Lilo Locher[1]

The Impact of Merger Control on Competition in the Railway Sector

September 2006

Abstract

This paper gives an overview over recent merger control decisions concerning railway transportation in Germany. Whereas merger control has little or no impact on competition in the freight transport and in the long distance passenger transport sector, it is able to protect emerging competition in the local passenger transport sector. We put this down to the fact that merger control is an ex ante instrument preventing monopolistic market structures to emerge. Thus, in freight transport and long-distance public transport, merger control is not able to restrict the prevailing market power of the incumbent Deutsche Bahn. Competition in local public transport is different, as there is competition not in, but for the market. Furthermore, local public transport markets are in motion, which gives merger control the opportunity to intervene in the reorganization process. Though there are a large number of small incumbents – former public services companies – merger control can contribute to the formation of a competitive market structure as market entry is easier and as DB Regio and adjacent small incumbents can easily start competing for local markets.

JEL-Classification: L51, L92
Key Words: merger control, railway competition

1 The author is working for the Federal Monopoly Commission, Germany. Postal address: Monopolkommission, Adenauerallee 133, D-53113 Bonn, Tel: 0049-228-9499-273, lieselotte.locher@monopolkommission.bund.de

1. Introduction

One the one hand, merger control is a crucial pillar of modern competition policy. On the other hand, merger control should by its very nature not be able to introduce competition in a network industry that is, to start with, dominated by a powerful incumbent. First, note that merger control, in contrast to the persecution of cartels and dominance abuse, acts as an ex ante tool to prevent the emergence of market structures that foster anti-competitive behavior. Thus, in a market that is already dominated by a single company merger control cannot deploy any effect. In an extreme case, we can imagine a market in which the dominant company has a 100 % market share. It is not possible for this company to perform a horizontal merger, as it already dominates the whole market. Thus, there is also no merger case that can be blocked by the cartel authorities. Second, we expect even the persecution of cartels and, in particular, dominance abuse, not to be sufficient to establish competition in a network industry. In the railway sector, the track network forms a natural monopoly, and it is common sense today that competition in upstream and downstream markets is only possible through the regulation of the network by a regulatory agency.

This said, it is obvious that merger control can never be sufficient to protect or even establish competition in the railway sector as well as in any other network industry. However, it might still contribute to the evolvement of competition, in particular in cases in which the liberalization process leads to a restructuring of markets as in the local public transport sector.

In order to see which impact merger control has had on competition in the railway sector so far, we give a survey on merger control in Germany, presenting merger control cases the Federal Cartel Office and the courts of appeal have dealt with within the last few years. We also touch on some decisions by the European Commission. We find that in the freight sector, merger control is not able to exert a positive effect on competition. In long-distance passenger transport, competition on the tracks is only just starting. So far, there have been no merger cases. However, in the franchise bidding markets for local public transport, merger control seems to play a non-negligible role in protecting new entrants. Accordingly, the major part of this paper deals with the situation in this area. So far, the Federal Cartel Office has blocked one merger in the local transportation sector and imposed remedies in two other cases. Merger control already seems to act as a deterrent in some further cases, in particular as the Federal Court of Justice so far has approved the Cartel Office's decisions in this area. In general, remedies to activate intermodal competition as imposed by the

European Commission in a number of decisions in the airline industry seem to have little or no effect.

2. Merger control in the freight sector – a limited impact on competiton

Within the last few years, the Federal Cartel Office dealt with a number of minor cases in the freight sector. Only one case has been reviewed in the second phase. Railion, the freight company within Deutsche Bahn AG, planned the acquisition of 100 % of the shares of RAG Bahn und Hafen (RBH), a subsidiary of the RAG.[2] RAG is a large German power company, which also produces coal. RBH is in charge of shipping the coal via rail to its destinations. Railion's market share in railway freight traffic is around 90 %. Yet, the merger has been cleared by the Federal Cartel Office.

The classical two-step approach to assess a merger consists, first, of a market definition, and second, of an evaluation of the competitive structure in the market(s) that have been identified in the first step. In this case, the Federal Cartel Office defined a product market for dry, free flowing bulk cargo. Products that fall under this category are ore, scrap metal, stones, earth and coal. Dry, free flowing bulk cargo is transported in special open carriages. It is characterized by large volume and weight compared to its value. This is the reason why the Federal Cartel Office decided that transport by road was not part of the relevant product market. It would be, according to the Office, too expensive to ship ore and coal on the road. In contrast, water transport was considered to be part of the relevant product market. A ship has about the same capacity as a freight train (1 000 – 3 000 t as compared to 20-30 t of a lorry), freight costs per ton are comparable as well. The Federal Cartel Office assumed that the geographical market was national, i.e. it did not define every route as a single market as it is done in air transportation by the European Commission and in local public railway transport by the German Court of Appeal. The fact that the water grid is much smaller than the railway grid (7 000 vs. 35 000 km) does not mean that water transport cannot act as a substitute for railway transport. According to the Federal Cartel Office, industries that have to transport bulk cargo are situated in places that allow the shipment of bulk cargo. They are more likely to locate at the side of navigable rivers, so that the existing waterway grid is sufficient for them.

The Federal Cartel Office cites two market shares for railways and ships in the transportation of dry, free flowing bulk cargo, one for internal traffic (origin and destination of the transport in Germany), and one for domestic traffic (traffic within Germany, including the German sections of international traffic). For internal

2 Federal Cartel Office, Case No. B9-50/05, 30 September 2005, WuW/E DE-V 1113 “Railion/RBH”.

traffic, railways have a market share of about 71 %. With a Railion market share of roughly 90 % in the freight transport sector, Railion has an estimated total market share of 64 % on the relevant market. As to domestic traffic, railways have a market share of about 51 %. The market share for railways is much lower if cross-border traffic is included because cross-border traffic is much more complicated by train than by ship due to the fact that the engine or at least the driver have to be exchanged at the border. Yet, even for domestic traffic, the Railion market share amounts to 46 %, which is much above the level for a presumption of market dominance in the German law, which amounts to one third (§ 19 Sec. 3 GWB). Generally, in-house services are not part of the relevant market and are thus not included in the calculation of market shares. Only in the second step of merger analysis, the assessment of competitive effects, in-house services are taken into account, too. Due to a lack of data, in-house services have been included in the calculation of market shares as well in this case. However, the Federal Cartel Office does not expect any major changes in results depending on whether in-house services are included or not. Note, however, that the company to be taken over, RBH, has so far only delivered in-house services for RAG.

At first sight, it seems clear that the projected merger increases the dominant position of Railion on the market for dry, free flowing bulk cargo, and has thus to be blocked by the Cartel Office. Yet, the merger has been cleared for three reasons. First, Railion has already been in charge of the operation of RBH traffic before the merger due to a long-term contract, which continues till 2012. Thus, although the merger leads to a different ownership structure, there is no material change in the allocation of tasks to be expected. Second, the Federal Cartel Office stresses the vertical aspects of the merger. Considering that RBH does not execute most of its transport, but only organizes its execution, the merger is rather vertical than horizontal. Third, the parties notified the merger in combination with two other projects: first, to resign from a leasing contract of freight cars, and second, to sell 200 freight cars to a commercial vehicle leasing company. These two projects are part of the notified merger and are thus not remedies, at least not in judicial terms. In economic terms, however, they act as remedies. The Federal Cartel Office expected them to facilitate market access for competing suppliers of transport services.

Like many access commitments, these proved to be ineffective as well. According to the Federal Cartel Office, the competitors of Railion had complained that they could not enter the market due to the lack of freight cars. As buying new freight cars is quite a considerable investment decision, it might be preferable for potential competitors to rent them. However, it turned out that none of the competitors was willing to rent any of the 200 freight cars offered by a vehicle leasing company as a consequence of the merger, at least not at rates usual in the market, as has been stated in the decision of the Cartel Office.

Overall, it seems that the acquisition of RBH by Railion may to a certain degree aid to amplify the dominant position of Railion in the German freight market. However, at the same time the Federal Cartel Office could hardly have blocked the merger in accordance with the German law. Also, "may to a certain degree" is certainly not something on which a government authority should be able to intervene in a market process. It seems that a clearance of the merger in combination with a release of rolling stock in order to give competitors a chance to enter the market, is a good way for a cartel authority to deal with the case.

Yet, the question remains why the market access measures did not prove to be effective. One reason might be that the economies of vertical integration seem to be quite large in the rail freight sector. Pittman (2005) argues that the economies of vertical integration are focused on the interface point of wheel and rail. For railway engineers, the point where steel wheels meet steel track is crucial. Bad wheels can cause serious damages on the tracks, even more so because there is a trend toward heavier axle loads in freight railways. Ivaldi et al. (2005) find that the positive welfare effects of merger-related efficiency gains in the U.S. rail industry exceed the negative welfare effects of merger-induced increases in market power. However, the interface point of wheel and rail should not be an issue if competitors of Deutsche Bahn rent rolling stock that has been used by Deutsche Bahn itself before to organize their own transport. The U.S. rail mergers Ivaldi et al. investigate are – at least partly – mergers between vertically integrated companies, each of them with its own grid, so that their results cannot be used to justify the reluctance of market entrance in our case.

Thus, it remains to stress that competition on tracks may be difficult for entrants, because there must be a large degree of coordination between the entrant and the incumbent company that operates the tracks. The vertically integrated incumbent has a wide range of possibilities to discriminate against the entrant. Yet, the fact that the latest freight sector decision of the Federal Cartel Office has not fostered competition seems above all to be due to the fact that merger control can only avoid a monopolistic market structure to develop. As soon as the market structure is oligopolistic, there is no more role to play for merger control. Finally, it is perhaps not surprising that the supply of rolling stock has not proved to be successful. It is obvious that an entrant in any market is forced to make an investment before he can start earning money. Nevertheless, there is entry. Furthermore, current competitors of Railion like, e.g. Rail4Chem, are companies whose financial endowments seem to allow for the acquisition of their own rolling stock; they do not depend on the possibility of leasing in order to start their business.

For the sake of completeness, we should not conclude this section without mentioning that there have been some merger cases concerning joint ventures between incumbents of different member states in the European Union. There are also two merger case decisions by the European Commission dealing with joint ventures between Deutsche Bahn and smaller companies in the freight sector. In both cases, the joint venture is supposed to offer a combination of freight transport and port services.[3] They have been cleared without further commitments by the parties.

3. No mergers in long-distance passenger transport

Competition in long-distance passenger transport is intended to be on the tracks, i.e. different companies, one of them Deutsche Bahn, offer services on different lines of the same network. Entrants must, first of all, cooperate with the vertically integrated incumbent on the use of the tracks, which may be used by DB passenger and freight trains as well. Second, they must cooperate about the use of stations and station services. Third, there may be cooperation necessary about ticket fares and timetables. The latter point may be optional, however, it is hard to imagine that an entrant can obtain a significant market share if his tickets and timetables are not attuned to those of the incumbent. This is particularly true for networks like the German one with a large fraction of connecting traffic.

Apart from problems of non-discriminatory access, Ivaldi et al. (2003) stress the fact that there is a fundamental asymmetry between an incumbent operating a network and an entrant, competing on point-to-point routes (p. 61). Everything equal, the marginal cost of running a train may be lower for the incumbent than for the entrant, because the incumbent's marginal cost is reduced by the additional profit made on the connecting routes of the line in question. Higher frequency on the line in question increases traffic on connecting routes. If the entrant operates the line, this effect turns out to be a positive externality for the incumbent. Again, this effect is of particular importance in the German network with a large fraction of connecting traffic.

3 European Commission, Case No. COMP/M.2632 – Deutsche Bahn/ECT International/United Depots/JV, 2 February 2002, Case No. COMP/M.2859 – Deutsche Bahn Cargo/Contship Italia/JV, 15 July 2002.

The problem may be solved if tickets etc. are completely transferable, and passengers perceive services of both the entrant and the incumbent as complements. In that case, each provider contributes to the network as a whole. However, we expect that this turns out to be quite difficult in practice, due to the very asymmetric distribution of market shares and the fact that the incumbent operator, Deutsche Bahn, is vertically integrated. Problems with connection trains, the handling of delays, the allocation of revenues etc. abound. Thus, there is a broad range for frictions and conflicts between the incumbent and the entrant.

This being said, it is not surprising to see that in the few cases in which an entrant offers some point-to-point services, the respective routes are rather short and predominantly in sparsely populated areas, in which connecting traffic may be less important. Also, they run relatively slow trains with many stops, which may mainly be used by commuters from small villages which do not depend on the facilities of the network as a whole. For instance, Veolia covers some routes in the former GDR, the routes Gera-Berlin, Leipzig-Berlin, Dresden-Stralsund and Harz-Berlin. Metronom, a joint venture of several local public transport providers, runs regional trains on the Bremen-Hamburg line.

So far, no mergers in this area have been notified to the cartel authorities, which is in line with the overall sluggish development of competition in this sector.

4. Merger control as a safeguard: Competition for the market in suburban and local passenger transport

In Germany, suburban and local passenger transport is split up in two segments. First, there is public road traffic (ö*ffentlicher Straßenpersonenverkehr* – ÖSPV), covering bus and metro services. The ÖSPV is regulated in the Law for the Transportation of People (P*ersonenbeförderungsgesetz* – PbefG). Second, there is local public railway traffic (S*chienenpersonennahverkehr* – SPNV), i.e. the suburban railway system. The SPNV is regulated in the General Railway Law (A*llgemeines Eisenbahngesetz* – AEG). I will use the term “suburban transport“ or “local transport” if I am talking about both of them and refer to ÖSPV and SPNV to distinguish the two, if necessary.

In two ways, suburban passenger transport differs fundamentally from both long-distance freight and passenger transport. First, though Deutsche Bahn is the typical incumbent in the operation of SPNV networks via its subsidiary DB Regio, its national market share in ÖSPV networks is quite low. Usually, the incumbent in ÖSPV networks is a local municipal provider. In recent years, Deutsche Bahn has tried to enter this market via its subsidiary DB Regio. Second, in suburban passenger transport, competition does not work *in*, but *for* the market. There is a franchise bidding process which allocates one of the bidders the management of the respective network for a certain number of years. In this period of time, the winner of the bidding process is a monopolist. Collaboration with Deutsche Bahn is only necessary in cases in which tracks are used both for local and long-distance traffic. Competition *for* the market facilitates entrance. In fact, there are a non-negligible number of companies, both German and foreign, entering the market. Some domestic companies like Hamburger Hochbahn are companies that operated public transport in one urban area – Hamburg in our example – and are now expanding within Germany by participating in franchise biddings of various other cities. In Kiel, Wiesbaden, Lübeck and Fulda they organize ÖSPV transport in cooperation with the local incumbent. There is also at least one foreign company entering the market, Veolia, a French company that organizes local public transport in Pforzheim and Müritz, for example.

So far, the public authorities that are in charge of organizing local public transport – cities and counties - do not have to hold a tender. Instead, they can organize public transport themselves or, which is still very common, assign a company – usually the incumbent - without tender to organize their local traffic. In theory, we expect that consumer welfare increases through the introduction of competition. Franchise bidding ensures the benefit of scale economies through the selection of a single supplier, while at the same time it secures the sampling and rent-reducing benefits of competition (Armstrong et al., 2006). In fact, Lalive et al. (2005) show that in Baden-Württemberg SPNV networks that are operated by a competitor of DB Regio after a procurement auction have enjoyed higher growth in the frequency of services than lines of non-competitive networks, operated by DB Regio. However, the fact that Deutsche Bahn might refrain from infrastructure investments in case SPNV networks are given to competitors might hinder public authorities from organizing a procurement auction (Booz Allen Hamilton, 2006, p. 158).

In recent years, the Federal Cartel Office had to check quite a large number of mergers in the local transportion area. However, only a handful of cases have been analyzed in a second phase. Among them, one concentration has been blocked. In a second case, the parties withdrew their notification after a statement of objections by the Federal Cartel Office. Two more cases have been cleared with commitments. So far, all the remaining cases have been cleared. In the following, we concentrate on the case that has been blocked and one of the cases that have been cleared with commitments. In both cases, the merging parties filed an appeal.

Thus, there are also decisions by the Court of Appeal (Oberlandesgericht Düsseldorf) on the respective mergers and, due to a further appeal, even by the Federal Court of Justice. We will first present the decisions and then discuss their consequences for competition in the local public transport sector.

4.1 Local transport in Saarland

In June 2004 the Federal Cartel Office prohibited RSW (Regionalbus Saar Westpfalz), a 100 % subsidiary of DB Regio to buy a 30 % share in KVS, a local transport company owned by Saarlouis county (*Landkreis Saarlouis*).[4] In its assessment of the merger, the Federal Cartel Office first defines a market for local public transport. As to the relevant product market, it remains open whether ÖSPV and SPNV form two different or just one single market. However, this is not relevant for the Office's decision. Geographically, the market is restricted by the area of Saarland. The Federal Cartel Office assumes that the demand side for local public transport are its passengers. The communities that are in charge of organizing public transport are only indirect consumers. They organize consumption for others, i.e. the passengers. Although each passenger can travel only on one specific route at once, the Federal Cartel Office states that the whole network is one single market, as there is a general demand for using the network as a whole – realizing a particular demand for a certain line each time the network is used. Note that all other modes of transport like taxi, bike and car are not part of the relevant market and do not play any role for the competitive assessment of the Cartel Office.

Next, the Federal Cartel Office calculates market shares using the length of lines a particular company is allowed to serve as the relevant unit.[5]

Table 1: Market structure in Saarland

Company	***Market share ÖSPV***	***Market share SPNV***	***Market share combined***
DB Regio		85 % - 95 %	5 % - 15 %
RSW	40 % - 50 %		35 % - 45 %
Sum	40 % - 50 %	85 % - 95 %	50 % - 60 %
KVS	5 % - 15 %		5 % - 15 %

4 Federal Cartel Office, Case No. B9-16/04, 9 June 2004, WuW/E DE-V 937 "ÖPNV Saarland".
5 Usually, market shares are calculated on the basis of revenues. Due to subsidies and the widespread use of generally valid tickets for the whole regional transportation system this is not possible in local transportation systems.

Note that the numbers for the combined market shares presented in table 1 imply that the ÖSPV network is much larger than the SPNV network. In its decision, the Federal Cartel Office states that DB Regio, together with its subsidiary RSW, has a dominant position in Saarland. With a combined market share of at least 50 %, it is high above the threshold of 33 % in § 19 Sec. 3 GWB. The Federal Cartel Office states that there is not much competition to be expected in Saarland anyway. So far, there has never been a franchise bidding, and only two communities said that they may hold a tender in the future. Furthermore, it is likely that only local companies participate in a potential bidding process. The fact that all local companies that exist in Saarland have a much smaller market share than DB Regio is further evidence for the dominant position of the latter, as well as its overwhelming financial power. According to the Federal Cartel Office, the projected concentration would further strengthen the dominant position of DB Regio on the relevant market. First, DB Regio would hold a 30 % share in a competing company, KVS, which would obviously weaken competition in the relevant market, in particular as KVS is one of the very few significant competitors existing at all. Second, as KVS is owned by Saarlouis county, the merger would also have a vertical foreclosure effect. The participation in KVS creates a link between DB Regio, the dominant supplier of local public transport, and a public agency, Saarlouis county, which is on the demand side of the market.

The merging parties filed an appeal. However, the Court of Appeal (OLG Düsseldorf) affirmed the Cartel Office's decision.[6] Although its competitive assessment is different than the assessment of the Federal Cartel Office, the material result is the same. Only recently, the decision by the Federal Cartel Office has finally been affirmed by the Federal Court of Justice.[7]

Table 2: Geographical market definition for local public transport by the Court of Appeal

Demand side	***ÖSPV***	***SPNV***
Public agency	by network	by network
Passenger	by route	by route

In contrast to the Federal Cartel Office, the Court of Appeal distinguishes two product markets for the two demand groups. First, there is a market in which the responsible public agency (community or county) assigns the provision of local public transport to a transport company (“*Aufgabenträgermarkt*”). Second, there

6 OLG Düsseldorf, Case No. VI-Kart 19/04 (V), 4 May 2005, WuW/E DE-R 1495 “ÖPNV Saarland”.
7 Federal Court of Justice, Case No. KVR 28/05, 11 July 2006.

is a market in which the passenger asks for a certain ride ("*Fahrgastmarkt*"). As the Court of Appeal also distinguishes between ÖSPV and SPNV, there are four product markets altogether. In principle, each of them has to be analyzed separately. Geographically, the public agency markets comprise an entire region, as has been done by the Federal Cartel Office. However, according to the Court of Appeal, passenger markets have to be delineated by routes. The Court of Appeal states that each time a passenger uses the public transport system, she uses only one route. Furthermore, she is typically not able to substitute this route by another route, as the starting and the end point of her trip are defined ex ante. As less than 5 % of passengers traveling on ÖSPV routes in the relevant region change trains during their trip, the routes taken by a particular train are a good approximation of the routes used by passengers. Thus, each train route can be considered as one market. Table 2 summarizes the Court's market definition.

In spite of the differences in market definition, the grounds of the Court are completely in line with the Federal Cartel Office's decision. The Court restricts its analysis to the ÖSPV public agency market and states that RSW has a dominant position on this market, which would be strengthened through the merger. Finally the court stresses that even on the passenger market, other modes of transport are not a substitute for public transport and do not have to be considered for a competitive analysis.[8]

4.2 Local transport in the Hanover region

In December 2003, the Federal Cartel Office cleared a merger of DB Regio and üstra intalliance, a subsidiary of the üstra Hannoversche Verkehrsbetriebe, the local public transport provider in the Hanover region, under one condition and four resolutive conditions.[9] Basically, the public agency in charge of organizing public transport in the Hanover region, "Region Hannover", was obliged to assign future local public transport contracts in a competitive way, i.e. by franchise biddings.

The merging parties intended to jointly organize SPNV and ÖSPV in a joint venture called intalliance. So far, ÖSPV had already been organized by intalliance, SPNV had been organized by DB Regio. In its market definition, the Federal Cartel Office again assumes that there are one or two product markets, either one for

8 § 2 Abs. 1 ÖPNVG of the Saarland states that the aim of public transport is to offer an alternative to motorized individual traffic, in particular in urban areas. Thus, there seems to be an apparent contradiction between this aim and the assessment of the competition authorities. However, the Court argues that though it may be that local public transport may have relevant substitution effects with respect to motorized individual traffic, this does not justify to conclude that motorized individual traffic may have relevant substitution effects on local public transport. Note that this means, in economic terms, that B is a substitute for A, while A is not a substitute for B.

9 Federal Cartel Office, Case No. B9-91/03, 2 December 2003, WuW/E DE-V 891 "DB Regio/üstra".

SPNV and one for ÖSPV or just one market for local public transport in general. As to the geographical delineation of the market, it remains open whether it is just the Hanover region, or whether some more cities in the surrounding of Hanover belong to the relevant market. Again, this does not play any role for the Office's competitive assessment.

According to the Cartel Office, in case of two separated markets for SPNV and ÖSPV, the concentration would strengthen the dominant position of DB Regio on the SPNV market and of üstra on the ÖSPV market. In case of one single market for local public transport, the projected merger would strengthen the common dominant position of both DB Regio and üstra. First, the Office states that to begin with there is hardly any competition on the local public transport markets in the Hanover Region and its surroundings, the main reason being that most contracts are not assigned to a company after organizing a procurement auction, but are provided as services on own account or assigned to the previous provider without holding a tender. According to current case law, the smaller the remaining scope of competition, the stricter the Cartel Office has to be in its assessment. The remaining competition in this market has to be protected particularly well by the authority, as it is particularly small.

As shown in table 3, the market shares for the merging parties are even higher in this case than in the Saarland case.

Table 3: Market structure in the Hanover region (Hanover region and surroundings)

Company	***Market share ÖSPV***	***Market share SPNV***	***Market share combined***
DB Regio		100 % (>90 %)	10 % - 20 % (10 % - 20 %)
üstra	60 % - 70 % (40 % - 50 %)		50 % - 60 % (30 % - 40 %)

In case of a common local public transport market, the dominant position of the merging parties is strengthened by the merger, because the ties between the two become closer. In case of two separate markets, the merger does not lead to an increase in market shares for neither of the two merging parties. However, the dominant position of each of them is strengthened. So far, each of them acts as a relatively strong potential competitor for the other one. In case of a merger, this competitor would no longer exist and, thus, competition be weakened.

The Federal Cartel Office holds the opinion that the remedies imposed will lead to an opening of a large part of the relevant markets. More specifically, the obligation to organize franchise biddings for provision contracts will open 30 % of traffic services in the ÖSPV and 100 % of traffic services in the SPNV to competitors. However, due to the long remaining duration of the current provision contracts with DB Regio and üstra, the market opening will only take place in several steps within the period from 2007 to 2013.

After the merging parties had filed an appeal, the Court of Appeal vacated both the remedy and the four resolutive conditions.[10] As there are, according to the Court, no competitive concerns about the projected merger, it should have been cleared without any remedies. As in the Saarland case, the Court of Appeal distinguishes four product markets, separated by demand side (public agency or passenger) and by transport mode (ÖSPV or SPNV). The geographical market definition on the passenger markets is by route, as in the Saarland case. On the public agency markets, the market is, according to the Court, at least national. Bid invitations are pan-European, so that in principle there may be even a European market. However, as it is not to be expected that undertakings without at least a German subsidiary win the tender, the Court assumes the market to be national. The market definition is summarized in table 4.

Table 4: Geographical market definition for local public transport by the Court of Appeal

Demand side	***ÖSPV***	***SPNV***
Public agency	national	national
Passenger	by route	by route

In contrast to the Court's market definition, the Federal Cartel Office stresses that only companies that are located closely are able to provide transport services relatively cheap. Thus, companies situated far away rarely participate in a public tender, and if so, their chances for winning the tender are rather low. This leads to a regional definition of geographical markets.

In its competitive assessment, the Court first states that DB Regio does not have a dominant position on the German public agency market for local public transport, in spite of a national market share of more than 90 %. DB Regio has only won 39 % of all franchise biddings organized from 2001 to 2003, which is the relevant number for discussing market power. Furthermore, there is, according to the Court, no evidence that

10 OLG Düsseldorf, Case No. VI-Kart 1/04 (V), 22 December 2004, WuW/E DE-R 1397 "ÖPNV Hannover".

DB Regio is favored in single tender actions. Even if DB Regio had a dominant position on the German public agency market for local transport, the projected merger would not strengthen this position. It is not to be expected that the relevant public agency, Hanover region, will abstain from organizing a franchise bidding or favor DB Regio in a franchise bidding just due to its bond with DB Regio.

Second, the Court states that neither does DB Regio have a dominant position on the SPNV passenger market, nor does the merger create such a position. As each SPNV route is operated by a single company, no competition is to be expected in the lifespan of a contract. Only when a contract has elapsed and there is a franchise bidding for its renewal, competition can take place, which corresponds to the competition on the public agency market.

Third, üstra does not have a dominant position on the German public agency market for ÖSPV transport. It is obvious that the market share of üstra, which is only active in the Hanover region, is quite small if the underlying geographical market is national.

Fourth, üstra does not have a dominant position on the passenger market for ÖSPV transport. Again, the Court argues that competition can only take place when a procurement contract is renewed. As the public agency in charge, Hanover region, plans to organize a franchise bidding in this case, and as there are several companies that are able to participate in the bidding, üstra neither has a dominant market position, nor is the position strengthened through the merger.

The Federal Cartel Office successfully filed an appeal. In the beginning of 2006, the Federal Court of Justice nullified the decision of the Court of Appeal and send the case back to the lower court, whose decision is, at present, still pending.[11] The Federal Court of Justice does not share the opinion of the Court of Appeal in Düsseldorf that the merger does not create or strengthen a dominant position.

Yet, the Federal Court basically confirms the market definition of the Court of Appeal in Düsseldorf. However, its conclusions are in line with the decision of the Cartel Office. On the German public agency market for SPNV transport, DB Regio has a dominant position. With a market share of 90 %, there have to be extremely strong arguments in order to refute a dominant position, according to the Federal Court. Still, the lower court had not stated arguments that were that strong. Also, it can be expected that the projected merger strengthens the dominant position of DB Regio, both due to its horizontal and its vertical component.

11 Federal Court of Justice, Case No. KVR 5/05, 7 February 2006.

The public agency market for ÖSPV transportation is, according to the Federal Court, a regional market. The fact that in 80 % of cases, a new contract is given to the previous provider, and the fact that in almost all cases, closely located companies are the winners of a bid is evidence for a regional delineation of the market. Due to its high market share, it is obvious that üstra has a dominant position on this market. A strengthening of this position due to the participation in DB Regio is self-evident.

The Federal Court does not comment on the situation on the passenger markets, it just mentions that it is to be expected that competition on the passenger markets manifest only on the public agency markets, as every line can only be operated by a single provider.

4.3 Discussion: The impact of merger control on competition in local public transport

As market definition seems to play a crucial role in the assessment of mergers in the local public transport sector, let me first comment on that. Interestingly, both the Cartel Office and the courts denied that there is intermodal competition in the local public transport sector. In the short term, this may be correct. However, economic studies on long-term cross-elasticities show that different modes of transport are substitutes (cf. Ivaldi et al., 2003, p. 15). Thus, it seems to make sense to assume that there is intermodal competition on the passenger markets for public local transport. However, passenger markets do not play any role for the assessment of a merger between public transportation companies. Intermodal competition between a bus line and other modes of transport like cars, bikes etc. does not depend on the ownership structure of the local public transportation provider.[12]

Thus, public agency markets are the crucial markets to look at in order to assess the competitive effects of a merger. In public agency markets, there is no intermodal competition, as a public agency is by law obliged to offer local public transport. Though, of course, the community or county in charge of public transport has some authority to decide on the closure of single lines or the construction of new tracks for a new line, it is not possible to refrain from offering public transport at all. The geographical delineation of public agency markets is, as is often the case, somewhat arbitrary. On the one hand, it is true that in most cases a regional provider wins the bid. On the other hand, it is likely that the pricing power of these companies is restricted

12 In contrast, in countries in which there are, at least partly, parallel networks of competing public transport providers, the situation on the passenger markets is decisive for the assessment of a merger. So the Office of Fair Trading stated in the First Group/GB Railways case that “the relevant frames of reference for assessing the competitive effects of this merger are considered therefore to be the point-to-point routes where there are overlaps between the parties' services...”, OFT, Anticipated acquisition by First Group plc of GB railways, 30 September 2003, p. 3.

by the potential entry of a more distant provider. Furthermore, there are at least two companies, DB Regio and Veolia, that participate in tenders nationwide. Thus, it seems to be necessary to strike a balance between the two poles of market definition.

In contrast to long-distance public transport and freight transport, in local public transport merger control seems to be able to protect competition. In at least four cases, a merger could not be accomplished as planned due to the intervention of the Cartel Office. In general, the market seems to become more competitive. The number of franchise biddings increases, the market share of DB Regio decreases. In the long run, it is likely that the number of independent local providers of public transport will decrease as well. As in the waste sector, it may be that the communities increasingly switch from offering the respective service on own account to outsourcing the service by founding a community-owned corporation. Finally, they organize a franchise bidding and assign the respective task to one of the larger companies that emerge within this process, either by market entrance or by internal growth of former community-owned corporations. In the waste industry, the current consolidation seems to lead to a final market structure in which only a handful of companies are the main players on the market, operating nationwide, and competing with each other for franchises.[13] This may be the market equilibrium in the local public transport markets as well.

As mentioned in the introduction, the ex ante nature of merger control makes it unlikely that merger control is able to break open a monopolistic market structure. Consequently, it does not play a role in long-distance transport, where Deutsche Bahn has a dominant market position for historical reasons. However, in local transport, the situation is different. First, in ÖSPV, DB Regio has not had a dominant position. Although each local provider may have had or may still have a dominant position, on a nationwide scale there are a large number of local public transport providers. Second, competition is now starting to propagate even in SPNV transport, although DB Regio does have a dominant position in this area. Here, the fact that competition takes place as competition for the market and not as on-track competition seems to make the difference. Entering the market turns out to be more attractive than in long-distance railway transport. We have discussed reasons for that in the previous section.

5. Remedies in intermodal competition

13 The consolidation in the waste industry is reflected in a large number of merger decisions in this area. Cf. http://www.bundeskartellamt.de/wDeutsch/entscheidungen/fusionskontrolle/Entschfusion.shtml.

The existence of intermodal competition implies that other modes of transport can exert competitive pressure on railway traffic. Thus, a survey on the impact of merger control on competition in the railway sector is not complete without mentioning some decisions in other transport areas that might be relevant for the railway sector. Notably there is some effort in the Directorate General for Competition to take intermodal competition between long-distance railway and air transport into account. In recent years, DG Comp had to deal with quite a large number of merger cases in the airline industry. In some cases, there have been competitive concerns on special routes, in particular for time sensitive passengers. In these cases, the respective mergers have been cleared under some market opening remedies including a commitment by the parties to offer intermodal services. E.g., one of the remedies in the Lufthansa/Swiss merger stated that:

> "The Parties undertake to enter, at the request of a railway or other surface transport company operating between Switzerland and Germany, into an intermodal agreement. This would allow these transport services to increase the number of frequencies and shorten at least one leg of the round trip so they can become adequate alternative also for time sensitive passengers."[14] [15]

To my knowledge, there is no study to analyze whether these remedies have had any impact so far. Anecdotal evidence suggests that there is none. One reason might be that time sensitive passengers, for which competitive concerns according to the European Commission are particularly large, do not consider railway and air transport as an alternative. In principle, this is what the Commission itself states in the respective decisions, emphasizing that business tickets in airline transport are regularly twice as expensive as first class train tickets on the same route. This is strong evidence for different markets. Thus, it would be rather surprising if the obligation for intermodal agreements had a large effect.

6. Conclusions

Merger control is not sufficient to establish competition in the railway sector. So far, it seems that its role in the freight transport and the long-distance public transport segments is negligible. We put this down to the fact that merger control is an ex ante tool that can only prevent the development of monopolistic market structures. If the market structure is monopolistic to begin with, merger control is not an appropriate tool to

14 European Commission, Case No. COMP/M.3770 – Lufthansa/Swiss, 4 July 2005, p. 41, analogously in Case No. COMP/M.3940 – Lufthansa/Eurowings, 22 December 2005, p. 22, and Case No. COMP/M.3280 – Air France/ KLM, 11 February 2004, p. 34.

15 The same obligation can be found in antitrust cases as well, e.g. Case No. COMP37.730 – Austrian Airlines/Lufthansa, 5 July 2002, No. 113.

protect competition.

In the local public transport sector, the situation is quite different, because a new market structure is emerging. Before, DB Regio has had a dominant position in SPNV markets, whereas local providers have had dominant positions in their respective ÖSPV market. Due to the increasing use of franchise biddings to assign contracts for the provision of local public transport, some former local providers get the chance to expand into other areas, competing, among others, with DB Regio. With merger control remaining active in this field, there is hope that the market may drift to a new equilibrium in which several large public transport providers compete for the assignment of provision contracts on a supra-regional or even national scale.

Literature

Armstrong, Mark and Davi E. M. Sappington (2006): Regulation, Competition, and Liberalization, Journal of Economic Literature Vol. XLIV, 325-366.

Booz Allen Hamilton (2006): Privatisierungsvarianten der Deutschen Bahn AG 'mit und ohne Netz'".

Pittman, Russell (2005): Structural Separation to Create Competition? The Case of freight Railways, Review of Network Economics Vol. 4, Issue 3, 181-196.

Ivaldi, Marc and Gerard McCullough (2005): Welfare Tradoffs in U.S. Rail Mergers, IDEI Working Paper No. 344.

Ivalidi, Marc and Paul Seabright (2003): The Economics of Passenger Rail Transport. A Survey, IDEI Working Paper No. 163.

Lalive, Rafael and Armin Schmutzler (2005): Competition for Railway Markets: the Case of Baden-Württemberg, University of Zurich, Working Paper No. 0511.