

Chris Hemsley
Deputy Director, Railway markets and economics

24 May 2018

Peter Swatridge
Head of Regulatory Economics, Network Rail

Dear Peter,

Volume incentive – conclusions to working paper

In November 2017, we published [PR18 working paper 6 on the volume incentive](#). In the paper we set out our views on the effectiveness of the existing volume incentive mechanism, and the case for retaining, reforming or removing it in CP6. We asked for stakeholder views on how effective this mechanism had been in CP5 at encouraging Network Rail to add services to the network, and whether there is a role for it going forward.

The volume incentive is designed to encourage Network Rail to be more responsive to unexpected demand for network capacity. Network Rail receives a payment (or makes a payment) if passenger or freight traffic volumes are above (or below) agreed growth baselines, set at the time of the periodic review. This is intended to provide a financial incentive to encourage Network Rail to consider the trade-off between risks to reliability and punctuality and the additional income received from the volume incentive.

We received nine responses to our working paper¹. They were from a range of stakeholders including franchised train operating companies, freight operating companies, funders and industry bodies.

Most respondents agreed with our view that the volume incentive has not made a significant contribution to Network Rail's incentives to add services to the network in CP5. Some thought the volume incentive has made a marginal contribution. However, they agreed that recent changes to Network Rail's funding mean the incentive is unlikely to be effective in CP6.

In light of the responses received to our working paper, we have concluded that the financial aspect of the volume incentive should be removed in CP6 (option 2 in the working paper). This means we will:

¹ The responses are available [here](#).

- Remove the financial payment element of the volume incentive; and
- Require Network Rail to continue reporting on volume metrics (relative to a baseline) through an appropriate mechanism (for example the Regulatory Accounts and/or scorecards). We will consider potential changes to simplify the reporting metrics and the calculation of economic benefits.

Some responses to the working paper highlighted that the removal of the volume incentive was of particular concern to the freight industry. This is because in CP6 there will be fewer volume-related incentives and charges which encourage Network Rail to approve applications for additional freight traffic. This was in light of PR18 policy decisions, including the removal of the capacity charge.

Our work on infrastructure cost charges (known as ‘mark-ups’ under the relevant domestic and European legislation) in PR18 should provide Network Rail with additional financial incentives to increase volumes for some – but not all – types of services. This is because ICCs are only levied on a sub-set of commodities. These concerns are also relevant to some open access operators in CP6.

We recognise these concerns and will continue to require Network Rail to report on volume metrics through an appropriate mechanism, in order to provide transparency and support reputational incentives. We expect to agree on reporting metrics in relation to traffic volumes with Network Rail by the end of 2018.

In addition, as part of PR18, we have been developing a new regulatory approach to providing incentives on the system operator (SO) function and the freight and national passenger operator (FNPO) route. The SO and FNPO should support freight operators in growing traffic on the network. The SO will provide expert analysis to support improved timetabling and better use of the existing network. The FNPO will be accountable for the delivery of a number of outputs, and will act as a single point of contact for freight operators, passenger customers that operate nationally, and prospective open access operators.

Respondents to the working paper also outlined alternative ways to encourage volume growth in CP6 and highlighted the routes/SO scorecard as a possible tool to encourage Network Rail to add traffic. We have worked with Network Rail to develop “use of the network” measures for both the passenger and freight markets which will be included on Network Rail’s Route Comparison Scorecard. Further details of these measures will be included in our draft determination.

If you wish to get in touch to discuss this letter, please email Natasha Frawley (natasha.frawley@orr.gsi.gov.uk). A copy of this letter will be placed on our website.



Yours faithfully,

A handwritten signature in black ink, appearing to read 'Hemsley', is written over a light grey rectangular background.

Chris Hemsley