PR18 working paper

Working paper 6: The volume incentive

Date of publication: 30 November 2017

1. Introduction

1.1 The volume incentive is a payment between Network Rail and governments that aims to encourage Network Rail to be more responsive to additional demand from operators to use the network. This reflects the absence of normal commercial arrangements with its customers, where Network Rail would benefit financially from selling more of what its customers want.

1.2 In this working paper, we set out our initial thinking around the role and design of the volume incentive in Control Period 6 (CP6). This work is part of our review of Network Rail's charges and incentives, a key element of the 2018 periodic review (PR18). Our charges and incentives work aims to improve the decisions that Network Rail, train operators and funders make, and will play an important role in producing better outcomes for passengers, freight customers and taxpayers. Alongside this working paper we have published a letter updating on our charges and incentives work (available here).

1.3 The purpose of this working paper is to set out our emerging thinking in relation to the volume incentive, and its possible development over the next control period. We are seeking stakeholder feedback on high-level options we are considering. This builds on the discussions we have been having with stakeholders in recent months.

1.4 In setting out the possible options for the incentive going forward, we have considered the wider changes that have taken place over the course of control period 5 (CP5) to Network Rail's structure, funding and regulation.

1.5 We want to understand whether stakeholders think the volume incentive has made a significant contribution to the overall incentives on Network Rail to grow traffic in CP5, and whether there is a continued role for the mechanism in CP6, given the recent changes in the wider context.

1.6 In the rest of this section, we provide an overview of the structure of this working paper, and information on how to respond.

Structure of this working paper

1.7 This working paper is structured as follows:

- section two provides an overview of the volume incentive, including the changes we made to the mechanism in the 2013 periodic review (PR13);
- section three discusses arguments we have identified in favour of, and against, retaining the volume incentive in CP6. In setting out these arguments, we discuss the wider changes that have taken place since PR13 in terms of

Network Rail's structure and regulation. This includes an overview of traffic growth trends; and

- section four presents our emerging thinking around how the volume incentive may fit within this changing environment, and high level options for how the mechanism might evolve in CP6.

Responding to this working paper

1.8 We will continue to engage with stakeholders to consider the overall effect of our charging and incentive decisions on Network Rail's incentives to grow traffic, and therefore on the rationale for retaining the volume incentive in CP6. We welcome all responses to this working paper, including less formal responses such as emails, bilateral or multilateral discussions on any aspects covered in the paper, as well as alternative ideas and proposals.

1.9 Written responses to this working paper will be accepted until 25 January 2018. Please submit your responses, in electronic form, to natasha.frawley@orr.gsi.gov.uk.

1.10 We plan to publish all substantive written responses to this working paper on our website. Accordingly, when sending documents to us, we would prefer that you send your correspondence to us in Microsoft Word format or Open Document Format. This allows us to apply web standards to content on our website. If you do email us a PDF document, where possible please:

- create it from an electronic word processed file rather than sending us a scanned copy of your response; and
- ensure that the PDF's security method is set to "no security" in the document properties.

1.11 Should you wish any information that you provide, including personal data, to be treated as confidential, please be aware that this may be subject to publication, release to other parties or disclosure, in accordance with the access to information regimes. These regimes are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004). Under the FOIA, there is a statutory code of practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence.

1.12 In view of this, if you are seeking confidentiality for information you are providing, please explain why. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on ORR.

1.13 If you are seeking to make a response in confidence, we would also be grateful if you would annex any confidential information, or provide a non-confidential summary, so that we can publish the non-confidential aspects of your response.

2. Overview of the volume incentive

2.1 In this section, we provide some background on the volume incentive. We outline the original purpose of the incentive, its main design features, and the changes we made in PR13.

Purpose of the volume incentive

2.2 One of Network Rail's key functions is to manage efficiently how operators make use of the capacity available on the network. As such, it is responsible for the processes by which train operators secure permission to operate on the network (more detail on this process is available in Annex A)[1]. However, because of how Network Rail is funded and regulated, it does not have normal commercial relationships with its customers. This means Network Rail does not necessarily benefit from selling more of what its customers want to buy (in this case, the ability to run more services on the network).

2.3 When Network Rail accepts additional services onto the network, it only receives charges that cover the costs imposed on Network Rail in the short-run by the additional services (e.g. the cost of the additional wear-and-tear on the track caused by the additional train). The charges do not reflect the full cost of providing the infrastructure or the value of capacity on different parts of the network.

2.4 Network Rail is subject to incentives in relation to service reliability and punctuality, through ORR-led mechanisms including the Schedule 4 and Schedule 8 regimes, and regulated targets for punctuality. In previous periodic reviews, we identified that there was a risk that Network Rail may limit access to the network to improve its chances of meeting these performance targets.

2.5 The volume incentive is a mechanism designed to encourage Network Rail to be more responsive to unexpected demand for network capacity over a baseline growth rate. Network Rail receives a payment (or pays a penalty) if passenger or freight traffic volumes are above (or below) the agreed baseline. 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.

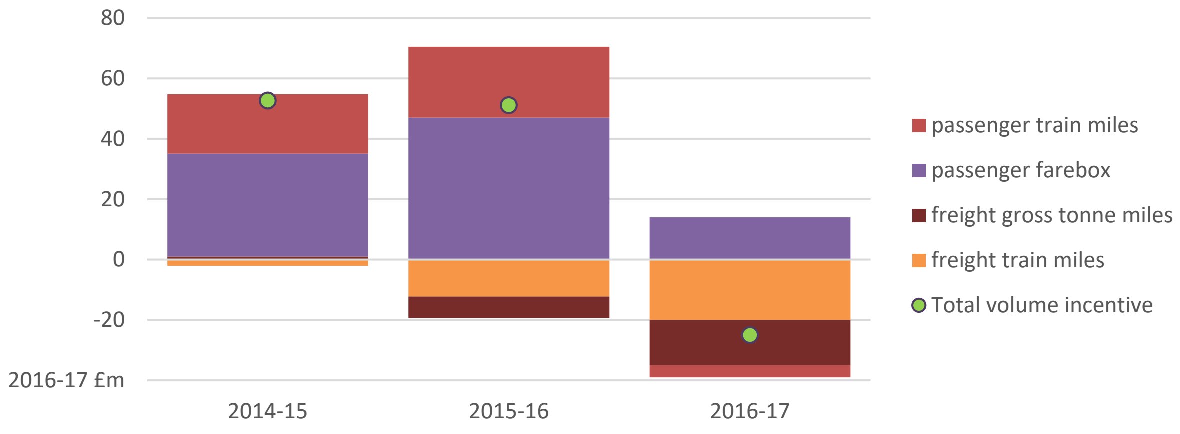
Development of the volume incentive

2.6 The volume incentive was introduced in the 2000 Periodic Review as an incentive for Railtrack (the company that owned the track infrastructure before Network Rail) to

[1] ORR also has a role in this process, as it is ultimately responsible for approving applications for access. Operators can also appeal to ORR when Network Rail has rejected their applications for access.

promote the use and development of the network. It was originally an upside-only incentive mechanism, based on passenger train miles and farebox revenue. Changes were made to the design of the mechanism several times, including in PR13. Cumulative volume incentive payments of around -£25 million[2] were credited to Network Rail for the first three years of CP5 (Figure 2.1).

Figure 2.1 Volume incentive cumulative, 2014-15 to 2016-17



Source: Statement 12: Volume incentives, Great Britain, *Network Rail Regulatory Financial Statements* 2014-15, 2015-16, 2016-17

2.7 The volume incentive incorporates volume indicators for both passenger and freight traffic. Therefore, Network Rail receives a payment (or pays a penalty) if passenger train miles, passenger fairbox revenue, freight train miles or freight gross tonne miles are higher (or lower) than a pre-determined growth baseline level.

2.8 The volume incentive now has an upside and a downside. Payment rates are symmetric, so the same incentive rates apply for both the upside and the downside.

2.9 The levels of payments made under the volume incentive result from applying incentive rates to the volume indicators. There are specific incentive rates for each of the four volume metrics (Table 2.1). The rates are based on a proportion of the social and economic value of accommodating additional growth. Incentive rates are applied to national growth baselines, but Network Rail also calculates notional payments at the route-level based on the route-level baselines as part of its annual regulatory reporting. The incentive rates have been updated at each periodic review.

[2] The cumulative volume incentive is calculated based on current year's volume metrics, 2016-17 in this case.

Table 2.1 Incentive rates

2016-17 prices	CP5 value	CP4 value
Per additional train mile	150p	91p
% of additional farebox revenue	2.5%	1.5%
per additional freight train mile	304p	147p
per additional freight 1,000 gross tonne mile	258p	132p

Note: values in 2016-17 pounds (RPI adjusted).

2.10 While the volume incentive payment rates are set nationally, baseline annual growth rates are disaggregated to route level (Table 2.2).

Table 2.2 Baseline annual growth by route for 2015-16

	Passenger train miles	Passenger farebox	Freight train miles	Freight gross tonne miles
Great Britain	**0.7%**	**2.6%**	**2.1%**	**2.6%**
England and Wales	0.7%	2.6%	2.1%	2.6%
Scotland	0.4%	2.1%	2.0%	3.0%
Anglia	0.2%	2.6%	3.1%	4.1%
East Midlands	0.2%	2.6%	1.3%	1.5%
Kent	0.2%	2.6%	1.8%	2.4%
London North East	0.6%	2.6%	1.4%	1.6%
London North West	0.7%	2.9%	2.7%	3.7%
Sussex	0.2%	2.2%	1.4%	1.7%
Wales	5.9%	3.3%	1.1%	1.1%
Wessex	0.2%	2.5%	2.6%	3.5%
Western	0.3%	2.8%	1.5%	1.8%

2.11 Notional payments are calculated and credited to Network Rail on an annual basis and recorded in its regulatory financial statements. The final actual payment is calculated at the end of the control period and credited to Network Rail through a memorandum account. The memorandum account increases (decreases) as a result of Network Rail's performance on the volume incentive metrics and an amount is added to (deducted from) Network Rail's revenue requirement for the subsequent control period. Volume incentive performance has been reflected in senior staff pay since PR13.

Periodic Review 2013

2.12 We undertook a review of the volume incentive in PR13. While we initially considered whether there was a case for replacing the volume incentive with a mechanism that had a broader purpose, we decided not to pursue this in PR13[3].

2.13 Having decided to retain the volume incentive as a mechanism between Network Rail and governments, we made several changes to its design to increase its effectiveness. These included:

- asking Network Rail to make changes to the volume incentive transmission mechanism (i.e. the way it operates within Network Rail). This was in order to increase the effectiveness of the volume incentive by targeting decision makers within Network Rail. Changes included incorporating volume incentive payments when determining senior staff pay; publishing baseline and outturn traffic figures at a route level in Network Rail's annual regulatory accounts; and encouraging routes to submit proposals for how to spend the volume incentive payments associated with outperformance;
- disaggregating growth baselines to a route level to provide visibility around volume growth relative to a baseline within each route;
- introducing a symmetrical downside to volume incentive payments. A ceiling and floor were also introduced; and
- changing the payment mechanism so volume incentive payments were calculated and credited to Network Rail's routes on an annual basis. This was introduced to inform the reward package for route level managers.

Changes in context within CP5

2.14 Since the implementation of changes to the volume incentive, there have been several changes to the structure of Network Rail. Network Rail was reclassified as a public sector arm's length government body in September 2014. Its sole member is the Secretary of State for Transport. Network Rail has also begun the process of reorganising itself into route businesses and a system operator (SO).

2.15 As part of PR18, we have been making changes to the way we will regulate Network Rail in CP6, as well as to the structure of charges and incentives in place. All of these changes will have an impact on the effectiveness of the volume inventive going forward.

[3] This alternative mechanism would have been aimed at incentivising Network Rail to manage capacity more efficiently in general, for example by taking the form of a charge payable by operators to Network Rail.

2.16 In the next section, we describe the changes that have occurred since our last review of the mechanism and how they may have affected the rationale for and role of the volume incentive going forward.

3. The case for retaining, reforming or removing the volume incentive in CP6

3.1 When considering the continued role for the volume incentive going forward, we have asked two high-level questions:

1. Has the volume incentive been effective in CP5 at encouraging Network Rail to accommodate unanticipated demand for network capacity?
2. Given wider recent developments in terms of Network Rail's funding, structure and regulation, is the volume incentive likely to play a significant role in incentivising Network Rail to accommodate unanticipated demand going forward?

3.2 In this section, we set out our emerging thinking around these two high-level questions. We begin by summarising known industry views around the effectiveness of the mechanism. We then discuss the changes that have been occurring over the course of CP5, including in Network Rail's funding, structure and regulation, namely:

- recent trends in traffic growth;
- the funding of Network Rail and its 2014 reclassification to an arm's length public body;
- the devolution of Network Rail's responsibilities from the centre to its routes;
- Network Rail's increased focus on the SO; and
- ORR changes to Network Rail's structure of charges.

Initial views on the effectiveness of the volume incentive in CP5

3.3 Between 2014 and 2015, RDG conducted a review of Network Rail's charges and incentives, setting out industry's views on Network Rail's existing charging and incentives regime. This review highlighted that industry does not consider the volume incentive to be sufficiently effective. It noted that operators considered there were insufficient incentives on Network Rail to accommodate additional traffic. Some of the reasons given for this lack of effectiveness were the complexity of the volume incentive and the uncertainty of payment.

3.4 Additionally, Network Rail also conducted an internal review considering the effectiveness of the mechanism at incentivising decision makers internally[4]. It set out

[4] As part of this internal review, Network Rail sought views from routes, the system operator and Sale of Access participants, to see how Network Rail is incentivised to grow traffic across the network.

its emerging views to an RDG working group. Network Rail's emerging views following this review were that, while income from the volume incentive is rarely a key factor in its decision making, it provides a financial 'nudge' toward accommodating extra traffic.

3.5 Network Rail has highlighted a number of issues it believes exist with the current design of the mechanism, such as the complexity due to the use of four growth metrics and the fact that payments are not made within the control period. Should we conclude that there is a role for the volume incentive in CP6, we will review the issues Network Rail has identified and discuss them further with stakeholders to understand whether any changes are required to the existing design of the mechanism.

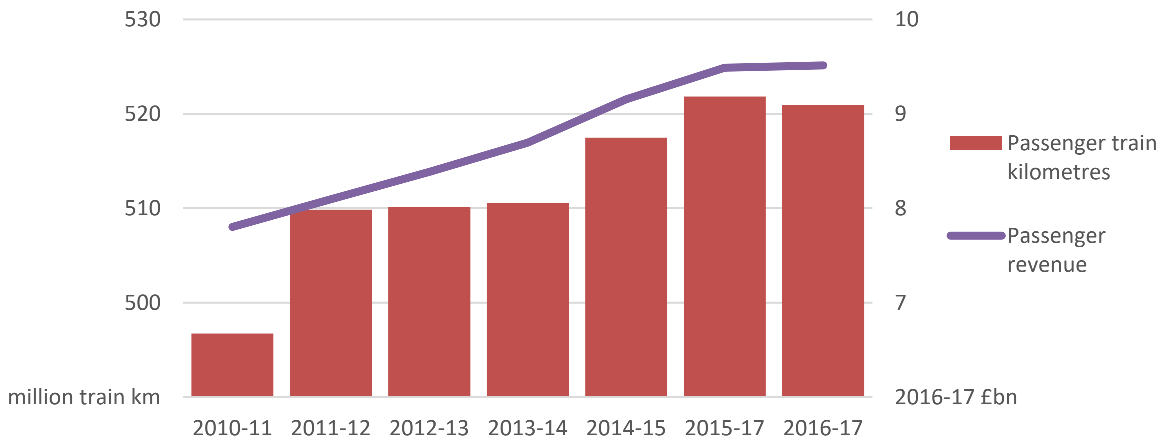
3.6 We now turn to discuss the changes which have been taking place over CP5, and how they may have affected the rationale for and role of the volume incentive going forward.

Recent trends in traffic growth

3.7 When thinking about whether there is a role for the volume incentive in CP6, it is useful to start by looking at what has been happening over the course of this control period in terms of traffic growth. In the six years to 2016-17, passenger train kilometres increased by 5% to more than 520 million kilometres (Figure 3.1). Passenger journeys increased by nearly 30% and revenues increased by more than 40%. Many freight metrics fell in the six years to 2016-17, but this has been driven by the fall in the volume of coal shipped in the United Kingdom (Figure 3.2), which has been driven by government policy around decarbonisation of electricity generation. Excluding coal, the volume of freight increased by nearly 15% between 2010-11 and 2016-17.

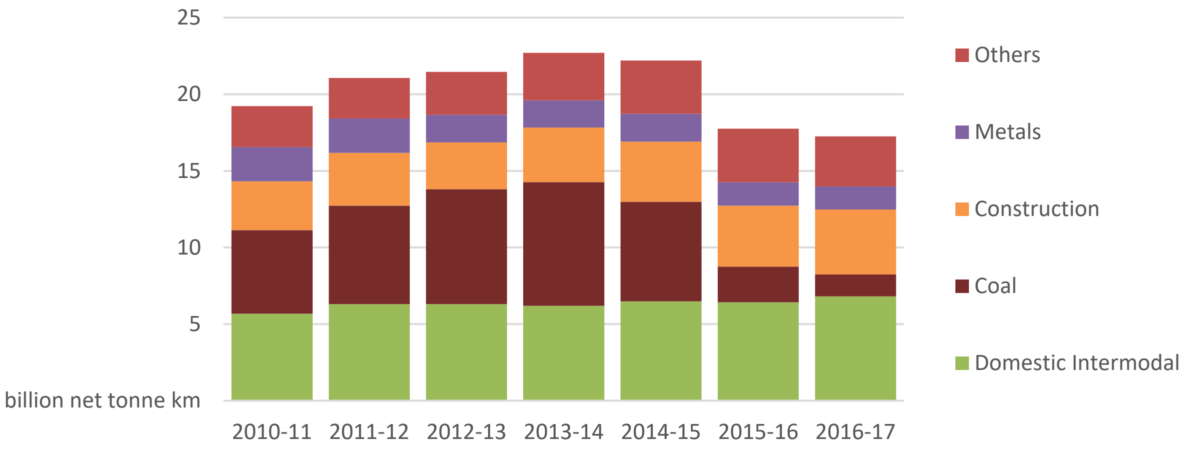
3.8 There seem to be strong external drivers for these growth trends. Therefore, without further analysis, it is difficult to say whether this growth has been driven by the volume incentive. We note the views of stakeholders that it seems that the volume incentive has had, at most, a marginal effect, which is supported by the fact Network Rail does not appear to be discouraging this growth. However, Network Rail does not appear to pro-actively seek out opportunities for new services and open-access operators have raised concerns that the company does not support their applications.

Figure 3.1 Passenger train kilometres and revenue, 2010-11 to 2016-17



Source: ORR 2017

Figure 3.2 Freight moved by commodity, 2010-11 to 2016-17



Note: Others includes oil and petroleum, international, and other.

Source: ORR 2017

Changes in the way Network Rail is funded

3.9 Following the reclassification of Network Rail to an arm's length public body in September 2014, the way Network Rail is funded has changed. This means that it is no longer practical to log up amounts earned through the volume incentive to the opex memorandum account and then add them to the revenue requirement in the next control period (this is the way Network Rail received the payments currently)[5].

3.10 As such, the financial incentive properties of the volume incentive are also unlikely to be significant in practice. However, we can continue to include the volume incentive in our reporting of Network Rail's financial performance, which will have reputational

[5] We will discuss this in more detail in our February 2018 financial framework document.

incentive properties, as discussed in the next section on the high-level options we are considering.

Changes in Network Rail's structure and regulation

3.11 During CP5, Network Rail has been changing the way it organises itself and runs its business. This has included continuing the process of reorganising itself into route businesses and an SO. Responsibility for day-to-day operation and management of the railway has been devolved to eight geographic routes and the Freight and National Passenger Operator (FNPO)[6].

3.12 As routes are more autonomous, they are expected to be more customer-focussed and therefore more responsive to customer needs. The routes (including the FNPO) are key contacts for train operators and are where operators first request additional access rights. The proximity of the routes to the operators and the direct benefits from additional direct revenue from new services may encourage routes to support applications without reference to the volume incentive.

3.13 Network Rail introduced route-based scorecards in CP5. In July 2017, ORR consulted on route requirements and scorecards. We proposed to include traffic-related metrics (both freight and passenger) on route scorecards to reflect Network Rail's responsiveness to its customers regarding their need for more network capacity. The inclusion of these metrics could balance some of the existing performance metrics and incentivise route customer teams to support applications for additional capacity, reducing the need for the volume incentive.

3.14 The SO provides expert analysis to support improved timetabling, better use of the existing network and an outlook on how the network should be enhanced over time. It is a check against the routes to protect the benefits of a coordinated and integrated network, while also ensuring that operators retain fair and non-discriminatory access to the network and that operational decisions taken by routes treat all operators fairly.

3.15 A more proactive SO with increased technical capability could mean that when operators apply for capacity, the impact of the request is better understood, and growth can be accommodated without undue impacts on performance and with greater confidence that these effects are understood. Consequently, the extent of the SO's effectiveness at improving its capability in this area could affect the need for a volume incentive.

3.16 Network Rail is also developing a scorecard for the SO. The current draft of the scorecard does not include any volume or capacity related metrics, as it is difficult to accurately isolate the SO's contribution to capacity provision. However, the scorecard

[6] The FNPO covers freight operators and some passenger operators.

does include metrics relating to the production of the timetable, an important element of the SO's role in accommodating more capacity on the network. We would also expect the SO to report on its contribution to supporting growth across the network and within each market segment (e.g. freight and passenger operators).

3.17 The route customer team and the SO play key roles in determining the allocation of new or additional access rights (see Annex A). In addition, there is a sale of access rights (SoAR) panel that sits within Network Rail periodically to provide network-wide governance on the process to negotiate and agree the sale of access to train operators.

3.18 The principal role of the SoAR panel is to ensure that Network Rail applies a consistent approach across the network and makes best overall use of network capacity, while ensuring an acceptable level of performance can be achieved. While the income received from the volume incentive is considered when applications for track access are made, it is not currently a key component of the decision. However, where the volume incentive provides an indication of the societal value of accommodating growth, this could be incorporated into the decision-making without the need for the financial incentive.

Reforms to Network Rail's structure of charges

3.19 As part of the PR18 review of charges, we have made a number of changes to Network Rail's charges. The most relevant ones for the volume incentive are removing the capacity charge and our work developing infrastructure cost charges (i.e. charges that recover Network Rail's fixed costs).

3.20 In June 2017, we announced that the capacity charge would no longer apply from CP6. The purpose of the capacity charge is to provide Network Rail with additional revenue to cover the increase in performance regime (Schedule 8) costs that typically result from adding traffic. When it is abolished in CP6, the income from this charge will be recovered by Network Rail through other charges, including infrastructure cost charges. However, it is important to note that currently the capacity charge is received in respect of each additional service Network Rail adds to the network, and therefore provides Network Rail and operators with incentives to consider their use of the network, at the margin.

3.21 Currently, Network Rail receives revenue in relation to additional services from the capacity charge, other variable usage charges[7] and the volume incentive. Given the removal of the capacity charge, if the volume incentive was also removed for CP6, this would mean that Network Rail's financial incentives to add services to the network would be significantly worse than currently.

[7] The variable usage charge, the electricity asset usage charge, the coal spillage charge etc.

3.22 However, we are currently working to extend fixed cost recovery through infrastructure cost charges to all operators, subject to a market-can-bear test. We published a consultation in relation to these charges in September 2017.

3.23 The consultation discussed our approach to the market-can-bear test. It would determine to what extent different types of freight and open access passenger services (i.e. different market segments) can contribute towards fixed costs. In both cases, this would mean that higher than expected traffic volumes would likely generate higher charges income for Network Rail.

3.24 Our consultation also included a proposal to make franchised passenger operators' infrastructure cost charges responsive to changes in traffic (relative to what was forecast). The detail of this proposal is still under development. Similar to infrastructure cost charges for freight and open access services, the proposal would mean that Network Rail would receive additional revenue when it added franchise services to the network. If we conclude to adopt this proposal, this could improve Network Rail's incentives to add services to the network in relation to one of the biggest users of the network—franchised passenger operators.

3.25 These reforms could potentially increase Network Rail's income in CP6 when it adds additional services to the network. Network Rail would receive infrastructure cost charges, in addition to variable charges, when it adds services to the network that belong to market segments that we have determined can bear them[8]. However, even if we conclude that we can introduce such charges, there might be a case for continuing to provide Network Rail with a high-level incentive to add traffic to the network, particularly for services not paying infrastructure cost charges.

3.26 We note that a benefit of infrastructure cost charges would be that Network Rail would receive this income within the control period, which could improve its incentives to add traffic to the network. In addition, in our September 2017 consultation we have set out proposals to reflect changes in traffic in franchised passenger operators' fixed track access charge payments (which are currently a lump-sum payment from operators to Network Rail). These changes could improve Network Rail's incentives to add services, particularly given that franchised passenger operators currently operate the majority of passenger services.

3.27 Overall, our PR18 reforms to Network Rail's structure may have mixed effects on the need for the volume incentive. However, the payment mechanism for charges (whereby payments are received within the control period) provides a stronger financial incentive than that of the volume incentive.

[8] For example, in CP5 three types of freight services have paid such charges (which in CP5 are called mark-ups), trains carrying ESI coal traffic, spent nuclear fuel and iron ore.

Table 3.1 Summary of possible impact of changes on the need for a volume incentive in CP6

Change	Potential impact on rationale for a volume incentive
Reclassification of Network Rail	New relationship with funders (DfT and Transport Scotland) might mean we need an increased focus on non-financial incentives (e.g. through scorecards), although financial incentives will still be important.
Route devolution and route regulation	Network Rail routes will become more responsive to customer needs, including their need for more capacity on the network. Route scorecards could reflect volume-related measures, which should incentivise Network Rail routes to add traffic.
The SO and its regulation	Increased focus on effective management of network capacity and better data and use of technology to unlock capacity benefits. The SO's scorecard will include measures related to the production of the timetable, but not related to use or capacity production more generally.
Changes to charges (capacity charge and infrastructure cost charges)	Removing the capacity charge in CP6 may weaken Network Rail's incentives to grow traffic in response to unanticipated demand. However, proposals for the infrastructure cost charges could provide a link between Network Rail's within-period income and unanticipated growth on the network.

4. Emerging views and high level options

4.1 As we have outlined in section three, there are concerns that the existing volume incentive mechanism has not been very effective. In addition, under Network Rail's new funding model, the existing payment mechanism through the memorandum account (a future promise of higher funding) looks unlikely to be effective.

4.2 However, it may be useful to continue having a way of recording the notional income Network Rail receives from new services in its financial results, and/or for growth to be reflected in scorecards, to provide incentives for staff within the company.

4.3 In addition, there are changes taking place as part of PR18, in terms of Network Rail's structure, regulation and access charges, which could also affect the way Network Rail manages capacity and its incentives to grow traffic.

4.4 Overall, in light of the considerations set out in this working paper, we think there is a case for considering whether the volume incentive should cease to apply in CP6 or change significantly. One potential option would be to turn the mechanism into a non-financial incentive but retain the reporting of performance relative to traffic metrics.

4.5 We set out below the three high-level options we are considering and invite stakeholder feedback on these options and any of the other issues raised in this working paper:

- **Option 1: retain the existing mechanism, with potential improvements to its design.** If we conclude that the changes in Network Rail's structure and regulation are not sufficient to provide it with effective incentives to meet growing demand for capacity, there is a possible continued role for the volume incentive in CP6. In terms of improving the design of the mechanism, Network Rail highlighted a number of issues it believes exist with the current design following its internal review and industry discussion. We also welcome any views from stakeholders on any improvements which could be made to the existing mechanism;

- **Option 2: Remove the volume incentive in CP6 and replace it with an alternative mechanism.** The alternative mechanism we are considering here is removing the financial payment element of the volume incentive while continuing to record volume growth relative to a baseline. Under this approach, we could also continue to calculate the social and economic value of accommodating additional growth, which could be published as part of Network Rail's regulatory financial statements; and

- **Option 3: remove the volume incentive in CP6.** If we conclude that, given the potential reforms to infrastructure cost charges and Network Rail's improvements to the way it manages capacity in CP6 (including through a more effective SO), Network Rail will be effectively incentivised to grow traffic, there could be a case for completely removing the volume incentive.

4.6 We note that the case for option 3 depends, in particular, on the successful implementation of our infrastructure cost charging policy. We have not yet concluded on policy in this area.

4.7 On balance, given the views around the lack of effectiveness of the current volume incentive, our proposal at this stage is to take forward option 2, which would retain ongoing reporting of the growth in traffic volumes.

4.8 Within option 2, it would still be important that Network Rail has appropriate incentives to grow traffic, and we see opportunities here due to the other changes taking place in advance of CP6. These include the development of a distinct system operator function, the development of route scorecards and the emergence of route supervisory boards.

4.9 The reforms to system operation provide opportunities for Network Rail to improve its management of network capacity and how it supports operators wishing to operate additional services, backed by updated governance arrangements. In addition, the growing use of scorecards and the route supervisory boards could allow for ways to retain a focus on supporting growth, including the potential to reflect this in management incentives.

4.10 We would welcome stakeholder views and ideas on potential alternative mechanisms, including how to make best use of these wider changes.

Consultation questions

We welcome your thoughts on any of the issues discussed in this working paper, and specifically on the consultation questions set out below:

- Do you think the volume incentive has made a significant contribution in CP5 to Network Rail's incentives to add services to the network?
- Which of the three high-level options we have set out above do you think we should take forward? Could you explain your main reasons for supporting this option?
- If you think we should take forward option 1 (retain the existing mechanism), do you have any views on the current design of the volume incentive, and how it could be improved going forward?
- Do you think there are potential reputational incentives from Network Rail continuing to report on its performance against the volume metrics used to calculate the volume incentive, even if the financial aspect is removed?
- If you think we should take forward option 2 (remove the volume incentive in CP6 and replace it with an alternative mechanism), do you have ideas for additional changes that we should consider to improve the balance of incentives?

Annex A: Network Rail's sale of access rights approval process

Sources of demand for network capacity

A.1 Demand for additional network capacity largely comes from:

- **Franchised passenger operators**. These operators may request additional capacity in response to increased demand or in response to requirements placed on them by franchising authorities;
- **Open access operators (OAOs)**. OAOs run a small proportion of passenger services currently. OAOs may request additional capacity in order to increase frequency or to develop new services; and
- **Freight operators**. These operators may request additional capacity in order to meet changing freight needs. For example, between 2013-14 and 2016-17 coal traffic declined by more than 80% while biomass, intermodal and aggregates traffic increased. In addition, the Scottish HLOS set an explicit growth target for freight in CP6 which may result in increased demand for additional network capacity for freight operators in Scotland.

Network Rail’s access rights approval process

A.2 In order to obtain additional capacity, operators must request access from Network Rail. They must discuss their request with the relevant route customer teams, who then take the application to the sale of access rights (SoAR) panel.

A.3 The SoAR panel sits within Network Rail and meets periodically to provide network-wide governance of the process to negotiate and agree the sale of access to train operators. The principal role of the SoAR panel is to ensure that Network Rail applies a consistent approach across the network and makes best overall use of network capacity, while ensuring an acceptable level of performance can be achieved. The SoAR panel includes a range of Network Rail executives and specialists, and is chaired by the Managing Director of the Freight and National Passenger Operators (FNPO) route.

A.4 The main process an operator must follow to apply for new or increased access rights is outlined below (Figure A1):

(i) Operators request rights through Network Rail’s relevant route customer team.

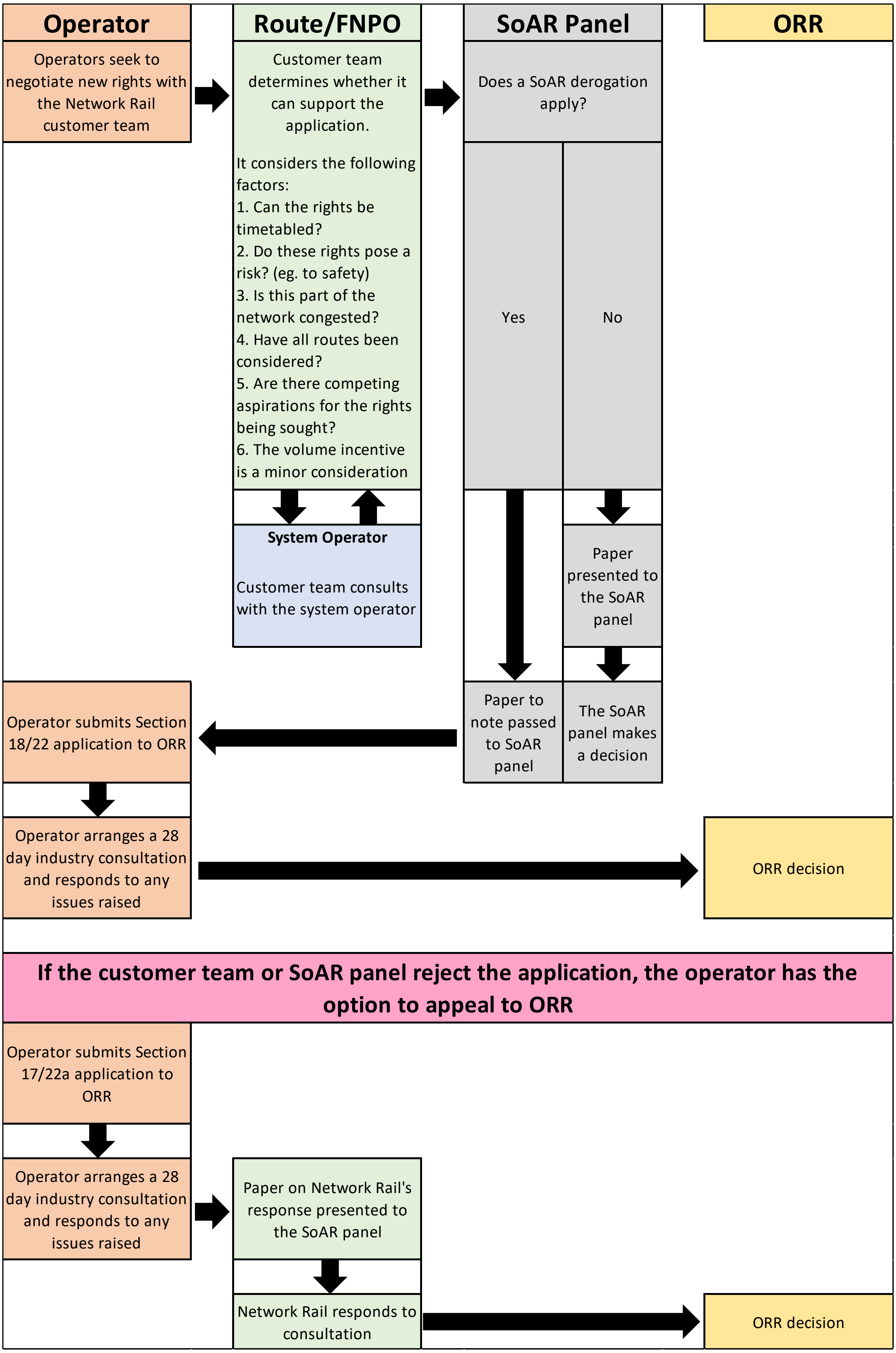
(ii) The customer team considers the request in consultation with the SO. The customer team determines if it can support the application.

(iii) If the application is supported by the customer team, it goes to the SoAR panel.

(iv) If the SoAR panel authorises the request, the train operator then consults with industry and submits the agreed track access contract to ORR for approval.

(v) If the customer team or the SoAR panel reject the request, the operator can appeal to ORR.

Figure A1: Sale of access rights



Note: when derogations apply, it removes the requirement for specific authorisation for agreed and disputed sales.

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