MOFAIR

Compensatory measures to strengthen competition in the railway sector

in the event of a further capital increase for the Deutsche Bahn AG

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Bündnis für fairen Wettbewerb im Schienenpersonenverkehr

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0. Preface

The German government plans to further increase the equity capital of Deutsche Bahn AG. After various absolute levels - between 6.9 and 8.4 billion euros[1] - had been discussed beforehand, the decision of the coalition committee on June 3, 2020 speaks of 5 billion euros.[2] The Bundestag is expected to pass this measure on July 2, 2020 as part of the 2nd supplementary budget law for 2020 which is meant to deal with the consequences of the COVID 19 pandemic.

While the use of these funds was still limited to infrastructure when the capital increase was agreed as part of the climate protection package (originally estimated at 11 billion euros, now 5.5 billion euros) in the autumn of 2019, the new capital increase is also and primarily intended to support the transport companies.

The threat of distortion of competition is therefore now immediately obvious.

Since the Federal Government, as the owner of DB AG, nevertheless wishes to maintain its support for the group in the form of equity capitalisation, the question arises as to what measures are available to offset the competition-distorting effect of this recapitalisation.

Such compensation is not uncommon in the cultivation of certain markets, both in merger control - see the acquisition of Arriva by DB in 2010 - and in current state aid in the context of the Corona pandemic - see the conditions under which the Federal Republic of Germany will acquire stakes of the Lufthansa AG.

In the following, mofair makes a number of suggestions which should serve as an introduction to the debate.

They are not to be understood in such a way that mofair would no longer have any objections to the Federal Government's plans to increase the equity capital of the Deutsche Bahn AG and would accept it. It is up to the EU Commission to assess the planned increase in Deutsche Bahn's equity capital under state aid and competition law.

Prior to any decision on the admissibility of such massive aid in the form of an increase in equity capital, it must be demonstrated to the EU Commission <u>and to the public</u> that the need actually exists in this form and amount, for each of the individual companies within the DB Group, and that it is actually attributable to the effects of the COVID 19 pandemic. So far, this has not happened, despite urgent reminders by the Federal Court of Auditors[3], the opposition in the German Bundestag and many others, including mofair.

A package of possible compensatory measures would have to meet the following criteria:

- It must have a positive impact on all modes of transport – long-distance, regional and freight - as well as on the infrastructure and other essential facilities,

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[1] Paper by DB, BMVI and BMF, dated 10 May 2020, which was submitted to the relevant parliamentary committees in mid-May 2020.
[2] Cf. *https://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Schlaglichter/Konjunkturpaket/2020-06-03-eckpunktepapier.pdf?__blob=publicationFile&v=9*, measure35.g.
[3] Report to the Budget Committee of the German Bundestag pursuant to § 88 (2) of the Federal Budget Code (BHO) on current findings on the economic situation and the corona-related additional financing requirements of the DB AG Group dated 25 May 2020, *https://www.bundesrechnungshof.de/de/veroeffentlichungen/produkte/beratungsberichte/langfassungen/langfassungen-2020/2020-bericht-aktuelle-erkenntnisse-zur-wirtschaftlichen-lage-und-zum-corona-bedingten-zusaetzlichen-finanzierungsbedarf-des-db-ag-konzerns-pdf*.

- It must be binding and it must be possible to bring it into force quickly.
- The federal government and DB AG should be able to implement it in a leading role.

Finally, it must be clear that at least a substantial part of the measures cannot benefit all market participants equally. In order to compensate for a unilateral market intervention in favour of Deutsche Bahn AG - and there is no doubt that this is the case through a capital increase - measures must be taken which Deutsche Bahn AG and its owner, the Federal Republic of Germany, would not take on their own initiative. There is no other way to rebalance the "competition scales" that have been thrown off balance.

In the following we will make and comment on various proposals for

1. regional and suburban rail
2. long-distance rail
3. infrastructure
4. ticket sales, tariff and revenue sharing, and
5. the structure of the DB Group.

1. Regional and Suburban Rail (SPNV)

It is true that the competitive market in regional rail transport is largely established. But there are strong persistent forces, especially in networks with a high passenger volume. In order to maintain the SPNV market in the long term and to avoid setbacks in market opening, which are likely to occur if DB companies are strengthened unilaterally, the following points should apply in future:

- Direct awards to DB subsidiaries must be effectively prevented. Delays in the transition to competition, such as in the Munich and Hamburg S-Bahn (suburban rail) networks, due to overlong "interim contracts" must be ruled out.

The principle of competitive awarding of regional rail transport services, which has been legally undoubtedly required in Germany since 2011 at the latest, has been increasingly called into question in recent years by recent direct awards - in the vast majority of cases to DB Regio or its subsidiaries. Particularly on high-volume networks, real or supposed constraints have been or are being used or created which use DB's dual function as infrastructure manager and operator and/or DB's access to existing rolling stock to justify direct awards (often "interim awards") for up to six years.

- The trend towards ever larger allocations must be limited. For this reason, public procurement law should be rewritten in such a way that a partition of tenders is made mandatory for annual award volumes of 8 million train-kilometres or more. From a volume of 12 million train-kilometres, it should be mandatory to have more than one railway undertaking.

In recent years, networks have tended to become larger and larger. It is true that it is important to make the awarding procedures themselves as economical as possible by ensuring that the networks are of an appropriate size. However, networks that are too large clearly prefer the state-owned company DB because of the very high financing costs involved and the often correspondingly higher risks. Partition of tenders and, above a certain size, having more than one operator are therefore suitable means of maintaining the regional markets in the long term.

- Offers for transport services below the own costs have to be effectively excluded. "Regionalverkehre Start Deutschland GmbH" will be dissolved.

The equity increase for DB alone may mean that it will try more aggressively than before to win back terrain lost in recent years. For this reason, even greater care must be taken to ensure that no offers are made below its own costs. The "Regionalverkehre Start Deutschland GmbH", which was founded as a low-cost subsidiary of DB Regio specifically for the purpose of reconquering the market, must therefore be dissolved.

- The market share of the regional transport subsidiaries of the Deutsche Bahn Group is limited to 60 %, measured in terms of the planned annual operating performance in train-km.

For historical reasons, the share of DB Regio and its subsidiaries in the operating performance at the time of the 1994/96 rail reform was around 95 %. Since then, it has fallen to just over 60 % of the operating performance throughout Germany. This is still an order of magnitude at which one can speak of a dominant position. In order to avoid an anticompetitive use of the additional equity capital, a cap on the current market share would therefore be appropriate.

- Advantages that the DB subsidiaries can draw from their large used vehicle fleet in tenders are effectively neutralised. The retention of existing vehicles from the market instead of making them available to competitors at own costs must be prevented.

It is still the case that new and used vehicles can be offered equally in tenders of the contracting authorities and that the valuation discount for used vehicles is relatively low. This regularly leads to a clear advantage for DB Regio, as it is the only company that has a significant number of available used vehicles. The retention of used vehicles from the market can also be applied tactically and must be prevented.

- In the case of transfers of operations in regional rail transport, incentives will be strengthened to promote and cooperatively support the transfer of personnel from the previous operator DB Regio to a non-Group successor operator.

Since the amendment of the Act against Restraints of Competition (GWB) in December 2015, the principle has applied that new operators of regional rail networks must make a takeover offer to the employees of the previous operator, provided that this is in line with their operating concept and that the employees in question are those who are required to directly provide the transport service (i.e. train drivers, train attendants and closely related activities). In reliance on this, competitors have calculated their training costs. However, DB has done everything in its power to retain its staff and, if necessary, to deploy them on neighbouring networks or in freight and long-distance transport. It is also opposed to supporting the direct approach of personnel by the new operators. This thwarts the purpose of the amendment to the law.

2. Long-Distance Rail (SPFV)

Competition is still very weak in long-distance transport. Above all, access to attractive train paths at favourable prices and to vehicles is a very high hurdle.

- Appropriate measures will be taken to ensure that DB's *de facto* monopoly in the procurement of long-distance vehicles is broken. Possible variants include making new vehicles available to competitors by passing on the favourable financing terms, or a vehicle pool at a federal company that receives and can pass on equally favourable financing terms.

To be able to make a competitive offer in the SPFV, alternative providers must put a certain critical mass of connections on the tracks. In the long run, this is only possible with a correspondingly large vehicle fleet. There is practically no second-hand market for - especially higher-value - long-distance vehicles. On the other hand, due to its status as a purely state-owned company, Deutsche Bahn can take advantage of financing conditions that competitors can never match. Here, a way must be found to enable other companies to obtain comparable financing conditions. This measure will be particularly effective if it is linked to access to attractive train paths (see below).

- A certain proportion of the attractive train paths in the regular/core network, including the high-speed network, will be made available to competitors. This can be arranged in anticipation of a new train path allocation model within the framework of the *Deutschlandtakt*.

Considerations regarding the implementation of the *Deutschlandtakt* are currently also becoming more concrete as far as regulatory terms are concerned. How the competitive allocation of long-distance train paths will be organised in future is still open. The crucial point, however, is that a minimum quantity, which should continue to increase successively, must in any case not be allocated to DB Fernverkehr.

- DB Fernverkehr will be obliged to subcontract a proportion of its transport services to other railway undertakings, starting on the IC- or the future regional long-distance network of the *Deutschlandtakt* timetable (so called FR-lines), and later also on the high-speed network.

It has been common practice for many years in many areas of public transport (e.g. in municipal bus transport) not to provide a certain proportion of the transport services themselves but to subcontract them. New providers can thus be integrated into the market, gain further experience and develop innovative concepts.

- It is also conceivable that in future competitors will be allowed to market an increasing proportion of the seating capacity on long-distance trains (resale).

In order for new entrants to the long-distance train market to become known to a wider public and to establish a brand before they can establish a market presence through their own transport services, they can be involved as intermediaries in the distribution of long-distance transport services. An analogous procedure has proved its worth in the opening of the telecommunications market.

3. Infrastructure

High infrastructure costs and poor access to the infrastructure have so far disadvantaged rail transport as a whole. On the other hand, however, they also disadvantage infrastructure users outside the DB Group, as they do not receive Group-related compensation for the high costs.

- The train path and station charges are permanently reduced to the direct costs of train operation ("uKZ"). The missing cost recovery contributions are paid directly from the federal budget.

This measure would benefit all users of the track network, but would, especially at this stage, support the smaller companies which do not have the German State as guarantor. New offers could be brought to the market more easily after the crisis. And in order to support rail transport in accordance with the EU Commission's "Green Deal", this measure would significantly improve the market position of rail compared to today's motorised private transport. It would fit in excellently with the German Council Presidency in the second half of 2020 and herald the "European Year of Rail 2021".

- The Railway Infrastructure Units (EIUs) of the DB Group include in their Terms of Use clear provisions on liability for consequential damage incurred by the railway undertakings due to poor infrastructure condition or as a result of the significant increase in construction activity. The Federal Government compensates the resulting additional requirements of the EIUs in an appropriate manner.

The introduction of clear liability rules for consequential damages suffered by railway undertakings due to poor infrastructure quality or lack of availability is a long-standing demand. It would catch up with what is common practice in other sectors of the economy and thus also strengthen the relative market position of rail. Although the DB transport companies are also affected by today's unsatisfactory regulations, unlike the competing railways, their compensation is taking place within the DB Group.

- There will be no more in-Group priority concerning sidings, workshops and other service facilities. A systematic expansion plan is drawn up for facilities that are already in high demand today.

Capacity is becoming scarce not only for train paths, but also for sidings and workshops as well as other service facilities, especially near hub stations. Longer inward and outward journeys to more distant locations are becoming necessary, which in turn consume capacity in the track network. Therefore, a systematic expansion plan strengthening the overall system is necessary. The possibility still available today for DB, as the operator with by far the most facilities, to use its resources strategically - e.g. to charge excessive prices for non-Group customers in the event of a change of operator - must be excluded.

4. Ticket Sales, Tariff and Revenue Sharing

Passenger information and ticket sales are still dominated by DB and its sales subsidiary. Many discriminations on a small scale still prevent fair competition today.

- All tickets of the railway tariff will be released for distribution by all railway companies at short notice. The timetable data (target, forecast and real-time) as well as capacity utilisation and similar data are also released. All sales channels are included. Commissions are structured in a competition-friendly manner.

In this regard, the "Industry Initiative for Mutual Sales" already exists, which has made good progress towards non-discriminatory sales in the past one and a half years. It is important, however, that the concessions made so far by the former monopolist Deutsche Bahn are secured at a higher level of standards and safeguarded against future setbacks. The decisive factor here is competition-friendly regulations on commissions, the allocation of cash-related income, etc., so that the opening of the market is not only nominal, but also commercially attractive for other providers.

- The long-distance tariff (current price categories A and B) will be transferred to the sovereignty of "Deutschland Tarif GmbH" (founded on June 9, 2020). This will enable all rail transport companies to sell and help shape the long-distance tariff. Any transport company that wishes to do so will have the right to apply the long-distance tariff. The proceeds will be divided among the transport companies applying the tariff within the framework of a revenue sharing scheme based on the model of local transport.

The long-distance tariff, which is particularly present in the public perception, is, unlike the local transport tariff outside of transport associations, still an in-house tariff of Deutsche Bahn AG even after the founding of "Deutschland Tarif GmbH". DB can continue to use it strategically. This can be done, for example, by using special discount offers (*Sparpreise* and *Supersparpreise*) on routes that are served to a considerable extent by competing railways, which are obliged by law and transport contracts to accept the products of DB's long-distance tariff. It is unacceptable for a company to make special offers, but then to have its competitors - or, gross contracts, the public authorities- pay for them.

- Third party ticket vendors should also be given access to all products of the rail tariff.

In order to stimulate competition in sales to the benefit of consumers, third parties who do not necessarily provide transport services themselves should also be allowed to sell tickets on fair and non-discriminatory terms. The condition is, of course, that these ticket vendors commit themselves to the standards jointly set by the transport industry, for example on safety, controllability, etc.

- Transport companies who so wish are given access to the distribution infrastructure of Deutsche Bahn on fair, non-discriminatory and economically attractive terms.

In view of the market power of the former quasi-monopolist DB Vertrieb, it may make sense for some companies to establish no or only a lean sales organization of their own. In such a case, it must be possible for competitors of Deutsche Bahn to sell their own tariff products through the channels of DB Vertrieb for a reasonable fee.

- Rules on revenue sharing for the recognition of long-distance tickets on local trains will be revised in such a way that it will no longer be possible to exploit DB's previous monopoly.

Up to now, the regulations on the distribution of revenue between the long-distance and regional transport in downwardly compatible long-distance train tickets have been designed in such a way that regional transport companies often receive less than the share of the ticket revenue to which they should be entitled. This must be changed.

- The market power of the portals www.bahn.de and DB Navigator has been made possible solely by the market foreclosure by DB in the past. Therefore, these sales channels must be regulated in an appropriate form by the regulatory body, the *Bundesnetzagentur*.

Even though Deutsche Bahn's competitors have established their own sales channels and will continue to do so: The portals www.bahn.de and the smartphone app "DB Navigator" have already achieved an extremely high level of market penetration in the years of the market foreclosure by DB, which is hardly possible to counter even with the highest sales quality and customer friendliness. Therefore, these two portals will have to be regulated in the future. The appropriate authority for this is the *Bundesnetzagentur*.

- In this context, the URL www.bahn.de must be abandoned because the competition railways are also "*Bahnen*" (railways).

This supposedly small change will increase the awareness of customers to be dealing with a railway *system*, not only with the incumbent. With this change, millions of people will for the first time realize that the market has changed.

5. Group Structure of DB

Especially at a time when a state-owned company is to be supported with further state funds in the billions, it is time to review the structures of this company. The new state involvement should not be put into a bottomless pit. An increasing state involvement in a company, which is intended as an acute emergency measure, must also be limited in time.

- In order to rule out cross-subsidisation between the monopoly and competitive divisions with immediate effect, the <u>profit transfer and control agreements within the DB Group will be terminated</u>.

This is the absolute core measure, because the "marshalling yard" between the monopoly and the competitive areas within the DB Group is the central obstacle to fair competition on the railways in Germany. It is true that many norms attempt to avoid cross-subsidisation of transport by the infrastructure sector. But these norms remain incomplete and are practically impossible to monitor even at enormous expense. The Federal Court of Auditors has also repeatedly pointed this out.

An end to the contracts would finally provide the necessary transparency about the actual economic situation of the individual group divisions and thus also give politicians indications about the future configuration of the individual group companies or divisions, both in terms of optimal service provision and economical budget management. It is the only effective measure to make cross-subsidisation between infrastructure and transport companies visible.

- <u>After a certain period of time, company shares of the rail transport companies DB Fernverkehr AG, DB Regio AG and DB Cargo AG to the value of 5 billion euros</u>, the volume of the capital increase now being considered, <u>are to be sold</u>.

State involvement in crisis situations is usually conceived as a temporary measure. And since the capital increase in question here for Deutsche Bahn AG is explicitly justified by the negative consequences of the COVID 19 pandemic, it is only appropriate that this new state involvement should be terminated at a suitable point in time, which by its very nature cannot yet be precisely determined, once these consequences have subsided. Since the equity capital increase is also explicitly intended for the competing transport subsidiaries, the Federal Government must withdraw from these companies, i.e. primarily from DB Fernverkehr, DB Regio and DB Cargo.

- In order to close a gap in energy regulation, the <u>functions of network operator and energy supplier will be separated from each other under company law in the current DB Energie</u> ("unbundled"). The new "DB Energieproduktions- und -handels GmbH" is to be sold.

Today's DB Energie is an integrated group on a small scale, which distorts competition both with regard to competing railways and alternative traction current suppliers. However, a fair traction current market is becoming increasingly important in view of the envisaged complete decarbonisation of rail transport.