Competition in the transport sector: Market entry barriers in railway and aviation?

WORKSHOP

EN 2013
Competition in the transport sector: Market entry barriers in railway and aviation?

WORKSHOP
3 September 2013, BRUSSELS

Abstract
Liberalisation in the railway and aviation sector takes place at a different pace and the number of competitors to former state owned monopolists in particular in the railway sector is relatively low. The participants to this workshop discuss practical experiences and specific problems in both sectors.

The views exchanged during the workshop discussion shall provide support the ECON Members in determining their position in regard to the current discussion of the Report on the 'Annual Report on EU Competition Policy 2012'.
This document was requested by the European Parliament's Committee on Economic and Monetary Affairs.

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1. **INTRODUCTION**

The Committee on Economic and Monetary Affairs held a workshop on the topic 'Competition in the Transport Sector: Market entry barriers in railway and aviation?' on 13 September 2013 with the aim to provide background information and advice for the Members of the ECON Committee as regards the 'Annual Report on EU Competition Policy 2012', the ECON Rapporteur is MEP Ramon TREMOSA i BALCELLS (ALDE, ES).

**Background**

On 7 May 2013 the European Commission published its annual 'Report on EU Competition Policy 2012'.¹ In Chapter 7 of this report covering transport issues it is mentioned that even though market integration and liberalisation has been promoted, there remains much variation regarding speed and scope of the liberalisation process between the different transport sectors. Especially the market for international railway services for passengers has only been opened in 2010. Several national rail passenger services have remained restricted. Moreover, many consumers regard railway services as unsatisfactory.

As the aviation and the maritime transport sectors have been open to competition for many years, they can serve as a basis for practical experiences.

Prior to the workshop and as a starting point for the discussion all panellists have been asked to give their respective views towards the questions, on which also their presentations should elaborate:

- Which are the key experiences with the liberalisation process in the railway and the aviation sectors?
- What are the reasons that the number of competitors to former state owned monopolists in particular in the railway sector is still relatively low and remains below expectation? Are there obstacles for ex-monopolists to access other Member States' markets?
- Consumer satisfaction with liberalised services?
- In which way could competition policy foster market entry of new service providers?
- What are the specific problems for incumbents in the railway sector? Are there specific difficulties in specific Member States?
- Could experiences made in the aviation sector be useful for other areas of transport?
- Is rail transport able to successfully compete with other mediums of transport?

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2. PROGRAMME OF THE WORKSHOP

3 September 2013, European Parliament, Brussels
12.30 - 15.00 hrs, Room ASP 5G1, EN only, no webstreaming

12.30 - 12.40 hrs Welcome and Introduction:
Ramon TREMOSA i BALCELLS, Chair of the ECON Working Group on Competition Policy 2013 and Rapporteur for the 'Annual Report on EU Competition Policy 2012'

12.40 - 14.50 hrs Presentations and discussion with guest speakers:

Kay MITUSCH
Professor of Network Economics, Institute for Economic Policy Research (IWW), Karlsruhe Institute of Technology (KIT), Karlsruhe, Germany

Brian KOGAN
Deputy Director, Railway Markets and Economics, Office of Rail Regulation, London, UK

Hubert DE BROCA
Head of Unit 'Antitrust Transport, Post and other services' (F1), Directorate-General for Competition of the European Commission, Brussels

Jean-Eric PAQUET
Director 'European Mobility Network' (Directorate B), Directorate-General for Mobility and Transport of the European Commission, Brussels

14.50 - 15.00 hrs Closing remarks:
Ramon TREMOSA i BALCELLS, Chair of the ECON Working Group on Competition Policy 2013 and Rapporteur for the 'Annual Report on EU Competition Policy 2012'
Possible points to be discussed:

- Key experiences with the liberalisation process in the railway and the aviation sectors? Why has liberalisation been delayed in many Member States? What are the market entry barriers?
- Positive effects and shortcomings of liberalisation in the railway sector - the German and UK experiences
- What are the reasons that the number of competitors to former state owned monopolists - in particular in the railway sector - is still relatively low and remains below expectation? Are there obstacles even for ex-monopolists to access other Member States' markets?
- What are the specific problems for incumbents in the railway sector? Are there specific difficulties in certain Member States?
- Is rail transport able to successfully compete with other mediums of transport?
- Could experiences made in the aviation sector be useful for other areas of transport?
- In which way could competition policy foster market entry of new service providers?
- Are the air services agreements\(^2\) harmful to competition?
- Would the creation of a European sector regulator be useful?
- Consumer satisfaction with liberalised services?

\(^2\) See for example the ‘Air Transport Agreement’ between the EU and the US, OJ 134 L of 25.5.2007, p. 4.
3. CURRICULA VITAE OF THE SPEAKERS

Prof. Dr. Kay MITUSCH
Professor of Network Economics, Institute for Economic Policy Research (IWW), Karlsruhe Institute of Technology (KIT), Karlsruhe

Prof. Mitusch was born in Lübeck, Germany in 1961. Since 2009 he is the chair in Network Economics (IWW) at Karlsruhe Institute of Technology (KIT). In addition, he's a scientific advisor of the IGES Institut GmbH, Berlin, in the section of mobility. His is a member of the Advisory Board to the German Federal Minister of Transport, Building and Urban Development. His background includes consulting activities for the Ministry, for the German Regulatory Agency (Bundesnetzagentur) on railway regulation, for the European Commission and others. Furthermore, he gave several expert testimonies on issues of railway policy in front of the Committee on Transport, Building and Urban Affairs of the German Parliament (Bundestag). His main fields of research are: transport economics, regulation economics, industrial and competition economics, impacts of natural events on transport networks and their economic consequences. Prof. Mitusch is a member of Transportnet and CEDIM.

Brian KOGAN
Deputy Director, Railway Markets & Economics, Office of Rail Regulation, London

Brian Kogan has worked in a range of different roles at the Office of Rail Regulation since 1997. Currently, his responsibilities include the consideration and approval of access applications for both passenger and freight services on the British railway network. In addition, he has been instrumental in the implementation of a number of changes to the structure of track access contracts designed to facilitate competition on the railway network.

Brian Kogan studied at Oxford University and later completed an MBA at Brunel University. In his early career he was as a manager in the British coal industry. Subsequently he became a policy administrator at the Department of the Environment before moving to the Office of Rail Regulation.

Hubert DE BROCA
Head of Unit 'Antitrust Transport, Post and other services' (F 1), Directorate-General for Competition of the European Commission, Brussels

Hubert de Broca is Head of Unit in the Directorate-General for Competition (DG COMP) of the European Commission. His Unit is notably dealing with antitrust enforcement in the transport sectors as well as the antitrust regulatory framework applicable to these sectors. Since he joined DG COMP in 2000, he has been dealing with enforcement of antitrust law in the agriculture and pharmaceutical sectors. Later he moved to the competition policy Unit, there notably dealing with the antitrust fining policy of the Commission. He moved to the transport Unit in 2008.

From 1995 to 2000 Mr de Broca was a référendaire at the European Court of First Instance where he worked with Judge Potocki.

He is a member of the Paris bar and of the New York bar. He practised from 1990 to 1995 in the French law firm Gide Loyrette Nouel, first in Paris and then in Brussels.
Jean-Eric PAQUET  
Director 'European Mobility Network' (Directorate B), Directorate-General for Mobility and Transport of the European Commission, Brussels

Mr Paquet began his career in the European Commission in 1993 in the Directorate-General for Transport, in the International Relations area, and later as assistant to the Transport Director General, Robert Coleman.

In 1999 he joined Mr Verheugen’s office, Member of the European Commission in charge of enlargement.

In 2002 he became the deputy head of office of M. Busquin, member of the European Commission in charge of research policy.

Mr Paquet was EU Ambassador in the Islamic Republic of Mauritania between 2004 and 2007.

He returned to transport in 2007 where he lead the development of the Trans-European Transport Network policy.

The Directorate "European Mobility Network" is responsible for European infrastructure policy and investment strategies, the single European rail area, inland waterways and port policy.
4. CONTRIBUTIONS BY THE SPEAKERS

4.1. Background Note by Brian KOGAN

This paper provides an overview of the developments in the UK rail industry since 2004. It begins by providing some information on the structure of the industry. It then considers the passenger and freight sectors. It also covers the access charging framework, investments and high speed rail.

Structure and ownership

The rail sector in the UK comprises an infrastructure manager, Network Rail, which is a private sector organisation established as a company limited by guarantee (for profit but not for dividend); an independent economic and safety regulator which is also the sectoral competition and consumer authority, the Office of Rail Regulation (ORR); and private railway undertakings which provide passenger and freight services. Rolling stock companies (ROSCOs) own the trains and lease them to the train operators. Government rail policy is the responsibility of the Department for Transport, with some rail matters devolved to the Scottish Government.

In 2004, the Government published a White Paper – The Future of Rail, which was intended as a blueprint for a new streamlined structure for Britain's railway. The proposals aimed to provide a single point of accountability for the network's performance, allow closer working between track and train and provide for greater devolved decision making. This brought about some structural changes including ORR becoming the joint safety and economic regulator in 2006, with the transfer of responsibility for railway safety from the Health & Safety Executive, and the Strategic Rail Authority (then responsible for providing strategic direction for the rail industry, including awarding and ensuring compliance with passenger

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3 ORR can investigate abuses of competition law and refer markets where it believes that there are reasonable grounds for suspecting that any feature, or combination of features, of a market in the UK for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the UK, and can take action under Part 8 of the Enterprise Act 2002 to enforce consumer law where there is a collective harm to consumers. ORR is also the National Enforcement Body for Regulation 1371/2007 on rail passengers’ rights and obligations.

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rail franchises\(^4\) being abolished with the majority of its functions, including all its financial obligations, being transferred to the Department for Transport.

In May 2011, following the rail value for money study carried out at the request of the Government, Sir Roy McNulty published a report on Realising the Potential of GB Rail. The report put forward a wide range of recommendations focused on creating an industry environment which encourages cost reduction, changes which deliver new efficiencies, and mechanisms to drive implementation. The study estimated that implementing these recommendations could deliver savings between \(\text{£}700\) million and \(\text{£}1\) billion annually by 2019.

One of the recommendations made by the McNulty study was that a leadership body be established to take responsibility for coordinating and leading on cross industry initiatives, including delivery of the other McNulty recommendations. The Rail Delivery Group was established in June 2011 by the major passenger and freight train operator groups and Network Rail to fulfil this role. In 2013 the structure of the group was formalised to ensure that it continued to receive the full commitment of key people and organisations from across the railway industry. This was achieved through the incorporation of a new membership condition into the licences\(^5\) of Network Rail and those passenger and freight operators that operate over the mainline network.

In November 2011, Network Rail devolved the day-to-day running of Britain’s railway infrastructure to 10 strategic routes as part of its plans to reduce costs and work more effectively with passenger and freight operators. Each route not only operates as a separate business unit with its own accounts allowing greater benchmarking of financial performance and efficiency sharing best practice between the routes, but also has its own management team to operate, maintain and renew the infrastructure.

In March 2012, Network Rail introduced a new type of framework agreement called an alliance, which is a discrete individual agreement between the infrastructure manager (Network Rail) and a train operator. The agreement commits the companies to working together including on specified projects where there is an opportunity for more integrated working and an opportunity to improve the service to passengers or reduce cost. For example, the alliances may look at how stations can be better managed to provide a better service to passengers, how engineering work can be better planned or how improvements to train punctuality can be delivered.

A different kind of alliance, called a ‘deep alliance’, is also being developed involving the Wessex route (one of Network Rail’s devolved operational regions) and South West Trains. This may see the establishment of a single, senior joint management team formed to look after both train and track on the Wessex route, leading to a more integrated way of working.

All the agreements have some common features including:

- Network Rail and the train operator will remain separate entities
- Employees will continue to have the same employer (with their current terms and conditions)
- Each company continues to be ultimately accountable for their own areas of responsibility
- The interests of other passenger rail companies and freight operators are protected.

\(^4\) (Public service contracts).

\(^5\) Condition 25 of Network Rail’s network licence and Condition 28 of train operators’ Statement of National Regulatory Provision.
**Competition for the provision of freight services**

ORR would characterise the intra-modal competition that takes place in the UK rail freight sector as being competition within the market. Freight customers (e.g. a utility company or a shipping company) choose suppliers for individual contracts based on the price and service offerings of tenders from would-be suppliers. Customers typically send out invitations to tender which attract bids from some or all rail freight companies and, sometimes, operators from other modes. There are currently nine active rail freight hauliers in GB. Whilst some ‘spot’ traffic exists, most rail freight contracts are of fairly long duration (e.g. 2+ years is common).

An alternative characterisation would be to view each individual contract as a discrete market that operators compete for, but ORR, depending upon the circumstances of the traffic, tends to see freight services as distinguishable from franchised passenger services, where government awards long-term (mostly monopoly) contracts (see below).

ORR has had two competition cases in relation to the provision of freight services since 2004, one infringement decision and one non-infringement decision. Both cases were focused on the conduct of the incumbent for bulk rail haulage, EWS/DB Schenker.

Rail’s overall share of the wider freight sector has increased slightly since 2004, amounting for 4-5 % of all freight lifted and 8-9 % of all freight moved. These modal shares are somewhat lower than the equivalent figures for some other member states, primarily reflecting, in ORR’s view, the geographic characteristic of the UK.

New entrants have made significant headway into freight haulage markets since privatisation and since 2004. A good example of this is the market for coal haulage by rail. The incumbent DB Schenker (formally EWS)’s share of this market was 100 % until the end of 2000, had fallen to 77 % by the end of 2004, and is now below 50 %. ORR believes that the infringement decision referred to above played an important role in this change.

**Competition for the provision of passenger services**

Competition within GB’s passenger rail sector currently takes place principally ‘for the market’ by way of franchise competitions. Franchises are contracts between government and private sector train operators for the provision of passenger rail services in a particular geographical area, or over particular routes.

Since privatisation there has been a trend towards franchise consolidation, leading to fewer, larger franchises. The Office of Passenger Rail Franchising (OPRAF) initially let 25 initial franchises, but this number has since fallen, and will be reduced to 17 if current plans to merge franchises go ahead. The move towards fewer franchises was initiated by the Strategic Rail Authority (SRA) starting in the early to mid-2000s, with an objective of ensuring a single passenger train operator at key London termini. The trend has continued under the franchising process conducted by the Department for Transport and, combined with the small role of open access (see below), means that most franchised operators face very little on-rail competition on key flows.

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6 Measured on a tonnes carried basis.
7 The Office of Passenger Rail Franchising (OPRAF) was responsible for letting and supervising passenger rail franchises between 1993 and 2001, when it was subsumed into the new Strategic Rail Authority (SRA).
8 Some services are provided via alternative arrangements, for example London Overground and Merseyrail services are let by Transport for London (TfL) and Merseytravel respectively.
9 The Department for Transport and Transport Scotland are GB’s two franchising authorities but this document primarily refers to the Department for Transport given that there has historically been a single Scottish franchise, ScotRail.
The Department for Transport announced a new schedule for rail franchising on 26 March 2013. This set out the full programme of upcoming franchises for the next 8 years, covering all of the above franchises. The details of this announcement can be found at: https://www.gov.uk/government/speeches/rail-franchising--17.

The Department for Transport does not distinguish within franchise contracts between social and commercially run services. These commercial services have many social features such as running off-peak services; providing stops at smaller stations; running key services to assist commuter markets.

The extent of on-rail competition 'in the market' between overlapping franchises or between franchised passenger train operators and open access operators is very limited. Open access operators¹⁰ account for less than 1 % of all timetabled train kilometres.

The growth of the rail sector since privatisation (traffic has nearly doubled since 1997) has corresponded with an increase in the cost of running the railway in Britain. ORR publishes the overall subsidy per passenger mile on an annual basis, including a breakdown by franchise. Latest figures on this can be found at: https://www.gov.uk/government/publications/rail-subsidy-per-passenger-mile.

The Department for Transport’s view is that competition for passenger rail services has been fairly vigorous and that there have been no cases of collusion between bidders. There are a growing number of different companies that have and continue to compete for the franchise competitions. This view was supported by a review carried out in 2008 by the UK’s National Audit Office (http://www.nao.org.uk/report/the-department-for-transport-letting-rail-franchises-2005-2007/).

Following the cancellation of a competition to run GB’s InterCity West Coast franchise, the UK government commissioned an independent review of the implications of flaws in the West Coast procurement process for the rest of GB’s rail franchising programme. The findings of this report are at https://www.gov.uk/government/publications/the-brown-review-of-the-rail-franchising-programme. The head of the review, Richard Brown, said:

“In carrying out this review I have come to the conclusion that the franchising system is not broken, but rather it has made a major contribution to Britain’s increasingly successful rail network. It is therefore essential for both passengers and the wider rail market that the franchising programme is restarted as soon as possible. To achieve this goal, my review has identified a series of practical proposals and recommendations which, if implemented, will result in a stronger and more effective approach to franchising...”¹¹.

The Secretary of State for Transport has a statutory requirement (under the Railways Act 1993) to provide for the continued provision of rail services in the event of the failure of a franchise. This occurred in 2009 when the operator of the East Coast franchise went into default and the publicly owned Directly Operated Railways was brought in to maintain the services.

Franchises have ranged from approximately 3 years to 15 years in term. Franchisees are required to run defined train services, achieve specified levels of reliability/ punctuality and recent franchises also contain targets on passenger satisfaction metrics. Train operators lease rolling stock, employ the work force and pay access charges to Network Rail for the

¹⁰ Open access operators are those who operate services purely on a commercial basis, i.e. not under either a franchise or a concession agreement. These are companies who identify an opportunity to run a service which is not currently being provided, and they apply to ORR for the necessary track access rights and to Network Rail for train paths in the timetable.

use of the Network and stations. Franchisees collect and retain revenue but franchises generally have some form of risk sharing with the Department for Transport in recognition of the fact that revenue is strongly impacted by exogenous factors outside of the operators’ control. Franchise payments, from the operator to Government or vice-versa, are contracted as part of the overall franchise agreement.

Bidders have to provide evidence that they can deliver the specification and they will be excluded if they are assessed as undeliverable. The Department assesses the risk of financial delivery and in past competitions has required capital to mitigate this risk. Award is then made on the basis of price, with provision for other non-financial elements to be considered in the event of two bids being close financially. The role of ‘quality’ (non-financial factors) in awards is currently being considered for future franchise competitions.

The complex nature of franchise contracts means that the Department for Transport constantly identifies areas for improvement. Every franchise competition has included minor changes to make franchise management and the delivery of services more effective. There is no ‘one-size-fits-all’ approach. The last major change was in 2004 when Department for Transport switched to a new franchise contract template.

The majority of staff transfers directly to the new operator at change of franchise. The new operator will employ its own small management team. UK privatisation was designed so that a franchisee can quickly take over a business as a going concern with access to all of the assets necessary to successfully operate that business. Mobilisation of a franchise takes typically 4 months from the date of franchise award.

ORR has not opened any competition cases since 2004 in relation to the provision of passenger services, although it has received a small number of complaints, mostly about fares or car park charges. In response, ORR has published a guidance document\textsuperscript{12} which provides information on how these prices are regulated and explains its approach to considering such complaints under competition law.

**Access charges**

In Great Britain, ORR carries out a periodic review every five years of the access charges paid by train operators for access to the national rail network operated by Network Rail. The process for this is set out in primary legislation\textsuperscript{13}. At a high-level this involves:

- ORR formally requesting the two governments in Great Britain (Scotland and England & Wales) to set out the high-level outputs that they each want the railway to achieve in their respective areas during the next ‘control period’. The governments do this in a ‘high-level output specification’ (referred to as ‘HLOS’). ORR also requires them to set out how much public money they are prepared to make available to support the achievement of these outputs (they each do this in a ‘statement of funds available’ – ‘SoFA’);
- Network Rail, the infrastructure manager, is then required to develop a strategic business plan (SBP) setting out how it would deliver the high-level outputs in both HLOSs and how much it considers this would cost;
- ORR then reviews the SBP to determine whether it represents an efficient way of delivering the high-level outputs and whether there are sufficient funds, alongside other sources of income, in the SoFA; and finally,
- ORR determines the outputs that Network Rail shall deliver in the control period.


\textsuperscript{13} Schedule 4A to the Railways Act 1993.
For example, ORR’s determination for Network Rail during the current control period, CP4 (2009-2014) is published at [http://www.rail-reg.gov.uk/upload/pdf/383.pdf](http://www.rail-reg.gov.uk/upload/pdf/383.pdf) and ORR’s draft determination for CP5 (the control period from 2014-19) was published on 12 June 2013 for consultation, with the final determination due to be published in October 2013. Other major elements of the review include the establishment of an appropriate incentive framework for Network Rail and train operators and establishing the structure of the access charges to be paid by train operators to Network Rail.

In summary, by means of the periodic review, ORR assesses the efficient level of revenue that Network Rail needs to run its business and deliver the required regulated outputs. This includes an allowed return on its regulatory asset base (RAB). The access charges ORR determines are set at a level that enables Network Rail to recover this revenue requirement, but taking account of any other income that Network Rail receives (such as commercial income from property and direct grants from the government paid in lieu of a proportion of access charges).

ORR’s approach to establishing the regulatory framework is based on the standard ‘building block’ methodology widely used by economic regulators - see Figure 1.

**Figure 1: Overview of the regulatory framework**

The key features of the building block methodology are:

- ORR assesses what Network Rail needs to spend on operating and maintaining the railway for each year of the control period. Network Rail receives income for this on a ‘pay-as-you-go’ (PAYG) basis. This means that for each pound it needs to spend each year it receives a pound in income;

- ORR assesses what capital expenditure on renewals and enhancements Network Rail needs to undertake in the control period. This expenditure is added to the regulatory asset base (RAB) in the year in which it is incurred. But the income Network Rail receives is not on a PAYG basis. Instead Network Rail receives an amortisation allowance (which covers the depreciation on the assets); and

- the allowed return on the RAB that ORR calculates and allows Network Rail to recover through access charges. This therefore covers, amongst other things, the cost of financing the company’s capital expenditure programme.
Adding up all the income needed by Network Rail to fund these elements produces what is called the ‘gross revenue requirement’.

In the review for CP5 (2014-19), income (which is called ‘other single till income’) that ORR expects Network Rail to earn on activities such as commercial property is deducted from the total costs of the network (i.e. from the gross revenue requirement).14 This then leaves the ‘net revenue requirement’ which ORR uses to estimate the income that Network Rail will require in access charges to earn an appropriate level of return.

With the exception of the fixed track access charges, the regulated track and station access charges paid by train operators to Network Rail are set so as to recover particular costs. Most track access charges are set to reflect the costs that vary with traffic, which is consistent with Directive 2001/14/EC.15 The regulated station charges recover costs for station maintenance, repair and renewal.

The fixed track access charges, paid only by franchised passenger operators, are set to recover Network Rail’s net revenue requirement, i.e. Network Rail’s residual revenue requirement after deducting other track access charges and other single till income. The fixed track access charges, therefore, recover the bulk of Network Rail’s fixed costs.

During the CP4 (2009-14), more than 80 % of Network Rail’s revenue16 will be earned through a combination of the network grant17 (c. 63 %) and fixed access charges (c. 17 %).

As set out above, Network Rail recovers its costs through track access levied on train operators using its network, network grant and other single till income.

The variable usage charge is designed to recover Network Rail’s operating, maintenance and renewals costs that vary with traffic. The variable usage charge paid by franchised and open access passenger operators and freight operators ensures that operators meet at least their costs directly incurred of operating on the network, as required by EU legislation18.

Network Rail’s fixed costs are the residual of its gross revenue requirement after deduction of income from variable charges and other single till income from its revenue requirement as determined at each periodic review. Up until 2008, Network Rail recovered its fixed cost through a fixed charge levied on franchised passenger operators. Freight and open access operators made no contribution to fixed costs.

EU legislation allows mark-ups to be levied on charges above the level of cost directly incurred to contribute to the recovery of fixed cost, but only on those market assessed as able to bear the cost.

In CP4 (2009-14), ORR introduced a freight only line19 (FOL) charge in order that freight operators made a contribution to the fixed cost of freight only lines. The charge was calculated to recover the fixed costs of FOL for the commodities on which it is levied. In legal terms, it represents a mark-up on charges for costs directly incurred on those market segments which ORR determines could bear the mark-up in line with European legislation.

14 The alternative ‘dual till’ approach would involve a separate price control for Network Rail’s activities in each market that it operates in – effectively treating each of these as a separate business.
16 http://www.rail-reg.gov.uk/pr13/PDF/freight-conclusions-jan-2013.pdf. Figure 2.2-3.
17 Government currently pays network grant directly to Network Rail in lieu of a significant proportion of access charges.
19 Freight only lines are defined as lines that would close if freight services ceased to operate. It includes segments of branch lines used only by freight traffic and terminal lines.
In support of this, ORR carried out a market assessment of all freight commodity market segments.

Broadly, ORR commissioned an assessment of which markets would not see a significant shift to other modes, in particular road as a result of higher track access charges i.e. where demand for transport by rail was relatively price inelastic. ORR’s assessment determined that coal for the electricity supply industry (ESI) and spent nuclear fuel as commodities able to bear a mark-up. The FOL charge was levied on these commodities as a mark-up on the variable usage charge on a per thousand gross tonne mile (kgtm) flat rate.

As part of this current periodic review (PR13), following extensive consultation with its stakeholders, ORR concluded, in January 2013, that it would also introduce a new Freight Specific Charge (FSC), for CP5 (2014-19) on top of the FOL charge. The purpose of this charge is to recover infrastructure costs caused by freight operating on the network that are not currently recovered through other freight charges. The introduction of this charge means that rail freight will pay a greater contribution to the costs that it imposes on the network.

The result of a further ORR assessment showed that ESI coal, nuclear spent fuel and iron-ore as market segments able to pay this additional charge. As with the FOL charge, it is levied as a flat rate per commodity, per kgtm, as a mark-up on the variable usage charge.

During CP5 (2014-19), ORR intends to carry out a further review of the structure of charges which may include looking at other mark-ups such as a scarcity charge which ORR would consider, this time, introducing on a geographic basis.

ORR has not run any competition cases in which the infrastructure manager was the key issue. Full structural separation makes this a relatively low risk. But ORR is aware of competition issues caused by the control of (and charging for access to) certain key strategic sites by certain freight operators. It has carried out a market study of this issue, leading to the drafting of a Code of Practice for freight operators and measures to increase the transparency of information available to operators competing for traffic which involves use of sites owned by their competitors.
4.2. **Introductory Statement by Hubert DE BROCA**

1. **General**

Aviation and rail sectors are at different stages of liberalisation. As a result, it is not surprising that these two markets developed differently in the last twenty years. From a competition law perspective, it is therefore also not surprising that issues are quite different in nature.

2. **Aviation**

- The aviation sector mainly grew within national borders (not simply at EU level, but also at international level). It therefore led to a number of separate national markets, where a local flag carrier was by law (and international conventions) protected from competition.

- The market opening at EU level has led notably to the following results:
  - Generally speaking, a huge growth of aviation services in Europe (higher number of routes served, growth in number of passengers).
  - Consolidation of former air transport flag carriers, with three main operators in Europe, operating a hub and spoke business model, which are active at national, intra-EU and international levels. These carriers face different forms of competition (such as low cost carriers, carriers from third countries. Some former flag carriers have been subject to mergers or, more exceptionally, to bankruptcy. Still today, some relatively minor former flag carriers are facing difficult economic conditions, which may notably raise some State aid issues.
  - Thanks to liberalisation, new airlines with new business models have started business. A large number of them are low cost carriers, some of which have been extremely successful. These airlines grew quickly within Europe, but are so far almost absent from the international market (from EU to third countries). Unlike hub and spoke carriers, they offer point to point services, with varying degrees depending on the airline. They generally serve secondary airports, which may raise questions on the conditions for access to such airports and can give rise to State aid issues.
  - Consolidation may also take different forms of cooperation (joint-ventures, code-share agreements, alliances). Such forms of cooperation may have to be assessed under antitrust rules (see, on the general framework of analysis, the 2010 and 2013 decisions in, respectively, the BA/AA/IB and LH/UA/CO/AC cases).

- At international level, markets remain very much regulated by national authorities and the provision of air services is very much regulated by so-called bilateral Air Service Agreements (ASAs), which provide for the conditions under which airlines can have access to a market. Such agreements traditionally contained rather restrictive provisions, which were not competition-friendly. In recent years, through a lengthy renegotiation process, a large number of ASAs have however been amended in the right direction. Since ASAs are international conventions between

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20 The views expressed are purely those of the writer and may not in any circumstances be regarded as stating an official position of the European Commission.

21 See e.g. the Commission’s reports on air transport, [http://ec.europa.eu/competition/sectors/transport/reports/index.html](http://ec.europa.eu/competition/sectors/transport/reports/index.html) and also the ‘Air Transport Agreement’ between the EU and the US, OJ 134 L of 25.5.2007, p. 4.
Member States, competition rules are however generally not appropriate means to tackle such concerns.

3. Rail

- As the aviation sector, the rail sector mainly grew within national borders (to the point that rail gauge may not even be the same in every Member State!). Most markets have therefore long been legal monopolies of a national carrier.

- The rail sector is still at relatively early days of liberalisation at EU level: less than 10 years for freight, a couple of years or so on international passengers, no opening on domestic markets yet (some member States are however more advanced). A proper, fully effective liberalisation is obviously a prerequisite to the entry of competitors on the market. This notably implies a proper separation between infrastructure manager and provider of transport services, as well as an independent and effective rail regulator. But it also implies a high level of harmonisation of applicable technical and administrative rules.

- The Commission and national competition authorities have a number of on-going investigations and recently decided cases, which illustrate the type of conduct that one may face. In the Deutsche Bahn (DB) investigation, the Commission is investigating a possible margin squeeze in relation to the pricing of traction current (electricity) by the DB arm providing electricity. In the Lithuania rail market, the Commission is investigating whether the removal of 19 kms of tracks between Lithuania and Latvia may have constituted an abuse of dominant position. Reports have indicated a complaint by NTV, an independent rail carrier, against Trenitalia, alleging predatory pricing. All these cases generally involve barriers to entry raised by the incumbent to delay or make entry of competitors more difficult.

- Considering the relatively recent level of liberalisation, there have been encouraging signs of competition in some markets, such as block wagon rail freight transport and regional passenger market (competition for the market in MS where it is allowed: UK, Germany, Sweden).
4.3. Introductory Statement by Jean-Eric PAQUET

Introductory statement

- Obstacles to a smooth functioning of and effective competition in the Internal Market persist. The objective for the next decade is to create a genuine Single European Transport Area by eliminating all residual barriers between modes and national systems, easing the process of integration and facilitating the emergence of multinational and multimodal operators. The Commission complements this action by a vigilant enforcement of the competition rules across all transport modes.

- A Single European Transport Area should ease the movements of citizens and freight, reduce costs and enhance the sustainability of European transport. Over the past decades, a lot has been achieved to facilitate transport operations in Europe and further market opening has taken place in aviation, road and partly in rail transport.

- The Internal Market for aviation is well-advanced but the Commission has taken new initiatives to foster the implementation of the Single European Sky and to address the capacity and quality of airports. The area where bottlenecks are still most evident is the Internal Market for rail services, which must be completed as a priority in order to achieve a Single European Railway Area.

- On 30 January 2013, the Commission put forward the 4th railway package with the main goal to offer better quality and more choice through allowing new operators to run rail services. To encourage innovation, efficiency and better value for money, domestic passenger railways should be opened up to new entrants and services from December 2019, either by competing commercial services or through bidding for public service rail contracts.

- The proposals would bring clear benefits to passengers in terms of improved services, increasing choice. However, it will deliver results only if fair access can be ensured for all to the railway infrastructure. Independent infrastructure managers must run networks in an efficient and non-discriminatory manner and coordinate at EU-level to underpin the development of a truly European network.

- To this aim, the Commission is also proposing to strengthen infrastructure managers so that they control all the functions at the heart of the rail network – including infrastructure investment planning, day-to-day operations and maintenance, as well as timetabling.

- Faced with numerous complaints from users, the Commission considers that infrastructure managers must have operational and financial independence from any transport operator running the trains. Institutional separation remains the simplest and most transparent way to achieve this. For vertically integrated structures, strict legal, financial and operational separation requirements are necessary to ensure the necessary independence.

- This is essential to remove potential conflicts of interest and give all companies access to tracks in a non-discriminatory way. The completion of the Single European Rail Area is crucial to enable rail transport to grow and to take its full place in a competitive and resource-efficient European transport system.
4.4. Presentation by Prof. Dr. Kay MITUSCH

Market entry barriers in railway and aviation?

Prof. Kay Mitusch, KIT
September 3, 2013
Workshop: Competition in the transport sector
European Parliament, Brussels

Network Economics (KIT/MMW)

Different experiences with market liberalisation:
“The open air versus the closed railways” (?)
The planned 4th EU Railway Package addresses the right topics

Substantial steps towards a single European railway market in the 4th Package:
- Towards homogenization of technical standards across the EU
- Towards centralisation of certification procedures at the European Railway Agency, ERA
- EU wide opening up of railway passenger markets, particularly of the markets for regional / local public service contracts financed by the public

→ Overcome fragmentation!
→ Maybe also overcome technological retardation in freight?
  - Importance of the EU rail freight corridors!

Railways are not so closed after all!

Example – freight:
- Competitors have about 50% market share on the main German routes from the Northern ports to the South
- Main reasons:
  - General Open access in Germany since 1994
  - Long distances, simple production processes (block trains)
  - German regulator (Bundesnetzagentur, BNetzA) is quite strong concerning general access conditions (except access charges)
    → reduces discriminatory behavior by incumbent
  - Initially, German ports and some companies helped competitors to get started and develop (even took part in some of them) in order to reduce their dependence on DB
- Remark: The biggest threat to the development of EU railway freight is political ignorance for this segment (its infrastructural and regulatory needs, upgrade of technical standards) and in particular political capture by national trucker interests.
Railways are not so closed after all!

**Example – long-distance passenger:**

- High speed competitor NTV in Italy (Torino-Milan-Rome-Naples)
- **Main reasons:**
  - Substantial competitive advantage of rail over to road and plane on this line
  - Relatively simple business: Mainly just one line (not a complicated network of lines with passengers changing trains)
  - Sufficient slots on the line are obviously available → hard to deny access by the vertically integrated incumbent
- **Remark:** The biggest threats to the development of a common EU market for long-distance are:
  1. Co-operation among the national incumbents (creating some international trains, but also creating an anti-competitive atmosphere among them)
  2. The vanishing of independent competitors
  3. Technical fragmentation

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Railways are not so closed after all!

**Example – regional / local passenger:**

- Competitors have about 15% market share (pass. km) for German public service contracts (PSCs)
- **Main reasons:**
  - Quite some money to earn on PSCs in Germany
  - Relatively simple business: many details of traffic (incl. passenger fares) are determined by the public authority, track access charges paid by them
  - Initially, German federal states and regional public authorities helped competitors to get started (even took part in some of them) in order to reduce their dependence on DB
  - Later on, national incumbents from other European countries (Italy, France, Netherlands) took over several of the new entrants
Remark on regional / local passenger:
Obstacles for the development of a common EU tender market for public service contracts

1. Side deals of regional authorities with the vertically integrated national incumbent
2. Forbidden information transfers about competitors’ offers in the vertically integrated national incumbent
3. The vanishing of strong independent competitors (Arrival)
4. Market closure justified by social concerns
5. Fragmentation of the market (different types of rolling stocks, different types of public service contracts)
   - No homogenous EU market for new or used rolling stock!
   - High sunk cost share of rolling stock
   - High risks due to long life of rolling stock (about 30 years)
   - Difficulties of obtaining financing
   - Barriers to market entry! [Problem also addressed in 4th Package]

Political recommendations
(1) Technical standards
- Support the 4th Package’s thrust on harmonising technical standards and certification procedures and strengthening the European Railway Agency (ERA)
- After the 4th Package:
  - For a long time, national particularities will have to be considered in certification. ERA should become responsible for the national particularities as well. If national institutions remain responsible here, they will develop a second tier in certification, making everything more difficult.
  - EU should as soon as possible monopolise certification of new technologies like locomotives driven by hydrogen (i.e. forbid national institutions to grant such certification)
  - EU should push for the definition of a future common standard of traction power (voltage, details of the overhead traction line, etc.) in the Union. Maybe by an auction among the efficient standards already in use. Conversion period of about 30 years.
Political recommendations

(2) A single EU market for public service contracts
- Support the 4th Package’s thrust on creating a common market in passenger transport, particularly for public service contracts
- Mandatory open tendering of public service contracts
- After the 4th Package:
  - Set common standards for tendering procedures and contractual types
  - Add common standards for rolling stock for regional / local traffic (maybe at first on a voluntary basis, like a quality label)
  - Also add common standards for infrastructure aspects (in particular length and height of station platforms)
  - Beware that the issue of social standards of the employed might be used to effectively block market opening and fair tendering

(3) We need a “Lex Arriva”
- The acquisition of Arriva by Deutsche Bahn did not violate any national or EU antitrust law: In no country did it create or add to a dominant firm
- Still, it was a disaster for the long-term development of European railway passenger markets: Arriva was the single purely private firm of significant size active in almost all European markets for public service contracts
- Deutsche Bahn bought it using, among others, its privileged access to credit markets as a publicly owned company
- Independent Arriva is lost. We can only learn for the future. Next targets could be Transdev/Veolia, FirstGroup, National Express, DHL, Kühne & Nagel, ...
- Note that integrated railway companies benefit from an exemption from State aid regulations – it therefore seems to be justified to subordinate them to special antitrust regulations
Political recommendations

(3 cont’d) We need a “Lex Arriva”

- Proposal for a “Lex Arriva”: Any proposed merger in the transport sector in which a railway undertaking is affected either as target or as overtaking or as equal part should need the explicit consent of a special EU board to be made up by DG Mobility and Transport and DG Competition
- The merger should not be allowed if the long-run development of competitive railway markets in the EU will likely be hampered by it
- The board should have ample discretionary room to make this assessment
- Criteria: Approval should be less likely if the target is:
  - an active or potential future participant of railway markets
  - independent of national railway incumbents
  - privately owned
  - financially sound with a fairly good economic outlook
- Criteria: Approval should be less likely if the overtaking party is:
  - a national railway incumbent, particularly if vertically integrated
  - has significant market power in a large EU country

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Political recommendations

(4) Strengthen access regulation

- In order to assure open access for competitors, strong and independent national regulators are needed
- Task 1: Guard fair general access conditions and licensing conditions
  - Mind the problem of “non-price discrimination” in railways
- Task 2: Regulate access charges with a view to “achievable efficient costs”
  - This is relevant for all countries that allow infrastructure managers (IMs) to levy mark-ups for full cost recovery according to Art. 32 of Dir. 2012/34/EU (irrespective of vertical separation or integration)
  - These mark-ups shall not be based simply on the actual costs of IMs: Cost plus problem!
  - Rather they should be based on critical cost assessments by regulators using benchmark methods and comparisons of various kinds
  - This is what regulators usually do in other regulated sectors (telecom, energy, …)
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4.5. Presentation by Brian KOGAN

Competition in transport: the UK rail industry

Brian Kogan, Office of Rail Regulation
September 2013

Overview

- Background – UK rail since 1993
- The role of the regulator
- Competition – theory and practice
- The way forward?
Initial liberalisation...

- Objective: “To harness the management skills, flair and entrepreneurial spirit of the private sector to provide better services to the public”
- Railways Act 1993
  - 1 infrastructure manager
  - 25 passenger franchises
  - 6 freight operators
  - 3 rolling stock companies
  - Franchising body
  - Regulatory body

...and the key changes since then

- 2001: default of Railtrack, the infrastructure manager. Network Rail established as not-for-dividend company, with debt backed by government.
- Franchising brought in-house by government.
- Franchise consolidation from 25 to 17
- 10 owner groups: some owned or part-owned by ‘incumbent’ operators from other member states
UK customer satisfaction with liberalisation?

- In public, privatisation is often criticised
- But the numbers tell a positive story
  - More passengers than at any point since 1940s.
  - 44% increase in last decade.
  - Record levels of performance
  - Record levels of customer satisfaction (despite fare increases)
  - Joint-best safety record in Europe
Role of the regulatory body

- Determine funding and outputs for Network Rail, and hold them to account
- Approvals body for access to network
- Licensing of operators
- Safety authority
- Passenger rights enforcement
- Joint competition authority for the railway
  Statutory duties include the obligation “to promote competition in the provision of railway services for the benefit of users of railway services”

Where does competition exist?

The rail industry market chain

ORR holds Network Rail to account – counteracts the lack of competition
Competition for the market

- Public Service Contracts – “franchises”
  - Competitive tendering: usually 4-6 bids for a contract.
  - Multi-annual concessions to operate the routes.
  - Profitable and unprofitable services bundled together.
  - Some franchises are profitable, and attract a premium.
  - 7 – 10 year contracts, with potential for extensions.

Does franchising work?

- Some high-profile failures:
  - Bankruptcy of operator – franchises can be taken back into public operation before being re-let
  - Cancellation of West Coast mainline award in 2012: Errors of calculation and analysis.
- Process is here to stay. Has brought many benefits, but can be improved
  - More flexible contracts.
  - Service specifications tailored to nature of the route, as appropriate.
  - Adequate resourcing and expertise in government.
Competition *in* the market

- Open-access operators run services on a purely commercial basis (all freight is open-access).
- 3 open-access passenger operators in UK.
- They apply for capacity from infrastructure manager, and pay a track-access charge.
- So far, operate at the margins. 1% of p/km.
- ORR has exercised powers to allow open-access: prioritising duties to promote competition.

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How to encourage competition

- *For* the market
  - Opening of rail markets in Europe: more bidders, more opportunities for operators to expand
  - In Europe, tackle the barriers to entry: rolling-stock, ticketing technical authorisations, safety certifications
- *In* the market
  - Allow open-access and franchise operators to co-exist: importance of economic equilibrium?
  - Strong independent regulation to ensure non-discriminatory access to network and industry systems
Can rail compete with other modes?

- Strong natural advantage in certain segments
  - Heavy freight
  - Commuter services into urban areas
- In other segments, allow operators the freedom to compete on:
  - Fare prices
  - Service quality
- Capacity constraints may impose a ceiling: targeted investment to let the industry grow
ANNEX: WORKSHOP POSTER

Competition in the transport sector: Market entry barriers in railway and aviation?

DATE / TIME
03.09.2013
12:30-15:00 hrs

ROOM
ASP 5G1

Committee on Economic and Monetary Affairs (ECON)

Participants needing a badge must register providing their name, full address, date of birth, nationality and passport or ID number by 28 August 2013
to: freya.windle-wehrle@ep.europa.eu
POLICY DEPARTMENT A
ECONOMIC AND SCIENTIFIC POLICY

Role
Policy departments are research units that provide specialised advice to committees, inter-parliamentary delegations and other parliamentary bodies.

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- Economic and Monetary Affairs
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