SCHEDULE 9.3

THIS IS SCHEDULE 9.3 REFERRED TO IN THE FOREGOING FRANCHISE AGREEMENT AMONG THE STRATEGIC RAIL AUTHORITY, STRATHCLYDE PASSENGER TRANSPORT EXECUTIVE AND FIRST SCOTRAIL LIMITED

Runs of the Financial Model

1. RUN OF THE FINANCIAL MODEL

1.1 Any Run of the Financial Model that is required for the purposes of this Agreement shall be performed, after making any Model Changes and utilising the Revised Inputs, and shall be performed by:

(a) the Franchisee promptly on receiving notification of the Revised Inputs and any Model Changes from the Authority pursuant to paragraph 2.3; or

(b) the Authority if the Franchisee fails to do so.

1.2 The party that performs the Run of the Financial Model pursuant to paragraph 1.1 shall provide the other parties to this Agreement with a reasonable opportunity to be in attendance and shall promptly notify the other parties to this Agreement of the New Results.

1.3 The Authority, as soon as reasonably practicable after receiving or generating the New Results pursuant to paragraph 1.2, shall either:

(a) certify to the Franchisee its approval of the New Results; or

(b) notify the Franchisee that it requires the Run of the Financial Model and its results to be audited by an independent auditor appointed by the Authority with the approval (not to be unreasonably withheld or delayed) of the Franchisee.

1.4 For purposes of paragraph 1.3 (b), the requirement for an audit is one that requires the auditor either to certify:

(a) that the New Results have been produced by applying the Revised Inputs (as provided to the Franchisee by the Authority pursuant to paragraph 2.3) to the Financial Model after making the Model Changes (as provided to the Franchisee by the Authority pursuant to paragraph 2.3) ; or

(b) the following, by itself applying the Revised Inputs (as provided to the Franchisee by the Authority pursuant to paragraph 2.3) to the Financial Model after making the Model Changes (as provided to the Franchisee by the Authority pursuant to paragraph 2.3):

(i) the restated amounts of Target Revenue to be specified for each Franchisee Year in Appendix 1 (*Target Revenue*) to Schedule 8.2 (*Annual Franchise Payments*); and

(ii) the restated values of FXD, VCRPI, PRPI and TRRPI to be specified for each Franchisee Year in Appendix 2 (*Figures for Calculation of Annual Franchise Payments*) to Schedule 8.2.

1.5 The parties shall procure that any auditor is, as soon as reasonably practicable after his appointment, able to discharge the audit requirements.

1.6 The results as certified by the Authority pursuant to paragraph 1.3 or by the auditor pursuant to paragraph 1.4 shall be final and binding on the parties, except in the case of manifest error.

1.7 The costs of any audit shall be met as the auditor may direct.

2. REVISED INPUTS AND MODEL CHANGES

2.1 ***Revised Inputs*** means :

(a) the data that the Financial Model utilised in order to produce the Old Results, as such data is recorded in the Financial Model released to the Franchisee by the Authority pursuant to paragraph 2(d) of Schedule 9.2 (*Identity of the Financial Model etc.*) for the purposes of a Run of the Financial Model; but

(b) amended, whether by way of increase, reduction or other alterations to such data, (if at all) only as the parties may agree or the Authority may reasonably determine is required by the provisions of:

(i) paragraphs 3 to 8 (inclusive) of this Schedule 9.3; or

(ii) paragraph 5 of Schedule 9.1 (*Financial Consequences of Change*),

in respect of a Change in order to produce the New Results.

2.2 ***Model Changes*** means any changes that the parties may agree or the Authority may reasonably determine are required to the Financial Model and/or the Operational Model, as released to the Franchisee by the Authority pursuant to paragraph 2(d) of Schedule 9.2 (*Identity of the Financial Model etc.*) for purposes of a Run of the Financial Model, as a consequence of and in order to give effect to the Revised Inputs.

2.3 The Authority shall provide a written statement of the Revised Inputs and any Model Changes to the Franchisee for purposes of paragraph 1.1 promptly after they have been agreed or determined.

3. AGREEMENT OR DETERMINATION OF REVISED INPUTS

The parties shall agree or the Authority shall reasonably determine the Revised Inputs that are required in respect of a Change:

(a) on the basis of the general adjustments and/or assumptions referred to in paragraph 4;

(b) on the basis of the assumptions in the Record of Assumptions as added to and/or amended (if at all) in accordance with paragraph 5;

(c) so as to provide for Traction Electricity Charges in accordance with paragraph 6;

(d) so as to provide for profit in accordance with paragraph 7;

(e) so as to provide for Estimated Revisions in accordance with paragraph 8.

4. GENERAL ADJUSTMENTS/ASSUMPTIONS

4.1 Revised Inputs are to be agreed between the parties or reasonably determined by the Authority on the basis that:

(a) any increase in costs relating to a Change, and/or

(b) any reduction in revenues relating to a Change,

that is attributable to any activities, actions or omissions of the Franchisee which are not permitted under, or would otherwise constitute a contravention of, the terms of this Agreement, is to be disregarded.

4.2 Revised Inputs are to be agreed between the parties or reasonably determined by the Authority on the basis that:

(a) any reduction in costs relating to a Change; and/or

(b) any increase in revenues relating to a Change,

that is attributable to any activities, actions or omissions of the Franchisee which are not permitted under, or would otherwise constitute a contravention of, the terms of this Agreement, is to be taken into account.

4.3 Revised inputs are also to be agreed between the parties or reasonably determined by the Authority on the basis that:

(a) the Franchisee will use all reasonable endeavours to:

  (i) reduce any costs that may arise or income that may be foregone; and

  (ii) increase any revenue that may arise or avoid any cost that may be avoided

  as a consequence of a Change; and

(b) any requirement for borrowing in respect of Capital Expenditure by the Franchisee is dealt with in accordance with paragraph 3 of Schedule 19 (*Other Provisions*)

5. ASSUMPTIONS IN THE RECORD OF ASSUMPTIONS

5.1 The parties shall (unless to do so would be contrary to paragraph 4) agree or the Authority shall reasonably determine Revised Inputs that are in accordance with the assumptions that are contained in the Record of Assumptions, as added to or modified pursuant to paragraph 5.2 or paragraph 5.3.

5.2 Where the Authority reasonably considers that additional assumptions are required in relation to circumstances not dealt with by the assumptions in the Record of Assumptions, the parties shall agree or the Authority shall reasonably determine additional assumptions for this purpose.

5.3 Where the Authority reasonably considers that:

(a) a Change is likely to result in an increase in either or both of the costs of the Franchisee and the revenues of the Franchisee; and

(b) an assumption relevant to the Change contained in the Record of Assumptions does not accord with what would be achievable by, or experienced by, an economic and efficient franchisee,

then the parties shall agree or the Authority shall reasonably determine a modification to the assumption so that, as modified, it does accord with what would be achievable by, or experienced by, an economic and efficient franchisee

5.4 Where there is:-

(a) a Variation made for the purpose described in paragraph 9(a) of Schedule 5.7 (*Changes to Fares and Fares Regulation*); or

(b) a Change arising from the exercise by the SPTE of its rights under Schedule 5.9 (*SPTE Control of Fares*);

and that Variation or Change is limited to only a very few fares so that the Authority can reasonably conclude, after consulting with the Franchisee and, if affected, the SPTE that the Record of Assumptions (and, if applicable, the Operational Model) is not sufficiently detailed to deal with those circumstances, then, to the extent that an assumption is needed for the revenue consequence of those circumstances on a Fare, it shall be reasonable for the Authority to have (if it wishes) as an additional assumption that there is no significant change to the distribution of travel on the Flow or between Flows as a consequence of those circumstances and therefore the aggregate Gross Revenues recorded by RSP as attributable to the sales of that Fare will increase or reduce accordingly in line with the amount of the Fare.

6. **Traction Electricity Charges**

6.1 This paragraph 6 applies only in relation to Charge Variations.

6.2 No Revised Inputs shall be made to the extent that a Charge Variation relates, directly or indirectly and however it may be effected, to the amount payable (in pence per kwh or otherwise) for traction current consumed by rolling stock vehicles operated by or on behalf of the Franchisee unless and to the extent that paragraph 6.4 applies.

6.3 As at the date of this Agreement, the amount payable for traction current consumed is reflected in the component Egit referred to in paragraph 4 of Part 2 of Schedule 7 of the Track Access Agreement [*to which the Franchisee is a party on the Franchise Commencement Date*].

6.4 The parties shall agree or the Authority shall reasonably determine Revised Inputs to reflect any change in the basis of calculation of the margin or premium (if any) which the counterparty to the Relevant Agreement is entitled to charge in respect of traction current.

7. **Revised Input for Profit**

7.1 The parties shall agree or the Authority shall reasonably determine Revised Inputs in relation to profit:

(a) where a Change is forecast to result in an increase to the Franchisee's costs, that provide for an increase in the amount of profit in any Franchisee Year equal to the Profit Margin percentage of the forecast increase in costs for that Franchisee Year; and/or

(b) where a Change is forecast to result in a reduction in the Franchisee's costs, that provide for a decrease in the amount of profit in any Franchisee Year equal to the lower of:

(i) the Profit Margin; or

(ii) the average profit margin in the current Business Plan for the remaining Franchise Term,

of the forecast reduction in costs for that Franchisee Year.

Profit Margin in this paragraph 7 means:

17 October 2004 to 31 March 2008 [redacted]

1 April 2008 to 31 March 2011 [redacted]

1 April 2011 to 31 March 2014 [redacted]

Costs in this paragraph 7 means all net operating costs excluding Total fixed access charges, Total variable access charges, Total Capacity Charge Base

Case, Depot Charges, Total EC4T, Total Non-SSA station access charges, Plant and Equipment leases and Other as defined in:

Charge	AccCalc row reference in Financial Model
Total fixed access charge	21
Total variable access charge	65
Total Capacity Charge Base Case	26
Depot Charges	67
Total EC4T	84
Other	86
Total Non-SSA station access charges	100
Plant and Equipment Leases	102

7.2 In agreeing or determining Revised Inputs in respect of any Change, the parties or the Authority shall effect such change (if any) in the amount attributable to profit in paragraph 7.1 as they agree or the Authority reasonably determines to reflect:

(a) the risk for the Franchisee in continuing to operate the ScotRail Franchise on the terms of this Agreement after and as a result of the Change; and

(b) the likelihood of

(i) material benefit from such Change arising after the expiry of the Franchise Term; and

(ii) material detriment from such Change arising prior to the expiry of the Franchise Term.

The Authority agrees with the SPTE to consult with the SPTE and to obtain the consent of the SPTE to such a determination where the determination will have an effect on the monetary level of the SPTE Share. The SPTE agrees with the Authority that its consent shall not be unreasonably withheld or delayed.

7.3 In agreeing or determining Revised Inputs for the purposes of any Protected Proposal, the parties or the Authority shall effect such change (if any) to the amount attributable to profit as they agree or the Authority reasonably determines:

(a) fairly rewards the Franchisee for proposing the Protected Proposal; and

(b) reasonably incentivises the Franchisee to propose further Protected Proposals, by sharing with the Franchisee a reasonable amount of the decrease in the Franchisee's costs that is expected to arise from implementing the Protected Proposal.

7.4 The Appendix (*Incentivising Long-Term Investment*) to this Schedule 9.3 sets out guidance on incentivising long term investment in ScotRail.

8. **ESTIMATED REVISIONS**

8.1 This paragraph applies only where and to the extent that, prior to the Run of the Financial Model, payments made between the Authority and the Franchisee or between the SPTE and the Franchisee (as the case may be) have been altered in accordance with Estimated Revisions notified by the Authority to the Franchisee pursuant to paragraph 2 of Schedule 9.1 (*Financial Consequences of Change*).

8.2 Where payments between the Authority and the Franchisee or between the SPTE and the Franchisee (as the case may be) have been altered in accordance with Estimated Revisions, the amount of the alteration shall be included in the Revised Input that relates to (as the case may be) the Franchisee's receipts from or payments to the Authority or the SPTE (as the case may be).

9 **CALL OFF OF PRICED OPTIONS**

9.1 When a Priced Option is exercised by the Authority and/or the SPTE the Financial Model shall be updated so that Target Revenue, FXD, VCRPI, PRPI and TRRPI are restated to reflect the amounts agreed for the relevant Priced Option in Schedule 3 (*Priced Options*). The amounts stated in Schedule 3 are not unless otherwise stated indexed to RPI, or otherwise subject to change (as a result of the Change mechanism or otherwise), in the period between the date hereof and the exercise of the relevant Priced Option and, when the Financial Model is updated, it will be adjusted so that the amounts agreed for the relevant Priced Option are not, unless otherwise stated, indexed to RPI, or altered as a consequence of a Change (which may involve deflating figures in Schedule 3 before updating the Financial Model), over that period; provided that (a) those amounts which are expressed in Schedule 3 to be subject to adjustment being the charges listed in column 4 of each relevant table shall be adjusted to reflect the actual amounts at the time of implementation of the Priced Option or as otherwise agreed between the parties and (b) adjustments will be made to the Priced Option including the costs to the extent necessary to reflect that the specification or requirement for the Priced Option has been varied by the Authority and/or the SPTE where the Priced Option has been so varied. Once a Priced Option has been called-off, and the Financial Model updated, it is agreed, for the avoidance of doubt, that the amounts stated in Schedule 3 will, as from the date of call-off, both be subject to RPI (from that date or, if later, the start of the second Franchisee Year) unless otherwise stated and to the financial consequences of a Change occurring after the date of call off.

9.2 If there is an extension of the Franchise Term pursuant to paragraph 1.3 of Schedule 18 (*Franchise Continuation*) then the relevant costs in relation to the Priced Options shall be carried over for such period on a pro-rata basis.

APPENDIX TO SCHEDULE 9.3

Incentivising Long-Term Investment

This Appendix sets out guidance on incentivising long term investment.

1. The Franchisee is to be encouraged to:

(a) improve the efficiency;

(b) reduce the cost; and

(c) enhance the revenue earning potential of the delivery of services to passengers, from the commencement of the ScotRail Franchise, through the Franchise Term and into the successor franchises.

2. It is recognised however, that the Franchise Term may be perceived to be a barrier to undertaking investment or change programmes where:

(a) the time scale for implementation limits the benefit to the Franchisee; or

(b) the business case for such investment or change has a payback period longer than the Franchise Term.

3. In this context investment or change may be considered to encompass:

(a) capital investments undertaken solely by the Franchisee;

(b) capital investments undertaken in association with others;

(c) changes in working practices of the Franchisee's employees; and

(d) changes in the contracted roles and responsibilities between the Franchisee and its major suppliers; and

(e) where it is consistent with Scottish Ministers' policy from time to time, the possibile total or partial substitution of certain train services by bus services where an enhanced service level could be provided for reduced cost or where the provision of bus services improves the overall capacity of the network or delivers other benefits.

4. Accordingly, the Franchisee is encouraged to propose schemes that seek to achieve the objectives set out in paragraph 1 for consideration by the Authority, the SPTE and Scottish Ministers during the Franchise Term.

5. In considering the Franchisee's proposals for any investment or change proposed to be undertaken, the Authority and the SPTE may recognise:

(a) the capital cost and proposed payment profile;

(b) legitimate costs of the Franchisee in developing, procuring, delivering and project managing the project;

(c) the life of any capital assets and the duration of the benefits stream arising;

(d) the remaining Franchise Term and the projected payback period;

(e) the benefits associated with undertaking the investment early rather than waiting until the ScotRail Franchise is re-let;

(f) the risks of cost overrun or under performance of the projected benefits;

(g) a profit element for undertaking the project commensurate with the risks of the proposed project; and

(h) alternative benefit sharing arrangements which could be based on:

   (i) a capital lump sum when the expenditure is incurred;

   (ii) an enhanced Franchise Payment over the Franchise Term;

   (iii) a balloon payment on expiry of the Franchise which allocates a proportion of future benefits to the Franchisee;

   (iv) an ongoing payment if the benefits materialise after the Franchise Term; and/or

   (v) any combination of any of paragraphs (h)(i) to (h)(iv).

6. In evaluating the Franchisee's proposals for any investment or change proposed to be undertaken and to enable best value for money to be obtained from third party financiers, the Authority may also give consideration to the appropriateness of the provision, by the Authority, of an undertaking (or other form of comfort) pursuant to Section 54 of the Act