

EU COMPETITION BRIEFING

EU RAIL SECTOR COMPETITION:  
INEVITABLE CONFLICT?

DECEMBER 2017

- EUROPEAN COMMISSION FINES LIETUVOS GELEŽINELIAI (“LITHUANIAN RAILWAYS”) €28M FOR ABUSE OF DOMINANCE.
- A WARNING SHOT FOR INFRASTRUCTURE OWNERS.
- IS THERE AN ALTERNATIVE APPROACH TO RESOLVING THESE CONFLICTS?



**The challenge of liberalising State-run monopolies**

In Europe, many former State-run monopolies have been opened to competition, but competition has often been impeded by former incumbents, and competition law enforcement has therefore followed. We are now seeing this in the rail sector.

Imagine a vertically-integrated rail operator, which owns both the track and a freight operation, and peacefully enjoys its monopoly. One day, the law changes and new rail companies may now enter the market and compete with the incumbent. Can the incumbent carry on as before? How should it adapt to competition?

To change the perspective, imagine you are a new operator, seeking either to compete with the incumbent directly, or perhaps serve new markets in which the incumbent has declined to operate. The law has changed and liberalisation is coming, but the incumbent is not willing to release its hold over the industry. How should you secure your position?

Competition law and the regulatory framework provide one answer to both questions, but is there an effective commercial solution? This question is not unique to rail: other utility industries (both in energy and transport as well as communications) have faced a similar problem.<sup>1</sup> But a recent European Commission decision in the rail sector highlights the issue, as we now explain.

<sup>1</sup> For example, in 2009, the Commission accepted commitments from RWE to address competition concerns in the German gas market. The Commission gathered evidence that RWE had engaged in margin squeeze behaviour by setting its transmission tariffs at an artificially high level and had pursued a strategy aimed at keeping the transport capacity on its gas network for itself. To address the Commission's concerns, RWE agreed to divest part of its gas

### Two views of the same problem

Let's start with the incumbent's view. It is 2007, and the Commission has liberalised the rail freight market. From now on, rail infrastructure must be managed independently from operations, to allow competing operators to use the tracks. This is a threat to your future: new rail operators may enter and cherry-pick your customers and your operational revenue will fall if they do. Moreover, the cost of maintaining tracks which are more heavily used will only increase. You look at your network – infrastructure you own – and see future repair costs building up: the track has, according to some, a history of technical problems and a decreasing speed limit. It may become unsafe. You could try to repair it, or you could rebuild it, after first dismantling it.

But you also see the incumbent from a neighbouring market eyeing up the cross-border trade. They swoop in and try to grab one of your customers for cross-border freight, and that's when you take a fateful decision: you dismantle the track and force the customer to use an alternative, much longer route at higher cost, which in effect means you force the customer to stay with you.

Now let's suppose you are the competitor. You have three problems. The first: you have to negotiate access to the track in return for a fee. Fortunately, the EU rail framework together with competition law regulates this fee through legislation introduced as part of the railway liberalisation packages.<sup>2</sup> The second: can you effectively compete with the track owner, who operates a competing freight service on its own tracks? Again, competition law and regulation should prevent margin squeeze. You have the opportunity to provide a rail freight service for a valued customer of the local incumbent. Now the third problem strikes: you can't provide it after all because the infrastructure owner has ripped up the tracks covering the shortest and most cost-effective route for the service. So now you have to provide the service on a much longer, less cost-effective route. You have no practical alternative: you leave the market.

In between the incumbent and the competitor is the customer. The liberalisation of rail freight heralds more competition, which, as a customer of rail freight services, you see lowering your input costs and improving your profitability. Until competition is forcibly prevented by the actions of the rail incumbent. Thus thwarted, you complain to the authorities.

The competition authorities find in your favour, after many years of investigation, and require the infrastructure owner to cure the problem, with a strong hint it should rebuild the track.

Meanwhile, throughout this period, the shortest routing has been unavailable.

transmission network to give suppliers a credible alternative to RWE. Although this investigation happened prior to the implementation of the Third Energy Package, it took place in the shadow of the liberalisation legislation and should be viewed in this context. See Commission Press Release: [http://europa.eu/rapid/press-release\\_IP-09-410\\_en.htm?locale=en](http://europa.eu/rapid/press-release_IP-09-410_en.htm?locale=en).

In the telecommunications sector, following competition concerns expressed by Ofcom, BT put forward commitments requiring Openreach (the broadband infrastructure operator) to be incorporated as a separate legal company within the BT group. Under the legal separation, Openreach must develop its own operating plans (within a budget set by the BT Group) and has responsibility for maintenance of the physical network assets. See Openreach consultation: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0035/98855/Openreach-consultation-2017.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0035/98855/Openreach-consultation-2017.pdf).

<sup>2</sup> Directive 2001/12/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure and safety certification (forming part of the First Railway Package), as amended by Directive 2007/58/EC (forming part of the Third Railway Package).

### Who won?

No one has won from this situation. The infrastructure provider has (successfully) prevented competition on that route for an extended period, but now has to pay a substantial fine for anti-competitive behaviour, must cure the infringement (probably by re-building the track, coupled with an ongoing implicit obligation to maintain it in usable state) and may face damages actions to compensate those who have been harmed. In the end, it must allow for competition on its network.

The competitor has not won. For a substantial period, it has been unable to compete directly on cross-border trade. It may seek damages for its losses, but proving the level of these losses to compensate for all the business it has lost during the whole period may be tricky.

The customer has not won. The promise of lower transport costs for its freight has been dashed. Again, it would need to travel the complicated route of seeking damages for as much of its losses as it could prove.

Could there have been an alternative solution?

### The Lithuanian railways case

What we have dramatised above is the recent Lithuanian Railways abuse of dominance case. On 2 October, the Commission fined Lithuanian Railways €27.87m<sup>3</sup> for abusing its dominant position by removing a 19km stretch of track connecting Lithuania and Latvia, so preventing a competitor (Latvian railway incumbent Latvian Dzelzceļš) providing a service to its customer – AB Orlen Lietuva – a subsidiary of Polish oil company PKN Orlen. The full Commission decision is awaited.

We say “recent” case, but the story goes back to 2008 when the track was dismantled. The Commission dawn raided Lithuanian Railways in 2011; opened formal competition proceedings in March 2013; and, in October 2017, issued its infringement decision. As of today, the track has not been re-built, nine years after being dismantled.

Although there have been reports about the state of the disputed track, Lithuanian Railways apparently did not argue – or the Commission did not accept any argument that – its conduct was justified. It must now cure the infringement, probably by rebuilding the track, and – as Commission press releases point out in standard wording – any person or firm affected by its behaviour may bring the matter before the courts of the Member States and seek damages, whereby the Commission decision is binding proof that the behaviour took place and was illegal. Damages need not be reduced on account of the Commission fine.

EU Competition Commissioner Margrethe Vestager said it was “unacceptable and unprecedented that a company dismantles a public rail infrastructure to protect itself from competition.”<sup>4</sup> Perhaps so, but it is only one of a growing number of competition law cases across the EU in the rail sector.

### Proliferation of rail competition cases across the EU

In the first table below, you see four ongoing cases involving several EU Member States, alleging cartels/anti-competitive behaviour, and abuse of a dominant

<sup>3</sup> For the Commission guidelines on fines, see: [http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52006XC0901\(01\)](http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52006XC0901(01)).

<sup>4</sup> For the Commission press release, see: [http://europa.eu/rapid/press-release\\_IP-17-3622\\_en.htm](http://europa.eu/rapid/press-release_IP-17-3622_en.htm).

position. Two of these were in the operations – passenger rail services sphere, and two in related sectors (maintenance, electrification/electromechanical equipment). All four cases began recently.

COMPETITION AUTHORITY	NATURE OF ALLEGED INFRINGEMENT
25 July 2017 – Portuguese Competition Authority	Suspected cartel among companies in the railway maintenance sector. Dawn raids were carried out at the premises of nine companies located in Lisbon and Oporto.
22 May 2017 – Spanish National Commission on Markets and Competition	Probe launched into a potential cartel in the market of manufacture, distribution and maintenance of systems for rail electrification and electromechanical equipment for railways. A number of dawn raids were carried out (May 2017).
10 November 2016 – Czech Competition Authority	Investigation into alleged abuse of dominance by Czech incumbent, České dráhy, in rail passenger transport services. The Czech Competition Authority is concerned that České dráhy's pricing policy forces competitors out of the market.
28 June 2016 – European Commission	Commission raided various companies across several EU member states (including Austria's incumbent ÖBB and Slovakia's Železničná spoločnosť Slovensko) over concerns that they entered into anti-competitive agreements.

This next table lists recently concluded competition cases. All involved abuses of dominance, including by incumbent rail operators, and some substantial fines.

COMPETITION AUTHORITY	NATURE OF INFRINGEMENT	OUTCOME
25 October 2017 – Finnish Competition and Consumer Authority	Abuse of a dominant market position in market for freight interconnection between Finland and Russia. The investigation was launched following a complaint by Easmar Logistics (a competitor).	The complaint was dropped by the Easmar Logistics and the investigation was concluded. A separate complaint by a different competitor (Nurminen Logistics) remains.
29 June 2017 – The Netherlands Authority for Consumers and Markets	Abuse of dominance by Dutch Railways NS in the tender process for a public-transport contract in 2014. NS submitted a loss-making bid to obstruct competitors and shared its competitors' confidential information.	NR was fined €40.95m for abuse of dominance (29 June 2017).
15 June 2017 – Spanish National Commission on Markets and Competition	Nokia Solutions and Networks Spain abused its dominant position in a regional tender process organised by rail operator Adif for the maintenance and renovation of a rail communications network, by setting wholesale and retail prices so that rivals purchasing wholesale services would be unable to compete profitably.	Nokia Solutions and Networks Spain was fined €1.74m (15 June 2017).
1 June 2017 – French Competition Authority	Transdev complained that SNCF was using its passenger transport monopoly to eliminate competition in the inter-city coach transport sector. Transdev alleged that SNCF cross-subsidised its competitive activities through its monopoly activities and engaged in predatory or other exclusionary pricing.	The French Competition Authority rejected the complaint citing that there was no evidence of a breach (1 June 2017).
6 March 2017 – Spanish National Commission on	RENFE, Deutsche Bahn and various other rail companies engaged in agreements which restricted	The companies involved were fined €75.6m for blocking liberalisation by

COMPETITION AUTHORITY	NATURE OF INFRINGEMENT	OUTCOME
Markets and Competition	competition (by effect). RENFE also abused its dominant position.	limiting how far international companies could do business in Spain.

### Conclusions

As these cases show, the rail sector sits in the crosshairs for regulatory enforcement, and the Lithuanian Railways case will not be the last, even if the abusive conduct was the most dramatic.

In the Lithuanian Railways case, a negotiated solution might have created a better outcome for all parties. Without details of the assets, we can perhaps only speculate, but devising a track access charging formula that properly accounted for the need to maintain the disputed track while compensating the incumbent for its properly-incurred costs would not have been impossible. Such an outcome would have allowed competition in the market and met the needs of the customer in this case. The message – and the challenge in such cases – is to identify, label and address emerging conflicts between incumbents and competitors so that appropriate answers can be found and solutions negotiated.

As the latest in a growing line of rail sector competition enquiries, and in a longer line of liberalised industry competition cases, the Lithuanian railways case reminds all stakeholders of the need to adapt positively to the advent of competition and to be vigilant against – in particular – abuses of dominance by incumbent operators.

## FOR MORE INFORMATION

Should you like to discuss any of the matters raised in this Briefing, please speak with a member of our team below or your regular contact at Watson Farley & Williams.



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