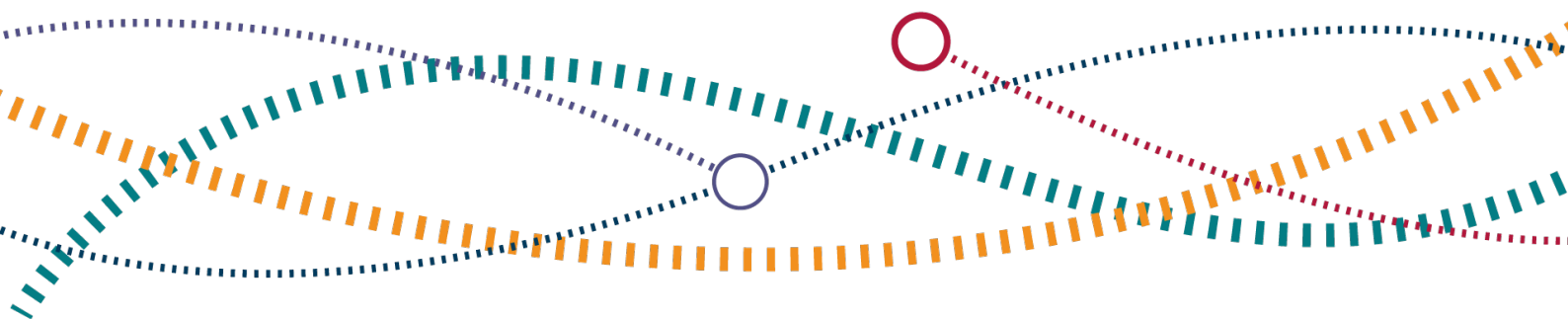




# PR23 draft determination:

## Policy position – Schedules 4 and 8 incentives regimes

15 June 2023



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## About this document

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This Schedule 4 and Schedule 8 performance regime draft decisions policy document is one of four policy positions documents of our draft determination for the 2023 periodic review (PR23). Schedule 4 places incentives on Network Rail to plan possessions efficiently so as to minimise disruption, and Schedule 8 places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance.

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

This strongly influences:

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

Our draft determination sets out:

- our review of Network Rail's strategic business plan (SBP); and
- decisions on its proposed outcome delivery and its planned expenditure to secure the condition and reliability of the network;
- changes to access charges and the incentives framework; and
- relevant policies on managing change and the financial framework.

In addition to [this document](#), we have also published as part of our draft determination:

Document type	Details
<b>Executive summaries of our determination</b>	Our key proposals from our draft determination for: <ul style="list-style-type: none"><li>• England &amp; Wales</li><li>• Scotland</li></ul>

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<b>Overviews of our determinations</b>	What Network Rail will need to deliver and how funding will be allocated in: <ul style="list-style-type: none"><li>• England &amp; Wales</li><li>• Scotland</li></ul>
<b>Consolidated decisions</b>	A summary of our draft decisions across Great Britain
<b>Introduction</b>	An overview of PR23 and background to our draft determination
<b>Settlement documents</b>	Detailed draft decisions for each of: <ul style="list-style-type: none"><li>• Scotland</li><li>• Eastern region</li><li>• North West &amp; Central region</li><li>• Southern region</li><li>• Wales &amp; Western region</li><li>• System Operator</li></ul>
<b>Supporting documents</b>	Technical assessments of: <ul style="list-style-type: none"><li>• Health and safety</li><li>• Outcomes</li><li>• Sustainable and efficient costs</li><li>• National Functions</li><li>• Other income</li></ul>
<b>Policy positions</b>	How we intend to regulate Network Rail during CP7 in relation to: <ul style="list-style-type: none"><li>• Financial framework</li><li>• Access charges</li><li>• <b><u>Schedules 4 &amp; 8 incentives regimes</u></b></li><li>• Managing change</li></ul>

## Responding to the consultation on our draft determination

We are consulting on our draft determination and welcome comments from stakeholders on any of our documents which form the draft determination on or before 31 August 2023.

Responses should be submitted in electronic form to our inbox: [PR23@ORR.gov.uk](mailto:PR23@ORR.gov.uk). We request stakeholders provide their response using [this proforma](#).

We intend to publish all responses on our website alongside our final determination in October 2023. Annex A to our proforma document sets out how we will treat any information provided to us, including that which is marked confidential.

### Next steps

After taking account of stakeholder responses, we expect to issue our final determination on Network Rail's delivery and funding for CP7 by 31 October 2023.

We expect to issue our review notices by December 2023 and, subject to Network Rail's acceptance, issue notices of agreement and review implementation notices. These will give effect to the decisions made during PR23 in time for CP7 to commence from 1 April 2024 and for Network Rail to develop its plans for delivery.

# 1. Introduction

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- 1.1 Network Rail's possessions and performance regimes compensate train operators for financial impacts arising from planned and unplanned service disruption. The possessions and performance regimes are contained within Schedules 4 and 8 of track access contracts. Schedule 4 places incentives on Network Rail to plan possessions efficiently so as to minimise disruption, and Schedule 8 places incentives on Network Rail and train operators to limit the disruption they cause and therefore to improve network performance. In a vertically separated railway, which has multiple different operators, these regimes provide benefits by encouraging Network Rail and train operators to factor in the costs of disruption that they impose on other parties.
- 1.2 The regimes are calibrated to be largely 'financially neutral on expectation', meaning that Network Rail and operators would not make or receive payments if prior expectations were met in terms of possessions management (for Schedule 4) and train performance (for Schedule 8). An access charge supplement (ACS) is payable by publicly contracted passenger operators in return for Schedule 4 compensation. Schedule 8 does not have an ACS and instead works on the basis of performance benchmarks – payments are made or received when a party's performance is worse or better than these benchmarks.
- 1.3 As part of PR23, we have been reviewing the framework for these regimes. In October 2022, we published our [Schedule 4 & 8 conclusions](#) on the framework for the regime in CP7, which also included a consultation on outstanding matters. These conclusions followed initial consultations in [June 2021 \(Schedule 8\)](#) and [September 2021 \(Schedule 4\)](#), followed by a combined [April 2022 'preferred options' consultation](#).
- 1.4 Through PR23 we are retaining the essential structure of Schedules 4 and 8. We are proceeding with a small number of proportionate changes to the regime during CP7. This document summarises decisions made in respect of Schedule 4 and Schedule 8, and updates on recalibration of the regimes for CP7. Recalibration is an ongoing process that will conclude shortly after the final determination.
- 1.5 We have taken our draft decisions on the CP7 incentives framework based on the existing legal requirements, while also ensuring the framework can be applied by Great British Railways (GBR) when it takes on responsibility for the national rail network. As such, we anticipate that this framework will apply for the duration of

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CP7. While we refer in this document primarily to Network Rail, our draft decisions are also therefore relevant for GBR as infrastructure manager.

### Next steps

- 1.6 We welcome comments on this document and/or the other documents that form part of our draft determination by 31 August 2023. We will confirm our decisions on Schedule 4 and 8 issues in our final determination, which will be published in October 2023. This will include an update on decisions that are being made through the recalibration working groups.
- 1.7 In addition, in July we will be publishing a consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'. This will give effect to policy decisions as well as proposals made in response to our October 2022 [consultation on drafting improvements](#).
- 1.8 The recalibration of the Schedule 4 and 8 regimes is proceeding, and regime parameters are being released in draft and final versions in a phased way from May 2023 to November 2023. Chapters 2 and 3 provide more information on the timescales for Schedules 4 and 8 respectively. Finalised parameters will ultimately be implemented in track access contracts through review notices in December 2023, and will take effect from the start of CP7 in April 2024.

## 2. Schedule 4

### Summary

We will proceed with introducing an opt-out mechanism for Schedule 4 in CP7, which can provide train operators with the flexibility to adjust to rail reform in line with their commercial circumstances.

We will include two provisions within Schedule 4 to cover the potential need to reopen the Schedule 4 access charge supplement (ACS) calculation during CP7. One provision will account for the proposed changes to the timetabling process and another may be activated in the event of a within-control period recalibration of Schedule 8 (see Chapter 3). Both of these circumstances could require recalculation of the ACS should they occur.

The recalibration process is underway with Network Rail leading on recalibrating Schedule 4 for PR23.

### Summary of draft decisions

2.1 The table below summarises draft decisions made during the PR23 review of Schedule 4. In some cases, decisions relate to initial proposals for change that have not been taken forward – in the table these are phrased as decisions ‘not to change policy.’

**Table 2.1 Schedule 4 draft decisions**

Draft decision	Consultation reference	Decision reference
To introduce an opt-out mechanism to Schedule 4	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 3.2). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (paragraph 1.21).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (paragraph 1.11).



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Draft decision	Consultation reference	Decision reference
To increase monitoring of Network Rail's possessions management to maintain its incentive to minimise disruption <sup>1</sup>	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 4.2 and 4.21). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (paragraphs 2.14 and 2.25).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (paragraph 1.25).
Not to develop a method for settling compensation claims for lengthy possessions and periods of sustained planned disruption	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 4.8). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 4, paragraph 10).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex A, A.8).
Not to develop a tool to estimate Schedule 4 formulaic compensation	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 4.23). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 4, paragraph 19).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex A, A.11).
Not to review the methodology for calculating the access charge supplement for open access operators	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 4.29). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 4, paragraph 29).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex A, A.17).
Not to update freight compensation rates	Proposed in our September 2021 <a href="#">Schedule 4 consultation</a> (paragraph 5.2). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (paragraph 2.33).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex A, A.20).

## Schedule 4 opt-out mechanism

### Conclusion in October 2022 document

2.2 In our [October 2022 document](#) (paragraph 1.11), we concluded that we would introduce a Schedule 4 opt-out mechanism for passenger and freight operators for CP7. This decision was supported by an [impact assessment](#). Should the UK Government proceed with plans to create GBR as an integrated rail body, we

<sup>1</sup> This work is being taken forward in the PR23 draft determination: [supporting document on outcomes](#). See Chapter 12, 'Network availability and possessions management'.

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expect that many operators contracted to GBR would not face revenue risk for possession related service disruption. We consider that the opt-out mechanism can provide operators with the flexibility to adjust to rail reform in line with their commercial circumstances.

- 2.3 Publicly contracted operators who choose to opt out will not receive any compensation for planned possessions nor pay the access charge supplement (ACS), which funds passenger contract Schedule 4. Open access passenger operators will retain the choice to fully opt in (and pay an ACS) or continue to receive limited Schedule 4 compensation (only for the most disruptive possessions and sustained planned disruption, while paying no ACS). Freight operators can choose to remain in Schedule 4 and receive current levels of compensation or opt out completely – any decision will last for the entirety of CP7.
- 2.4 We will limit the scope of the opt-out mechanism such that publicly-contracted operators that wish to opt out of Schedule 4 must do so completely, i.e. both from the revenue and cost compensation components<sup>2</sup> for the entirety of the control period. This is in the interest of simplicity. In the future, Great British Railways (GBR) may seek to include its own cost compensation arrangements for planned disruption within its passenger service contracts.
- 2.5 The table below summarises the opt-out mechanism for operators by sector.

**Table 2.2 Schedule 4 opt-out mechanism**

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

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

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Operator type	Current position	Decision to opt out	Decision to opt in
Freight operators	Receive standard freight Schedule 4 compensation. No payment of an ACS.	Receive no standard freight Schedule 4 compensation. No Payment of ACS.	N/A

### Introducing the Schedule 4 opt-out mechanism

- 2.6 In order for a passenger operator to decide whether to opt in or out, it would need to have an understanding of the likely level of ACS it expects to pay over the control period.
- 2.7 To inform operators on their decisions, Network Rail will provide indicative ACSs by August 2023. After this date operators will have up to eight weeks to notify Network Rail of their decision whether to opt in or out of Schedule 4. We will treat any publicly-contracted operators that do not state an intention to opt out as opting to remain in the Schedule 4 regime.
- 2.8 Open access and freight operators will also need to decide whether to opt in or opt out to the same timescales. Open access operators that do not state an intention within eight weeks will remain in receipt of the baseline levels of Schedule 4 compensation currently applicable in their track access contracts. Freight operators that state no preference will also continue to receive Schedule 4 compensation as currently.
- 2.9 Network Rail will inform ORR of all operators' decisions by the end of October 2023.
- 2.10 An operator's decision on whether to opt out or opt in will last for the entirety of CP7. Operators will not be permitted to opt back in or out after the start of CP7, except for publicly-contracted operators under the circumstances listed below:
- (a) re-tendering of an existing franchise or concession-style contract;
  - (b) change of ownership of a franchise or concession-style contract mid control period that involves significant changes in service levels; or

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(c) a change to the franchising authority that is a party to the operator's franchise or concession-style contract.<sup>3</sup>

2.11 In the case of a new franchise or concession, or a new open access or freight operator, that comes into existence in the middle of the control period, the operator would have the choice whether to opt in or opt out when it enters into its track access contract.

2.12 We welcome views on this process for the opt-out mechanism. We will be consulting on the legal drafting of the opt-out mechanism as part of our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

## Potential changes to Schedule 4 within CP7

### Timetabling process changes: reopener provision

2.13 Since our October 2022 document, Network Rail has proposed changing the timetabling process, following consultation with the industry. Under the proposed process, known as Better Timetabling for Passengers and Freight (BTPF), Network Rail's proposals would enable it to make up to three timetable changes per year. This may have a significant impact on Schedule 4 as described below.

2.14 The proposal within BTPF that will impact on Schedule 4 is for Network Rail to reduce the notice period for giving operators details of the 'Informed Traveller Timetable' (ITT), from 12 to eight weeks before services are due to operate. The release of the ITT is usually the earliest point at which operators are able to make their timetables available to passengers and sell tickets.

2.15 Under Schedule 4, Network Rail receives a discount on the level of revenue loss compensation it pays operators if it provides early notification of possessions. The level of discount varies according to notification thresholds – the earlier Network Rail notifies operators about forthcoming possessions the greater the level of discount (see [ORR Schedule 4 factsheet](#), chapter 3, 'Notifications factors' section). One of the notification thresholds is aligned to the ITT notification date – i.e. in order to receive the level of discount at this notification threshold, Network Rail is currently required to notify operators about a possession at least 12 weeks before publication of the ITT.

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<sup>3</sup> This is an additional circumstance to the cases set out in our October 2022 document. It could apply, for example, if GBR is created and takes over franchising powers.

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- 2.16 Moving the ITT notification to eight weeks before publication would also require reducing the notification threshold to eight weeks. This is likely to increase the number of possessions notified to operators before the ITT threshold. As a result, Network Rail is likely to receive a higher discount across more possessions than previously, and to pay less in Schedule 4 compensation overall. Conversely, shortening the earliest date at which timetables are published to eight weeks reduces the amount of notice passengers will have about forthcoming disruption due to possessions. To the extent that this is captured in the recalibration of revenue loss discounts, the level of discount Network Rail receives will be lower.<sup>4</sup> Network Rail will pay out higher or lower revenue loss depending on the net effect of these two impacts. Therefore, the ACS will need to be adjusted accordingly to ensure the correct funding.
- 2.17 A decision on whether to proceed with BTPF will not be made until after the start of CP7 and after the ACS has been determined for CP7. Given that BTPF is likely to affect the level of Schedule 4 payments (as described above), we will need to recalculate the ACS if a decision is taken to proceed with BTPF. We therefore intend to include a provision for a Schedule 4 reopener to reflect this.
- 2.18 We welcome views on this proposal. We will consult on contractual wording to enable within-control period changes to Schedule 4 as part of our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

### Reopener for consequential changes to ACSs following within-control period changes to Schedule 8 payment rates

- 2.19 We have made a draft decision to include a new provision to allow for within-control period recalibration of Schedule 8 (see Chapter 3 below). Schedule 8 payment rates are used in the calculation of Schedule 4 revenue loss payments, and thereby affect the required ACS. If Schedule 8 payment rates change, flowing through to different Schedule 4 revenue loss payments, the ACS may become incorrectly set. It is therefore necessary to include a reopener provision to recalculate the ACS in the case of a significant change to Schedule 8 payment rates during CP7. We welcome views on this proposal. We will consult on contractual wording to enable within-control period changes to Schedule 4 as part

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<sup>4</sup> The level of discount Network Rail receives is dependent on the proportion of passengers who are aware of service disruption due to possession before they travel. The higher the proportion, the greater discount Network Rail receives. See the [factsheet](#) for more details.

of our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

## Recalibration of Schedule 4

### General update

- 2.20 The recalibration of the Schedule 4 parameters for CP7 is underway, led by Network Rail. Working groups comprising Network Rail and train operators have been set up to support the recalibration process, with separate groups for the passenger and also freight and charter sectors. The groups meet monthly to discuss points of methodology, with final decisions being made by ORR where required.
- 2.21 In March 2023, we [wrote to the passenger recalibration working group](#) to confirm our approach to updating Schedule 4 parameters. Network Rail is leading the work to recalibrate each passenger operator's ACS, and it has set out its recalibration methodology to the passenger recalibration working group.
- 2.22 The recalibration of Schedule 8 Network Rail payment rates for CP7 involves a change in the methodology for calculating how passenger demand responds to service disruption caused by poor performance (see paragraph 3.49). The change in approach may affect the calculation of Schedule 4 notification factors, which set the level of discount on revenue loss Network Rail receives for early notification. Because of their impact on revenue loss payments, notification factors affect the ACS calculation. We are currently assessing how best to adapt the notification factor calculation to the new approach.

### ACS Methodology

- 2.23 Network Rail will use the same methodology to calculate the ACS as used for PR18. Network Rail has explained this methodology to the passenger recalibration working group, and it is summarised here.
- 2.24 Schedule 4 operating and maintenance possession costs for years one to four in CP6 are used as reference years and allocated into four 'buckets' of Schedule 4 expenditure – emergency timetables, enhancements, maintenance and renewals. Schedule 4 costs associated with enhancements are not funded through the ACS so are removed from the analysis. Emergency timetable costs are also treated differently and we discuss this below.
- 2.25 Maintenance and renewals costs and volumes are obtained for years one to four of CP6, broken down by route. The Schedule 4 costs are divided by maintenance

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and renewal volumes to produce indicative Schedule 4 unit payment rates. Where possible these unit payment rates are based on volumes, such as track kilometres. Where this is not possible, these are based on cost per spend, i.e. the amount of Schedule 4 compensation paid out relative to the amount spent on a project. Forecasted operating and maintenance volumes or costs for CP7 are applied to these Schedule 4 unit rates to produce the total CP7 Schedule 4 forecast, split by route. Finally, route totals are split by TOC on a basis intended to represent the operator's likelihood of being impacted by a possession.

- 2.26 The financial impact of Network Rail missing the informed traveller timetable notification threshold during the Coronavirus (COVID-19) pandemic and during strike action is being removed from the analysis.
- 2.27 For emergency timetables, the estimate for CP7 is based on the average Network Rail spend over the past five years. This is calculated at a national level as it is difficult to predict where future instances of emergency timetables will occur.

## 3. Schedule 8

### Summary

We will proceed with a proposal to allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, if GBR is established and if there is sufficient legislative change to permit the removal of payments.

We will also proceed with a new provision to allow for the update of Schedule 8 parameters during the control period. This will allow ORR to initiate recalibration of Schedule 8 in the event that there is a material change in circumstances.

The recalibration of Schedule 8 is underway. This chapter summarises the process, and outlines the key decisions that have been made to update Schedule 8 parameters for CP7.

### Summary of draft decisions

3.1 The table below summarises draft decisions made during the PR23 review of Schedule 8. In some cases, decisions relate to initial proposals for change that have not been taken forward – in the table these are phrased as decisions ‘not to change policy.’

**Table 3.1 Schedule 8 draft decisions**

Draft decision	Consultation reference	Decision reference
To retain the link between Network Rail’s benchmarks and forward-looking trajectories	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 3.10). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 7).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.7).
Not to update benchmarks annually	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 3.14). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 18).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.18).



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Draft decision	Consultation reference	Decision reference
Not to share allocation of some types of delay within Schedule 8	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 3.24). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 29).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.27).
Not to change how TOC-on-TOC delay is handled within Schedule 8	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 4.2). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 37).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.33).
Not to change the allocation of delay within Schedule 8 for unidentified incidents	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 4.22). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 48).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.38).
Not to change Schedule 8 compensation to more fully reflect financial impacts of delay	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 4.30). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 57).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.45).
To retain the sustained poor performance (SPP) mechanism for franchised passenger operators	Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 58).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.46).
Not to update the evidence base underpinning the freight and charter Network Rail payment rates	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 5.5). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (paragraph 3.7).	Concluded in our October 2022 <a href="#">Schedule 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.50 & B.51).

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Draft decision	Consultation reference	Decision reference
Not to revisit the structure of freight caps	Proposed in our June 2021 <a href="#">Schedule 8 train performance regime consultation</a> (paragraph 5.8). Consulted on in our April 2022 <a href="#">Schedules 4 &amp; 8 consultation</a> (Annex 5, paragraph 65).	Concluded in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (Annex B, B.57).
To implement a mechanism that may switch off Schedule 8 payments for GBR's future operators in the event of legislative change	Proposed in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (paragraph 2.8)	Concluded in PR23 draft determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.8)
To create a new provision to allow for ORR to initiate within-control period recalibrations of Schedule 8	Proposed in our October 2022 <a href="#">Schedules 4 &amp; 8 conclusions and consultation on outstanding matters</a> (paragraph 2.27)	Concluded in PR23 draft determination: policy position on the Schedules 4 and 8 incentives regimes (paragraph 3.28)

## Scope of application of Schedule 8

### Proposal in October 2022 document

- 3.2 In our [October 2022 document](#) (in paragraphs 2.1 to 2.18 of that document, which paragraph references in this sub-section refer to), we proposed to allow for the removal of relevant Schedule 8 payments between GBR and its contracted operators, in the event that there is sufficient legislative change to permit this. This would simplify financial arrangements under GBR should the Government proceed with rail reform plans to create GBR as a new body.
- 3.3 The proposal was that, for each of GBR's future contracted operators, a new conditional clause in Schedule 8 would state that no relevant Schedule 8 payments would be made between GBR and GBR operators (paragraph 2.9 explained which payments would cease and which would remain). This clause would take effect if (1) the legal requirements for a performance scheme in the 2016 Regulations<sup>5</sup> are changed, and (2) ORR issues a notice confirming that the relevant new paragraphs within Schedule 8 shall take effect (we refer to this as the 'switch-off' mechanism). If there is no legislative change, payments under the

<sup>5</sup> A train performance scheme which encourages parties to minimise disruption is a requirement of the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 ('the 2016 Regulations'). Network Rail meets this requirement through Schedule 8. The legal framework was explained in our [April 2022 consultation](#), paragraphs 1.7 to 1.8.

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Schedule 8 performance regime would continue to apply between the infrastructure manager (whether Network Rail or GBR) and all operators. Proposed contractual drafting was provided in Annex C to the October 2022 document.

- 3.4 We stated conditions that would need to be satisfied in order for ORR to trigger the new clauses (paragraph 2.14).<sup>6</sup> Only once we were satisfied that these conditions were met would we issue the notice.
- 3.5 We considered that the impacts of the notice would be limited to the parties directly concerned, i.e. GBR and its contracted operators (paragraphs 2.16 to 2.17). Schedule 8 payments would be retained for non-GBR operators, including those contracted by devolved bodies, and delay attribution would continue across the system. The change would not affect the size of payments made between GBR and non-GBR operators, because Schedule 8 would still be calibrated at a system-wide level, including all operators in the calculations. This would ensure that all payment rates between GBR and non-GBR operators would still reflect the full financial impacts of disruption, regardless of whether disruption is caused by GBR (as infrastructure manager), GBR's contracted operators or non-GBR operators. The only difference from the current system is that the new contractual clauses would mean that no relevant payments took place under Schedule 8 between GBR and GBR operators.
- 3.6 While we proposed that the new Schedule 8 'switch-off' mechanism would apply only to GBR's contracted operators, we invited consultation responses on whether the scope should be widened to include other train services, such as those contracted or operated by devolved bodies (paragraph 2.10). We said that this would need to be clearly justified.

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<sup>6</sup> We said that ORR would: consider whether the 2016 Regulations had indeed been amended in such a way as to allow the removal in Schedule 8 of the requirement for the majority of financial payments between GBR and its contracted operators; would need to be satisfied that developments in rail reform and changes in industry structure meant there was sufficient justification to remove the operators from exposure to the majority of Schedule 8 payments; would need to be satisfied that there were reasonable incentive structures in place for GBR and its contracted operators (for example through financial performance incentives set by GBR for its operators) to minimise disruption for passengers and freight customers across the whole network; and would need to be satisfied that there was no reduction in the financial protection offered through Schedule 8 to non-GBR operators such as freight and open access ('third-party operators') that remained fully exposed to payments under Schedule 8.

## Responses to October 2022 document

3.7 There was a range of responses to our proposal:

- (a) While some **passenger operators** expressed support, seeing the ‘switch-off’ mechanism as a sensible and pragmatic response to rail reform, others were concerned that it could weaken incentives on GBR to deliver good train performance. Rail Partners expressed concern about weakened incentives on Network Rail, and also said that the regime “must ensure that the signal around Schedule 8 is not weakened for those operators that remain in scope of this regime”. There was support for our proposed drafting that would enable Schedule 8 payments to be ‘switched back on’ if needed.
- (b) **Freight operators**, in their responses, focused on ensuring that Schedule 8 continues to apply as it does today in the freight sector.
- (c) **Network Rail and the Great British Railways Transition Team (GBRTT)**, in a joint response, welcomed the flexibility provided by the proposed ‘switch-off’ mechanism as a “practical solution”. However, they requested that ORR provides more specifics on the conditions that must be met in order for ORR to trigger the new clauses. They also strongly objected to ORR reviewing the financial performance incentives set by GBR for its operators: they said that this would step beyond ORR’s envisaged role, and was unnecessary as ORR will already hold GBR to account on train performance. They also said it may be useful for ORR to allow the new clauses to be applied flexibly to other operators (e.g. those currently contracted by devolved bodies) depending on their circumstances and agreements with GBR at the time.
- (d) **Transport Scotland** said that ORR should make available the ‘switch-off’ mechanism for its operators, as it says the current arrangements create “a mini industry with teams employed to argue over misaligned incentives”. Transport Scotland noted the current legal framework, which limits the ability of operators to opt out of the performance scheme. However, Transport Scotland asked ORR to “remain open to applying changes mid control period” if legislation changes in a way that would “allow Scottish Ministers to access the same benefits as offered to DfT”.

## Our draft decision

3.8 Our draft decision is to proceed with this proposal. Taking account of consultation responses, our view remains that, if implemented (in the event of creation of GBR and sufficient legislative change), the proposal will simplify financial and incentive

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arrangements for GBR's future operators. This is consistent with our intention for the PR23 settlement to be robust to the outcomes of rail reform. DfT and GBRTT have said that switching off Schedule 8 payments is a necessary step for GBR to be formed and for existing concession-style contracts to be transferred to GBR as the franchising body. Our draft decision is supported by an [impact assessment](#).

- 3.9 We note concerns expressed by some operators that the 'switch-off' mechanism could have adverse impacts on performance incentives. We would not expect this to be the case. We expect ORR to have a role holding GBR to account across infrastructure management and train services. Given its receipt of passenger revenues, GBR will have its own commercial incentives to run a high-performing railway so as to attract and retain passengers. Further, GBR will be exposed to Schedule 8 payments in respect of non-GBR operators, so there will be a strong financial incentive for GBR to limit the disruption caused by both its infrastructure and contracted train services.<sup>7</sup>
- 3.10 We recognise that there is still a degree of uncertainty as to the future regulatory structure in respect of GBR. Therefore, as stated in paragraph 3.16(b), we will require that there is a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance before we issue a notice to give effect to the new sub-paragraphs.
- 3.11 There were limited comments on the wording of the proposed new clauses. Network Rail and GBRTT said they were comfortable with the proposed drafting. Southeastern said that the proposed clause 12.3(a) was too broadly drafted, and the word "amended" should be replaced with "amended in such a way as to prohibit the Schedule 8 performance regime".<sup>8</sup> We recognise the broad nature of the drafting, but we still consider that the proposed drafting is appropriate in order to cover different legislative scenarios. How we may use this paragraph is underpinned by the guidance in paragraph 3.16 below. Therefore, the drafting of the new clauses is expected to be unchanged from the version in Annex C to the October 2022 document. The clauses will be included in our upcoming

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<sup>7</sup> In this respect, we note the UK Government's intentions for incentives on train operators as stated in its response our April 2022 consultation: "The Government is strongly committed to ensuring that contracts between Great British Railways and operators include strong performance incentives."

<sup>8</sup> The drafting proposed by ORR was as follows:

Paragraph 12.4 shall apply if:

- a) the provisions in the Railways (Access, Management and Licensing of Railway Undertakings) Regulations 2016 relating to the performance scheme are amended; and
- b) ORR issues a notice to the parties confirming that paragraph 12.4 shall take effect.

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consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'. The clauses will be included in Schedule 8 of track access contracts for those operators that the UK Government intends will be contracted by GBR.

- 3.12 The contractual changes would, if implemented, have the effect, for GBR's contracted operators, of stopping the main regular Schedule 8 payments, known as 'Performance Sums' (Schedule 8, paragraphs 9 and 10), as well as payments under Sustained Poor Performance provisions (Schedule 8, paragraph 18). It would leave intact some limited payments relating to adjustments to previous payments (Schedule 8, paragraph 6.3), the resolution of disputes (Schedule 8, paragraph 12.2) and the costs of assessing and implementing any amendments to Schedule 8 Appendix 1 and the Performance Monitoring System (Schedule 8, paragraph 17.4).
- 3.13 We confirm that a notice can only be issued at or after the start of CP7 but, by including the capacity to retrospectively adjust the payments, we can ensure that it could apply from the first day of CP7 (if necessary and in line with the legislative timetable). Should it be necessary to issue a notice with retrospective effect, this would, at the earliest, only be backdated to the date from which the amended 2016 Regulations came into force, and no sooner than the start of CP7. If there is such a change to the 2016 Regulations, we would engage with the industry in order to provide clarity about our intentions.
- 3.14 As stated in our October 2022 document, the clauses will include a new subparagraph 12.5 which will enable Schedule 8 payments to be 'switched back on'. This could be required in the event of a further change to an operator's commercial contractual model – for example, the re-adoption of revenue risk that may result in a requirement for Schedule 8 protections. Any notice issued in accordance with paragraph 12.5 would not apply retrospectively.
- 3.15 The Government has not yet brought forward legislation that would amend the 2016 Regulations, so we do not yet know the nature of any legislative change. If legislation prohibits performance scheme payments between GBR and its operators, then we would expect to issue a notice to trigger the 'switch-off' mechanism and meet this requirement. If legislation provides discretion on whether payments between GBR and its operators under a performance scheme should apply, we would make a decision on whether to issue a notice under the new paragraph 12.3(b) taking into account our duties. This includes the duty to promote improvements in railway service performance.
- 3.16 We would therefore consider the conditions set out here:

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- (a) We will consider whether the 2016 Regulations have indeed been amended in such a way as to allow the removal in Schedule 8 of the requirement for the majority of performance scheme payments between GBR and its operators.
- (b) We will need to be satisfied that there are sufficient developments in rail reform and changes in industry structure to justify issuing a notice – the combining of infrastructure manager and franchise authority within the same organisation is likely to be consistent with this requirement. There needs to be a sufficiently robust regulatory and incentive framework in place to promote improvements in railway service performance.
- (c) We must be satisfied that there is no reduction in the financial protection offered through Schedule 8 to non-GBR operators such as freight and open access operators that remain fully exposed to payments under Schedule 8.

3.17 We have considered Transport Scotland’s position that ORR should make available the ‘switch-off’ mechanism for Scottish operators. Transport Scotland said that this could simplify the financial arrangements in Scotland, where Transport Scotland both funds Network Rail and operates train services through a subsidiary. At present, there is no indication from the UK Government that its intended legislation would remove non-GBR operators from the legal requirement for a performance scheme, so we do not yet see a justification for the new clauses to be applied to Scottish operators. However, if legislative amendments removed the requirement for a performance scheme from Transport Scotland’s operators, GBR and each operator could jointly agree a change to their track access contract to include the ‘switch-off’ mechanism. This would be subject to ORR’s approval, in accordance with section 22 of the Railways Act 1993, and we would apply similar conditions as we intend to use for GBR operators in issuing a notice to give effect to the ‘switch-off’ mechanism (paragraph 3.16).

## Adding flexibility to Schedule 8 in CP7

### Proposal in October 2022 document

3.18 In our October 2022 document (in paragraphs 2.23 to 2.33 of the October 2022 document, which paragraph references in this sub-section refer to), we proposed to include a provision in Schedule 8 to allow for the update of Schedule 8 parameters during the control period. This was intended to add flexibility to Schedule 8 to address the current situation where parameters are set for the whole control period and do not respond at a system-wide level to external shocks such as changes to traffic volumes. We said the current position can mean that,

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when circumstances materially change, the regime is not accurately calibrated, potentially resulting in large and volatile payment flows between parties.

- 3.19 We noted in particular that it may be appropriate to consider within-control period recalibration during CP7 if uncertainties about recovery from the pandemic mean that parameters turn out to have been inaccurately determined (paragraph 2.24). This had been a key concern raised by Network Rail and train operators during the recalibration process.
- 3.20 This option was chosen over an alternative proposal to annually update benchmarks during CP7, on the basis that the chosen option would provide greater certainty and keep intact the incentive properties of Schedule 8, as well as carrying lower administration costs (Annex B, paragraphs B.18 to B.22).
- 3.21 We said that the proposed new provision would only be used if there were clear benefits to the industry from recalibrating, and if it was clearly justified by a material change in circumstances, i.e. a divergence from the assumptions made in the PR23 recalibration (paragraph 2.27). We said that we would seek to avoid recalibrating in response to a shock that was likely to be short-lived or had limited effects, and we would not recalibrate as a result of poor performance that was under the control of industry parties. We noted that we would require a sufficiently high-quality evidence base on which to base the calculations.
- 3.22 We noted that the existing passenger Schedule 8 paragraph 17 provision, which allows Network Rail and each passenger operator to request changes to the operator's parameters, would remain in place (paragraph 2.28). ORR would only initiate recalibration under the proposed new power where the existing paragraph 17 provision would not suffice.
- 3.23 We proposed that the new provision would be included in the passenger, freight and charter regimes (paragraph 2.32). We noted that any recalibration would be limited to an update of parameters, rather than being an opportunity to change the wider contractual terms of Schedule 8, and would be based on the policy framework determined through PR23 (paragraph 2.30). We said we would focus any recalibration on the parameters with the greatest impact on payment flows (2.29). We noted that Network Rail's benchmarks could be based on newer performance trajectories in circumstances where ORR had agreed for Network Rail's baseline performance trajectories to be adjusted through ORR's established change control process (paragraph 2.29). This would help to retain consistency between benchmarks and our regulatory expectations of Network Rail.



## Responses to October 2022 document

- 3.24 In response to our October 2022 consultation, **Network Rail and GBRTT** supported the proposed new provision in light of its potential to reduce perverse incentives and financial risks. Their view was partly due to concerns that the PR23 recalibration is reliant on data which is affected by the pandemic. Network Rail and GBRTT's view is that "a more flexible approach can be achieved through the use of multiple recalibrations throughout CP7 (providing specified triggers are met and ORR agree a recalibration is necessary), which could be carried out via simple mechanistic updates to the regime's parameters". They said that benchmarks could be updated mechanistically within the control period to account for the relationship between traffic and performance only, and payment rates adjusted to reflect changes in revenues year on year. Network Rail and GBRTT therefore proposed that there be an annual review point at which ORR considers whether a recalibration should take place, and also that ORR should be open-minded towards allowing more than one recalibration to Schedule 8 parameters if appropriate triggers are met. Network Rail's viewpoint was also stressed within its CP7 SBP submission, which made clear Network Rail's desire for more flexibility during CP7.
- 3.25 Network Rail and GBRTT also asked for guidance from ORR on the approach to recalibrations within control periods, including on the materiality thresholds that ORR would use. They suggested that ORR should decide on the scope of recalibrations based on an assessment of industry circumstances. They suggested that the provision should allow ORR to temporarily suspend or adjust Schedule 8 in response to a significant exogeneous shock.
- 3.26 **Passenger operators** expressed support for the proposal. They welcomed the potential for increased flexibility, given the difficulty of creating representative benchmarks and payment rates for five years in current industry conditions. Rail Partners highlighted that there should be a balance struck between greater flexibility and the benefits of a stable performance regime which gives clear incentives and confidence for future investment. Operators asked for guidance from ORR regarding how and when a recalibration would take place. Several operators suggested setting specific materiality thresholds or 'triggers', which could be quantified as a change in service volumes, traffic levels and revenue. GTR said that the scope should be "pragmatic and limited to just those areas most affected (i.e. performance/revenue) setting the impact against the recalibration cost, as well as industry time and effort". TfL proposed that the power should be used where there is a "demonstrable and disproportionate financial effect of

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Schedule 8 against the value of a service group revenue”. Several operators asked for clarity on the funding of future recalibrations.

- 3.27 There were mixed views in respect of the proposal for the **freight and charter regimes**. Network Rail favoured an approach where benchmarks are updated annually, but said there should be less need for ‘wholesale’ recalibrations as the regimes are being calibrated on relatively stable data. Freight operators emphasised that Schedule 8 should provide clear incentives to invest in train performance, and expressed concern that incentives should not be diluted by recalibrations. Two FOCs responded to our consultation: GB Railfreight disagreed with the proposal, except in exceptional circumstances, while Freightliner welcomed the proposal but again said that recalibration should only happen in exceptional scenarios. We did not receive responses from charter operators.

### Our draft decision

#### Summary

- 3.28 Our draft decision is to proceed with this new provision to allow for the update of Schedule 8 parameters during the control period. This draft decision is supported by an [impact assessment](#). Most consultation responses agreed with us that the proposal offers potential benefits in allowing parameters to adjust during the control period to better reflect industry conditions. This would reduce the extent of any ‘windfall’ payments that are the result of exogenous factors. Comments in response to the consultation were mainly focused on the way in which ORR would exercise the power to initiate recalibration of Schedule 8. We give information on this here.
- 3.29 The new provision will be implemented through clauses in model track access contracts; we will propose legal drafting through our upcoming consultation, ‘Implementing PR23: Consultation on drafting changes to access contracts’. We expect these clauses to say that a decision to recalibrate will only be made in the event of a material change in circumstances.
- 3.30 We will include the new provision in Schedule 8 for the passenger, freight and charter sectors. We noted in our October 2022 document that the case for the provision is strongest in the passenger regime, which has less stable underlying data than the freight regime and faces the greatest uncertainty about future demand and traffic volumes. However, external shocks do also impact the freight and charter markets, including through the knock-on effects of changes in passenger traffic volumes which may affect performance in freight and charter. In addition, the calibration of each sector regime uses inputs from the other sector

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regimes, which helps to keep the Schedule 8 ‘star model’<sup>9</sup> in balance – this may justify an update to one sector regime as the consequence of an update to another sector’s regime.

- 3.31 As we said in the October 2022 document (paragraph 2.28), the existing passenger Schedule 8 paragraph 17 provision, which allows Network Rail and each passenger operator to request changes to the operator’s parameters, will remain in place.<sup>10</sup> (This provision is not present in the freight and charter regimes.) The existing paragraph 17 provision should continue to be used in TOC-specific circumstances such as service changes or franchise remapping. ORR will only initiate recalibration under the new provision where the existing provision does not suffice. This is likely to be where there is a material change in circumstances that affects multiple operators, where coordinating multiple contractual changes under paragraph 17 would be burdensome.
- 3.32 Any change to Network Rail payment rates in Schedule 8 will feed through into revenue compensation formulae in Schedule 4 (in line with paragraph 3.4 of Schedule 4 in the passenger model contract). This may mean that Schedule 4 ACSs are inaccurately calculated, with Network Rail’s ACS income no longer being in line with expected Schedule 4 compensation. In such circumstances, Schedule 4 ACSs are likely to need to be recalculated. For this purpose, we are proposing a new provision in Schedule 4 to allow for ACSs to be recalculated during the control period – see paragraph 2.19.

### Using the new provision

- 3.33 We remain of the view that Schedule 8 should only be updated within control periods in the event of a material change in circumstances. Fixing Schedule 8 parameters over time provides parties with incentives to improve performance in the knowledge that performance gains will not be immediately ‘clawed back’ through an updated recalibration. In addition, recalibration of Schedule 8 is a complex and potentially costly exercise – for example, the PR23 recalibration exercise is taking around a year, and is requiring specialist consultant resources to carry out the calculations, in addition to staff time from ORR and the industry. While the PR23 recalibration models are being built in such a way as to be readily updateable, any update will still come at a material cost in industry resources.

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<sup>9</sup> Under the star model, all Schedule 8 payments are made bilaterally between Network Rail and operators, with no payments flowing directly between operators. The star model is calibrated so as to leave Network Rail financially neutral based on expectations of disruption caused by operators to one another.

<sup>10</sup> We expect to propose that, in the passenger contract, this paragraph 17 will be amended so as to implement the new power for ORR to initiate within-control period recalibration of Schedule 8.

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- 3.34 A material change in circumstances will be outside the circumstances assumed in the PR23 or subsequent recalibration. A material change in circumstances is unlikely to be the result of poor performance that is under the control of industry parties. In addition, the circumstances would need to be likely to lead to a sustained material change in realistic performance expectations in future years of the control period, rather than be a short-lived change or one with limited effects. We do not intend to set quantitative thresholds that will ‘trigger’ recalibration, and will instead make a judgement based on the full set of relevant considerations, including metrics such as traffic and passenger volumes. We expect to be able to reach a better overall judgement by looking at changes in the round rather than based on a limited set of quantitative triggers. The emergence of significant net financial payments may be indicators that a material change in circumstances has occurred, but will not in themselves be a reason to recalibrate.
- 3.35 As we proposed in our October 2022 document, the provision will only be used if there are clear benefits to the industry from recalibrating. We will consider whether there is sufficiently high-quality evidence on which to base the calculations. We will also consider the other factors mentioned in this section, such as the time and resources available to carry out a recalibration. Any recalibration would be likely to require support from specialist consultants, which would need to be funded by the industry.
- 3.36 As explained in paragraph 3.33, there is value in Schedule 8 parameters being stable over time, and we concluded in our October 2022 document that we will not carry out annual updates of Schedule 8 benchmarks. We consider it possible that the materiality threshold may be met more than once in a control period. However, the frequency of recalibration will in practice be limited by the materiality threshold, the resource cost, and the time lag for recalibration (in terms of historical data becoming available, recalibration being carried out, parties being consulted and implementation processes being completed). Furthermore, the legal framework for ORR's periodic reviews of Network Rail creates an expectation that the periodic review settlement will be in place for the whole control period, unless change is necessary.<sup>11</sup> We would expect to respond to change when necessary, and limiting consideration of whether a recalibration should take place to fixed annual review points may not allow the regime to respond to changes that happen in between review points.

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<sup>11</sup> Schedule 4A, Railways Act 1993 and Regulation 15 of the 2016 Regulations.

### **Scope of recalibration**

- 3.37 The scope of any recalibration will be decided at the time, based on the nature of the material change in circumstances. The decision on scope will cover the following:
- (a) The sectors within scope – i.e. whether the passenger, freight and charter sector schemes are each within scope.
  - (b) The operators within scope – this will be decided by the scope of the change in circumstances. It seems likely that any material change in circumstances would be national in its scope, and affect different market segments, but it will be assessed at the time whether the change is more contained.
  - (c) The parameters within scope – this will be decided based on the nature of the change in circumstances, e.g. whether it affects performance (in which case benchmarks could be within scope), revenue (in which case payment rates could be within scope) or both. Additionally, as noted in the October 2022 document (paragraph 2.29), we would expect the Schedule 8 parameters with the greatest impact on payment flows to be most likely to be within scope of any recalibration during the control period.
- 3.38 In addition, in each decision on scope, retaining balance in the ‘star model’ will be a consideration.
- 3.39 We expect that any update would be limited to parameters in Schedule 8 appendices.<sup>12</sup> The update would be based on the policy framework determined through PR23, and it would not provide an opportunity to make policy changes or alter the wider terms in contracts.

### **Updates to Network Rail’s benchmarks**

- 3.40 Network Rail’s Schedule 8 benchmarks are being calibrated to be consistent with the baseline performance trajectories set through ORR’s PR23 determinations. As we said in our October 2022 document (paragraph 2.29), benchmarks could be based on newer trajectories in circumstances where ORR has agreed for Network Rail’s baseline performance trajectories to be adjusted. This will help to retain consistency between benchmarks and our regulatory expectations of Network Rail. We otherwise expect the benchmarks to remain consistent with the baseline trajectories in ORR’s final determination.

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<sup>12</sup> The relevant appendices are as follows: in the passenger regime Appendices 1 and 3; in the freight regime Appendix 1; and in the charter regime Appendix 8A.

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- 3.41 ORR's PR23 [policy position on managing change](#), which we are consulting on as part of the PR23 draft determination, sets out the principles governing change in Network Rail's baseline trajectories. It states that "updates to headline success measure baseline trajectories, which are set in ORR's determination will only be made following a material change in circumstances" (paragraph 3.6 of the 'managing change' document). These circumstances are "those unforeseen in Network Rail's forecasts or ORR baseline trajectories, and are likely to be outside of Network Rail's control and lead to a sustained change in realistic performance expectations in future years of the control period". The policy adds that "ORR does not expect consulted changes to be made frequently". The policy also states that a change in baseline trajectories could be initiated by Network Rail or ORR (paragraph 3.6(ii)).
- 3.42 While benchmarks may be updated following an update to baseline performance trajectories, this may not automatically follow. We will take into account the other factors mentioned above, such as the time and resources available to carry out a recalibration.

## Other Schedule 8 policy matters

### Sustained poor performance and open access operators

- 3.43 The sustained poor performance (SPP) mechanism provides for additional compensation to be payable to a train operator when lateness and cancellations attributable to Network Rail reach a specified threshold, beyond which the standard Schedule 8 formula may significantly undercompensate the operator. The mechanism is contained in the model passenger contract (Schedule 8 paragraphs 18 and 19 and Appendix 3), but it has not yet been made available to open access operators. Our understanding is that this is because these operators had previously benefited instead from 'local output commitments', but these have fallen into disuse.<sup>13</sup>
- 3.44 Network Rail has proposed that the sustained poor performance mechanism should be extended to open access operators in CP7. Network Rail and ORR have recently engaged with several open access operators, who told us that they would like the mechanism to be included in their contracts. We agree that this would have benefits, as it would extend a financial protection to open access operators and remove a potential source of discrimination between different types

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<sup>13</sup> Local output commitments (LOCs) are covered in Part L of Network Rail's Network Code. For franchised operators they were replaced with Schedule 8 sustained poor performance provisions as part of ORR's [2005 Review of the Schedule 8 performance regime](#), but were retained for open access operators.

of passenger operators. We intend to publish a model contract for open access operators alongside our other model contracts, and will include new paragraphs containing the SPP mechanism. This proposed drafting for the SPP mechanism will be part of our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

## **Recalibration of Schedule 8**

3.45 Our recalibration programme is currently updating the Schedule 8 regime's parameters for CP7. In PR23, ORR is leading the recalibration of Schedule 8 for passenger operators, and Network Rail is leading the recalibration of Schedule 8 for freight and charter operators. The working groups mentioned in chapter 2 are meeting monthly in support of the recalibrations to discuss and agree points of methodology, with final decisions being made by ORR where required. The most significant decisions, which we have made through consultation with the working groups, are summarised below.

### **Recalibration of the passenger Schedule 8 regime**

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

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

3.48 In the calculation of Network Rail payment rates, which are based on operator service group revenue, an adjustment is being made to account for the adverse impact of the pandemic and industrial action on revenues. This will raise the revenue in the adversely impacted periods to the percentage rate of revenue recovery seen in unimpacted periods (as compared with pre-pandemic levels). This is to give a better representation of likely revenue levels during CP7. While this will raise payment rates above the pre-adjustment level, the effect is more

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than counteracted by the overall fall in operator revenues from pre-pandemic levels. In draft results, the net impact is to reduce Network Rail payment rates by around 15 percentage points.

- 3.49 Another key input to Network Rail payment rates is the set of estimates of the elasticity of passenger revenue to disruption, which is used to quantify the revenue impact of disruption. Since PR18, new studies have been commissioned by the Rail Delivery Group (RDG) from Steer (2019) and SYSTRA (2022), which directly estimate the relationship between revenue and disruption<sup>14</sup>. These studies build on an earlier study from Oxera (2017) which directly estimated this relationship for flows in London and the South East and which was adopted in the PR18 recalibration for these flows. The PR18 recalibration had, for flows outside London and the South East, indirectly estimated the relationship between revenue and delay through evidence on how demand responds to changes in generalised journey time. In the PR23 recalibration, we have used the new Steer and SYSTRA studies to estimate the relationship between revenue and delay. This follows a recommendation from a sub-group of the recalibration working group and [specific recommendations from Steer](#) on how to combine the Steer and SYSTRA studies. The estimates show that demand is less responsive to disruption than had previously been estimated. In draft results, this has resulted in a material fall in Network Rail payment rates of around 60 percentage points on average. These draft results, which are confidential to operators and Network Rail, are currently being reviewed by each party, and we will provide an update in the final determination.
- 3.50 In the calculation of benchmarks, we are not adjusting benchmarks for the impact of strikes. While strikes affected train service volumes in the latter part of the recalibration timeframe, the impact on TOC performance benchmarks would be limited. This is because performance is measured against the reduced timetable, and recalibration takes the proportion of on-the-day services delayed or cancelled across the whole year, so strike days carry little weight in the calculation.
- 3.51 We have also made a decision not to adjust benchmarks in response to high levels of TOC cancellations. Network Rail has stated that TOCs' cancellations of their own services ('TOC on Self cancellations') were unusually high during the latter part of the recalibration timeframe. It said that this created a risk that, if TOCs' beat the cancellation element of their benchmarks in CP7, Schedule 8

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<sup>14</sup> The studies were commissioned by the Passenger Demand Forecasting Council (PDFC), part of RDG. PDFC maintains the Passenger Demand Forecasting Handbook (PDFH), which summarises research on rail demand forecasting for a variety of industry purposes such as investment appraisal. The Steer (2019) and SYSTRA (2022) studies are available to industry subscribers to PDFH.



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would become imbalanced and leave Network Rail financially exposed. However, we have set a high threshold for making adjustments to the recalibration data, and were not persuaded that the risks were material enough to depart from the standard methodology. This is particularly in light of the likelihood of lower Network Rail payment rates, which would materially lower the scale of any financial imbalance.

- 3.52 The final determination will provide a further update on recalibration, including on how Network Rail's performance benchmarks are being calibrated to be consistent with its performance trajectories for the On Time and Cancellations measures.
- 3.53 The work to recalibrate the passenger regime is continuing and will receive quality assurance and external audit ahead of completion. The recalibration is taking place in phases, as summarised below. We will liaise with the passenger recalibration working group ahead of confirming each set of parameters (as set out in Table 3.2). We will then confirm the parameters through letters to the industry.

**Table 3.2 Timings for Schedule 8 passenger recalibration**

Phase	Parameters	Completion date
Phase 1	Monitoring points, monitoring point weightings and cancellation minutes	Initial industry agreement in January 2023; formal confirmation to follow
Phase 2	Network Rail payment rates	June-July 2023
Phase 3	Network Rail benchmarks, TOC benchmarks, TOC payment rates and sustained poor performance thresholds	November 2023

Note to Phase 1: Network Rail and train operators have carried out an exercise to agree any updates to monitoring points, monitoring point weightings (MPWs) and cancellation minutes for CP7. These were agreed in January 2023. They will be formally confirmed in or before November 2023, incorporating any minor changes to MPWs that occur due to network changes in the interim period.

### Recalibration of the freight and charter Schedule 8 regimes

- 3.54 We [wrote to members of the freight and charter recalibration working group](#) in March 2023 on the expected methodology and assumptions for the PR23 recalibration of Schedule 8. This letter stated that the PR23 recalibration would follow a similar methodology to the PR18 recalibration, with the key points being as follows:

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- (a) The recalibration timeframe, the historical period from which data is taken to recalibrate some of the regime's parameters, has been agreed by members of the group as being 2015-16 to 2019-20. This period was chosen on the basis of it being a continuous five-year period (the length of time that has been used in previous freight and charter recalibrations), and that it largely avoids the disrupted data that resulted from the pandemic. Data from this timeframe will be used for parameters such as the freight and charter operator benchmarks.
- (b) Network Rail's benchmark in the freight regime will be recalibrated to be consistent with Network Rail's CP7 freight cancellations and lateness (FCaL) forecast. This is the inverse of the freight delivery metric, FDM, that was used in the PR18 recalibration. (Freight cancellations will be removed from the FCaL forecast to focus on delay.)
- (c) Most financial parameters in the freight regime, e.g. the Network Rail payment rates and cancellation sums, will as in PR18 be uplifted for CPI inflation. Some financial parameters are also subject to adjustments, such as annual liability caps which are adjusted for changes in traffic volumes. The [March 2023 letter](#) provides a summary.<sup>15</sup>

3.55 During the recalibration process, Network Rail noted that the prolonged disruption amount has not been used for the past nine years. When a prolonged track closure takes place, with no alternative route available, Network Rail now issues a restriction of use and provides short notice possession compensation under Schedule 4. The working group agreed that the prolonged disruption amount should not be recalibrated in PR23, and that the Schedule 8 clauses relating to the calculation of the prolonged disruption sum should therefore be removed. We agree that this step would help to simplify the freight regime. The proposed changes to contractual wording will therefore be part of our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

3.56 The working group also agreed to a simplification of incident caps in the freight and charter sectors. There is currently an incident cap that offers a 30% exposure level of delay minutes beyond the cap, but this has not been taken up by any operator in CP6. Therefore, the group has proposed that, for the benefit of simplifying the freight and charter regimes, the cap with a 30% exposure option

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<sup>15</sup> We decided in our [October 2022 Schedule 8 conclusions](#) (paragraphs B.50-B.51) that the respective Network Rail payment rates for freight and charter operators would not be subject to a full recalibration using new evidence. The industry felt there was insufficient time available to generate the evidence required. Instead, the existing rates will be uplifted for inflation.

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will not be included in CP7, and the only option should be the cap above which operators have 0% exposure. We agree that this step would help to simplify the freight and charter regimes. The required contractual changes will be implemented through our upcoming consultation, 'Implementing PR23: Consultation on drafting changes to access contracts'.

- 3.57 The recalibration working group was unable to reach agreement on the calibration of the freight cancellation threshold. This threshold sets a level of cancellations, above which freight operators receive a higher rate of compensation for each service cancellation for which Network Rail is responsible. ORR was asked by the recalibration working group to decide on the setting of the threshold. In PR18, the threshold was calculated as the percentage of FOCs' services that were cancelled during the PR18 recalibration timeframe (2012-13 to 2016-17), resulting in a threshold of 0.40%. For CP7, the threshold will be calculated in a similar way, using the PR23 recalibration timeframe. This will allow the threshold to reflect changing circumstances while retaining consistency with the approach used in previous recalibrations.
- 3.58 Network Rail's work to recalibrate the freight and charter regimes is underway and will be independently quality assured ahead of completion. The work is taking place in three phases, as summarised below. We will liaise with the freight and charter recalibration working group ahead of confirming each set of parameters (as per Table 3.3). We will then confirm the parameters through letters to the industry.

**Table 3.3 Timings for Schedule 8 freight and charter recalibrations**

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

## Annex A: Supporting documents

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Alongside this document, we have also published:

- (a) [Impact assessment](#) on Schedule 8 'switch-off' mechanism for GBR's future contracted operators.
- (b) [Impact assessment](#) on provision to allow for recalibration of Schedule 8 within control periods.
- (c) [Steer review](#) of the available evidence about the passenger demand response to rail disruption.
- (d) [ORR letter](#) summarising methodology and assumptions for PR23 recalibration of freight and charter Schedule 8 regimes.
- (e) [ORR letter](#) summarising methodology and assumptions for PR23 updates of Schedule 4.



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