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STRUCTURAL REFORM IN THE RAIL INDUSTRY

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GERMANY

1 Overview of the Rail Sector

1.1 Objectives of the 1994 rail reform

In the last 10 years the German rail sector has undergone fundamental changes. This development was initiated by the rail reform in 1994 which brought about radical structural changes.

The objectives of the 1994 rail reform can be summarized as follows:

- Transformation of Deutsche Bundesbahn (DB) and Deutsche Reichsbahn (the state-owned rail company of the former GDR) into a profit-oriented enterprise in the legal form of a joint-stock company.
- Reduction of the financial burden incurred by the German taxpayer in connection with the railway system
- Prevention of further market share losses of the rail traffic sector vis-a-vis other means of transport in the transportation of passengers and goods and
- Compliance with European Law requirements on non-discriminatory access to the railway network for other railway companies.

1.2 Structure of the Deutsche Bahn Group

Other than Deutsche Bundesbahn and Deutsche Reichsbahn, which were managed under direct federal administration, Deutsche Bahn has been organised as an affiliated group under civil law (Deutsche Bahn AG) since the 1994 rail sector liberalisation. However, the state still owns all shares of Deutsche Bahn AG.

The company heading the Deutsche Bahn group is Deutsche Bahn AG. The different areas of transport services offered by Deutsche Bahn AG are organised in independent subsidiaries. These include long-distance passenger rail transport (DB Fernverkehr AG), local public passenger transport (DB Regio AG) and rail freight transport (Railion Deutschland AG, former DB Cargo AG). Deutsche Bahn is still dominant in all three areas. In addition, Deutsche Bahn AG operates the rail network via its subsidiary DB Netz AG. The two subsidiaries DB Station & Service and DB Projektbau GmbH complement the work of DB Netz AG. DB Station & Service operates, maintains and develops train stations and provides services for travellers and railway companies. DB Projektbau GmbH comprises all capacities for the design, project management and monitoring of infrastructure projects of the Deutsche Bahn AG. Finally, the services sector, part of Deutsche Bahn's core business, comprises the following six business sectors: DB Energie, DB Fuhrpark, DB Services, DB Systems, DB Telematik and vehicle maintenance.

1.3 Regulatory authorities in the rail sector

The Federal Railway Office (Eisenbahn-Bundesamt, EBA) was also established in the course of the rail reform. It is a higher federal authority responsible to the Federal Ministry of Transport, Building and Housing (Bundesministerium für Verkehr, Bau- und Wohnungswesen). The EBA has supervisory functions, in particular in the field of legal procedures for rail track construction, monitoring of compliance with technical safety standards and granting of operating licenses for railway companies. In addition, the EBA helps to ensure non-discriminatory access to the railway network.

These sector-specific powers of the EBA do not affect the general competence of competition authorities to apply competition law (as laid down in the Act Against Restraints of Competition, ARC) in the rail sector. There is no regulation which requires the EBA as a sector-specific regulatory authority to reach consensus with the Bundeskartellamt, as is the case in the telecommunications and postal sector. However, the two authorities must inform each other on any proposed decisions.

1.4 Amendments to railway legislation

In the context of the implementation of the EU directives on infrastructure, the third amendment to the legislation covering the regulation of the German rail sector is under way. Most affected are the General Railway Law, (Allgemeines Eisenbahngesetz, AEG) and the Regulation on railway infrastructure use (Eisenbahninfrastruktur-Benutzungsverordnung, EIBV). The amendment aims to further advance the opening up of the rail sector to competition and, in order to do so, enforce the principle of non-discriminatory access to infrastructure more effectively. For this purpose, the definition of railway infrastructure and thus the right to non-discriminatory access thereto will be extended to facilities at the “last mile” stage of rail transport services, such as loading and unloading facilities. Furthermore, a new provision will be introduced which commits railway companies to provide non-discriminatory information services, including information on train connections offered by other providers, in their timetable information systems.

As regards institutional changes, a railtrack agency (*Trassenagentur*) will be established at the EBA which will monitor non-discriminatory train-path allocation and access conditions, thus complementing the powers of the EBA and the competition authorities. The main task of the railtrack agency will be to monitor the preparation of an annual working timetable defining all planned train and rolling-stock movements by DB Netz AG and to solve train-path allocation conflicts arising in this context. As the legislative process has not been completed, it cannot be assessed yet whether and in which way the powers of the railtrack agency will affect the competencies of the EBA and the competition authorities.

2. Role for competition and role for regulation

Since the rail reform and the liberalisation of the rail sector, railway services have had to be subjected to the principle of competition. There are two forms of competition in this context: intermodal competition with other means of public transport and intramodal competition between individual railway companies.

2.1 Intermodal competition

As regards intermodal competition with other means of public transport, one has to consider that various forms of state aid are granted to the transport sector as a whole. Such aid can be provided through tax advantages and/or disadvantages granted for individual means of transport by having different tax rates apply to certain types of energy and fuel. For example, rail transport is burdened with a mineral oil tax, while air traffic and inland waterway transport are exempted from this tax. Due to the infrastructural responsibilities laid down in the Constitution, the federal government is responsible for the construction and maintenance of the federal traffic routes, including the rail tracks of the federal railway companies, the

federal highways and the federal waterways. On this basis, the federal government invested approx. 41 billion euro in rail infrastructure between 1994 and 2004.

2.2 Intramodal competition

As regards intramodal competition, one has to differentiate between the individual railway service sectors. Long-distance passenger rail transport and freight rail transport are subject to competition within the market. DB Netz AG provides several railway companies with the necessary infrastructure for their respective services.

Especially in the area of freight rail transport competition has heightened. One of the reasons for this development is the fact that industrial companies have taken up business in this sector, usually as joint ventures. As many of them use their own railways (*Werksbahnen*) they have the necessary know-how in terms of railway operation. For example, BASF AG, together with the Swiss carrier Bertschi AG, the German logistics company Hoyer GmbH and VTG Lehnkering AG, which belongs to the Preussag group, founded a railway company specialised in the transport of chemical goods, the rail4chem Eisenbahngesellschaft mbH. In addition, some foreign companies have also become active in freight rail transport. The activities of the new companies are currently still confined to individual transport projects on specific routes. Apart from Deutsche Bahn and its daughter Railion currently 120 railway companies offer freight rail transport services. In 2003 their market share amounted to 6.8 per cent. The heightened competition in the freight rail transport sector has induced Deutsche Bahn to adapt its market behaviour. It has expanded its activities in carrier and logistics services and is making increased efforts to improve cross-border freight rail transport. In the field of long-distance passenger rail transport, there is currently only one competitor, the Connex group which belongs to the Vivendi group. It offers regular train connections on the routes Gera-Leipzig-Berlin-Rostock and Zittau-Görlitz-Berlin-Stralsund.

As regards local public passenger transport, new competition is arising due to the fact that some *Länder*, in order to meet their responsibility to provide and finance services in the local public passenger transport, have started to issue public invitations to tender for transport contracts for specific routes and parts of the rail network (competition for the market). In the past, most of the transport service contracts were awarded to DB Regio AG without public invitations to tender. DB Regio AG still holds a market share of approx. 90 per cent in the local public passenger transport sector. The remaining market shares are distributed between approx. 60 transport companies.

2.3 Regulated sectors

Companies wishing to take up business in the rail transport sector need a general operating licence which is issued by the EBA. Prior official authorisation for transportation conditions in the passenger rail transport sector and for transportation conditions and fees in the local passenger transport sector is required. The EBA also issues technical quality and security requirements and monitors compliance therewith.

3. Vertical structural issues

There is only one significant infrastructure provider in the German rail sector. Apart from Deutsche Bahn's railway network which covers about 36,000 track kilometres, only few regional or local railway networks exist in ports or industrial estates. Deutsche Bahn is thus the largest network provider and at the same time the leading provider in all railway services sectors. Within the framework of the amendment of the AEG, the abandonment of a complete separation between the network and operation sectors is, however, to be compensated for by establishing DB Netz AG's independence from intragroup instructions regarding the establishment of train-path pricing and allocation of train paths, a strict separation, in accounting terms,

between track network and operation, and increased transparency requirements for the service relationships between DB Netz AG and other DB group companies. This is the context in which the planned establishment of an independent railtrack agency (Trassenagentur) has to be

3.1 *The principle of non-discriminatory access*

In accordance with the objectives of the rail reform the railway companies must be granted non-discriminatory access to Deutsche Bahn's railway network in all transport sectors, cf. Art. 14(1) of the AEG. Access is provided by DB Netz AG which allocates rights of use for individual route sections to the railway companies, i.e. the companies within the Deutsche Bahn group on the one hand and private railway companies on the other. For this purpose temporary exclusive operator contracts are concluded for specific infrastructure segments which do not involve an actual transfer of the infrastructure (which would correspond to vertically integrated franchise operations) but merely its use. This also means that maintenance and servicing of these infrastructure segments continue to be the responsibility of DB Netz AG as the infrastructure provider; the railway company which was granted access is under no obligation to provide these services. The rights granted to the railway companies for the use of a certain part of the infrastructure at a certain time are called "train paths" (*Trassen*). The allocation of train paths and train-path pricing are under the exclusive competence of DB Netz AG (in accordance with future legal provisions), these are not transactions subject to agreement by the group executive board.

3.2 *Deutsche Bahn's train-path pricing system*

The railway companies have to pay a train-path fee which is based on the most up-to-date version of Deutsche Bahn's train-path pricing system. In 1999 and 2000 the Bundeskartellamt examined the train-path pricing system in place since 1998 (TPS 98) and found that the costs incurred by a DB subsidiary, DB Regio AG, were up to 40 per cent lower than those of its competitors. This was primarily due to a two-stage degressive tariff structure which included a basic price calculated per track kilometre and a price calculated per train kilometre covered. The price per train kilometre decreased with increasing train frequency. However, only Deutsche Bahn's subsidiaries were able to benefit substantially from these degressive effects. By introducing TPS 98 Deutsche Bahn, the dominant provider of rail infrastructure, thus violated the ban on abusive practices. Private railway companies in the market for local passenger transport were unfairly hindered. In 2001 Deutsche Bahn introduced a new train-path pricing system (TPS 01). TPS 01 was characterised by a linear tariff which provided a different train-path price for different categories of routes (route quality) and types of transport. However, the essential feature was that, on the basis of this linear tariff, each transport company operating in a specific route section at a specific time by using a specific type of transport paid the same price per train kilometre covered. In 2003 Deutsche Bahn included a regional factor in this train-path pricing system. Deutsche Bahn thus addressed the problem of a lack of cost recovery in route sections which are not used to full capacity, trying, in accordance with transport policy provisions, to avoid shutting down these routes. Recently another new train-path pricing system (TPS 05) has been introduced which provides for a 10 per cent surcharge on the price in cases where so-called "special train paths" (*Sondertrassen*) are notified. The EBA prohibited this surcharge stating that it was not consistent with the principles for calculating train-path prices laid down in the currently applicable EIBV regulation on railway infrastructure use. However, the decision is not yet final as DB Netz AG has appealed against it.

3.3 *Powers of intervention of the EBA*

As mentioned above, the EBA has also competencies to ensure non-discriminatory access to the railway network. Access to the network is generally negotiated between the railway company and the network operator (see also Section 14 (4) of the AEG). Where an agreement is not reached between the railway company and the rail infrastructure operator, the EBA decides either upon request of a company

concerned or ex officio whether a discriminatory conduct of Deutsche Bahn AG can be affirmed, which is to be prohibited under Section 14 (5) AEG. Such an intervention by the EBA can substitute for an agreement between the parties.

In the past, the EBA has repeatedly exercised its powers in the area of non-discriminatory access to the railway network. Such interventions concerned on the one hand train-path allocation conflicts between DB subsidiaries and competing providers of rail transport services. However, the proceedings also concerned individual technical details of network access, such as the extent to which DB Netz AG had to provide specific services (e.g. manning periods of signal boxes) or the extent to which technical requirements had to be fulfilled by railway companies seeking access.

4 Competition Law Enforcement

4.1 Merger control

Increased merger activities could merely be perceived in the local public transport sector, not in the main rail transport sectors. However, when these cases were examined, local rail public transport was also taken into consideration. Due to the specific regulatory and competitive conditions in this market segment, some proposed mergers had to be abandoned (for the time being) and some were only cleared under obligations directed at opening up the market.

4.2 Abuse control

After the impediments to non-discriminatory competition created by the TPS 98 had been removed, the complaints of private railway companies about potentially abusive practices of Deutsche Bahn and its subsidiaries shifted to other areas. However, so far there has been no need to initiate formal abuse proceedings or to issue prohibition decisions. This was also due to the fact that, in the course of the investigation of facts by the Bundeskartellamt, in individual cases an amicable agreement could be reached between the parties involved. This applies inter alia to complaints relating to the problem of non-discriminatory access to the “last mile” in the rail freight transport sector, i.e. in particular access to loading, unloading and shunting facilities (rail freight villages, railway sidings) which were operated by Railion (at that time: DB Cargo AG) on the basis of exclusive agreements. Since non-discriminatory access to these infrastructure facilities is a basic prerequisite for non-discriminatory access to the network, the Bundeskartellamt saw a potentially increasing need for investigations in this area. The amendment to the AEG stipulates that the term “railway infrastructure” includes the facilities of the so-called “last mile” thus extending the right to non-discriminatory access to these facilities.

In February 2003 the Bundeskartellamt initiated investigation proceedings on account of the refusal of Deutsche Bahn AG to include information on timetables and fares for two long-distance routes operated by the Connex group in DB information and timetable systems. In parallel, the Connex group took legal action before the civil courts and obtained a preliminary injunction obliging Deutsche Bahn to include the timetable data of Connex connections in their timetable information systems. The proceedings are pending because Deutsche Bahn AG has submitted an appeal against this decision. However, the draft amendment to the AEG will also contain a corresponding provision under which railway companies will be obliged to provide non-discriminatory information services, including information on train connections offered by other providers, in their timetable information services.

