

Agenda

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Getting back on track: repackaging the rules for European rail

The 'First Railway Package' of 2001, which forms part of the EU's legislation to revive the European railway industry and ultimately move towards a European Rail Area, has not yet been fully implemented. Where its adoption is incomplete, market monitoring indicators suggest that the rail industry is underperforming. As the European Commission considers a recast of the Package to clarify matters, how might the potentially controversial proposed changes affect railway infrastructure and access to it?

Recently the European Commission issued a warning about the incomplete adoption of the 'First Railway Package', sending reasoned opinions to 21 Member States highlighting their shortcomings in adopting appropriate measures.¹ By seeking to introduce a degree of liberalisation to the industry, this legislation is aimed at helping to revive the railways from the decline they had been experiencing.

The main focus is the freight market, with the intention of permitting railway undertakings to have fair, non-discriminatory access to infrastructure in order to provide international freight services on the trans-European rail freight network. Other measures in the Package included setting out the relationship between the state, infrastructure manager and railway undertakings, as well as introducing a policy for capacity allocation and infrastructure charging. Despite the Package having been agreed eight years ago, there is still some way to go in its implementation, and the Commission's warning highlights three main areas of concern: lack of independence of the infrastructure manager; insufficient provisions on track access charging; and a failure to set up an independent regulatory body.

This follows previous warnings such as the letters of formal notice sent to 24 Member States in 2008.² The Commission has indicated that it plans to simplify and improve the Package in order to make compliance more consistent across Member States.³

To assess the effectiveness of the Package in achieving the goals of liberalising and revitalising the European rail industry, the Commission committed to publishing Rail Market Monitoring Reports,⁴ covering technical and economic developments. In a communication from 2007 it found that those Member States with the highest scores for market opening were performing better, in terms of freight tonne-kilometres, recouping infrastructure costs and intensive use of the network, than those with less competition.⁵

Legislative framework

The Package is made up of three Directives adopted in 2001 (Directives 2001/12, 2001/13 and 2001/14), which aimed to establish the appropriate framework to allow for rail market opening in Member States. The box below details some of these key measures.

Requirements of the 'First Railway Package' (2001)

Accounting separation and independent decision-making between operators and the infrastructure manager.

The introduction of an access charging system based on marginal cost principles.

Non-discriminatory access to capacity and rail-related services.

An independent regulatory body to monitor the market and to settle disputes.

The requirement on infrastructure managers to publish network statements explaining the nature of the infrastructure, the charging principles and the criteria for being granted capacity.

The requirement on infrastructure managers to seek to reduce costs through multi-annual contracts with the state, or through a regulatory body.

Harmonised provisions for granting licences for railway undertakings.

Identifying the constraints to implementation

A recent study and a separate survey for the Commission have looked at some of the barriers to the First Railway Package achieving its desired outcomes.⁶ By surveying people from the industry, it was hoped that any obstacles to successful implementation could be identified, and in particular that stakeholders' willingness to adopt measures to overcome these obstacles could be gauged. The findings of the survey, from 73 respondents across the vast majority of Member States covering railway undertakings, regulators, infrastructure managers, transport ministries and other stakeholders, indicate some of the themes for a potential recast of the Package, considered next.

Rail-related services

One of the requirements of Directive 2001/14 yet to be implemented by some Member States is non-discriminatory access to rail-related services (eg, supply of traction current and fuels, terminals, shunting yards, rolling stock maintenance). A lack of transparency in the access conditions can be a problem, including unclear descriptions of the infrastructure. The SERVRAIL study found wide variation in charges for rail-related services and a lack of transparency in pricing schedules, making international price comparison difficult. Furthermore, the survey conducted for the Commission found that access to these services was one of the main barriers to full implementation of the Package. As such, it remains a key area of focus for the Commission.

It appears that one of the main problems in this regard is asymmetric information between incumbents and potential entrants. One solution might be to be more prescriptive over the contents of the infrastructure manager's network statements, with the introduction of a requirement to include information on the opening times of key facilities, the capacity available, the access charges, the services and equipment available, and contact details.

There is a debate, however, over whether the Directive's approach is the most appropriate one. It may not be appropriate to treat rail-related services in the same manner as core infrastructure—arguably, some services listed in the Directive, such as maintenance, lie outside the core infrastructure. A competition-based essential facilities type test could be a more appropriate method of determining access, rather than automatically assuming that access should be granted.

Regulatory independence

In Great Britain, many regard independence from government, train operators and infrastructure

managers as fundamental to the effectiveness of regulatory bodies.⁷ Yet, in some Member States, fully independent regulatory bodies are yet to be established, despite this being a requirement under Article 30(1) of Directive 2001/14.

Currently the regulator is permitted to be part of a government ministry, which could have interests in operators and the infrastructure. In this case, the degree of independence and the ability of a regulator to make a fair decision are questionable. A recast could strengthen the legislation to remove such links in order to ensure full regulatory independence.

Some of the other potential improvements highlighted in the responses to the survey for the Commission, include the need for a harmonised job description and prescribed legal powers for regulatory bodies across Member States. It would also be beneficial to empower regulatory bodies to take joint decisions where appropriate and to increase the level of international cooperation through exchange of information on decision-making principles. Further, they need to be properly resourced in terms of skills, staff and funding, which is not always the case. The competences of the regulatory body should be clarified to ensure that there is no unnecessary overlap with those of the national competition authorities.

One more fundamental change could be the introduction of a European regulatory body, although such a proposal would be likely to have mixed support.

Further separation

As Oxera recognised in the September issue of *Agenda*, when considering the appropriate extent of separation, one needs to trade off the efficiency gains of vertical integration against the negative effects of any discriminatory practices.⁸ A recent paper compares the efficiency performance of railway undertakings under vertical separation with those in a vertically integrated structure.⁹ Based on one year of data (2006/07) for 43 European passenger and freight operators, the analysis suggests that vertical separation does not affect technical efficiency per se, but that high transaction costs significantly reduce technical efficiency. Such transaction costs are most likely to be associated with vertical separation, although this is not the only source. In addition, the paper finds that vertical separation has a negative effect on the allocative efficiency of production staff and production materials.

While the paper has a relatively limited sample of more integrated railway undertakings (three owned by Deutsche Bahn out of the 43 in the sample), its findings suggest that if the Commission were to require a greater degree of vertical separation, it would need to ensure that impacts on transaction costs and efficiency

were minimised. It might also necessitate some more localised decision-making: it may be that conditions in a Member State would lead a regulatory body to decide that the costs of separation outweigh the benefits (eg, if a network is small and there is little prospect of new entry).

Previously, the Commission has taken a relatively positive stance towards a greater degree of separation than currently required by the Package:

The current structure of the national railway markets is detrimental to the development of [coordination between infrastructure managers] because railway undertakings are still in a position to control the infrastructure management, at least in the model of organizational separation and vertical integration.

The fact that some infrastructure managers form an integral part of national railway undertakings threatens also the Europe-wide non-discriminatory access to rail related services and facilities ... there are concerns regarding the preference shown by service providers towards the railway undertakings operated by themselves. Transparency and separation of functions are therefore vital to ensure an equal treatment of the incumbent and the independent railway undertakings as regards access to the railway infrastructure and to service facilities in order to optimize their use at a European level.¹⁰

However, it has also warned that 'a thorough analysis of costs and benefits is essential'.¹¹

So where might a recast focus?

Clearly, the recast is likely to focus on the barriers to implementation of the Package, and ultimately on the success in achieving its desired outcomes. Formally, the Commission has announced that the recast will:

simplify the legislation, the three Directives will be merged and restructured while eliminating cross-references across the legal acts... . Furthermore ... institutional arrangements, such as strengthening of the powers of regulatory bodies and a strengthened cooperation of rail infrastructure managers for international services, will be enhanced to promote the emergence of a genuine internal market... . Overall by enhancing the legal and institutional framework the Commission hopes to see market access cost of railway undertakings being reduced.¹²

Furthermore, given the prominence of issues with rail-related services, it seems likely that the

Commission will seek to clarify the requirements on owners of relevant infrastructure in respect of non-discriminatory access.

The Commission is also keen to ensure that, where feasible, multi-annual contracts between the state and the infrastructure manager are implemented. Such contracts should facilitate better long-term project planning by providing greater funding certainty; in addition, these multi-annual contracts can provide incentives for efficiencies, through the prospect of cost-cutting by infrastructure managers, while still receiving the committed funding.

Crystal ball gazing

So what might rail access charging requirements look like in five years' time? Clearly, a lot depends on the political process around the recast. However, based on the direction of Commission statements in recent years, and insights from other sectors, some suggestions are provided below.

Rail-related services—a particularly controversial area, this could be resolved in one of two ways. The Commission might clarify in detail in legislation what it means by rail-related services, and how infrastructure managers and other facility owners need to behave in terms of offering non-discriminatory access. This would put the onus on regulatory bodies to react to complaints in light of the recast Directive. An alternative would be to address the issue of access to rail-related services under the competition rules applied by competition authorities or (where relevant powers exist or are created) by sector regulators. Intervention would then be limited to those services and facilities that are really 'essential', and not to those that are already competitive.¹³

Vertical separation—another controversial area, in its 2006 staff document it is clear that the Commission found further separation appealing, and hence may decide that a greater degree of separation is required across Europe. However, this would differ from the Commission's approach to other sectors (eg, telecoms) to enable regulatory bodies themselves to determine whether a greater degree of separation is warranted. This would lead to individual regulatory bodies undertaking cost-benefit analyses into the level of separation needed.

Powers of regulatory bodies—in addition to the changes to powers anticipated in relation to rail-related services, it is clear from the tone of the Commission's 2006 review that it would prefer regulatory bodies to be independent from government. The prime issue, however, is the power vested in regulatory bodies. If they do not have sufficient access to information, they cannot perform their functions, regardless of whether

they are within a government ministry or fully independent from government.

Regulatory consistency—given one of the intended outcomes of the recast is greater clarity, regulatory consistency should enable a more consistent approach to be taken by infrastructure managers and their regulators across Europe. This should facilitate more

competition among railway undertakings if companies feel that they will experience consistent treatment in different Member States. In a similar vein, a consistent application of the requirement for multi-annual contracts between infrastructure managers and the state should provide more funding certainty, and potentially better incentives for efficiency in infrastructure provision.

¹ European Commission (2009), 'Commission Warns Member States over Lack of Implementation of "First Rail Package"', press release, IP/09/1438, October 8th.

² European Commission (2008), 'Commission Calls on Member States to Ensure Correct Implementation of the First Rail Package', press release, IP/08/1031, June 26th.

³ European Commission (2009), 'Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions—Commission Legislative and Work Programme 2009: Volume 1', Annex 1, p. 21.

⁴ EC Directive 2001/12, Article 10b (1).

⁵ European Commission (2007), 'Communication from EC to the Parliament and the Council on Monitoring Development of the Rail Market', COM(2007) 609 final.

⁶ Steer Davies Gleave (2006), 'SERVRAIL Study – Assessment of Present and Likely Future Conditions of Providing Rail Related Services', December, prepared for the European Commission Directorate General Energy and Transport (DG TREN). European Commission DG TREN (2009), 'Amendments to the Rail Access Legislation in the Framework of the Recast of the 1st Railway Package, Stakeholders Consultation – Overview', March, excerpt from a Study prepared for the European Commission by PriceWaterhouseCoopers Advisory Consortium.

⁷ See, for example, House of Lords European Union Committee (2009), 'Recast of the First Rail Freight Package', June, para 38.

⁸ Oxera (2009), 'Separating Incumbents: Panacea or a Sledgehammer to Crack a Nut?', *Agenda*, September.

⁹ Merkert, R., Smith, A. and Nash, C. (2009), 'The Effects of Institutional, Environmental and Transactional Factors on Train Operating Company Performance—a Tobit Regression Approach based on DEA Scores', *Papers and Proceedings of the European Transport Conference 2009*, Leeuwenhorst, the Netherlands, October 5th–7th.

¹⁰ European Commission (2006), 'Commission Staff Working Document—Annexes to the Communication on the Implementation of the Railway Infrastructure Package Directives ("First Railway Package")', May 3rd, pp. 39–40.

¹¹ *Ibid.*

¹² European Commission (2009), 'Communication from the European Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions—Commission Legislative and Work Programme 2009: Volume 1', Annex 1, p. 21.

¹³ Oxera (2006), 'Essential or Nice to Have? A Competition-based Framework for "Rail-related Services"', *Agenda*, July.

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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