OFFICE of the
RAIL REGULATOR

REGULATORY OBJECTIVES FOR RAIL FREIGHT

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1. Regulatory objectives for rail freight

Introduction

1.1 The major changes in structure and ownership which have taken place in the railway industry over the past three years have had considerable effects on the delivery of rail services for freight users. The separation of infrastructure ownership and control, by Railtrack, from responsibility for the delivery of train services, by freight train operating companies, means that different parts of the railway industry need to work together and harmoniously to meet the needs of freight users. Moreover I believe there is a broad consensus that rail freight could be at a turning point. There is a prospect of - and a social and economic need for - growth after a long period of decline.

1.2 As Rail Regulator, I have a statutory duty to promote the use of the railway network for the carriage of freight and for the development of the rail network to meet these and other needs to the greatest extent economically practicable. I must aim to discharge those duties not only by setting and enforcing rules of conduct through exercise of the statutory functions I have in respect of licensing, access agreement and competition but also by doing what I can to help the railway play a growing part in meeting the country's freight transport needs. Already I have taken significant steps to help deliver the development of rail freight. I have sought to ensure and support the establishment of robust structural arrangements for rail freight under which freight operators can survive and thrive. I have sought to ensure that passenger benefit has been provided without excluding freight needs. And, recognising that rail freight receives little external financial support (there is no equivalent of the Franchising Director), I have sought to ensure that Railtrack has recognised - and acted on - the key role it has to play in promoting the development of rail freight.

1.3 Now that the period of reconstruction is almost complete, I need to do two things: first, ensure that freight train operators, Railtrack and others involved in meeting freight users' needs understand my strategic objectives, expectations and approach; and second, stand ready to act to secure improvements where those parties themselves fail to meet these expectations. In June of this year I set out my objectives and expectations in respect of Passenger Train and Station Operators (Regulatory Objectives for Passenger Train and Station Operators, June 1997) following my statement in January of this year setting out regulatory objectives for Railtrack

(Regulatory Objectives for Railtrack, January 1997). In this statement I am setting out my regulatory objectives for rail freight.

The Outlook for Rail Freight

1.4 Rail freight is at a crossroads in its development, with strategic factors now providing an historic opportunity for growth. Concerns about the environment, including road congestion and air pollution are becoming of greater concern to business and society, which look to increased use of the rail network as one of a range of solutions. Government policy in areas such as road building, emissions controls and land use planning increasingly reflect these concerns. The opening of the Channel Tunnel, enabling the development of new international markets, has been supported by large investments in recent years in rail infrastructure and rolling stock by both the railway industry and other property and distribution industry interests. Now, for the first time in many years, there is significant investment taking place in locomotives, wagons and terminals to support development of the rest of the rail freight business. Taking advantage of rail freight's opportunity, and the fulfilment of its potential, will depend on the concerted action of all involved, including infrastructure providers, train operators, government and regulatory authorities.

1.5 Faced with this prospect of growth, it is vital not to forget the background of rail freight's decline over the last 40 years as its offer became less attractive than that of its competitors, principally road transport. This decline was associated with the advance of the road network, vehicle technology and efficiency, the decline of traditional rail markets within the economy and changing distribution patterns. It was also associated with failure by rail to meet the challenges of competition. Without action to make what rail offers more attractive to users in terms of relevance, quality and price, this decline would be very likely to continue.

1.6 Earlier this summer, I commissioned a report (The Potential for Rail Freight, NERA, MVA, STM and ITS, September 1997) to advise me on the potential for growth in rail freight in Great Britain, what the main determinants of that potential are and the way in which that potential might be affected by the actions of key industry players and by regulatory action. This report, which I have separately made publicly available, concluded that concerted action by operators and Railtrack to reduce costs, improve service quality, flexibility and reliability could be implemented in a variety of identified areas, and could result in overall rail freight volume growing by up to half over ten years. It also identified ways in which regulatory action could make its contribution, focusing on action to bring about improvement in Railtrack's performance, including its carrying out of network enhancements, to maintain competitive pressure on existing operators and to collect, analyse and publish data on industry performance.

1.7 There is, of course, a wide range of views on future rail freight potential and some industry parties have taken an even more bullish view of what could be achieved in the longer term. My view is that at this stage, precise quantitative forecasts are less important than the identification and implementation of the actions needed to bring about rail freight growth. I am broadly content to accept the main findings of the report as a contribution to debate on this key issue and to the development of my strategic approach to the regulation of rail freight.

Regulatory Strategy

1.8 Given the opportunity for growth, my approach is to focus regulatory action on the objective of promoting the development of rail freight. To do this I will need to understand freight users' needs, speak up for their interests and use my powers and influence to ensure that the rail industry meets freight needs. The outlook for rail freight suggests a regulatory strategy which has the following three components:

(a) First, in my view the strongest impetus for growth in rail freight will come from improvements in efficiency, quality, value for money and competitiveness by freight train operating companies serving final customers and challenging the competition from other transport modes. I believe that rail freight companies should be free to show whether they can achieve this and in the meantime regulatory action should focus on protection against potential dangers of anti-competitive or exclusionary behaviour by dominant companies.

(b) Second, Railtrack has a critical role to play in supporting - and making a positive contribution to - the growth of rail freight. But Railtrack is in a monopoly position. It does not face the same market spur as the freight train operating companies and it faces competing priorities. My regulatory objectives in respect of Railtrack's contribution to rail freight are to ensure that it supplies rail freight with enough capacity, efficiently, effectively and at the right price to allow it to thrive and to ensure that Railtrack's broader investment and property management actions contribute to the development of the freight market.

(c) Third, Government and regulatory action can also contribute to the achievement of growth. Changes to the legislative framework and the development of the Government's Integrated Transport Policy, the availability, size and operation of freight grants, the development of EU legislation on rail access, licensing, charging and competition, and their incorporation into UK law, are all opportunities to provide a supportive framework for the development of rail freight. As Rail Regulator, in addition to regulatory action with train operators and Railtrack, I can also take steps to ensure that the administrative burden of regulation on the industry is minimised, to monitor - and publish information on - the industry's performance in delivering growth and to ensure that the voice of freight users is heard.

Specific Objectives and Priorities

1.9 In the light of the general objectives and approach to the regulation of freight set out above, paragraphs 10-25 below set out more specific objectives and highlight the key priorities as I see them.

Freight Train Operating Companies

1.10 Free standing freight train operating companies operating within a competitive haulage market have the incentives to act in a manner which may best deliver those improvements in product range, quality, price and service needed to increase rail freight's market. I believe that they should be free to demonstrate that they can deliver those improvements. There are already signs of how these forces are delivering benefits, reversing the trends of the last few decades, with new investment by English Welsh & Scottish Railway (EWS) and Freightliner in locomotives, wagons and terminal equipment, the recent decision by British Steel to transfer half a million tonnes of strip steel movements per annum to rail, and steps towards the development of new markets in non-traditional rail commodities such as supermarket goods and fresh milk. My policy in regulating train operators is based on allowing the benefits of these market forces to flow through to the industry and its customers. I aim, therefore, to avoid unnecessarily constraining or putting undue administrative burdens on those operators.

1.11 However, the current structure of the rail freight market is radically different from that anticipated when the original proposals for railway privatisation were introduced. In particular, EWS operates more than 80 per cent of domestic rail freight and proposes to acquire that proportion currently operated by National Power. Freightliner too, although having overall a much lower share of the UK rail freight market, dominates its niche in rail container haulage, and Railfreight Distribution is the only company currently operating through Channel Tunnel freight trains.

1.12 My policy, therefore, also includes affording the necessary regulatory protections against the potential misuse of these dominant market positions; in particular:

(a) anti-competitive or exclusionary behaviour in respect of existing or potential competitors, including open access development, and also the unfair use of market power over the rail supply industry for anti-competitive effect; and

(b) exploitation of dependent rail freight customers through excessive pricing.

1.13 I intend to protect the industry and its customers against such potentially adverse outcomes by using my powers under the licences held by each of the operating companies to investigate cases of such misuse of dominance, and to take enforcement action where necessary, by the use of general competition law, and by keeping the freight industry under review. I am prepared, should these powers prove insufficient, to seek further powers, through modifications to train operator licences.

1.14 EWS has a particular responsibility as overall market leader in rail freight, to recognise and deliver on the responsibilities that attend that position. It has made a positive beginning in the short time since its formation. The continued achievement of significant market growth and customer satisfaction will be the surest indicator to me that this high level of market concentration is delivering the public interest. I will therefore be paying particular attention to the performance of EWS in these areas.

1.15 Of particular relevance in this context is the new access agreement between EWS and Railtrack which I recently approved and which establishes the terms on which EWS will obtain access to the rail infrastructure for the next three years. This includes a simplified charging structure which I concluded would promote the use of rail by enabling faster responses to requests for new business. However, I have specifically concluded that I will want to be able to compare the prices which EWS quotes to dependent customers to those it charges its customers in general, to publish price information and to take such further steps as are necessary to ensure dependent customer protection.

1.16 My regulatory approach in respect of train operators, based on the policies outlined above is based on satisfying myself that the new market structure is delivering. I shall also keep under continuous review the use of the powers available to me to address any emerging concerns.

Railtrack

1.17 The development of rail freight is critically dependent upon the way in which Railtrack discharges its stewardship responsibilities as monopoly provider of an essential facility - access to and operation of the infrastructure. Because of this, I am setting out here my expectations as to how Railtrack should manage and develop its network for freight and how it develops its business relationship with its freight customers. In particular I expect Railtrack to develop, and share with freight operators and final users, a comprehensive freight strategy based on its recently published "10 Point Plan" and which takes account of industry concerns. I will want to see evidence that this strategy is being implemented and will expect Railtrack to:

(a) develop a clear approach to meeting the capacity needs of freight - within the overall development of the network. This should cover its routeing strategy, specific network enhancements and how to settle matters of priorities in network use. I expect Railtrack to take a constructive approach to investment risk and project management, and partnership for freight developments, and to be prepared to match partners in sharing risk and to give appropriate priority to freight projects;

(b) Railtrack's finalisation, after industry consultations, of a Code of Practice will be a good start. Delivery of the Code in practice is the challenge. I also expect Railtrack to take freight interests properly into account, and in the right timescale, on all matters which affect them. In particular I expect Railtrack to achieve a balance between its contributions to the development of passenger and freight services which properly reflects freight needs;

(c) act to improve its efficiency and to reduce the costs of freight operations. I expect to see the benefits feeding through into reductions in freight track access prices;

(d) work with operators to improve punctuality and reliability of freight services.

(e) allow the development of new open access business by ensuring that arrangements with existing operators do not create any undue exclusivity or otherwise frustrate new players' aspirations, and by reducing technical and other entry barriers; and

(f) manage its property estate in a manner which takes proper account of the needs of freight, in liaison with its freight customers, through its contractual agreements on "Strategic Sites" and in relation to other owned sites.

1.18 I intend to monitor closely Railtrack's delivery of the promises it has made in its Plans and Code, its obligations under its Network Licence in respect of freight, and how it meets the specific objectives I have set out in this document. Some of these objectives are primarily about behaviour towards customers. Therefore, my monitoring will involve obtaining feedback from those customers. The monitoring of other, more quantitative objectives, will involve the direct provision of information by Railtrack.

1.19 The powers I have at my disposal to ensure these outcomes are considerable. In the first instance, should I consider it appropriate to act to remedy failure to deliver, I would look to Railtrack's existing licence. I have recently agreed with Railtrack an important modification to that licence, which provides enforcement powers in respect of its investment commitments. This is very relevant to the delivery of freight objectives. Beyond that, I am prepared to make full use of my powers under the Railways Act 1993 including the seeking of further licence modifications and under present and prospective competition legislation, to ensure Railtrack delivers what is needed to secure rail freight's future.

Government and the Regulator

1.20 Government - at local, national and EC level - has a major role to play in providing the wider policy environment within which rail freight can develop. From local planning decisions, through the development of the Government's transport policy, to the further development of pan-European rail liberalisation (and specific initiatives such as Freight Freeways) Government actions will affect the way in which rail freight develops.

1.21 Working together with Government, at each level, to achieve shared objectives involves effective dialogue and cooperation. Consultation with local authorities and PTEs as funders of passenger services sharing rail infrastructure with freight services, is an important part of this dialogue. Specific Government initiatives, such as the review of the freight grants regime and the current consultation on the development of an Integrated Transport Policy, provide opportunities to contribute to policy development, and augment the more regular liaison established between my Office and that of the Secretary of State on rail freight development.

1.22 International rail freight is a key potential growth area highlighted in the report prepared by my consultants. They have emphasised that the large potential for international rail freight growth may only be realised if the performance and integration of other European railways improves. I am already working closely with both national Government and the EU Commission to help them effect such improvements, particularly in respect to the proposals in the EC White Paper "A Strategy for the Revitalisation of the Community's Railways" and the implementation of EC directives on access, licensing and interoperability to UK law. There will be opportunities afforded by the forthcoming UK Presidency of the EU to push forward these positive initiatives.

1.23 It is also right for freight train operators and Railtrack to expect me to ensure that the administrative burden associated with regulation is kept to the lowest level compatible with the objectives I am setting out in this Statement. The contractual arrangements required in the context of the new rail freight industry structure are now in place. An important element of this matrix was the recently approved agreement on revised access arrangements between EWS and Railtrack. Given the structure of that agreement, the need for specific regulatory approvals relating to individual pieces of new business is much reduced.

1.24 The industry has gained considerable experience over the years since its restructuring and I believe that further simplification of the contractual matrix could be consistent with my duties to promote the use of the network, promote efficiency and economy, enable the easier planning of business and reduction of unnecessary burdens on those working within the industry. Therefore I propose to work with the industry to identify where such simplification can be achieved and to take the necessary action on my part to secure this objective.

1.25 To understand customer needs more fully, I will further develop liaison with customer groups, rail industry suppliers and operators within my programme of industry review. I also propose to collect, analyse and publish data on industry performance as part of this programme. This will help inform my judgement as to what further actions I need to take, based on the behaviour and performance of the industry, to ensure rail freight's potential is realised, and the public interest thereby delivered.

Conclusion

1.26 Rail freight is in a strong position to grow substantially over the medium term. To enable this to happen, positive and sustained action is required of Railtrack and freight train operators to take advantage of market opportunities. Government and the Regulator also need to sustain the most favourable environment for success through legislative and administrative actions, including the reduction of obstacles and protection against anti competitive or monopolistic behaviour.

1.27 My policy approach is to leave train operating companies free to exploit market opportunities, while protecting competitors and customers against abuse of that freedom, and to set demanding expectations of Railtrack in respect of deliverables over which it has monopoly control, and to monitor and take any necessary action to ensure delivery of the benefits of this approach to freight customers. The approach focuses on my freight objective of promoting the development of rail freight in a manner which best meets the needs of freight customers. I intend to keep the rail freight industry under careful review and to monitor results closely.

JOHN SWIFT QC September 1997