensating customers for actual losses (for instance penalties related to interruption of supply in the energy industry), would not be appropriate for the rail industry. It is therefore ORR's current view that this review should build on and improve the existing structure of Schedule 8.
- 1.17 Do the objectives of the performance regime, as set out in paragraph 1.8, remain appropriate and how effective has the regime been in meeting these objectives?**

Interaction with other industry reforms and processes

- 1.18 Any changes made to the track access contracts need to be aligned with the binding arrangement between Government and Network Rail, the provisions of the franchise agreements, and the Network Code. A misalignment of incentives would provide confusing (and potentially conflicting) signals to Network Rail and train operators and would not lead to an efficient whole industry outcome.
- 1.19 It is expected that this review will inform and support the work being undertaken to reform the economic architecture of the Network Code. This reform is key to ensuring

² EU Directive 2001/14 requires some form of performance regime between train operators and the infrastructure manager. Elimination of the regime is therefore not an option.

that effective relationships between Network Rail and train operators encourage optimum decisions to be taken, in relation to both cost and performance. The Network Code contains a number of provisions designed to facilitate improvements in operational performance by:

- (a) setting out the basis for monitoring performance (Part B);
- (b) describing the arrangements for changes to vehicles and the network (Parts F and G);
- (c) setting out procedures and plans for minimising the effects of operational disruption (Part H);
- (d) providing for improved two-way flows of information between Network Rail and train operators to strengthen the management of key interfaces and network stewardship (including information on performance outputs in local output commitments (LOCs)) (Part K); and
- (e) providing for the establishment/creation of LOCs that contain commitments from Network Rail to each train operator on delay minutes, underpinned by detailed performance plans (Part L).

1.20 A review of each of these areas of the Network Code is, with ORR's active engagement, currently being taken forward by the industry. The whole performance architecture contained within the Network Code and track access contracts needs to be complementary to facilitate the achievement of significant and sustained improvements in performance.

1.21 It will also be important to align Network Rail's incentives with those of train operators through the franchise agreement, to ensure that both parties are incentivised to work together to deliver the necessary improvements in whole-industry performance. Two issues of particular importance are:

- (a) the impact of Clause 18.1/variation mechanism of the franchise agreements; and
- (b) the timetable for letting new franchises.

1.22 The operation of Clause 18.1 of the franchise agreements currently in place, in general, makes train operators financially indifferent to changes made by ORR at access charges reviews during the franchise term, including changes to the performance regime. This substantially weakens the extent to which changes to the

regime impact on train operator behaviour. ORR will be discussing with the Strategic Rail Authority (SRA) and the Department for Transport (DfT) whether there are any proposals to change the coverage of Clause 18.1 for future franchise agreements.

- 1.23 The type of performance regime in place at the time of franchise renewal will be an important consideration when putting together franchise bids. Ideally, franchise bidders require certainty about the level of performance they can expect from Network Rail and the compensation they will receive if Network Rail under-performs against target. ORR will be discussing with the SRA and DfT the priority information requirements in relation to the performance regime, in order to inform the future franchise bidding process. It should be possible to prioritise aspects of this review (for example, recalculation of payment rates) to inform the franchise bidding process for the franchises due for replacement in 2006.
- 1.24 It will also be necessary to ensure that the performance regime in track access contracts is aligned with any new performance regime in franchise agreements. ORR will work closely with the SRA and DfT to ensure that the conclusions of this review have full regard to the performance obligations in franchise agreements.
- 1.25 It will be necessary for representatives working on the various industry reforms related to performance to work together to ensure that proposals for the performance architecture in the industry are consistent and complementary.

The legal basis and scope of the review

- 1.26 The ACR2003 established the legal basis for a review of the performance regime through new provisions in Part 7 of Schedule 7 of the franchised passenger train operators' track access contracts. Paragraph 2.4 (c) of this Part states that 'the Regulator may carry out an access charges review in relation to any relevant part or parts of this contract at any time if he considers that it is necessary or expedient to do so [...] in order to establish appropriate incentives for the efficient use of the Network'³.
- 1.27 The conclusions of this review will be implemented through the procedures set out in Schedule 4A to the Railways Act 1993 (the Act). ORR has taken account of the statutory timescales required for each stage of implementation into the overall work programme proposed in Chapter 3.

³ The Office of Rail Regulation (ORR) took over the functions and duties of the previous Rail Regulator on 5 July 2004. In this document use of the term "the Regulator" refers to the previous Rail Regulator.

- 1.28 ORR believes that it is for the industry (particularly Network Rail and train operators) to take the lead in developing the detail of any proposals for change, which can then be put to ORR for consideration. In deciding on the desirability of such proposals, ORR must act in the manner best calculated to achieve the statutory duties contained in section 4 of the Act.
- 1.29 While the review will only lead to potential changes to franchised passenger operators' track access contracts, ORR will need to consider whether it is necessary to consult on updating its criteria and procedures for the approval of all passenger track access contracts (including those of open access operators) and freight track access contracts in the light of its conclusions. Any necessary changes to the performance regime could then be made at the time of approval of new freight and open access passenger contracts.

Structure of this document

- 1.30 The remainder of this document is structured as follows:
- (a) Chapter 2 consults on specific changes to the performance regime that may make the regime more effective and/or reduce the bureaucracy and cost of the regime; and
 - (b) Chapter 3 sets out the timescales, method of working and implementation arrangements for the review.

Responses to consultation

- 1.31 Responses to this consultation document should be sent in hard copy and electronic format, by 14 December 2004, to:
- Iain Morgan
Economist
Office of Rail Regulation
1 Waterhouse Square
138 – 142 Holborn
London
EC1N 2TQ
Email: iain.morgan@orr.gsi.gov.uk
- 1.32 Respondents should indicate clearly if they wish all or part of their responses to remain confidential to ORR. Otherwise it is expected that they will be placed in the ORR library and on its website and may be quoted from by ORR. Where a response is made in confidence, it should be accompanied by a statement summarising the submission but excluding the respondent's confidential information. This statement

may be published, placed in the ORR library and on the ORR website and quoted from by ORR. ORR may also publish the names of respondents in future documents or on its website unless a consultee indicates that he wishes his name to be withheld.

- 1.33 Copies of this consultation document are available from ORR's website (www.rail-reg.gov.uk) and its library.

2. Possible changes to the Schedule 8 performance regime

Introduction

2.1 This chapter describes some possible changes to the Schedule 8 performance regime. The intention is to gather feedback from consultees before developing a package of improvements consistent with the reform of the Network Code and the performance obligations in current and future franchise agreements, which the industry can then take forward in developing in more detail.

Recent changes to the regime

2.2 As a result of a combination of Railtrack's and then Network Rail's very poor performance relative to the performance benchmarks established in the 2000 periodic review, and the large payment rates in place, the average annual net out-flow to train operators under Schedule 8 between 2001/02 and 2003/04 was £388m⁴ (2003/04 prices). Two changes introduced by the ACR2003 have reduced these money flows significantly. Firstly, benchmarks were adjusted upwards to reflect actual levels of performance (but are then ratcheted down over time in line with required improvements in Network Rail's performance) and secondly, payment rates under the regime were reduced with the abolition of the societal rate⁵. Network Rail is currently forecasting a net outflow under Schedule 8 of £14m for 2004/05.

2.3 The revised forward-looking Network Rail benchmarks are based on a required reduction in network-wide delays each year up to 2008/09, as set out in table 2.1 below.

⁴ Source: Network Rail Infrastructure Limited Regulatory Accounts 2003 and 2004 & Railtrack Plc Regulatory Financial Statements 2002.

⁵ This is the element that Network Rail paid to train operators reflecting the wider social effects of lateness not reflected in the impact on the train operator's farebox revenue.

Table 2.1: Network Rail's performance trajectory

	Delay minutes affecting all operators	Year on year reduction
2004/05	12,300,000	-
2005/06	11,300,000	8.1%
2006/07	10,600,000	6.2%
2007/08	9,800,000	7.5%
2008/09	9,100,000	7.1%

Further possible changes to the regime

2.4 The possible changes to the Schedule 8 performance regime discussed in the remainder of this chapter build and expand on the suggestions made by Network Rail and ATOC in their joint submission to the Rail Review. In particular, the chapter focuses on the following issues:

- (a) setting incentives to improve whole industry performance;
- (b) improving the effectiveness of, and reducing the cost associated with, the delay attribution process;
- (c) considering approaches to enhance the effectiveness of Schedule 8 in dealing with persistently poor levels of operational performance (including the relationship between Schedule 8, local output commitments (LOCs) and network change); and
- (d) the accuracy of payment rates and benchmarks.

Network Rail and whole-industry performance

Introduction

2.5 The Government's White Paper envisages that Network Rail will have responsibility for the delivery of whole-industry performance as well as its own. This means that Network Rail will be accountable for the achievement of overall performance targets in respect of each individual train operator. ORR's September 2004 document⁶ set out

⁶ *Implementing The Future of Rail: ORR's role and proposed work programme*, Office of Rail Regulation, London, September 2004.

the work needed as part of the Network Code reform to enable Network Rail to deliver this responsibility. Complementary to the reform of the Network Code, the Schedule 8 performance regime could be adapted to incentivise Network Rail to manage and improve whole-industry performance. This could be achieved by relating Network Rail's Schedule 8 payments to the operational performance achieved across the industry and not just to that proportion of lateness and cancellations for which it is responsible.

- 2.6 If Network Rail were to pay performance penalties based on a whole-industry performance measure, a further element to the regime would be required to ensure that train operators are faced with an adequate incentive to improve their own performance⁷. One option would be for the payments from a train operator to Network Rail to be based on a number of factors affecting performance within the train operator's control, such as the availability of rolling stock and train crew⁸. Sufficient disaggregated data would be required to establish appropriate benchmarks for these train operator performance factors.
- 2.7 An alternative method would be to have no reciprocal performance obligations on train operators in the Schedule 8 performance regime. Instead Network Rail's payment rates could be set at a lower level than the expected revenue loss to train operators as a result of poor performance. Such an approach could reinforce the obligations under Part H of the Network Code by providing a direct financial incentive for train operators to support Network Rail in the timely recovery from Network Rail-caused incidents. Schedule 8 currently provides no financial incentive on train operators to support Network Rail in recovering from such incidents since they receive compensation equal to the full estimated marginal revenue effect (MRE).
- 2.8 The choice of the percentage rate of MRE to be used is important because the lower it is set:
- (a) the greater will be the network performance risk facing train operators and the higher the risk premium that will be factored into the franchise bids; and
 - (b) the greater the impact on Network Rail's operational and investment decision making, *i.e.* some performance-enhancing schemes that would have been

⁷ It is recognised that incentives and obligations in franchise agreements could also apply to encourage train operators to maintain and improve their own performance.

⁸ A variant on this model would be for Network Rail-caused primary delays and all secondary (or knock-on delays) to be attributed to Network Rail, and all train operator-caused primary delays attributed to the train operators.

prioritised (or justified) based on full MRE payments would not be so with a significantly lower percentage of MRE being used⁹.

- 2.9 The Rail Review submission by ATOC and Network Rail considered the use, on average, of 85% of the MRE as a reasonable level to provide the necessary incentives to train operators and Network Rail, whilst recognising that the appropriate percentage of MRE for different train operators would vary. This percentage was suggested in the context of train operators being compensated on the basis of Network Rail lateness rather than on whole-industry performance and therefore a further assessment might be required.

Measures of whole industry performance

- 2.10 In considering such a change to Schedule 8, a suitable measure of whole-industry performance is required to reflect the experience of the passenger. One possibility would be for Network Rail's performance target to be based on the public performance measure (PPM). PPM is a measure of reliability and punctuality (including both lateness and cancellations) currently collected by the SRA. Two advantages of PPM as a measure of operational performance are its common usage by both Government and the industry and the public awareness of the measure.
- 2.11 There are also a number of limitations to PPM as a measure of whole-industry performance, principally:
- (a) it does not incentivise the recovery of any individual train once that train has breached PPM lateness (although it does not prevent such recovery being incentivised by other means *e.g.* operational procedures);
 - (b) it focuses upon the final destination of a journey and so excludes the effect of poor performance on many passengers arriving at intermediate destinations (and would therefore not fully reflect the impact on farebox revenue);
 - (c) trains are not weighted either between each other or between stations on a route to reflect accurately where the largest effect of poor performance on passengers occurs;

⁹ This problem could be overcome if ORR agreed to add to the RAB the difference between Schedule 8 savings based on the full MRE and Schedule 8 savings based on the actual payment rate.

- (d) PPM cannot be disaggregated to give relative degrees of responsibility between parties causing the lateness, and cannot therefore form a basis for remedial action; and
- (e) the performance of freight train services is not included within the measure.

2.12 Possible alternatives to PPM could be to:

- (a) base the measure on the percentage of all arrivals within a specified time at all, or the principal, calling points en-route. This would produce a PPM-style measure which takes into account intermediate lateness as well as lateness at destination, but would still require trains to be weighted to reflect properly where the greatest impact on passengers had occurred; or
- (b) use a measure of average lateness, which could be a network wide figure or be disaggregated to individual train operators and service groups. This might be considered to be a more accurate measure of the experience of passengers using the network.

2.13 In these and alternative measures, consideration will need to be given to the software programming, and data architecture costs and timescales involved in implementation.

Whole industry performance and LOCs

2.14 A complementary (or perhaps alternative) mechanism to the above would be to replace LOCs with a joint performance improvement plan focusing on overall train performance. This would reflect the reasonable requirements expected from Network Rail, as established at access charges reviews, and the obligations on train operators through the franchise agreement. The performance target would be underpinned by performance plans produced by both parties, and either party could ask for remedial plans to be developed if the target was being missed. This will be considered further by the industry as part of the review of Part L of the Network Code, but ORR will ensure that there is a joint approach to the work being taken forward by this review and the Network Code reform by participating in the relevant working groups and if necessary establishing a working group consisting of representatives from the different workstreams.

2.15 None of the above suggestions would negate the need for accurate and comprehensive delay attribution to enable the identification of the root causes of delay and the management actions needed to address them, but they may facilitate improved efficiency and reduced cost in the delay attribution process.

- 2.16 Should Schedule 8 be changed so that the Network Rail incentives are at least in part based on a whole industry performance measure, with train operator incentives to improve their own performance by either:**
- (a) train operators being responsible for a number of factors affecting performance within their control; or**
 - (b) Network Rail payment rates being set at levels below the expected revenue effect resulting from poor performance?**
- 2.17 Should the development of a joint Network Rail/train operator whole-industry performance measure in Part L of the Network Code be complementary to, or an alternative for, a whole-industry performance measure in Schedule 8? In either case, what type of whole-industry performance measure would be appropriate? Should alternative measures to PPM be developed?**

Delay attribution

- 2.18 Delay attribution processes are currently being reviewed as part of the work on Network Code reform. In relation to this review, the key issue to address is whether Schedule 8 requires or incentivises delay attribution being carried out at a level that is unnecessary for performance management purposes and hence leads to inefficient costs being built into the process.
- 2.19 The remainder of this section discusses three possibilities for streamlining the Schedule 8 requirements from the delay attribution process:
- (a) the exclusion of certain classes of delay from the remit of attribution review and possible dispute;
 - (b) removing the right to dispute small delays; and
 - (c) the effect of increasing the delay threshold in the Schedule 8 performance regime.

Excluding certain classes of delay from review/dispute

- 2.20 The costs of the delay attribution process will generally increase with the number of disputes that occur. Therefore, one option to reduce such costs would be to exclude certain classes of delay in such a way as is sometimes done in the leaf fall season whereby delays not otherwise explained are consolidated and can be subject to commercial settlement outside the attribution process. This reduces the burden on

delay attribution resources, so reducing the costs that would have been associated with any review or dispute.

- 2.21 In order to evaluate whether this change would be sensible, the following questions need to be considered.
- (a) What scale of saving would be achieved from taking some classes of delay outside the scope of delay attribution?
 - (b) How would this change the effectiveness or credibility of delay attribution?
 - (c) How much useful information, currently available to managers in order to reduce particular causes of delay and thereby improve overall performance, would be lost by the reduction in the delay types that are the subject of the review?
 - (d) How stable is the attribution between Network Rail and train operators for particular classes of delay?

Removing the right to dispute small delays

- 2.22 The bureaucracy and cost associated with delay attribution might be reduced if the right to dispute delays below a defined threshold were removed. In order to incentivise accurate delay attribution for small delays, periodic sample surveys could be undertaken to enable an independent audit of the attribution process, with penalties applied in the event of attribution errors. To minimise any loss of management information, historic data could be updated with the output from such audits.

Increasing the delay threshold in Schedule 8

- 2.23 Another approach would be to increase the threshold level of delays recorded under Schedule 8. The threshold is generally set at three minutes (below which delays are not required to be attributed). ORR is not presently convinced that increasing the threshold, say to five minutes, would be of material benefit. This is because delay is only used in the Schedule 8 performance regime for attributing the share of responsibility for lateness and cancellations. This means that regardless of the level of the threshold above which delays are recorded, the compensation scheme and right to challenge attribution would remain unchanged even though the balance of responsibility might be different at a different threshold. Therefore the cost savings associated with this change would be limited to the minimal administration cost savings through not recording so many instances of delay. These cost savings need to be considered against the loss of information, which might include whole categories

of delay going un-recorded and therefore not being available to inform management decision-making.

2.24 What would be the impact on the effectiveness and cost of the Schedule 8 performance regime if certain classes of delay were excluded from the delay attribution process or if the right to dispute small delays was removed or if threshold levels of delay were to be increased?

Application of the regime to persistently poor performance

2.25 When operational performance is persistently poor, the compensation payable to train operators through Schedule 8 is unlikely to fully reflect the resulting lost farebox revenue. This is because the calculation of the MRE (and hence compensation) is based on small changes in the level of performance. Constant marginal payment rates in Schedule 8 imply a linear relationship between performance levels and farebox revenue whereas for more significant changes in performance, the relationship is actually likely to be non-linear.

2.26 The possibility of non-linear revenue impacts resulting from persistently poor performance is currently addressed through the Network Code (LOCs). Under Part L, train operators are able to claim for all relevant losses, net of any compensation already received through Schedule 8, if Network Rail breaches its LOC delay target thresholds. In addition, train operators may be able to claim compensation for poor performance due to network deterioration¹⁰ through Part G of the Network Code, irrespective of whether Network Rail has breached its LOC delay threshold. As an alternative to this structure, it could be possible to address persistently poor performance solely through Schedule 8.

2.27 This section discusses ways that, in circumstances of persistently poor performance, train operators might be compensated at a level closer to the full revenue effect solely through Schedule 8.

2.28 The following is considered below:

- (a) the definition of persistently poor performance;
- (b) the possibility of higher payment rates for persistently poor performance;
- (c) the impact, if any, upon the incentive properties of the Schedule 8 performance regime; and

¹⁰ Paragraph 2.1 (a) (iii), Part G, Network Code

- (d) the impact, if any, on the costs of the Schedule 8 performance regime.

Definition of persistently poor performance

2.29 Two possible approaches to define or measure persistently poor performance are:

- (a) historic benchmarking (during periods where it is considered that performance was persistently poor); or
- (b) performance level at a percentage (or a number of standard deviations) worse than the current benchmark level or worse than a trajectory established at the beginning of a franchise.

Higher payment rates for persistently poor performance?

2.30 The purpose of defining persistently poor performance is so that the compensation paid to train operators under such conditions could be higher, reflecting accurately the revenue effect of such poor performance. This raises the following considerations.

- (a) Should there be more than one higher payment rate associated with different levels of poor performance?
- (b) At what level should the payment rates be set?
- (c) Should the compensation regimes that currently exist under Schedule 8 and Part's G and L of the Network Code be aligned so that all poor performance, whether temporary or persistent, is addressed in a single regime and in a consistent manner?

2.31 These need to be considered against experience both from the Schedule 8 performance regime before the PR2000, which contained multiple payment rates, and experience from elsewhere. This could include the public-private partnership (PPP) arrangements on the London Underground, where there is a three-tier set of payment rates depending on the level of performance.

2.32 The PPP performance arrangements are centred around a benchmark level of performance, with bonus rates for performance better than benchmark subject to an upper cap. Where performance is better than this cap no payments are made. Abatements, paid where performance is worse than the benchmark, are set at twice the bonus rate until performance reaches an 'unacceptable' level, after which they are set at three times the bonus rate.

- 2.33 If it proved possible and desirable to have higher payment rates in Schedule 8 for persistently poor performance, consideration could be given as to whether such an arrangement might negate the need for the compensation provisions associated with breach of delay thresholds in LOCs (Part L of the Network Code) and in relation to poor performance resulting from network change (Part G of the Network Code). Such consideration needs to be taken into account the fact that compensation for breach of LOC thresholds and network change covers all relevant losses¹¹, not simply revenue loss.

Impact on incentives

- 2.34 In the provisional conclusions of PR2000¹² the Regulator set out the reasons why the Schedule 8 performance regime was being changed from containing several payment rates to a single payment rate. These reasons were that a single payment rate:
- (a) provides a clear and simple incentive for continuous improvement in performance;
 - (b) means that the method of setting benchmarks does not affect the marginal incentive to improve performance (since the incentive rate is the same whether or not performance is better or worse than the benchmark); and
 - (c) avoids the danger that the incentive for Network Rail to improve performance might be reduced in circumstances where the overall level of performance faced by passengers is deteriorating (*e.g.* Network Rail improves performance into the lower rate band but overall it remains poor due to poor performance by train operators).
- 2.35 The design of multiple payment rates should not reduce too significantly the benefits identified above while at the same time ensuring that train operators are properly compensated in periods of persistently poor performance.
- 2.36 Should higher payment rates be reflected in the current Schedule 8 performance regime to provide adequate compensation for persistently poor performance or is the current arrangement, whereby higher compensation can potentially be**

¹¹ As defined in *Model passenger track access contract*, Office of the Rail Regulator, London, June 2003

¹² *Periodic review of Railtrack's access charges: Provisional conclusions on the incentive framework*, Office of the Rail Regulator, London, April 2000.

claimed by train operators for Network Rail's breach of a LOC delay threshold or in relation to network change, a more effective and workable mechanism?

Changes to payment rates and benchmarks

- 2.37 Two further refinements are possible to improve the properties of the regime and to ensure consistency of performance targets across LOCs and Schedule 8. These are:
- (a) improving the accuracy of the Network Rail payment rate in reflecting the MRE on particular train operators; and
 - (b) relating the year on year efficiencies in the Network Rail benchmark to local performance targets.

Accuracy of the Network Rail payment rate

- 2.38 As described in Annex B, the Network Rail payment rate is intended to compensate the train operator for the MRE resulting from any lateness or cancellation of its services caused by Network Rail. This is estimated based on Passenger Demand Forecasting Handbook (PDFH) elasticities for different types of passenger (*i.e.* how business travellers', commuters' or leisure passengers' demand responds to lateness and cancellation of services). If the relationship between lateness and demand/revenue is wrongly calibrated, train operators may be under- or over-compensated, thereby leading to a distortion of the incentive properties of the regime.
- 2.39 The PDFH has recently been updated and demand forecasting research continues to be developed in the industry, including by train operators themselves. It therefore may be appropriate to review the calibration of payment rates and perhaps re-examine the basis of payments. Currently, payments for poor performance are calculated by comparing a single period average of lateness and cancellations against a benchmark level of performance. An alternative approach (used in the London Underground PPP performance regime) would be to compare a longer-term moving average of lateness and cancellations with the benchmark, so that payments are linked to movements in longer-term performance trends. The impact of this alternative approach on the achievement of the objectives of the Schedule 8 performance regime would need to be fully examined.
- 2.40 What is the understanding and experience of the accuracy of the current Network Rail payment rates in compensating train operators for lost revenue due to poor performance? What research has been undertaken to understand the impact of lateness and cancellations on demand/revenue, specific to**

individual train operators? Would payments linked to longer-term moving averages in performance more accurately reflect the impact of poor performance on a train operator's farebox?

Local performance trajectory reflected in Network Rail benchmark

- 2.41 Significant work has been, and continues to be, carried out within the industry on developing LOCs to improve Network Rail's accountability to train operators at a local level. The LOCs contain operator specific performance targets for Network Rail for a three-year period. These differ from Network Rail's Schedule 8 benchmarks, which are set on the basis of required network-wide improvements in performance.
- 2.42 Given the work on LOCs, and with Network Rail taking over responsibility for developing route utilisation strategies and moving to a route-based planning approach, it should be possible in future to set forward-looking benchmarks in Schedule 8 based on performance trajectories at a train operator level, so they are consistent with LOC delay targets and performance obligations in the franchise agreements. Until Network Rail further develops its understanding on the relationship between inputs and outputs at a local level through its route-based planning process, however, it is questionable whether benchmarks reflecting local performance trajectories would be robust for the length of a franchise agreement. This may therefore be an issue for further review in the future.
- 2.43 Is it appropriate at this time for the annual improvements applied to the Network Rail benchmarks to be based on forecast performance at a train operator level, consistent with LOC delay targets?**

Other issues

- 2.44 Any changes to the Schedule 8 performance regime may necessitate changes to capacity charges, which are contained in Schedule 7 of franchised passenger operators' track access contracts. The capacity charge is designed to enable Network Rail to recover the performance regime costs it incurs when additional traffic operates on the network. In parallel with this performance regime review, ORR is also consulting on possible options for change to the structure of track access charges paid by franchised passenger train operators, including capacity charges.
- 2.45 Schedule 4 of franchised passenger track access contracts sets out the regime that compensates train operators for the disruption caused when Network Rail restricts use of the network, for example to undertake engineering work. The compensation

calculation in Schedule 4 is currently based on Schedule 8 payments rates, albeit with discounts for early notification to train operators.

- 2.46 The impact that any changes to the Schedule 8 performance regime would have on Schedule 4 will be considered as part of the wider Schedule 4 review that ORR will initiate shortly. This will consult on changes required by the Government's Rail Review, the inclusion of cyclical maintenance possessions in franchise specifications and Network Rail's proposed efficient engineering access strategy.
- 2.47 Since the PR2000, franchised passenger train operators have all used template Schedule 8 performance regimes with all of the characteristics described in Annex B. Prior to this, some operators had bespoke regimes, often working in tandem with bespoke compensation regimes for the disruptive effect of possessions. Consultees may wish to consider whether the continuation of template regimes for all operators continues to be appropriate.
- 2.48 Changes to the passenger charter arrangements may also be considered in relation to any changes to the way that passenger charter compensation is dealt with in future franchise agreements.
- 2.49 ORR welcomes any other suggested changes to the Schedule 8 performance regime so that these can be considered within this review.
- 2.50 Are there any other changes to the Schedule 8 performance regime that would make it more effective and/or reduce the bureaucracy and cost of the regime? Should all train operators have templated performance regimes?**

3. *Next steps*

Introduction

3.1 This chapter sets out the method by which it is proposed that the review will be carried out, the options for implementation and the intended timescales.

Method of work

3.2 ORR believes that this review is most likely to identify the optimum package of changes needed to improve the effectiveness of the performance regime, if the detailed examination of the potential changes identified in Chapter 2 and any other issues arising from this document are led by the industry (principally train operators and Network Rail). This is partly because the industry has first hand knowledge and experience of the effectiveness of the current regime, it is best placed to understand the requirement for changes and to assess their possible impacts. The detailed arrangements for taking the work forward, including ORR's involvement and liaison with DfT, can be discussed at a workshop, that ORR will hold in early December 2004 (see paragraph 3.4).

3.3 As any changes to the regime would be implemented through the statutory access charges review procedure, ORR will need to, as far as practicable, ensure that the conclusions are formulated to discharge the statutory duties contained in section 4 of the Act.

Industry workshop

3.4 ORR will hold a workshop in December 2004 to discuss in more detail possible changes to Schedule 8. The purpose of this workshop will to:

- (a) give attendees an opportunity to ask questions and discuss the issues raised in the initial consultation document;
- (b) enable attendees to develop the issues they intend to include in their response and to hear other parties' views on these;
- (c) determine whether there is common ground, in advance of receiving the consultation responses, on a preferred package of changes;
- (d) discuss the arrangements for taking forward the required work; and

- (e) discuss the implementation options (see below).

Policy statement

- 3.5 ORR proposes to publish a policy statement in January 2005 that will set out the proposed new Schedule 8 framework, specifying the high level changes to be made as part of the review.

Implementation

- 3.6 It is envisaged that the conclusions of this review will be published by around July 2005. The conclusions of access charges reviews have generally been incorporated into all franchised passenger operators' track access contracts simultaneously. In relation to the conclusions of this review however, the implications of the timetable of re-franchising needs to be considered. One option would be to implement the conclusions only in respect of those train operators with forthcoming new franchise agreements, at the time of franchise renewal. This would avoid the SRA and train operators having to undertake the task of negotiating under clause 18.1 and the variation mechanism, which could be particularly complex if radical changes to Schedule 8 are implemented.
- 3.7 Phased implementation could have a number of disadvantages, depending on the nature of changes to Schedule 8. These include:
- (a) the increased complexity of potentially having dual systems for performance measurement and billing during the transitional period until all franchises have been replaced; and
 - (b) inconsistent incentives and signals to Network Rail on different parts of the network. For instance, Network Rail could have a financial incentive to improve whole-industry performance on some parts of the network but only own delay and train operator-on-train operator (TOC-on-TOC) delay elsewhere.
- 3.8 Any changes to the regime will impact on Network Rail immediately and for this reason it may be appropriate to make the changes to all track access contracts simultaneously .
- 3.9 If changes to track access contracts are to be made simultaneously, a further consideration is whether to delay implementation until April 2006. Then it will coincide with the commencement of a number of new franchises and other possible

changes, such as the revision of the LOCs and changes to the structure of charges under the structure of costs and charges review, which are due for implementation in April 2006.

Timescales

3.10 Table 3.1 below sets out the intended timescale for this review.

Table 3.1: Proposed timescales for the review

Time	Event in review
December 2004	Industry workshop to discuss options for changes to the regime meriting further study
14 December 2004	Deadline for responses to initial consultation document
November 2004 – February 2005	Technical work on options for change
January 2005	ORR policy statement on proposed new Schedule 8 framework
February 2005	Working paper consulting on outcomes of technical work on options for change
April 2005	Draft conclusions (including any proposed legal drafting changes required)
April 2005	Possible second industry workshop
July 2005	Final conclusions
September 2005 onwards	Implementation of any changes made in the review

3.11 Do Consultees support the proposed method of working in this review and the options for the timing of implementing any changes to the Schedule 8 performance regime?

Annex A: Consultation questions

- 1. Do the objectives of the performance regime, as set out in paragraph 1.8, remain appropriate and how effective has the regime been in meeting these objectives? (paragraph 1.17)**
- 2. Should Schedule 8 be changed so that the Network Rail incentives are at least in part based on a whole industry performance measure, with train operator incentives to improve their own performance by either:**
 - (a) train operators being responsible for a number of factors affecting performance within their control; or**
 - (b) Network Rail payment rates being set at levels below the expected revenue effect resulting from poor performance? (paragraph 2.16)**
- 3. Should the development of a joint Network Rail/train operator whole-industry performance measure in Part L of the Network Code be complementary to, or an alternative for, a whole-industry performance measure in Schedule 8? In either case, what type of whole-industry performance measure would be appropriate? Should alternative measures to PPM be developed? (paragraph 2.17)**
- 4. What would be the impact on the effectiveness and cost of the Schedule 8 performance regime if certain classes of delay were excluded from the delay attribution process or if the right to dispute small delays was removed or if threshold levels of delay were to be increased? (paragraph 2.24)**
- 5. Should higher payment rates be reflected in the current Schedule 8 performance regime to provide adequate compensation for persistently poor performance or is the current arrangement, whereby higher compensation can potentially be claimed by train operators for Network Rail's breach of a LOC delay threshold or in relation to network change, a more effective and workable mechanism? (paragraph 2.36)**
- 6. What is the understanding and experience of the accuracy of the current Network Rail payment rates in compensating train operators for lost revenue due to poor performance? What research has been undertaken to understand**

the impact of lateness and cancellations on demand/revenue, specific to individual train operators? Would payments linked to longer-term moving averages in performance more accurately reflect the impact of poor performance on a train operator's farebox? (paragraph 2.40)

- 7. Is it appropriate at this time for the annual improvements applied to the Network Rail benchmarks to be based on forecast performance at a train operator level, consistent with LOC delay targets? (paragraph 2.43)**
- 8. Are there any other changes to the Schedule 8 performance regime that would make it more effective and/or reduce the bureaucracy and cost of the regime? Should all train operators have templated performance regimes? (paragraph 2.50)**
- 9. Do Consultees support the proposed method of working in this review and the options for the timing of implementing any changes to the Schedule 8 performance regime? (paragraph 3.11)**

Annex B: The current Schedule 8 performance regime

Introduction

1. This Annex sets out how the current Schedule 8 performance regime operates, describing in particular the:
 - (a) benchmarks;
 - (b) payment rates;
 - (c) star model;
 - (d) role of delay and lateness in the regime;
 - (e) the delay attribution process; and
 - (f) intended incentive properties of the regime.
2. The template Schedule 8 is available from ORR's website at <http://www.rail-reg.gov.uk/server/show/ConWebDoc.5743>.

Operation of the current performance regime

Benchmarked regime

3. The Schedule 8 performance regime contains specified levels of benchmark¹³ performance for Network Rail and train operators (the benchmarks being measured in average lateness per day). If the actual level of performance is equal to this benchmark level then no payments are made through the regime. Penalty payments are made when performance is worse than the benchmark levels and bonus payments are received when performance is better than benchmark levels.
4. Unique benchmarks are established for both Network Rail and train operators for each train operator's service groups (a collection of train services). These rates were last calculated at the ACR2003 and are based on actual performance over the 12 months to October 2002. The period was carefully chosen (and consulted upon) to ensure that

¹³ Also known as performance points

it was the best representative time period available *i.e.* by minimising the distortions caused by effects that were known to be temporary. The Network Rail benchmarks contain year on year improvements as established in the interim review 2003.

Train operator compensation

5. A central purpose of the Schedule 8 performance regime is to compensate train operators for the adverse revenue effects of poor Network Rail performance. If operators were not to receive such compensation, then the revenue losses as a result of the poor performance of Network Rail and other train operators would become an additional 'cost' to the train operator. It would be reasonable to expect that this cost risk would then be included in franchise bids with the effect of lowering the value of the franchise through the addition of a higher level of subsidy being required by the franchisee (or lowering the receipts to Government where the bid for a franchise is in the form of a premium payment).
6. Since the implementation of the ACR2003, the compensation to train operators has been solely based upon the assessed marginal revenue effect (MRE) to that train operator. This followed the removal of a societal element (the societal rate) to these payments, as described in paragraph 2.2 of this document. The MRE is the forecast loss of farebox revenue to the train operator resulting from poor performance (or conversely the farebox gain resulting from good performance). Its measurement is estimated using elasticities (*i.e.* projected responses in customer demand to poor performance) set out in the Passenger Demand Forecasting Handbook¹⁴. Different responses to poor performance are observed for different types of passenger (*e.g.* commuter, leisure traveller, *etc.*) and therefore the distribution of elasticities to individual train operator service groups was mapped by ORR and its consultants at previous access charges reviews to model the effect.

Star model

7. On a multi-user rail network, any train operator's operational performance can affect other operators' performance. This effect is far wider than simply those train operators whose services run along the same routes. Indeed it is quite possible that a significant performance incident such as that caused by a train failure on the East

¹⁴ The Passenger Demand Forecasting Handbook (PDFH) summarises knowledge of the effects of service quality, fares and external factors on rail passenger demand, and provides guidance on applying this knowledge to the preparation of forecasts for investment and business planning. Intellectual property rights to PDFH, and its research, are owned by the Passenger Demand Forecasting Council and administered by the Association of Train Operating Companies.

Coast Main Line at Peterborough could affect other operators on that line, those operators running services that cross that line at some point and indeed to other lines as far away as the Transpennine route and the West Coast Main Line.

8. Train operators do not have bilateral contracts with each other and therefore any payment as a result of this impact from one train operator to another's operational performance is channelled through Network Rail. The payment rates paid to Network Rail by train operators are fixed for the five year control period (the current control period runs from 1 April 2004 until 31 March 2009). The rate is calculated such that at the level of national performance across all service groups during the calibration period, Network Rail could expect to be compensated in full by the responsible train operators for the payment it makes to the affected train operators.

Lateness and delay

9. Before it is possible to consider the implications of changes to the regime, it is important to understand that the regime is based on compensation for *lateness* as experienced by passengers, rather than *delay* in the sense of time actually lost in running.
10. Lateness is the difference between the publicly advertised arrival time at a particular point and the actual arrival time at that point. For instance if a service is due to arrive at York at 12:15 and actually arrives at 12:30, the train is 15 minutes late. Delay is the time lost between recording points. For instance, in the above example, the train could have incurred 20 minutes of delay between Peterborough and Doncaster, but then recovered 5 minutes between Doncaster and York resulting in the 15 minutes lateness. The regime is lateness based because it is this that best reflects the experience of passengers of poor performance.
11. Delay is only used in the regime to establish the share of responsibility for lateness minutes between Network Rail and the train operators. This is achieved by allocating delays for incidents which are the responsibility of one or other party.

The delay attribution process

12. The initial attribution of delay to either Network Rail or the train operator is carried out by Network Rail staff. The rules for attribution are set out in the Delay Attribution Guide (incorporated into Part B of the Network Code). In addition to facilitating the Schedule 8 regime, this attribution of delay provides the companies with information on the cause of delays, which can then enable changes to be made to reduce the

likelihood or impact of such delays in the future .This source of knowledge not only enables the operation of the Schedule 8 performance regime but also provides the crucial data required by the industry in order to manage performance improvement.

13. Train operators employ staff to review attribution, this is to enable challenge to be made to the initial attribution for the purposes of the operation of the Schedule 8 performance regime (as well as freight performance regimes) .
14. There are currently understood to be approximately 300 ‘level 1’ full time staff and around 40 full time equivalent supervisory staff employed in delay attribution by Network Rail .The number of people employed by train operators to both challenge and refine the information vary in proportion to the scale of the operations of the train operator but is understood to be around 100 although some of these are principally engaged in the operation of the Schedule 8 performance regime.
15. The extent of the delay attribution activity has seen a number of recent changes:
 - (a) through Network Rail bringing maintenance activities in-house, (this has reduced the need for third party contractors to use the TRUST system for adjustment of delay causes and descriptions within their responsibility);
 - (b) the establishment of integrated controls, (this should allow delay attribution to be undertaken at fewer locations); and
 - (c) franchise remapping, (will also permit greater efficiency in delay attribution as a result of the consolidation of several train operators into one train operator e.g. First Great Eastern and the West Anglia services formerly operated by West Anglia Great Northern (WAGN) being brought into London Eastern Railways (the ONE franchise).

How Schedule 8 is intended to incentivise behaviour and decision making

16. The Schedule 8 performance regime requires payments of compensation where the parties to the track access contracts are deemed to be responsible for levels of performance that are worse than the benchmark level. The Schedule 8 performance regime therefore incentivises the following:
 - (a) Network Rail’s operational resourcing and behaviour, *e.g.* efforts to recover from performance incidents in order to reduce out-payments to an efficient level;

- (b) Network Rail's investment planning *e.g.* prioritisation of renewals, the removal of temporary speed restrictions and performance enhancement investment in areas where high Schedule 8 out-payments have been incurred;
 - (c) train operators' operational resourcing and behaviour, *e.g.* recovery of failed trains; and
 - (d) train operators' investment planning *e.g.* as part of an appraisal of the purchase/leasing of new rolling stock and train crew recruitment.
17. The strength of these incentives will differ on different parts of the network dependent on the level of MRE associated with the particular service group. The incentive effect derived from Schedule 8 also needs to be seen as part of a wider influence over decision making including operational need, through obligations in the Network Code and licence conditions.

Other features of the Schedule 8 performance regime

18. The Schedule 8 performance regime also sets out:
- (a) the requirement for Network Rail and train operators to gather information relating to the reasons for delays and incidents and for Network Rail to establish and agree the records necessary to operate all train performance schemes (*i.e.* not just the Schedule 8 performance regime);
 - (b) the procedures and compensation payable as a result of cancellations of services;
 - (c) monitoring points and monitoring point weightings, ensuring that the regime compensation payments reflect the passenger usage along the route of the service; and
 - (d) Passenger Charter compensation arrangements relating to the compensation train operators need to recover from Network Rail to then pay to end customers under the Passenger Charter arrangements.

Annex C: Joint submission to the Rail Review on the performance regime by ATOC and Network Rail

Simplified Performance Regime

1. Network Rail and ATOC agree that professional delay attribution is critical to the management of performance and that financial incentives are needed to facilitate good working relationships which will help drive improvements in performance at a local level. TOCs share revenue risk with Government through their franchise agreements. Their ability to do so is threatened if TOCs do not receive compensation for revenue lost as a result of Network Rail failures .
2. The future compensation regime will build on the recent regulatory review's abolition of the societal rate and the adjustment to the benchmarks (which together with the improvement in performance of the industry have meant that Network Rail is not currently paying net compensation to TOCs). It will take account of any implications for freight. It will be based on the following –

Recalibration of penalties for delay to passengers

3. In future, better calibration of compensation payments and the franchise risk sharing arrangements should prevent windfall TOC profits or excessive losses as a result of NR failures. Once the recalibration of penalties for delay has been completed and incorporated into franchise agreements, TOCs will take the risk on changes to compensation rates in subsequent regulatory reviews.

Alignment of franchises and track access contracts

4. It is important that TOCs bid for franchises on the basis of a clear NR performance trajectory. In future, the new franchise regime – to be implemented after the Review – will align franchise agreements and access agreements. New franchises will be let on the basis of more robust route based plans and performance projections.

Pence in the pound

5. The aim of this is to have a shared industry incentive to improve performance (because TOCs don't receive "full" compensation for revenue lost due to NR failure). Our working assumption is that TOCs should receive 85p in every £ of revenue lost, but the precise number for each franchisee will depend on the revenue risk profile of each.

Professionalising DM-attribution

6. There will be improvements in the attribution process. Some progress has already been made in this area. The Delay Attribution Board will conduct a fundamental review of this process and systems in conjunction with the move to integrated controls. Both industry parties are committed to reducing man-marking while improving the quality of the management information provided by this process. It is expected that the main changes will be implemented within a year.

Further Simplification

7. Building on this work to simplify delay minute attribution, further reform may be appropriate to restrict dispute resolution to major incidents with a quarterly test of apportionment between Network Rail and TOCs for the aggregated smaller delays. It may also be appropriate in some circumstances to streamline the performance regime and other mechanisms which compensate TOCs for NR impacts (local output commitments and network change). The potential benefits of these changes are unclear, and will be examined in more detail.

Implementation

8. The ORR's review of the structure of charges should deliver much of the above (other than those that require consequential changes to franchise agreements). ORR has indicated that it would expect to complete this review for implementation by April 2006 (although it may be possible to implement some elements sooner than this).