Competition and Cooperation in Rail Transport From the Perspective of a U.S. Investor

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Henry Posner III addresses the Berlin audience

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In the past year, I have made the case in a number of settings that the European railway system needs both competition and cooperation, and that these elements have to come to a balance, just as it has evolved in North America since deregulation. Let me be clear that I understand very well the differences between North America and Europe—after all, we have been working in Europe since 2001.

But first, let me very briefly summarize what happened in North America. We began with an overbuilt, heavily regulated private sector network that was to a certain extent both held together by, and suffering from, regulation. Because of the evolution of road transportation we ceased being a monopoly as an industry almost a century ago, yet regulatory and political lag failed to account for that. The decline was so gradual that nothing might have been done about it, with the end result of nationalization.

However, several significant events occurred almost simultaneously, and whose shock value was sufficient to force the regulatory and political change that allowed the industry to break free of regulation and solve its own problems. Those events were the bankruptcy of the Penn Central, which resulted in the formation of Conrail, and the bankruptcy and liquidation of the Rock Island Railroad, which, unlike Conrail (whose name was "Consolidated Rail Corporation"), was the opposite of consolidation—it was a liquidation, which in only some cases allowed the survival of line segments: one of those is our very own Iowa Interstate Railroad, where we made an initial investment in 1991 and took control in 2004. .

To be clear—it was a series of significant events that were shocking enough to command the attention of both regulators and politicians to step out of the default mode of sleepwalking. I will argue today that we have reached that point in Europe. But I repeat that what makes North America work is the balance of both competition and cooperation which has evolved through several generations of working under deregulation.

I will discuss cooperation and competition in Europe in detail. But before I do, it is important to note that while these concepts are internal to our industry, there are bigger external challenges that suggest that we are beginning to lose control of our market positions in both the passenger and freight sectors. Because this is a German audience, I will focus on the passenger sector, though I should add that if this were a French audience I would be talking about freight.

The challenges in the passenger sector that I am referring to are both institutional and technological—namely, the emergence of both bus competition and ridesharing. While one can argue that these have evolved due to the opening of markets and deregulation, what is striking to me is that the financial marketplace considers them both to be technological evolution. I say this because if you look at how rideshare networks such as Uber and bus companies here in Germany are financed, they are described as technology companies, not transportations companies. This suggests that disruptive change is both being financed by the marketplace and believed to be of enormous value.

Here in Germany it is generally considered that bus competition is the #1 threat to the rail industry, though in France it is ridesharing—which one might consider as the long-distance equivalent of Uber. So, how should the industry respond?

I would argue that in Europe we are uniquely vulnerable and poorly equipped to respond to these challenges for a long list of reasons, ranging from the straightjacket of European regulation to the dominance of State ownership of railway interests to the uniquely European culture of hopelessness. But rather than spending time talking about how this happened, I will make a number of specific suggestions and also talk about what we as a small company are doing to play our part.

First and foremost, we come to Europe from North America where, yes, we have a lot to learn from Europe about the technical aspects of passenger service. But we do have some critical advantages that are at least partially translatable, namely:

1. Several generations of experience in functioning as a national network of commercially-independent operators, operating in a deregulated environment. Yes, this comes from freight but many of the underlying economics and even basic algorithms such as revenue allocation on interline ticketing do in fact translate to passenger networks.

2. A culture of optimism for our industry, based on the experience developed since 1980 under deregulation—which saved the freight railways but killed the airlines in our country.

3. Understanding of the benefits of the diversity in a network business: we believe that a diverse industry is healthier in terms of both innovation and the avoidance of monoculture.

4. Tolerance of failure: a defining difference between European and North American business culture is that it is okay to risk failure in the USA, as the natural byproduct of innovation.

All of the above suggests that what we are doing in Europe—RegioRail for wagonload freight in France and HKX as an alternative intercity passenger operator in Germany, which in both cases involves participating in interline traffic with both incumbent carriers and “other” carriers—is a modest contribution toward being part of the solution for Europe.

Having discussed our overall logic in entering the European market, let me now focus on Germany and offer the following comments:

1. Competition is evolving in Germany: for example, access to the infrastructure and the regulatory framework are evaluated positively overall (the “BUT” will follow later).

2. A culture of cooperation is beginning at the industry level in Germany. "Allianz pro Schiene” is a very positive example of this.

3. Following EU rules, track access fees have as a minimum level the incremental cost for train operations. But German track access fees are much higher than in other countries and we are afraid that they could rise further. And perhaps even worse, they are not market-sensitive.

4. The track access fee is like a tax on rail transport, up to 30% of the turnover of the train operators! This tax called track access fee is a problem, especially for open access passenger operators, the most high-profile casualty being Interconnex. But our main competitor, the Autobahn, has no system of charging the users for the infrastructure, not for cars, and not for busses, not for trucks on

95% of the roads. The common interest of the rail sector should therefore be at a minimum to limit the infrastructure fees to the EU minimum level, and to define that minimum level as the truly variable, direct cost related to train operations.

Now let's get even more specific, and talk about HKX.

1. HKX was originally a pure competition project. But since then, a new strategy of competition and cooperation has evolved for HKX, for the benefit of the national rail system.

2. HKX is based on competition. In search engines for bus services it is shown as an alternative to the bus, usually cheaper than the IC train, faster than the bus.

3. But HKX is also based on cooperation. HKX is in addition to having its own tariff also integrated into the tariff system of the DB; all tickets of the DB regional tariff also apply in HKX, so virtually nearly all tickets valid in DB trains are valid on HKX.

4. With HKX, we keep passengers in the rail system, for the benefit of the entire rail sector. With our cooperation strategy HKX is finally reaching the breakeven point.

So, in describing HKX I hope that I have made a compelling case that HKX is a small but important part of the national network based on cooperation.

Let me now talk about another initiative of ours in Germany, which is more about competition than cooperation. But let me first describe the railway culture of North America, in which competition and cooperation not only exist but flourish side-by-side.

As a network business with diverse traffic flows, most rail traffic in North America involves at least 2 carriers, and in some cases 5 or 6. This means that for truck competitive traffic, the chain of carriers from end to end must be structured in such a way that each link is strong- in other words, profitable. We have learned to work together since deregulation in 1980, based on, as I have mentioned before, several generations' experience.

But please think about this; in the USA we have private sector companies, all in the same country, with few interoperability issues, and no significant government regulation except for safety. This is very different from Europe.

But in many cases, the same carriers who cooperate on interline traffic find themselves competing for not just interline traffic but in some cases block train traffic where parallel railways serve the same origin and destination. There is strong competition in these cases, but fair competition and competition that is moderated by the fact that while you may be competing with a parallel railway today you will need to cooperate on a truck-competitive move tomorrow; this in itself is the most important inhibitor of, for example, pricing based on predatory or ideological grounds.

For these reasons, we believe that our presence in a market that can be described as more competitive than cooperative is nonetheless a good decision on our part, good for the customer, and in the long run even good for DB. Let me therefore describe our project, which could end with a similar story of development from pure competition to new forms of cooperation, for the benefit of all: The RDC Sylt-Shuttle, the ambitious plan to play a role in the car and truck transport of this unique rail line.

Our applications for framework agreements and for train paths in the annual timetable for the Sylt-Shuttle have been classified by DB as “hard-core competition.” This is understandable taking into account the high commercial value of this service for DB. But from our view, it is an approach to improve the quality of this service and this line, neglected for many years, with regard to both service and infrastructure.

There could be a model for cooperation, if we find each other and talk to each other directly, rather than through others and through the press. We hope that this will be the case soon and we can discuss how rail could provide better service to Sylt tourists and residents today together! Especially the customer group that takes the train only once a year, by car on the Autozug to Sylt, we should offer the best possible service and modern infrastructure, as a showcase of a modern rail system!

But unfortunately, when referring to the evolving success story of rail reform in Germany, with a remarkable competition level and good access to the infrastructure, there has to be mentioned a small “BUT” remark:

Because the success of the USA’s rail system is based on vertical integration I cannot criticize DB’s holding structure. But this is Europe and there are supposed to be clear governance rules for the holding not to intervene in competition between operators. Our experience has been that the DB holding supports the DB operators with their press office, the holding staff, the lobby units and its lawyers.

A holding of an integrated railway, financed by contributions also from the infrastructure parts of DB, should have clear and transparent governance rules. These rules should be effective for all units and persons connected to infrastructure or partially financed by infrastructure.

Let me close by saying that in my comments about DB, I recognize that within a large holding company, there are no doubt many different viewpoints among its many subsidiaries. Overall, we enjoy a good relationship with DB and could not have achieved many of the things we have achieved without the cooperation of any number of its subsidiaries—for example, RegioRail’s commercial integration for wagonload with DB in France, and HKX’s commercial integration with the C-tariff in Germany are good examples of balancing competition with cooperation. Further, it is easy to understand how cultural change and internal consensus are evolutionary, not revolutionary, in large and complex organizations. My comments are intended as constructive criticism to a friend—a very large friend indeed, but nonetheless a friend.

Finally, I invite you to look at how RDC has acted in other countries, and in particular the USA. We put the best interests of the industry ahead of our own, for the very basic reason that in a network business the overall health of the network is even more important than the health of individual players within that network. It would be a mistake, however, to interpret this as a sign of weakness. We work for the common good, and to do the right thing, and pride ourselves on knowing when to choose our battles. And while we prefer compromise, we recognize that compromise is not always possible and are prepared to act accordingly.

I hope that you will take my comments as a combination of commitment, resolve and, yes, optimism. I am now prepared for questions and thank you for the opportunity to speak.

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