

Agenda

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The Fourth European Railway Package: does one size fit all?

In January 2013, the European Commission proposed measures that it hopes will bring Europe one step closer to a single European rail market. However, due to major differences in market circumstances across countries, these measures will have different implications for the various stakeholders. What are the consequences for stakeholders, and does one size really fit all?

A new era in rail liberalisation is under way, according to the latest proposals from the European Commission (see the three boxes below).¹ These proposals seek to open up domestic markets in member states to new entrants, and thus address one of the remaining hurdles on the way to a single European rail market. Once implemented, the proposals will mean that railway undertakings from Europe and elsewhere will be permitted to compete in the domestic market in any member state. What are the consequences for such undertakings, and how will infrastructure managers (IMs) deal with the proposed measures?

Where are we coming from?

European rail legislation has undergone substantial changes in the last two decades. The Commission began its programme of economic restructuring almost 20 years ago, and has since published four 'packages' of railway legislation, with the aim of opening rail transport markets to competition; improving the interoperability and safety of national rail networks; and developing rail transport infrastructure.²

The purpose of the First Railway Package, adopted in 2001, was to gradually open up the European rail market to competition.³ This included aspects such as accounting separation between operators and the IM, an access charging system, and non-discriminatory access to capacity and rail-related services.

The Second Package, in 2004, aimed to open up the market for freight transport. In addition, the European Railway Agency (ERA) was established, to support interoperability in the market (and help to reduce barriers to entry arising from member state-specific standards and rules), together with providing safety and technical support.

International passenger markets were opened with the Third Package in 2007, giving railway companies the opportunity to compete on international routes. Working conditions for train drivers were also improved through the establishment of a European driving licence. The final strand of this Package was the strengthening of passenger rights.

As a result of the first three packages, the market for freight transport opened in 2007 and the market for international passenger transport in 2010. A recast of the First Package in 2012 has sought to simplify the legislation and tackle problems in the rail market by enhancing competition, strengthening the power of the national (independent) regulators, and increasing investment in the rail sector. Meanwhile, the Commission has proposed the Fourth Package. These proposals are likely to be subject to change, as they are currently hotly debated, and may depend on the upcoming European Parliament elections and a new Commission in 2014.

Key elements of the proposal: point 1

1. Strengthening the independence of the IM by creating a different structure:
 - separating track management from the running of trains. The Commission is proposing that the simplest way to ensure transparency and independence is through institutional separation of the two functions. However, IMs and train operating companies (TOCs) are allowed to remain in the same holding company if strict 'Chinese walls' are in place. These include separate financial flows, IT systems and decision-making bodies, and a cooling-off period for switching personnel. If the Commission decides that the Chinese walls are not being implemented properly, the TOCs can be prevented from operating in other member states from 2019;

- ensuring that a single entity performs all the functions relating to the development, operation (including traffic management) and maintenance of the infrastructure;
- establishing a coordination committee that will allow all infrastructure users to express their needs. This will make IMs more market-oriented and ensure that they meet user demands;
- enhancing cross-border operation, by establishing a network of IMs.

Key elements of the proposal: point 2

2. Opening of domestic rail markets:
 - introducing mandatory tendering of public service contracts (PSCs) above a certain threshold in December 2019. Competent authorities will have to provide certain operational, technical and financial data to all potential bidders, to ensure transparency. However, member states will be able to limit access when a PSC's 'economic equilibrium' is compromised;
 - ensuring all TOCs have access to rolling stock. The Commission is proposing an obligation on competent authorities to take on the financial risk of the residual value of rolling stock, and to take action if non-discriminatory access is not already in place;
 - enhancing non-discriminatory access to ticketing systems, by introducing national ticketing systems that are not run by the incumbent, much as the Rail Settlement Plan operates in the GB rail market. However, this is a recommendation rather than an obligation.

Key elements of the proposal: points 3 and 4

3. Maintaining and enhancing the skills of the existing workforce:
 - in line with the Transfer of Undertaking Directive (Directive 2001/23/EC), requiring new contractors to take on all the staff of the previous TOC;
 - requiring pan-European railway undertakings to create European Work Councils and take part in the Railway Social Dialogue Committee, a council established by the Commission to oversee aspects such as working rights.
4. Standardising technical standards:
 - lowering the burden for new entrants by giving the ERA greater powers of vehicle authorisation and safety certification. Instead of applying for vehicle authorisation in each member state, the ERA will be able to issue a joint authorisation for all member states. This is expected to lead to harmonisation at the European level and better interoperability for the railway undertakings. The Commission will modify the Railway Safety and Interoperability Directives in order to achieve a 20% time reduction and 20% cost reduction for vehicle registration.

Why is the Commission proposing this new package?

As well as aiming to create a single market, the Commission believes that the structural differences between member states block fair competition and prevent rail from being a good alternative to other modes of transport.⁴ More specifically, it believes that the close relationship between the IMs and the incumbent passenger operator in many member states distorts competition and leads to unfair market access. In addition, the direct award of contracts for providing rail passenger services is currently allowed by Regulation 1370/2007, which gives member states an opt-out for market opening.

Although the measures from the Recast of the First Package have not yet been implemented, the Commission considers the Fourth Package a necessary step.⁵ Some of the issues are also dealt with in the Recast of the First Package, and the European Parliament said in its appraisal of the Impact Assessment that the Commission may have introduced some of the proposals too early, and that it could have waited until the Recast was fully implemented.⁶ This argument was supported by the UK House of Commons Transport Committee.⁷

Controversial points in the proposal

The Fourth Package is likely to be particularly controversial in the following areas.

- **Market opening**—regulatory mechanisms are irrelevant if member states are unwilling to offer opportunities to compete against their incumbent passenger operators. Hence, the Commission's proposals to revise Regulation 1370/2007 to prevent direct award, except in limited circumstances, are likely to have the most effect on market behaviour. While such an amendment would make the rules for rail transport more similar to other parts of the state aid regime (such as the services of general economic interest (SGEI) Framework), enforced market opening is highly controversial.
- **Unbundling provisions**—the core element of the Package is the unbundling of the ownership of the railway network and the operation of trains. It does not require ownership unbundling, but proposes it as a 'general rule'; other forms of separation involving an independent track operator—such as a holding structure whereby the IM and train operator are owned by a holding company—may still be allowed. However, where ownership unbundling is not implemented, it will be necessary to ascertain whether the IM has enough independence and resources to perform its functions. The Commission therefore proposes strict rules for exemption which, if not met, may prohibit the TOC from competing in other member states. The Commission wants to be sure that there is no ambiguity about the allocation of basic functions between the owner of the

rail tracks and the train operators.

- **Third-party access**—access terms can distort competition if the level of charges bears no relation to the cost of the service, or if non-price terms make access to essential facilities difficult or unattractive to new entrants.⁸ Therefore, the Commission proposes that a concession should comprise no more than one-third of the size of the national train network, or 10m train-kilometres. Moreover, member states are allowed to limit access, both for setting up new tenders and for open access operations, when the economic equilibrium would otherwise be distorted. This means that a member state has the right to block other TOCs from entry when the revenues or profits of a PSC already in place fall below a certain threshold. However, several stakeholders have expressed concerns that this might also be used to limit competition, by setting unreasonably high thresholds (e.g. a loss of 1% in revenues).⁹ In addition, direct award, currently allowed under Directive 1370, will be permitted only under strict conditions.
- **Regulatory framework for regulators and awarding authorities**—national regulators will need to have the appropriate set of competencies to supervise the markets under their jurisdiction, and to coordinate their actions sufficiently to allow cross-border transport and open competition to work effectively, in terms of technical standards, capacity allocation, and awards of concessions. In addition, for awarding authorities, the Commission is proposing rules such as the publication of a public transport plan (PTP) requiring authorities to consult stakeholders on tariff policy, quality standards and geographical scope.

Implications and consequences for stakeholders

What are the consequences of the Package for countries, railway undertakings and IMs? Since market structures, operation and ownership vary across the EU, the impact will differ by member state. Some of the most controversial issues are discussed below.

Unbundling

The separation of functions, tasks and ownership is particularly controversial because best practice has not been set out, or at least not made clear in the Impact Assessment. It may mean complete separation by companies, as in Great Britain and the Netherlands, or the use of a holding structure with integration between the two functions to gain from efficiencies, as in Germany. As a final measure, the Commission states that TOCs might be excluded from operating in other member states if separation in the member state concerned is not managed according to these rules.

In some member states, the IM and the incumbent train operator are part of the same holding company. Other

operators sometimes see this as anticompetitive since the IM might favour its related train operator in providing track access. However, vertically integrated stakeholders point out the synergies and efficiencies achieved through these structures.¹⁰ They argue that separation can be undertaken in a less extreme way than complete separation of ownership, through functional separation, or accounting separation that already exists. Such functional separation is permitted under the proposals, subject to strict conditions.¹¹ However, some incumbent operators feel that, in practice, it is not possible to operate in a holding structure.¹² Therefore, if the Commission's proposal is implemented as published, it would mean a large change for the IMs and TOCs in countries with an integrated ownership structure, which could come with high transition costs.

In countries such as Great Britain and the Netherlands, which operate their rail systems with a separated IM, the proposals are unlikely to mean much change. Most TOCs in these countries are in favour of complete separation, as they think it will promote non-discriminatory behaviour by the IM, and therefore enhance competition.

While the proposed rule of complete separation divides opinion in Europe, the question remains: what is best practice?

Third-party access

Where possible, the Commission proposes open access for TOCs from 2019 onwards, and otherwise that the concession be no more than one-third of the total size of the national network, or 10m train-kilometres. While this sounds like a strict rule, member states may use the economic equilibrium rule to limit competition (see point 2 in the second box above). In addition, the direct award of concessions will be restricted and accepted only under strict conditions. member states have different opinions about these proposed rules.

In Great Britain, competition for concessions between TOCs has existed since the 1990s, and involves the international arms of several European incumbent TOCs. Other member states continue to protect their incumbent operators from international competition. The UK government is therefore welcoming the opportunity for its TOCs to compete in the European mainland.¹³ On the other hand, it is questioning the proposal on the maximum size of a concession, claiming that one-third of the national network is still too large. According to the UK House of Commons Transport Committee, this leaves less room for a range of TOCs and might damage competition in the longer term.¹⁴ Another concern is the strict ruling on direct awards. Many local or regional authorities currently use these to ensure the quality of their services, since they consider that direct awards enable them to influence and negotiate the quality criteria—however, due to the proposed rules, they might be forced to switch to public tendering and its large associated administrative burden. According to some MPs, a tender might also result in a worse outcome than direct awarding.¹⁵

Smaller countries, such as the Netherlands, Belgium and Luxembourg, on the other hand, may be in favour of opening their borders for competition, but argue that the Commission's maximum size for a concession is too small.¹⁶ By dividing the national network into three parts, they argue that the synergies, efficiencies and scale economies of larger concessions could be diminished, with potentially longer travel times and/or more changes for passengers. Another factor in relation to the maximum size is the risk of cherry-picking. Mountainous areas, such as those in Austria, are more costly for IMs and TOCs to operate in than flat areas. If the network is divided, cherry-picking of flat areas could mean that mountainous areas are left with no train services, or become more expensive if cross-subsidisation is no longer possible.¹⁷

The economic equilibrium rule has also led to discussions in several countries.¹⁸ A member state is allowed to limit access when the economic equilibrium is distorted—i.e. when the holder of a current concession is 'unreasonably' damaged by competition. Some stakeholders—mainly TOCs with international ambitions—are concerned that the rule might be used to limit competition, especially by smaller countries.

Given the different circumstances and preferences of the different countries, how will these rules work out in practice?

Regulatory framework

To make the regulation more effective, the European Commission is proposing measures to strengthen the powers of the regulatory body, as well as stricter rules for awarding authorities regarding tenders.

Countries that already have an independent rail regulator are unlikely to see much change. They might welcome the strengthening of regulatory powers, since this will help their national TOCs to compete abroad. Other countries, such as Italy, may face more difficult enforcement issues, where there are concerns that the regulator is not independent enough to enforce non-discriminatory access.¹⁹ For these countries,

considerable changes might be necessary, and they will take time.

Stricter rules, for example on transparency for awarding authorities, might encourage fair competition and a level playing field. A PTP might also address passenger needs better. However, some countries argue that the Commission has gone too far in prescribing such detailed rules, and claim that the proposal could conflict with principles of subsidiarity. For example, the UK House of Commons Transport Committee stated:

these provisions are overly prescriptive, and a significant regulatory burden will arise from this requirement²⁰

Resistance to this proposal may again be due to different market structures. In the UK, many regional and local authorities award PSCs for a whole region, whatever its size. According to the proposal, these authorities should instead be awarding either urban or rural contracts, which might force the authorities to split. As a consequence, the passengers in these areas might no longer benefit from the integrated (efficient) networks, as well as having to bear an increased administrative burden from new PTPs.

Are the proposals better and fair?

The Commission's aim in its Fourth Railway Package is to increase competition, leading to a single European market for rail passengers. This is widely welcomed—fair competition, lower prices, a level playing field and less bureaucracy are high on the wish lists of local and European politicians, as well as many IMs and TOCs.

The markets across the member states are diverse, and it is unclear whether a proposal or rule that is written to address a particular situation in a large country is also a good solution for smaller countries. The current proposals might yet be changed due to the upcoming European elections, but the question still remains: does one size actually fit all?

¹ See http://ec.europa.eu/transport/modes/rail/packages/2013_en.htm.

² See http://ec.europa.eu/transport/modes/rail/index_en.htm.

³ European Commission (2009), 'Commission Warns Member States over Lack of Implementation of "First Rail Package"', press release IP/09/1438, 8 October.

⁴ European Commission (2013), 'The fourth railway package – completing the single European railway area to foster European competitiveness and growth', COM(2013) 25, January.

⁵ European Commission (2013), 'The fourth railway package – completing the single European railway area to foster European competitiveness and growth', COM(2013) 25, January.

⁶ European Parliament (2013), 'Fourth Railway Package: European Commission proposal for a Directive on market-opening for domestic passenger transport services by rail and the governance of the railway infrastructure. Initial appraisal of a European Commission Impact Assessment', PE 507.508, May.

⁷ House of Commons Transport Committee (2013), 'The European Commission's 4th Railway Package', Twelfth Report of Session 2012–13, Volume 1, 23 April.

⁸ For example, minimum lot sizes may be arbitrarily high; required credit guarantees may be excessive; the types of service sold may be insufficiently flexible; balancing zones may be artificially small; or there may be no proactive measures to remove congestion.

⁹ Deutsche Bahn AG (2013), 'Workshop zum Eisenbahnrecht: Das geplante "Vierte Eisenbahnpaket"', 12 April.

¹⁰ Deutsche Bahn AG (2013), 'Workshop zum Eisenbahnrecht: Das geplante "Vierte Eisenbahnpaket"', 12 April.

¹¹ Article 7a to 7c of the proposed Package.

¹² Deutsche Bahn AG (2013), 'Workshop zum Eisenbahnrecht: Das geplante "Vierte Eisenbahnpaket"', 12 April.

¹³ House of Commons Transport Committee (2013), 'The European Commission's 4th Railway Package', Twelfth Report of Session 2012–13, Volume 1, 23 April.

¹⁴ House of Commons Transport Committee (2013), 'The European Commission's 4th Railway Package', Twelfth Report of Session 2012–13, Volume 1, 23 April.

¹⁵ House of Commons Transport Committee (2013), 'The European Commission's 4th Railway Package', Twelfth Report of Session 2012–13, Volume 1, 23 April.

¹⁶ Letter to the Chairman of the European Commission from the Dutch Parliament regarding the Fourth Railway Package, 26 March 2013.

¹⁷ AK Europa (2013), 'Das Vierte Eisenbahnpaket: Vollendung des einheitlichen europäischen Eisenbahnraums zur Steigerung von Wettbewerbsfähigkeit und Wachstum in der EU', May, available at http://www.akeuropa.eu/_includes/mods/akeu/docs/main_report_de_287.pdf.

¹⁸ Deutsche Bahn AG (2013), 'Workshop zum Eisenbahnrecht: Das geplante "Vierte Eisenbahnpaket"', 12 April.

¹⁹ European Commission (2011), 'European Commission vs Italian Republic', Case C-369/11, July.

²⁰ House of Commons Transport Committee (2013), 'The European Commission's 4th Railway Package', Twelfth Report of Session 2012–13, Volume 1, 23 April.