



OFFICE *of the*
RAIL REGULATOR

**CHARGING, COMPETITION AND
RAIL FREIGHT DEVELOPMENT ISSUES
RAISED BY THE PROPOSED
EWS TRACK ACCESS AGREEMENT

PROVISIONAL CONCLUSIONS**

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Introduction and summary

1. The Regulator received a proposed track access contract between Railtrack PLC and English Welsh and Scottish Railway Ltd (EWS) for approval under section 18 of the Railways Act in March 1997. He sought comments from current licensed operators and others on the operational impact of the agreement¹ and from the freight industry as a whole on the implications of the proposed contract, and the charging structure in it, for the promotion of rail freight and development of competition². The purpose of this document is to set out the provisional conclusions which the Regulator has reached, following consultation with the freight industry and the parties to the agreement, on the charging, competition and rail freight development issues raised by the proposed agreement. The Regulator has also issued a separate paper³ setting out his conclusions in respect of the operating issues the proposed agreement gives rise to and the modifications to the agreement he proposes to address those issues.
2. The consultation document was initially sent to 117 recipients including EWS' customers, licensed freight operators, terminal operators and industry associations. A press notice was circulated more widely and a number of other organisations requested the document. In total approximately 250 copies of the document were sent out. We received responses from 37 organisations. A list of the consultees whose responses are not confidential is given in Annex A. All non-confidential responses were placed in the ORR Library when the consultation period closed in the middle of May.
3. The consultation document sought views from consultees on four main areas:
 - (a) the extent to which the proposed agreement is likely to promote rail freight;
 - (b) the potential concerns the proposed agreement raises through possible undue discrimination by Railtrack;

¹ *Proposed track access contract between Railtrack PLC and English Welsh and Scottish Railways Ltd – A consultation document, April 1997*

² *Charging, competition and rail freight development issues raised by the proposed EWS track access agreement – A consultation document, April 1997*

³ *The Regulator's conclusions on the proposed track access agreement between Railtrack and English Welsh and Scottish Railways Ltd, July 1997*

- (c) the potential concerns the proposed agreement raises through the possible increased scope for EWS to exclude competition from other freight operators; and
 - (d) the potential concerns the proposed agreement raises through the possible exploitation of dependent customers.
4. This document considers the responses from consultees in each of these main areas. To the extent that consultees have expressed concern that approval of the proposed agreement in the current regulatory environment would raise public interest concerns, it also sets out the Regulator's provisional conclusions on appropriate remedies.
5. The Regulator considers that the proposed agreement with its simplified charging structure is likely to have a positive effect on the use of the rail network for the carriage of goods. However there are two areas where the Regulator considers that approval of the proposed agreement could have a possible detrimental effect, namely:
- (a) through reducing competition with EWS either as a result of undue discrimination on the part of Railtrack or as a result of exclusionary behaviour by EWS; and
 - (b) possible exploitation of dependent rail freight customers.
6. The Regulator has considered whether there are modifications he can propose to amend the access agreement which would ameliorate these detriments. He was concerned however that any modifications which he could propose would impact on the simplicity of the charging structure and would therefore be likely to reduce or remove the positive effect which the proposed agreement is intended to have on the development of rail freight. He has therefore reached the provisional conclusion that it would be more appropriate to seek remedies outside the scope of the access agreement, in particular:
- (a) he will be discussing with Railtrack the supply of additional information on the quotes it makes to other freight operators to monitor compliance with its licence condition not to discriminate unduly;
 - (b) he will be drafting and consulting the rail industry as a whole on guidelines for interpreting the undue discrimination provision later in the year;

- (c) he considers that the existing Condition 10 in EWS' licence, which allows him to investigate exclusionary behaviour, is likely to be sufficient to protect other freight operators and will not therefore be proposing amendments to it; and
 - (d) he will be discussing with EWS the maintenance and provision of additional information to enable him to monitor movements in prices to final customers more closely and to ensure that appropriate information is available as a basis for investigating allegations of excessive pricing to dependent rail freight customers.
7. The Regulator has, however, decided to require modifications to the proposed agreement in respect of a range of operating issues. These modifications are designed to provide protection of the rights of other freight and passenger users of the rail network. These modifications, and a full statement of reasons for them, are described in the associated paper referred to in paragraph 1.

Promoting Rail Freight

Issue

8. Railtrack and EWS consider that their existing contractual arrangements, which require them to enter into negotiations for each piece of new business that EWS wants to compete for, are slow and complex. The proposed agreement introduces a simplified charging structure enabling EWS to respond more quickly to customers' requests for prices. The agreement requires Railtrack to make available annually a specific amount of money which will be invested in the network on capital projects designed to develop freight on rail. The parties also propose to form a Joint Steering Group made up of senior representatives of Railtrack and EWS which will meet periodically to discuss how they may promote rail freight within the context of their track access agreement.

Consultation responses

9. The Regulator sought the views of consultees on whether they considered that these arrangements would promote the use and development of the rail network for freight. The majority of respondents explicitly welcomed the agreement as a means of encouraging the development of freight on rail by EWS. Some respondents agreed that the Joint Steering Group would be helpful in promoting rail freight but also wanted to participate in the Group themselves.

10. More generally respondents were concerned that the advantages which would accrue to EWS as part of this agreement, for example, through being able to quote more quickly to final customers, should also be available to other freight operators. These points are considered in more detail in paragraphs 15 to 22.

Provisional conclusion

11. The Regulator considers that the simplified charging structure will enable EWS to respond more quickly to new business opportunities and as a result it may be in a position to increase the proportion and amount of freight hauled by rail. It would therefore support the public interest objective of promoting use of the rail network for the carriage of goods.
12. The Regulator considers that a close working relationship between EWS and Railtrack will be critical if an increased proportion of freight is to be carried by rail and to this extent he does not consider that the proposed Joint Steering Group will necessarily operate against the public interest. He will however expect Railtrack to hold similar discussions with other freight operators or potential operators at their request (including those who hold access rights but contract out the operation of the train). To the extent that particular issues affect a number of operators he will expect Railtrack to hold either a series of bilateral discussions or multilateral discussions where appropriate.
13. In some cases customers of EWS wanted to take part in the Joint Steering Group. The Regulator considers that the parties may wish to share commercially confidential information at these meetings. Therefore in the first instance EWS (or where relevant other freight operators) should be the main point of contact for the customer. However he would expect EWS to arrange three way meetings with Railtrack to discuss relevant issues which emerge; for example, a particular network enhancement which will serve an individual customer.
14. The Regulator welcomes the inclusion in the proposed agreement of a minimum amount of money which will, at the request of EWS, be invested in the network on capital projects designed to develop freight on rail. The Regulator expects that, consistent with Railtrack's licence condition not to discriminate unduly, approaches made by other freight operators for investment in the network will be treated in the same way as investments made on behalf of EWS, ie on the basis set out in the Track Access Conditions.

Possible undue discrimination by Railtrack

Issue

15. The Regulator was concerned that the proposed agreement should not lead Railtrack to act in a way which is less favourable to existing freight operators and potential operators, with the effect of reducing competition in the future for EWS. If Railtrack did operate in this way it is likely that it would be in breach of Condition 6 of its licence not to discriminate unduly between particular persons or between any classes or description of persons.
16. In the consultation document the Regulator suggested that he could monitor Railtrack's behaviour, using the existing information provisions contained within Railtrack's licence, by seeking details of:
 - (a) potential access beneficiaries who have approached Railtrack for access to the network for the carriage of goods;
 - (b) the access rights which were being sought; and
 - (c) the quote that was given including the charges and other commercial terms and conditions including for example the performance regime.

Consultation response

17. Railtrack has said in its ten point plan for freight that its target is for a minimum of 10% of the rail freight market to be served by new entrants within five years. In response to questions from the Regulator it has said that:

"Each request for track access rights/charges will be dealt with on its individual merit. Where another customer seeks to negotiate a new access agreement based upon a high fixed level charge and low incremental rate, Railtrack will consider such a proposition taking full account of the division of commercial risk."
18. Respondents to the consultation who expressed a view generally considered that Railtrack should offer the same terms to other customers, although what this meant in practice seemed to differ between respondents. For example, one consultee said that this meant track access charges for other freight operators for new flows should be based on the variable element of EWS' access charge but that new entrants hauling existing traffic should be charged "the variable element of the EWS access charge, plus a proportional attribution of part of the fixed element of the EWS access charge."

Another respondent suggested that Railtrack should produce a simple "all flows" tariff for new entrant operators as an alternative to a negotiation with the delay that implies. Generally respondents considered that Railtrack's existing licence condition provided sufficient sanction if Railtrack failed to offer the same terms, although there some was concern about how it would be enforced. Support was also expressed for the production of guidelines by the Regulator.

Provisional conclusion

19. The Regulator considers that Condition 6 of Railtrack's licence prohibits it from unduly discriminating in a way which would restrict effective competition to EWS from developing. However additional processes will need to be put in place to provide other freight operators or potential operators with the reassurance they require that the Regulator can effectively monitor compliance with this condition. The Regulator will therefore be discussing with Railtrack the production of information along the lines set out in paragraph 16 and the frequency with which this information should be provided.
20. He has considered whether it would be appropriate to require Railtrack to publish an indicative tariff or range for each commodity group which would provide other freight operators a reasonable basis on which to compete with EWS. However he thinks that not only would this be complicated to administer, it is unlikely to be effective since EWS may be left with an incentive to undercut the competing operator down to its own low variable charge.
21. The Regulator considers that when Railtrack is quoting to other freight operators for traffic which can reasonably be considered to be new to the rail network (for example, it was previously hauled by road), then Railtrack should normally be prepared to negotiate down to at least the same marginal rate that EWS pays. There may be rational and defensible circumstances when this is not appropriate, for example, where the avoidable costs associated with a flow operating over a particular line are high. The Regulator would expect Railtrack to make this case to him at the same time that it supplies details of quotes it has made to other operators. Railtrack should also quote to other freight operators in a timely and efficient manner and process any section 18 applications or section 22 amendments with appropriate speed to ensure that EWS is not given any undue advantage as a result of the call-off nature of its proposed agreement.

22. The Regulator intends to produce general guidance on interpreting the undue discrimination provision later in the year, identifying particular circumstances in which it would be appropriate for Railtrack to seek to negotiate a contribution to cover costs above flow specific avoidable costs. The aim would be to clarify interpretation of what would (or would not) constitute "similar terms" to those agreed with EWS. More generally the Regulator will also want to ensure that not only is there no undue discrimination between freight operators but also that there is none between freight operators and passenger operators. It is therefore his intention to consult the rail industry as a whole on this guidance which will potentially affect a wider range of rail operators and users than the freight operators and customers affected by the proposed EWS access agreement. He will also be discussing with Railtrack the basis on which freight specific costs are measured to ensure that if Railtrack fails to recover the costs imposed by EWS through this agreement it is not able to recover them through higher charges to either other freight or passenger operators.

Possible exclusionary behaviour by EWS

Issue

23. The low tonnage charge in the agreement may enable EWS to quote prices for new and existing traffic which potentially exclude competition from other rail freight operators. There is already a provision in EWS' licence which allows the Regulator to investigate exclusionary behaviour. The Regulator can also use competition law provisions, including the Competition Act 1980, to investigate and take action (including reference to the MMC or accepting undertakings in lieu of such a reference) against anti-competitive practices.

Consultation response

24. A number of respondents considered that the low variable charge would enable EWS to act in a way which potentially excluded competition. However only a few felt that it was necessary to extend the scope of its existing licence on exclusionary behaviour along the lines set out in the consultation document. This view was more generally held by suppliers and competitors of EWS than its customers.
25. EWS has been asked by the Regulator to describe how it will set prices to customers in a way which does not represent exclusionary behaviour. EWS considers that it faces competition from road transport (and other transport services), other rail freight

operators and potential new entrants setting up as rail freight operators. As a result it considers itself to be a "price taker" not a "price maker" or "price setter".

Provisional conclusion

26. The Regulator considers that the existing protections in the form of Condition 10, which enables the Regulator to investigate any act or omission which may exclude or limit competition in the supply of railway services, and powers under competition law are likely to be sufficient to protect potential and existing freight operators from exclusionary behaviour by EWS. The licence condition as it is currently drafted is not a prohibition on exclusionary behaviour by EWS. A licence breach is therefore only deemed to have taken place when a Determination Notice issued following an investigation has been contravened. The Regulator can then take enforcement action. The Railways Act (section 57) does enable any person who has sustained loss or damage as a result of a breach of an enforcement order to seek redress through the courts.
27. The Regulator will be keeping the rail freight market under review and if at some later stage he considers that the licence condition as it currently stands is not offering the protection that other operators and suppliers require in order to compete effectively in the rail freight market he may consider seeking further modifications to the licence. The Regulator also notes that it is the Government's intention to adopt a prohibitive approach to deter anti-competitive practices or abuse of market power along the lines of Articles 85 and 86 of the Treaty of Rome. The adoption of such an approach is likely to have a similar effect to certain of the modifications set out in the Consultation Document.

Protection for dependent rail freight customers

Issue

28. Protections for dependent rail freight customers which were previously available indirectly through the Regulator's scrutiny of individual access agreements will be limited if the proposed access agreement is approved. Access charges will no longer be negotiated separately for individual flows and submitted to the Regulator for scrutiny. The opportunity to check whether they exceed a standalone cost ceiling or some other test of excessive price will be lost. Without the Regulator's scrutiny of individual access agreements, EWS may therefore have increased opportunities to charge an excessive price to its dependent customers.

Consultation response

29. One respondent to the consultation document suggested that there was no "truly dependent rail traffic" and another suggested that in the long term it would not pay to exploit dependent customers and there was therefore no need for any additional protections. Generally, others who expressed an opinion were concerned about the lack of protection for dependent customers. A number of respondents set out why they considered themselves to be dependent, for example, planning restrictions, environmental constraints and contractual obligations to supply their customers by rail. Some respondents thought that dependent customers would end up cross subsidising the new business which EWS was hoping to attract.
30. Respondents generally supported the inclusion of a non discrimination provision in EWS' licence along the lines of that in Railtrack's network licence. There was also agreement that guidelines would need to be issued and that more information was required on charges. Some respondents also included other suggestions:
- (a) approval of the agreement for two years only, at which point the Regulator would carry out an investigation of charging to dependent customers and ascertain whether they were out of line with charges in competitive market sectors;
 - (b) an independent arbitrator providing a right of appeal; and
 - (c) a Code of Conduct entered into by EWS.
31. EWS has said in correspondence with the Regulator that:
- "The main current customers of EWS are powerful, well informed companies. Each has at least one feasible alternative to using EWS. Almost without exception, none of EWS' major full trainload customers is in any sense a captive customer. This is not only because each of them is large and well established, but mainly because the services they buy from EWS are, in the nature of things, readily replicable."

Provisional conclusion

32. The Regulator considers that there are customers who, as a result of factors such as environmental constraints, planning restrictions and their existing infrastructure for handling raw materials or goods, are in the short to medium term at least dependent on access to rail freight services. He also considers that these rail dependent

customers are in the short to medium term dependent on EWS to supply these services because of the comparatively limited scale of operation of the other existing freight operators in terms of locomotive fleets, wagons, and route and traction knowledge of drivers or alternatively, the time it would take to set up as an open access operator. The Regulator wants to ensure that EWS is not able to charge excessive prices to these dependent customers in the short to medium term.

33. EWS' licence contains an information provision which requires EWS to supply the Regulator annually with the average prices it charges to final customers. The condition does not enable any action to be taken directly if he considers the charges are excessive. However the Regulator considers that competition law provisions, including the Competition Act 1980, would need to be explored in relation to actual problems before it was possible to conclude that a licence modification was the only way of protecting the public interest. Even when the action of EWS had no effect on competition within the rail freight sector, the Competition Act would allow the Regulator (with the agreement of Director General of Fair Trading) to investigate whether excessive prices were distorting competition in the final markets. Avoiding such distortion remains a regulatory objective for rail freight. The Regulator will keep the freight industry under review and if EWS' future behaviour led him to consider that the regulatory environment is not adequately protecting any dependent customers he may consider seeking further modifications to EWS' train operators licence, to the extent that implementation of Article 86 is not sufficient.
34. The Regulator is keen to ensure that the benefits of the proposed agreement arising from a simplified charging structure are not lost by placing an excessive regulatory burden on EWS. However the Regulator also wants to ensure that EWS is not charging excessive prices to its dependent customers. On a case by case basis, he will therefore want to be able to compare the prices which EWS is quoting to the prices it currently charges its customers in general and to other dependent customers. Where the charges quoted are different from the range which EWS currently charges, the Regulator will want to understand whether there are any rational or defensible reasons which underpin these differences. In order to carry out this type of analysis, the type of information which the Regulator is likely to require will include details of the quotations (including charges, service specification, commodity, forecast gross tonne miles etc) that it makes to actual or potential customers; and an explanation in those cases where the quote is significantly different from charges for the customer in question and for other customers competing in the same final markets.

35. On the basis of the information the Regulator receives on average prices to final customers under EWS' licence, he also proposes on an annual basis to analyse changes in the rates charged for different market segments. If he finds that market segments which face competition from other types of haulage are not benefiting from falling rates while those market segments with less or no competition from other modes are facing on average the same or increased rates, he will want to understand the reasons for this.
36. The Regulator will be discussing with EWS in more detail the exact type of additional information that he expects EWS to keep and the period of time which he expects EWS to keep this information available for. He expects that EWS will then be able to make this information available to him on request, for example, to enable complaints of excessive pricing to be investigated.
37. The Regulator also intends to discuss with EWS how information on prices to final customers can be put into the public domain in a summarised form (which would also ensure confidentiality was maintained for relevant parties) to give confidence to dependent customers that they are not being exploited.

Next Steps

38. This document sets out the provisional conclusions on the charging, competition and rail freight development issues raised by the proposed track access agreement between Railtrack and EWS. Before reaching final conclusions, the Regulator would welcome further comments by 8 August.
39. Comments should be sent to:
Joanna Whittington
Office of the Rail Regulator
1 Waterhouse Square
138-142 Holborn
London
EC1N 2ST
Fax: 0171-282 2046
40. Respondents should indicate clearly whether they wish their responses to remain confidential to ORR. Otherwise they may be published, placed in the ORR library or quoted from by the Regulator.

Office of the Rail Regulator
July 1997

Annex A - List of non-confidential responses to consultation

Freight customers

ASW Distribution
British Gypsum
ECC International plc
Murco Petroleum Ltd
Powergen Property
P&O Nedlloyd
RJB Mining (UK) Ltd
Russell Transport
Scottish Coal
Scottish Hydro Electric plc

Suppliers to the rail industry

CAIB UK Ltd
The Potter Group Ltd
Hutchinson Ports (UK) Ltd
Porterbrook
Union Railways Ltd

Trade Associations, academic organisations and individuals

Professor Bill Bradshaw, Wolfson College, University of Oxford
Freight Transport Association
Malcolm Gylee
Private Wagon Federation
Rail Freight Group
Railway Development Society
The Railway Forum

Government and local government

Convention of Scottish Local Authorities
OPRAF