Liberalisation and competition policy in railways

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Introduction

Historically, DG Competition activity in the rail transport sector has been fairly low key because, until relatively recently, all the national railway markets were operated on the basis of statutory monopolies. Cross-border services, where they existed at all, were possible only on the basis of cooperation between the flag carriers. Competition was non-existent.

However, after a slow start, rail transport liberalisation at European level is now gathering pace. A first liberalisation package entered into force in March 2002 and a second package is on the way. A number of established railway companies (some of them in protected home markets) have ventured onto neighbouring markets. Some new players have also entered the market.

Nevertheless, competition in railways is still at its infancy. Economic, technical and legal barriers continue to make it difficult for new railway companies to start operating international railway services. In addition, vertically integrated national railway companies have considerable market power. Their position has now been challenged by a Commission decision under Article 82 against the Italian national flag carrier, Ferrovie dello Stato. Under the decision, adopted on 27 August 2003, FS is obliged to provide access to the international passenger railway services market in Italy.

After first describing the general policy framework of the EU railway sector, we provide an overview of the main elements of this decision.

Policy framework

The Lisbon agenda

Railways have a key role in contributing to the overall Community objectives of greater competitiveness and sustainable development by providing services at times, frequencies and fares attractive enough to persuade people to switch from road to rail, and thereby help to relieve road traffic congestion and pollution. The problem is that national governments have presided over a sustained and uninterrupted decline in the fortunes of the largely unreformed State railways, which have continued to lose market share to road, in both relative and absolute terms. On various occasions, the Council, Commission and the European Parliament have emphasised the importance of revitalising the European railway sector which remains a key strategic aim in EU transport policy (1). Last year, Commissioner Monti set down the main competition concerns which need to be tackled to make the reforms effective (2). More recently, the Van Miert High Level Group on the trans-European transport network has proposed that the priority status given to a large number of railway projects, including projects on the high speed passenger services network, should be maintained (3).

The railway packages

The chosen method for tackling railway restructuring and reform at EU level is to do it step by step on the basis of legislation proposed by the Commission and tabled in the Council of Ministers and the European Parliament.

The process started with Directive 91/440/EEC (4). The idea behind the Directive was to start to make improvements in the way the railways are operated. First, the railways had to take responsibility for their own day-to-day management and, as part of this, financial accounting changes were introduced as the first tentative steps towards separating train services from track management. Second, the Directive opened the door, for the first time, to third parties interested in starting new, cross-border container freight services. The Directive also introduced the concept of the ‘international grouping’, an association of at least two

train operators based in different Member States to operate cross-border passenger or freight services. Only after having formed such an international grouping and after its partners have obtained a safety certificate from the national regulator, can an international railway passenger service be provided in the EU. At least at this early stage of liberalisation, this gives significant power to the incumbent national railway undertakings. As long as there is no other suitable partner in the other Member State, new entrants have to rely on the cooperation of incumbent national railway undertakings if they are to establish an international grouping.

1st railway package

With regard to freight services, this dependency on the incumbent undertaking was abolished under Directive 2001/12 (1). As part of the 1st railway package of Directives, it renders individual operators free to provide all types of cross-border freight services (i.e. not just container trains). For a transitional period, these new opportunities are limited to the so-called Trans-European Rail Freight Network (‘TERFN’). But from 2008 onwards, access rights will be the same as for container trains and extend across the whole EU rail network. Additionally, the Directive takes separation a stage further by requiring separate balance sheet accounting for train operations and infrastructure management and clearer accounting separation between passenger and freight services. The Directive also says that certain essential functions (2) concerning track charging, train path allocation, operator licensing, monitoring compliance with public service obligations and setting safety standards can only be carried out by people who do not themselves provide rail transport services. Another ingredient of the package, Directive 2001/14 (3), provides a framework for conditions of access, for both freight and passenger services, to the rail network - how train paths are allocated on the tracks, what the track charges should be, who should be responsible for the allocation and charging process, and how the newly created national railway regulators should oversee the process. Critically, the Directive makes clear that if the infrastructure manager also happens to be a train operator, the capacity allocation process on his network has to be carried out by someone else. The same rule applies for track charges (though not to their collection). In addition, the Directive requires governments to make sure that infrastructure managers encourage cross-border services by co-operating in the train path allocation process in a fair and non-discriminatory manner.

Second railway package

The Council has already agreed a Common Position on a 2nd package of reforms and the Commission tabled revised proposals (4) on 30 June. These include market opening for national rail freight markets. In its First Reading, Parliament voted heavily not only in favour of freight market opening, but also to open up both national and international passenger services, too. The Commission has decided not to include those amendments in its revised proposal, because there is already a separate proposal on the table to open up public transport and the Commission has said that further proposals for opening up cross-border railway passenger services will have to await the outcome of an impact assessment, now underway. Parliament will be debating the package again in the autumn.

Controlled competition for public transport

The existing EU framework for land public transport was drawn up over 30 years ago at a time when virtually all services were provided by local, regional or national monopolies operating under a public service obligation in return for which they received subsidy. The pattern in the rail sector was one of State railways with a statutory monopoly. But some countries have already opened up their national passenger markets and the result is that a number of train operators (some in protected home markets) have been able to bid successfully for the exclusive right to operate services, under fixed term contract, on neighbouring markets. This type of market opening – also known as ‘controlled competition’ – has brought about the highest.

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(2) With some derogations for Ireland, Northern Ireland and Greece.
growth in passengers with the ability to control subsidy more efficiently and effectively. The effect of the Commission proposal (1) would be to extend controlled competition right across the EU rail, road and inland waterway passenger markets. But the proposal has got stuck in the Council, largely because of a blocking minority resisting the inclusion of railway services.

Remaining obstacles and red lights

But, difficult and controversial as market opening undoubtedly is, it is not the end of the story. There are serious structural problems, even in some nominally open markets, which prevent the market from working as it should. Newcomers face a range of barriers. These include inadequate separation between track and trains; the absence of a level playing field in the provision of in-use rolling stock for those bidding to provide services in controlled competition; and a lack of transparency in the procedures which train operators have to go through to get suitable slots on the network to enable them to run their trains. On the first point, proper transposition of the 1st railway package ought to provide some relief though, certainly from the competition policy perspective, complete separation of services from infrastructure would be the preferable option. On the second issue, any Member State seriously interested in making the market for controlled competition work effectively ought to be interested in structuring it in such a way that incumbents do not enjoy perpetual competitive advantage. On the third point, we are currently in a dialogue with the organisations which co-ordinate international rail timetables in order to ensure that the process is genuinely open, transparent, objective and non-discriminatory and does not exclude new entrants.

The GVG/FS decision

This case was initiated by a complaint from the private German railway undertaking Georg Verkehrsorganisation GmbH (GVG) arguing that Ferrovie dello Stato S.p.A. (FS), the Italian national railway carrier, had prevented it from providing an international passenger rail service from Germany to Milan. GVG wanted to feed passengers originating in different cities in Germany into Basle. It then proposed a non-stop (“Sprinter”) rail link that would operate twice a day from Basle to Milan via Domodossola. Some of the passengers would continue their journey from Milan. Similarly, the train from Milan to Basle would take local passengers as well as beyond passengers.

This is one of the busiest north-south connections in the EU. In co-operation with the Swiss national operator SBB, FS already provides 10 trains a day. In addition, the FS/SBB joint-venture Cisalpino provides one daily connection between Basle and Milan. GVG’s envisaged Sprinter train would add a service which differs significantly from the existing ones. Unlike the Cisalpino, which calls at several stations between Basle and Milan, GVG’s envisaged Sprinter would be a non-stop service. By operating a connection which is more than one hour faster and by providing additional services on the train, GVG has been aiming to cater in particular for business customers.

In order to provide such a service, GVG needs access to the Swiss and the Italian railway network; it must form an international grouping with an Italian railway undertaking; it needs a safety certificate to operate on the Italian network; and it has to be able to ensure traction, i.e. a locomotive and a driver, on the Swiss and the Italian network.

As a vertically integrated company, FS has a statutory monopoly to operate the Italian railway infrastructure. In addition, as the designated infrastructure manager and allocation body, FS has assumed regulatory functions of the State. It is responsible for establishing and maintaining the Italian railway infrastructure and for assigning train paths to railway operators in Italy in return for a fee. FS is also responsible, as infrastructure manager, for issuing safety certificates to railway undertakings.

Since 1995, GVG has been asking FS to enter into an international grouping, to provide information about the price and availability of train paths, and to provide traction. For several years FS did not provide train path information on the grounds that EC legislation had not been transposed in Italy, that GVG had not established an international grouping and that it did not have a safety certificate. At the same time, it refused to enter into an international grouping with GVG and to provide traction. As regards the late transposition of EU legislation, the Commission concluded that Article

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10 (1) of directive 91/440, which establishes an international grouping, has direct effect. (1) Railway undertakings like GVG could therefore rely directly on the provision of Article 10 for instance to request from FS information as regards the price and the availability of train paths.

The relevant market

In the decision, the Commission establishes that there exist two upstream markets, i.e. the market for access to infrastructure and the traction market. With regard to the downstream market, it found that for a number of reasons the international rail passenger transport market is distinct from the market for transport by coach, car or aircraft. Access to the downstream market is limited to international groupings which establish the necessary access and transit rights (this includes Switzerland).

Dominance

FS is found to be dominant on the market for access to its national rail network, the latter being considered an essential facility. As regards traction, the Commission concluded on the basis of a detailed market investigation that FS is dominant on that market, too. For the time being, no other Italian railway company is equipped to provide the required traction service to GVG. In addition, it was concluded that GVG cannot provide traction by itself on the Italian market. As European railways have developed along national boundaries, each national railway has adopted its own technical and administrative standards. National systems differ in their operating procedures, safety systems, driver training and route knowledge. Therefore, unless they are equipped with multiple technology, locomotives have to be changed at borders. Similar barriers also exist for drivers, who need route knowledge, a national licence and language skills. To provide traction for international services by itself, a railway undertaking would have to set up separate locomotive and driver pools in every Member State where it wishes to operate. This, however, is prohibitively expensive and could not be justified on the basis of the existing relatively limited freedom to provide services at this stage in the liberalisation process (cabotage not being possible in Italy). It is therefore concluded that GVG depends on FS to provide such traction services.

Finally, as regards the downstream market, FS was found to be dominant, as it is the only company which provides railway passenger services on the Italian segment of the Basle – Milan route. As pointed out above, it provides a number of daily passenger train services between Basle and Milan in co-operation with SBB.

Abuse

Given that the national rail network is considered to be an essential facility and, in addition, that FS fulfils the regulatory function of an infrastructure manager, it was found that FS was obliged to provide the requested information as regards the access to the infrastructure to GVG. By effectively refusing to deal with GVG’s requests for access to the railway network, FS abused its dominant position in the infrastructure market with foreclosure effects in the downstream market.

As FS had not responded to GVG’s requests for traction, it also had effectively refused to provide traction services to GVG for this particular service. It is found that FS’ refusal was not justified by any objective reasoning, such as for instance the lack of any spare capacity in traction services, or a refusal by GVG to pay an adequate remuneration for the provision of such services, etc. As GVG depends on FS providing such services, FS’s refusal preserved its monopoly position on the separate downstream market for passenger transport. It eliminated potential competition on that market.

Finally, with regard to the downstream market, it was found that for the time being it is indispensable for GVG to enter into an international grouping with FS, as there is no other Italian railway company which fulfils the legal requirements for the purpose of operating passenger services on this particular route. FS did not provide any objective justification for its refusal to enter into negotiations with GVG to form an international grouping. By doing so, it prevented GVG from entering the downstream market which constitutes an abuse of dominant position.

Remedies

With a view to settling the case, FS has given important undertakings. In particular, FS has undertaken to enter into international grouping agreements with any duly licensed train operator

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(1) In line with the relevant case law of the Court of Justice, it is considered that this provision is sufficiently clear and precise, and unconditional, not leaving any margin of discretion in the implementation. See C 287/98 Linster, 19.9.2000, C-8/81 Becker of 19.1.1982, ECR p. 53 as well as case 28/67 Molkerei-Zentrale of 3.4.1968, ECR, p. 211.
with concrete proposals to start an international rail service. Furthermore, FS has undertaken that, for a period of five years, it will provide traction to other railway companies intending to provide cross-border passenger services. On this basis, FS has entered into agreements with GVG. It has also undertaken to provide GVG suitable train paths as soon as corresponding train paths are made available by SBB on the Swiss network.

Given the novelty of this case and the important commitments made by FS, the Commission decided not to impose a fine.

**Modernisation**

Modernisation will give the NCAs competence to enforce Community anti-trust law fully in the rail transport sector. With that and all the above developments in mind, DG Competition has taken the initiative of setting up a network of rail experts from the NCAs and DG Competition. The group will have its first meeting in October. Its job will be to identify current topics of common interest in the context of ongoing railway liberalisation, to discuss key issues arising out of individual cases and, in co-operation with DG Transport and Energy, to develop best practice between and among the NCAs and new national rail regulators set up under the 1st package. The overall aim is to get a common approach to the application of anti-trust law in the railway sector, so as to avoid conflicting decisions.

**Conclusion**

The EU is continuing to invest considerable resources, both financial and legislative, into the European railway market. European industry and consumers are entitled to expect a reasonable rate of return in the form of effective competition. That will only come about if passengers and freight customers are given freedom of choice in a genuinely European internal market.

In that respect, the GVG/FS decision is a landmark for competition in European rail transport and a good example of how competition cases can contribute to the railway liberalisation process. It deals not only with GVG’s immediate concerns vis-à-vis FS but also has implications for third parties generally and the way in which incumbents react to reasonable requests from them. It means that, for as long as the international grouping requirement remains on the statute book, the refusal of a dominant train operator to enter into such a grouping amounts to an abuse of the competition rules if the national flag carrier is the only possible partner with whom the grouping can be formed. Likewise, a refusal to provide traction services, in circumstances where there is no realistic alternative supplier, will also be deemed abusive. And there can be no excuse for refusing to discuss terms for access to the tracks.

The fact that FS continued to refuse track access to GVG demonstrates that the infrastructure manager within a vertically integrated structure, even if part of a holding structure as in the case of FS, faces a conflict of interest. Otherwise it is difficult to explain why the network operator FS (RFI) did not play a more pro-active role in marketing its own network capacity to GVG with a view to maximise revenue from infrastructure charges. This case therefore supports the view that the railway network must be completely separated from the transport service provider if the market is to operate in the public interest.