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1. The Situation 2nd fare disaster has undesirable consequences

DER SPIEGEL hit the nail on the head¹: the fare disaster caused once again by the DB AG has, above all, strategic dimensions: a) the group does not have the pricing power and b) with its new transport holding (DB ML) DB AG is not a "normal" company, but is subject to strong political influence. The capital market is now thinking more determinedly about downward evaluation adjustments. The CEO and his CFO will have to rewrite significant passages of the screenplay for the road shows.

What the DB AG most certainly did not intend either: the scandalous incidents bring to the fore the question of who controls the pricing policy of the DB AG at all? The regulatory authority has no bite as far as price control is concerned because there is no legal basis for efficient control of the track prices. All those concerned have known that for years. And nobody could claim that the Federal Government was interested in deactivating this number 1 discriminatory lever. In any case, the proposals of the BNetzA (Regulatory Authority) for track price control² have been sleeping in the drawers of the Ministry of Transport since the end of June.

¹ DER SPIEGEL: No. 38 of 15.9.2008, S. 36

² "Final report of the Bundesnetzagentur for the introduction of an incentive rulling in the rail sector" of 26.5.2008

2. Assessment of Holding Model

Via dialectic to a quantum leap

The railway reform of 1995 will by no means be completed with the Holding Model, as it is euphemistically called in the preamble to the Participation Contract. There can also be no mention of the 1st EU railway package (unbundling of infrastructure and transport) being implemented, particularly not inasmuch as the top positions at "ML" are to be filled by managers who manage or control the infrastructure companies in personal union. BUT: it must be borne in mind that, on the part of ML, there is the chance of there being no automatic coordination of interests for the first time. It is, for example, difficult to imagine that the new shareholders will stand on the sidelines as the DB group raises the track fees regularly and uncontrolled. The new shareholders will ask when, where and how much money is being spent in the maintenance of the network and why the rail freight operators have no definite prospects of *more* railway capacities. Those are exactly the questions the competitors (whose interests are articulated by Netzwerk Privatbahnen) are putting today. In this respect, the private operators expect the "Holding Model" and the new shareholders to exert a noticeable increase in pressure on the decision-makers in Berlin and in the Länder (i.e. the Part States of the FRG).

3. EU Aid Prohibition

Uncovered flank for going public

Several concrete problems have been swept under the carpet in the discussion on privatisation.

EU infringement proceedings for violation of aid prohibition: this is about the sinecure of the German national railway, in particular the exceptional profits DB Regio has made from regional transport.³ Although the practice so far of eliminating the competition when awarding transport contracts worth billions no longer infringes the EU procurement law, every contract awarded without tenders lays those participating (Länder and DB AG) open to suspicion that the agreed remuneration includes illegal aid components⁴. The first Länder have already reacted and withheld remuneration components from current transport contracts that were awarded without being put out to tender⁵. In addition, the EU Commission recently instituted infringement proceedings against the Federal Republic of Germany for a violation of aid prohibition⁶. In the medium term, DB Regio will thus lose its position as the cash cow of the group. The Länder can also no longer afford financially to forgo the savings potential created by fair competition.

4. Separation of Network and Transport

Top management issue

In the run-up to going public this is also a delicate subject: Netzwerk Privatbahnen lodged a complaint with the EU Commission back in 2006 because the (then new) Allgemeine Eisenbahn Gesetz (AEG-General Railway Law) left the function of *track allocation and fees* within the *integrated* German rail group. According to EU law these functions are to be outsourced to a neutral body *outside* the integrated group. This EU complaint is now in the phase of infringement proceedings being instituted against, among others, the Federal Republic of Germany.

Also concerning unbundling: the German regulator has ordered the corporate law

³ In a Bavarian award agreement the price per km fell from ca. € 8.50 € through competition to ca. 85 cents.

⁴ ...although the practice so far of eliminating the competition when awarding transport contracts worth billions no longer infringes the EU procurement law. In short: Tendering is no longer compulsive but without tendering: problem of violation of aid prohibition.

⁵ VRR – Public Transport Network Rhine - Ruhr

⁶ Case VBB – Public Transport Network Berlin - Brandenburg

department of the DB Group to be unbundled.⁷ In the first instance the Administrative Court said the regulator was right. Just how explosive DB AG considers this subject can be seen from the fact that the CEO has declared the *unbundling of corporate lawyers* his personal issue.

5. Half-yearly Figures of DB AG

Little growth despite positive environment

The half-yearly figures of the DB AG, presented mid August, lead to further discussions. Figures for the partial privatisation due for the division "DB ML" were made public for the first time. Most figures for the group as a whole were slightly above those of the previous year. However, if acquisitions are disregarded, the transport service in rail transport scarcely increased whereas the economic result increased significantly.

The new DB ML division booked sales of € 16.2 billion and a pre-tax profit of € 0.9 billion. The company assumes 7.2 billion € of the group's approximately 16 billion € financial debt. The figures were received with reserve on the capital market (Wirtschaftswoche, 25.8.08). Netzwerk Privatbahnen had the half-yearly figures analysed and published the result⁸.

6. Multi-Annual Agreement (LuFV)

Government makes serious strategic mistakes

It is right that the Federal Government wants to secure financing of the railway infrastructure in the long term. Every infrastructure operator needs planning reliability. However, it was the British colleagues who posed the heretical question at an EU Commission workshop of *how the state wants to sanction the national infrastructure manager (IM) in the case of legally insufficient performance? Every financial sanction by the State deprives the infrastructure of funds, which in the end have to be replaced by the State itself!* - Nothing need be added. More effective would be an unbundling of network and transport, stringent control and a significant influence over the profit bonuses of the management. The management board bonuses amount to around half of the total earnings. A direct intervention into the profit bonuses would, therefore, not be at all inconsiderable.

It is also fundamentally wrong for the government as the granter of subsidies to *negotiate on an equal footing* with the DB Netz as the receiver of subsidies. The Federal Government is on the verge of accepting the proposals of the DB to measure the quality of the infrastructure on the basis of theoretical values (running time of standard trains). What is not considered, for example, is how long a freight train has to wait somewhere in the Republic for the green light to continue its journey, what diversions a train takes due to capacity bottlenecks or construction sites and what restrictions the railway operator is subjected to on a particular route as regards weight or the opening times of railway signal boxes. Many parameters are inadequately defined, for example speed restrictions. It remains to be seen whether the Multi-Annual Financing Agreement (LuFV) can later be adjusted to practical experience and which neutral body checks the data of the DB AG.

⁷ <http://www.privatbahnen.com/content/view/40/70/>

⁸ Position and press statement of Netzwerk Privatbahnen on the half-yearly figures of the DB AG:
<http://www.privatbahnen.com/pdf/080819+NP+Stellungnahme+Halbjahreszahlen+DB+AG+2008.pdf>
http://www.privatbahnen.com/pdf/PM08_3.pdf

7. Performance Regime

Higher regional court throws out preliminary injunction

In 2007 the German regulatory authority tried unsuccessfully to stop the completely inefficient Performance Regime of the DB Netz AG: upon an application made by DB Netz the Higher Regional Court thwarted the regulator.

Netzwerk Privatbahnen thus applied the emergency brakes and obtained a preliminary decision against the DB Netz AG from the competent Regional (civil law) Court. However, the Higher Regional Court Frankfurt reversed the judgement in appeal proceedings. Reason: at the time the suit was filed it was not an *urgent* case. The court of appeal did not comment on the application for injunctive relief by Netzwerk Privatbahnen. The short-term goal of the competitive railways was achieved, however: the DB Netz had abandoned the Performance Regime. Netzwerk Privatbahnen has been working for months on a new Performance Regime *together* with the DB Netz AG, the DB's own railways and the regulator. - Why the present Performance Regime is so dangerous was recently published by Bahn-Report⁹.

8. Federal Railway Authority (EBA)

The wind of change is blowing

An isolated case on a 34.000 km network? - In Karlstadt DB Netz AG applied for the removal of sidings. Existing sidings at the Würzburg shunting yard were cited as compensation. Netzwerk Privatbahnen more or less discovered by accident that DB Netz had applied for the closure of the very same sidings in Würzburg at the same time. The EBA cracked down heavily. - In another case, when DB Netz had kept the authorising body waiting too long for information, the EBA stopped the matter being processed without further ado. Since then information from the infrastructure operator is flowing smoothly. It would also seem that the railway supervisory authority is no longer impressed by the normative power of the factual: the authority recently denied the approval of an integrated electronic control centre that had already been finished. - It appears that the times when the DB AG could "rely" on the EBA are over.

9. Complete blocking Berlin - Hamburg

An inbuilt scandal

It has been known for several years that all the concrete sleepers of this double-track extension must be replaced. This is at last supposed to be happening in the coming spring. A disaster, however, is the devastating investment policy of the DB AG that is becoming apparent: In order to save on maintenance costs, the DB dismantled all tracks not required for immediate transport in the 1990s, in particular almost all sidings. Railway experts both inside and outside the DB have been tearing their hair out over this strategic short-sightedness for years because, in the absence of sidings, almost every sizable construction site will have to be supplied via the second track. So instead of just one track being closed (minimum of intervention), one of Germany's most frequented railway lines will be completely closed for months. This management mistake does not hit DB management, but the customers: freight transport and ICE transport will be diverted via Stendal to the already completely overloaded Hanover-Hamburg route. The Baltic ports of Wismar and Rostock will be as good as unreachable for rail freight traffic. Regional rail transport will come to a complete standstill, as will local passenger rail transport on the detour section as this is the route the diverted trains will take. Netzwerk

⁹ Bahn-Report 4/08: <http://www.privatbahnen.com/content/view/39/69/>

Privatbahnen has taken up this unparalleled incident and expressed its concerns to the DB Netz AG¹⁰, as yet, however, without any tangible result. Further background information and causes – not contradicted by the DB Netz – are published in Bahn-Rreport¹¹.

10. And finally...

DB AG – EWS - ERFA

The European Railway Freight Association (ERFA) represents the interests of the railway operators in Brussels and stands up for fair competition on the European track. Netzwerk Privatbahnen is one of ERFA's most active members. By the way: DB AG through EWS is also (indirect) member of ERFA. EWS has even one seat in the board of the association. It is positive that EWS lobbies for complete liberalisation and – among others – for the abolition of state aid for state owned railway companies and even for unbundling of network and transport in the railway sector. Not only EWS benefits from that policy but also EuroCargoRail, the subsidiary of EWS in France.

Until the next newsletter

Yours sincerely,



The German version of this Infoletter

http://www.privatbahnen.com/pdf/Infobrief2_08.pdf

You can order the NewsLetter from our website → <http://www.privatbahnen.com/content/view/51/99/>

¹⁰ <http://www.privatbahnen.com/content/view/74/280/>

¹¹ <http://www.privatbahnen.com/content/view/74/280/>