6 MAY 2004

COMPETITION ACT 1998

Enron Coal Services Limited – accompanied by Freightliner Limited – complaint against English Welsh and Scottish Railway Limited regarding EWS's parts credit from General Motors Corporation

INTRODUCTION AND SUMMARY

1. The Rail Regulator ("the Regulator") is minded to reject a complaint under the Competition Act 1998 ("the Act") made by Enron Coal Services Limited ("ECSL") and Freightliner Limited ("Freightliner"), regarding the parts credit received by English Welsh and Scottish Railway Limited ("EWS") from General Motors Corporation ("GM").

2. On the basis of the material submitted with the complaint, the Regulator considers that the complaint is unlikely to turn out to be well founded, for the reasons indicated below. Additionally, even if there were grounds for further investigation into the facts in order to reach a definitive conclusion, the Regulator is conscious that the arrangement complained about was operative for only a limited time, and is no longer a continuing concern. Overall, it does not appear worthwhile to the Regulator to devote further effort to examining the matter.

THE FACTS

The undertaking

3. EWS was formed in October 1996 following the acquisition by North & South Railways Limited of Rail Express Services in December 1995 and Mainline Freight, Trainsrail Freight and Loadhaul in February 1996. In April 1998 EWS acquired National Power's coal haulage assets and operations.

The complainants

4. ECSL was formed in London in 1999 and was ultimately held by Enron Corporation ('Enron') in the United States. The failure of Enron in the USA resulted in administration for its European subsidiaries and on 18 December 2001, ECSL was acquired by AEP Energy Services Limited.

5. Freightliner is owned by Management Consortium Bid Limited ('MCB'), which in 1996 acquired the 'Freightliners' business of Railfreight Distribution, one of the formerly state-owned rail freight businesses.

The complaint

6. The complaint alleged that EWS had breached Chapter II of the Act, in that it had attempted unfairly to influence the pricing policy of GM, a manufacturer of locomotives, by which EWS received a parts credit for every class 66 locomotive sold to a competitor. The complaint claimed that "GM was the only producer of high

quality locomotives suitable for the carriage of coal by rail ('Class 66')."[1] It alleged that this arrangement had resulted in the price charged for such locomotives being higher for EWS's competitors than for EWS. It was argued by the complainant that EWS was effectively recovering a "fine" for each locomotive supplied to Freightliner or other competitors of EWS. ECSL and Freightliner alleged that this "resulted in a higher cost of entry which had serious anti-competitive effects".[2]

7. The Regulator exercises powers under the Act concurrently with the OFT in respect of agreements or conduct which relate to the supply of services relating to railways[3][4]

8. On 14 February 2001 the Regulator informed the Director General of Fair Trading[5] (now replaced by a statutory board) that he wished to exercise his concurrent jurisdiction to investigate this complaint. Agreement by the Director to the transfer of the complaint to the Regulator was given in a letter from the Director dated 20 February 2001.

9. The Regulator is also currently seized with a much wider, and complex, investigation into possible infringements of the Act by EWS.

ASSESSMENT

10. The parts credit agreement between GM as a supplier of locomotives and EWS as its customer is a vertical agreement, within the meaning of The Competition Act 1998 (Land and Vertical Agreements Exclusion) Order 2000 ('the Exclusion Order'). The Exclusion Order is relevant to the applicability of the Chapter I prohibition within the Act.[6]

11. A vertical agreement entered into by an undertaking which holds a dominant position in a market may be subject to the Chapter II prohibition.[7] The Chapter II prohibition is set out in section 18(1) of the Act, which states in particular:

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1 Para 5.21 of ECSL's complaint dated 1 February 2001.

2 Para 5.22 of ECSL's complaint.

3 As defined in section 67(3ZA) of the Railways Act

4 See the Office of Fair Trading "Application to services relating to railways", A Competition Act 1998 guideline published with the ORR: *OFT430, November 2002*

5 SI 2000 No.260 The Competition Act 1998 (Concurrency) Regulations 2000

6 The Chapter I prohibition is defined in section 2(1) of the Act and prohibits agreements between undertakings, decisions by associations of undertakings or concerted practices which may affect trade within the United Kingdom, and have as their object or effect the prevention, restriction, or distortion of competition within the United Kingdom.

7 See OFT Vertical Agreements and Restraints, OFT 419, March 2000 [paragraph 6.1]

….any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.

12. In order to establish an infringement of the Chapter II prohibition, the Regulator would, in particular, have to define the relevant market, establish that the undertaking concerned holds a dominant position in that market, and show that the undertaking has abused that dominant position,

Market definition and assessment of dominance

13. The market alleged to be foreclosed is that for coal rail freight services. From the information collected and analysis conducted pursuant to other alleged breaches of the Act by EWS, the Regulator is content to proceed on the basis that a relevant market for coal haulage by rail in Great Britain can be defined and that EWS is dominant in this market. A rule 14 Notice issued by the Regulator today to EWS states that he proposes to make a decision that EWS has infringed the Chapter II prohibition in relation to coal haulage by rail in Great Britain. That rule 14 Notice sets out the Regulator's evidence and analysis in support of a market definition for coal haulage by rail in Great Britain.

14. While the alleged anti-competitive effect at the heart of the present complaint would arise in the market for coal haulage by rail, the complaint alleges that EWS attempted "unfairly to influence the pricing policy of General Motors"[8]. It is unclear why GM would accept, or be motivated to price in such a way as to potentially harm downstream competition. Foreclosure of the downstream market would not be to GM's benefit since it is not vertically integrated downstream. Indeed, as pointed out below, less competition downstream would likely be to GM's detriment.

Assessment of abuse

Freightliner's calculation

15. Freightliner presented the Regulator with an analysis which purported to show how, as a result of the GM parts credit accorded to EWS, Freightliner had paid a greater price per locomotive of between 24% and 48% relative to EWS, between May 1999 and December 2000. These calculations were predicated on the following assumptions:

(a) EWS's price per locomotive was equivalent to the best Freightliner price minus a bulk discount of 10% (assumed on the basis of a bulk discount for 250 locomotives);

(b) GM's revenue foregone on spare parts sales to EWS as a result of the parts credit was entirely recouped on locomotive sales to other customers (eg Freightliner);

(c) The exchange rate over the period varied from $1.42/£ to $1.65/£.

16. The Regulator does not consider that assumption (a) is appropriate for the purposes of analysing EWS's conduct in this case. An adjustment for the bulk discount should not be incorporated into the analysis, since if Freightliner had

[8] Heading (d) of ECSL's complaint dated 1 February 2001

purchased in similar quantities as EWS, it too would have likely benefited from a bulk discount (even if not necessarily of the same order as EWS – which would depend on GM's ability to price discriminate – see below).

17. The Regulator does not consider that assumption (b) is appropriate either. GM's ability to price differently to different customers for the same product is an example of price discrimination. Leaving the parts-credit entirely to one side, if GM is able to profitably charge a higher price to other rail freight hauliers than to EWS, it will be rational for it to do so – whether via a discount on spare parts related to the number of purchases by other hauliers or whether achieved via an explicit discount on the price charged to EWS.

18. With regard to Freightliner's exchange rate calculations, the Regulator does not consider that exchange rate fluctuations are relevant to the analysis of EWS's allegedly anti-competitive conduct in this case. If the $/£ exchange rate moved against the timing of Freightliner's purchases, this represents a normal commercial risk associated with international transactions.

GM's incentives

19. The price of class 66 locomotives is set by GM and not EWS. GM is not vertically integrated into the supply of traction services (such as coal haulage by rail) in Great Britain. GM has no apparent incentive to facilitate foreclosure of any such downstream market.

20. Indeed, economic reasoning suggests that GM would rather face an unconcentrated buyers' side of the market than one in which EWS was the only customer of its locomotives in Great Britain. (That is, the less concentrated the buyers' side of the market, the less buyers will be able to influence terms and conditions, other things equal.) Therefore, it would appear to be against GM's interests to facilitate foreclosure of the market for coal haulage by rail in Great Britain.

Timing

21. Documents received from EWS indicate that the parts-credit agreement expired on 22 May 2001[9], although EWS's spare parts credit notes indicate that no further credits were received post-August 2000[10]. Therefore, even if there had been a material anti-competitive effect along the lines alleged, it would have been of limited duration and would in any event no longer be a continuing concern.

CONCLUSION

22. The Regulator therefore concludes that:

(a) because prices for class 66 locomotives are set by GM and not EWS, if GM can profitably price discriminate between different customers it is likely to do so in any event, irrespective of any rebate offered to EWS for the purchase of spare parts;

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[9] Tab 5a of EWS s26 response of 12 July 2001.

[10] Tab 6a of EWS s26 response of 12 July 2001.

(b) in any case, GM would unlikely be motivated to foreclose the market for coal haulage by rail, since otherwise it will face a more concentrated buying-side of the market which would diminish its own trading position as a supplier; and

(c) the parts credit arrangement was limited in time, and a substantial period (at the very least almost three years) has elapsed since the parts credit expired. Even if it could be characterised as anti-competitive conduct, the other complaints regarding EWS's conduct which the Regulator is investigating seem (i) substantially more significant in effect and (ii) longer in duration (both in the past and a number potentially going forward), and the Regulator has chosen to concentrate resources on those other areas in particular.

23. For the above reasons the Regulator is minded to close his investigation of the parts credit.

SARAH STRAIGHT

DEPUTY DIRECTOR

OFFICE OF THE RAIL REGULATOR

6 May 2004