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Cancellation of possessions – conclusions on the proposal for a liquidated sums approach to compensation payment

Dear colleague,

As part of PR13, there have been ongoing discussions around compensating train operators when a Type 1 possession is cancelled by Network Rail. Under the current Schedule 4 regime, when Network Rail cancels a Type 1 possession and an operator reinstates a service that otherwise would not have run, operators are not eligible to claim costs that have been incurred or committed. This is in contrast to Type 2 and Type 3 possessions, where operators are entitled to claim actual costs (on a claims basis) from Network Rail under paragraph 2.9 of the Track Access Contract.

In ORR's November 2012 consultation on Schedules 4 and 8, it proposed extending the scope of the protection provided by paragraph 2.9 of the Track Access Contract to enable the recovery of direct costs related to amended or cancelled Type 1 possessions. This is consistent with the way in which operators can already claim compensation associated with cancelled Type 2 and Type 3 possessions.

Network Rail has long agreed with the principle of providing compensation for cancelled Type 1 possessions. We believe that this aligns with the general principle of Schedule 4 that TOCs should be compensated for costs incurred from possessions and consider that this approach will better incentivise Network Rail to plan possessions efficiently.

Whilst the principle has been clear from the outset, the specifics of how such a regime could best be administered have been a matter of further debate. In particular, there has been a question around whether compensation should be provided on a 'claims' or 'liquidated sums' basis. Network Rail has argued that a liquidated sums approach would be preferable, on the basis that it would reduce transaction costs over time.

In June 2013, we consulted on a specific proposal developed by Network Rail for a liquidated sums approach to compensation, when a Type 1 Restriction of Use (RoU) is cancelled. In this consultation letter, we invited stakeholders' views on our proposed set of principles, processes and timescales for the work involved in the liquidated sums approach. Following careful consideration of the consultation responses, this letter concludes on the issues discussed in the consultation.

We received nine responses to the consultation letter, from the following stakeholders:

- ATOC
- Arriva Plc (ATW, Chiltern & Cross Country)
- Abellio (Greater Anglia & Northern)
- Govia (London Midland, Southeastern & Southern)

- First Group (First ScotRail, First Capital Connect, First Great Western & First TransPennine Express)
- Stagecoach (South West Trains & East Midlands Trains)
- LOROL
- Transport Scotland
- West Coast Trains Ltd

We would like to take this opportunity to thank those stakeholders which responded to the consultation. We value this feedback, and stakeholders' views have influenced our thinking in a number of ways, as set out below. The annex to this letter contains a summary of stakeholders' responses.

In reviewing the responses to the questions posed in the consultation, it was clear there was a general view among TOCs that a 'claims based' approach should be adopted, as opposed to Network Rail's 'liquidated sums' proposal. In addition, following the consultation, ORR proposed, in its PR13 Draft Determination, to increase the protection provided by paragraph 2.9 of Schedule 4 via a claims based approach.

The general view from stakeholders is that the number of Type 1 possessions cancelled at short notice is relatively low. In one response, a TOC provided information showing that in 2012/13, the *highest* level of late/very late notice changes to possessions was just over 3% of total possessions for a period, and the typical level was much lower. Our own analysis also suggests that these occurrences are relatively infrequent. Generally, TOCs also stated that trying to calculate specific payment rates (for example at market sector level) – as would be necessary for a liquidated sums regime – would need a large amount of resource and that it would be difficult to generate figures that would accurately reflect the costs incurred to a TOC as there would be a number of variables affecting each claim.

Network Rail Conclusion

We continue to believe that there could be merit in a liquidated sums approach to providing compensation for Type 1 possessions. However, we recognise and understand the points made by train operators, particularly in relation to the relatively modest sums involved and the costs associated with establishing a liquidated sums regime. **In light of operators' concerns, we conclude that a 'claims based' approach may be the most appropriate way forward for CP5 for the model contract, and do not plan to pursue a liquidated sums approach through the model contract for CP5.**

However, we consider that there could be considerable merit in pursuing a 'liquidated sums' approach for CP6. This would then be in line with the current Schedule 4 regime. We will gather data on the claims that take place during CP5, which in turn, could provide robust data to aid in potentially establishing an 'automatic' regime for CP6.

We note that not all respondents favoured a claims based approach for CP5. On this basis, we believe that it may be appropriate to explore the possibility of adopting a 'bespoke' regime in certain circumstances, under which compensation could be provided on a liquidated sums basis.

In light of the provision of this additional compensation for cancelled Type 1 possessions, we believe that a modest increase in the Schedule 4 Access Charge Supplement (ACS) is appropriate. We understand that Network Rail should not be funded when a possession is cancelled for reasons associated with 'inefficient' planning. In our response to the Draft Determination, we have included a request for additional ACS funding, taking into account that we should not receive an ACS for inefficient cancellation of possessions.

In summary, stakeholders have offered robust arguments supporting a 'claims based' approach for CP5. Taking these into account we are content that this provides the



appropriate mechanism to offer the additional compensation for cancelled Type 1 possessions in CP5. We believe it is appropriate to maintain the option of a 'liquidated sums' approach for CP6. During CP5, we will strive to collect robust data so that we will have a more informed idea as to the number of such claims that may occur each period. In addition, we believe that it may be appropriate to pursue a 'liquidated sums' approach in CP5 on a 'bespoke' basis and believe that it would be appropriate for ORR to look favourably upon any proposals coming from operators and Network Rail.

Yours faithfully,

Caitlin Scarlett

Planning and Regulation Assistant

Annex 1 – Summary of responses

Consultation question 1

What is your view on the proposed definitions by which a train qualifies as being affected by a cancelled possession?

Respondents were generally in agreement as to how to determine what type of possessions and which trains should be compensated, even if the 'liquidated sums' approach was not followed, and instead a form of claims based approach was used.

One respondent stated that the regime should only apply to possessions that would have been classified as a Restriction of Use and the impact of the cancellation must also have a material affect on the TOC business. Many stakeholders agreed that possessions cancelled in the Possession Planning System (PPS) for administrative purposes and cancellations by the operator should not have compensation applied.

With regards to timescales, operators suggested that an earlier threshold for making a claim fits in with current planning timescales and would better reflect the cost incurred to a TOC when a possession is cancelled. Some suggestions are that the period should be as much as 22 weeks.

Some TOCs did not agree that compensation should only be provided if the cancelled train would otherwise have been subject to EBM payouts.

Consultation question 2

Do you agree that the payment rate should be defined by market sector, and applied per affected train in the qualifying possession?

Responses generally suggested that the payment rates should be disaggregated to a more granular level if a liquidated sums approach was to be implemented i.e. to TOC level or even Service Group level. One stakeholder supported the payment rate being defined by market sector.

It was noted that market sector is a useful differentiator to use when determining compensation rates for the loss of revenue, but is not a suitable determinant of cost compensation.

It was suggested that using the number of trains that would have been affected by a possession is not necessarily going to give an accurate proxy for the level of cost which may be incurred by operators.

Consultation question 3

Do you agree with the cost categories which we propose to cover in the formulaic compensation payment? Do you consider that any other cost categories should be included?

We would request that TOCs provide evidence of the magnitudes of these proposed cost categories in response to this consultation.

Operators tended to agree with the cost categories that were identified, but considered that there are other costs not identified and advised that the impact of each cost could vary greatly between operators and where on the route the possession was in place.

One stakeholder highlighted the importance of categories of additional staff required to manage customer flows and the cost of ticket acceptance on services provided by other TOCs. Others noted costs such as re-planning on routes away from the site of the cancellation and the impact the cancellation of the possession has on the TOC as a whole. Several respondents emphasised that some of the cost categories may only occur if the cancellation occurs at a very late stage.

Consultation question 4

Do you agree with the process by which a claim could be made?

The principle point made by stakeholders in this regard was that they viewed Network Rail as leading the process for identifying the cancelled possessions, rather than TOCs themselves.

Some operators raised concerns with the proposed timescales, with the deadline of Day 35 potentially leading to a scenario of a TOC only having 5 working days to make a claim. Stakeholders also felt that Network Rail may struggle to have the claim included in the Day 42 statement. One suggestion was to include the claims in the following Day 42 statement.

Consultation question 5

Do you agree that an efficient level of compensation payments should be funded through the Schedule 4 ACS?

Most TOCs suggested that Network Rail should receive no additional ACS for cancelled possessions. One response did acknowledge that any increases in ACS may allow for the fact that Network Rail is liable for Schedule 4 payments in what might be considered force majeure events. Some stakeholders stated that they would accept a reasonable increase in the ACS, but emphasised that this should only be for 'efficient' cancellations.

Consultation question 6

Do you consider that the alternative approach, whereby compensation would be paid if cumulative costs exceeded a predefined threshold, is preferable? We would be interested to hear your views on how the threshold should be set under this approach.

Responses to this question were varied. However, the majority of responses demonstrated support for a 'claims based' approach.