

DECEMBER 31, 2015

~~CONCEPT PAPER ON RAIL
DEVELOPMENT AUTHORITY OF
INDIA~~CONCEPT PAPER ON RAIL
DEVELOPMENT & REGULATORY
AUTHORITY OF INDIACONCEPT PAPER
ON RAIL DEVELOPMENT & REGULATORY
AUTHORITY OF INDIA

MINISTRY OF RAILWAYS

RAIL BHAWAN, NEW DELHI

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Rail Development & Regulatory Authority of India – a concept paper

Comment [PSM1]: The word regulation must be inserted otherwise it's main functions will not be evident. This proposal is like the Insurance Regulatory & Development Authority.

“Indian Railways currently is the only rail-based trans-city infrastructure provider and operator in the country. Therefore, for the purpose of orderly development of infrastructure services, enabling competition and protection of customer interests, it is important to have a regulation mechanism independent of the service provider. Initially it was contemplated to set up only a Tariff Regulator, however, it is now proposed to set up a mechanism, which will be entrusted with making regulations, setting performance standards and determining tariffs. It will also adjudicate on disputes among licensees/private partners and the Ministry, subject to review in appeal”

Excerpts from Shri Suresh Prabhu, Hon'ble Minister for Railway's speech while presenting Rail Budget 2015-16

Background

1. **Independent Regulation** has emerged as one of the important policy tools to manage industries characterised by either too little or imperfect competition.
2. Regulators set the rules of the game and administer these rules as a neutral referee to enable long term development, by harmoniously balancing the interests of the consumers and the providers of services. Institutional separation amongst government, regulators and the industry enables independent decision-making duly addressing the concerns of different stakeholders.
3. Many countries and the European Commission have been working towards the opening up of markets under national monopolies and introducing competition in an integrated market across sectors such as electricity, gas, telecom and railways. In India the power sector was the first to go in for independent Regulators in the mid-90s as a part of the power sector reform process. Independent Regulators were set up to steer the sector towards tariffs which enabled full recovery of costs as well as reduce cross subsidy as mandated under the new Electricity Act.
4. Reduction in costs through efficiency gains is best achieved by a competitive industry structure. Regulators can manage monopolies through efficient regulatory practices and tariff determination with penalties/rewards, process innovation and cost reduction. However, in theory, this is always the second best option to genuine competition. For a regulatory process to be effective in this regard, sufficient capacity both in terms of cost accounting as well as domain expertise is a prerequisite.

Comment [PSM2]: Even government departments regulate, therefore the adjective Independent is necessary. As also stated below in Para: 3

Comment [PSM3]: Bad example because the electricity regulators did not perform as per the law and thus the power sector is in deep debt. Perhaps this example maybe replaced by the Telecom sector.

Comment [PSM4]: Redundant sentence, because where natural monopolies exist competition cannot be promoted. However, regulators are required to mimic competition which has been elucidated.

Context

5. While Indian Railways (IR) is a department of the Government of India, it is also a commercial organization that has to operate on sound business principles. Apart from recovery of costs, it is imperative to generate revenue streams adequate to generate surpluses required for capital investment and for future expansion, periodic renewal of assets, up-gradation of infrastructure, and providing for safety related works.
6. On the revenue side of IR's business model, the primary sources of earnings are passenger fares and freight tariffs, which constitute about 27% & 67%, respectively, of total earnings; other incomes accruing to IR on account of peripheral activities are marginal in comparison to the income streams arising out of fares and tariffs. Therefore, setting of tariffs at levels which can meet the operating and investment needs of Indian Railways is *sine qua non* to the viability of IR's business model.
7. Estimated losses in passenger segment have mounted from Rs. 6159 crores in 2004-05 to ~~around a provisionally estimated over~~ Rs.30,000 crores in 2015-16, primarily on account of sharp increases in input costs and no commensurate increase in fares over the same period.
8. Sustainability of the prevalent methodology as a long-term strategy is now severely constrained; scope for upward revisions in freight tariffs is getting increasingly circumscribed on account of the fast evolving nature and extent of competition from other modes of transport. It is noteworthy that the Fares to Freight ratio, which was 0.47 in 1950-51, has almost halved to 0.27 in 2010-11. Available estimates also reflect that the share of railways in the total transportation of freight traffic has declined from 89% in 1950-51 to 36% in 2007-08.
9. The policy of cross-subsidisation of passenger transport has led to high demand for passenger services while the necessary infrastructure creation to serve this increasing demand has not been commensurate with the requirement. Further, enhanced freight rates have not helped in attracting more traffic to the Railways and have, in fact, led to traffic moving to Road in certain segments. This has affected the internal generation of resources for investment and set in motion a vicious cycle of low investment, leading to lack of capacity to meet the demand and affecting service quality. It is necessary to set up a suitable regulatory mechanism to address the tariff and standards of service issues.
10. There have been several attempts to rope in private investment to supplement capital availability and raise the efficiency of service in several areas such as building rail lines (connectivity through participative models), private container train operations and acquisition of rolling stock (wagons investment scheme and special freight operators scheme). While these initiatives have evoked positive response, the full potential has not been tapped as investors have generally been shy of investing in an industry where far too much is still being done or controlled by Government and the

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Comment [PSM5]: Simpler wording.

Comment [PSM6]: Performance standards are also critical part of the regulator's duties.

risk/return trade-off is not always favourable. What investors look at is a stable policy environment, as both policy/[regulatory](#) uncertainty and frequent policy changes have negative impacts.

11. Ministry of Railways combines the role of policymaker and operator. While parliamentary scrutiny [and public opinion](#) has ensured that railway passengers are charged affordable rates and are treated preferentially in the matter of allocation of train-paths and other resources of the network, it is a fact that there is considerable cross-subsidisation of passenger services leading to steady and gradual erosion of railway's market share in freight. Further, Railway Claims Tribunals and Railways Rates Tribunal adjudicate certain categories of grievances of freight & passenger customers, but these institutions have not been designed to correct the distortions at the policy level.
12. A regulator properly conceived and constituted can address the aforesaid concerns of the investing community besides helping correct the historical distortion between the freight and passenger pricing on Indian Railways.

Recommendations of past studies

13. The need for a Rail Regulator has long been identified. The Rail Tariff Enquiry Committee 1997-80 emphasized requirements of a regulatory body entrusted with the task of expert examination (not a judicial examination) of tariff revision matters. Similarly, the Railway Convention Committee (2000) in its report endorsed the recommendation of Planning Commission for setting up of such an authority on the lines of Telecom Regulatory Authority. Dr. Rakesh Mohan Committee which was set up to examine the revamping of Indian Railways also reiterated the need for such an authority. The 10th Five Year Plan¹ of Government of India while doing detailed appraisal of the 9th Five Year Plan highlighted the need for a Rail Regulator for fixation of rail tariffs and regulation of the activities of Indian Railways. The Ministry of Railways itself proposed to set up a Rail Tariff Authority through a Cabinet note in January 2014. The NTDP report of 2014 had recommended that a Rail Tariff Authority should be set up which should finally become the overall Rail Regulator encompassing other regulatory functions in addition to tariff. Further the NTDP report recommended that an institutional mechanism to gather, analyse and use cost data and market intelligence needs to be established. The Bibek Debroy Committee Report (2015) has also gone into the detailed rationale and role for a rail regulatory authority and suggested a Regulator with over-arching functions.

Competition in international rail transport sector

14. The American experience of erstwhile vertically integrated over-regulated rail-road companies leading to inadequate and even negative financial returns and consequent lack of investment resulted in bankruptcy of several railways. These developments in 1980s led to a new regulatory regime in USA. The mandate of the new regime was financial viability of the railways, protection of

interests of vendors, and improvement in quality of services available to the rail customers. Since 1980, all performance measures of the railways have improved and financial returns have been adequate but not excessive. Average rail rates have fallen 55 percent, rail traffic volume has nearly doubled, and the railways have reinvested more than ~~Rs. 31,306\$460~~ billion into their system.

Comment [PSM7]: @Rs 68 per US\$

15. In Russia, railways were corporatized separating the management function from the government function. It has been planned that in future tariff regulation will be limited to track infrastructure charges by Federal Service of Tariff, a body responsible for tariff in all network industries in Russia.
16. In United Kingdom, the 'Office of Rail and Road' (ORR) is responsible for all regulatory affairs pertaining to rail sector in UK. The ORR is an independent economic and safety regulator for ~~all British Railways in UK~~.
17. In Australia, the Australia Competition and Consumer Commission (ACCC) is the economic regulator, for the national access regime established by the Competition and Consumer Act, 2010. The ACC is the economic regulator for the main parts of the Australian inter-state network and Hunter Valley Coal Network. It also regulates other sectors such Energy, Communication, Shipping etc.
18. In Germany, Federal Network Authority regulates Energy, Telecommunications, Post and Rail. It supervises non-discriminatory charges for use of rail infrastructure and services and EU legislation.

Comment [PSM8]: There are many private rail operators who are not part of the British Railway

Scope and role of Rail Development Authority

Guiding principles

19. The Authority shall exercise, perform and discharge the powers, functions and duties in a manner which it considers is best ~~achieved to~~ **achieved:**
 - (i) ~~to~~ protect the interests of all consumers, by ensuring quality of service and cost optimisation;
 - (ii) ~~to~~ promote competition, ensure level playing field,—efficiency and economy and prevent market domination, cartelisation and anti-competitive behaviour and for orderly growth of railways in India;
 - (iii) ~~to~~ encourage market development and participation of private sector in the rail sector for ensuring greater choice a fair deal to ~~the~~ customers;
 - (iv) ~~to~~ ensure adequate investment and promote an efficient allocation of resources in the sector;
 - (v) ~~to~~ benchmark, where feasible, the service providers in the sector against international standards and specify and enforce standards with

respect to the quality, continuity and reliability of service provided by them;

- (vi) ~~to~~ provide **fair, reasonable and** non-discriminatory open access to the infrastructure, for use by any other licensee or consumers as the case may be, on payment of fee to be determined by the regulator; and
- (vii) ~~to~~ promote equity of access and equitable geographical dispersion of services.

Role & Scope

20. The role of the Authority would have to be clearly demarcated. The areas which would NOT be within the purview of the Authority are –

- Policy Making: This is **the** prerogative of the legislature and Ministry and should remain so. **However, its advice will be taken on board.**
- Financial—/—Expenditure management: Although the Authority could suggest benchmarks that can guide decision making, the **powersresponsibility** would remain with **the** Indian Railways.
- Setting technical standards: Though internationally, many regulators handle this responsibility, it is proposed to keep this out of the Authority's scope to begin with, but this could be included at a later stage, if required. Currently this responsibility in Indian Railways is being fulfilled by Research Design and Standards Organisation (RDSO) and efforts are on to improve the processes. Further the expertise developed by RDSO over the years, would be difficult to replicate in a short time frame with the regulator.
- Compliance of safety standards and practices: Currently safety/technical standards are laid down by Indian Railways, while clearances/permissions are obtained from the Commissioner of Railway Safety, an independent body under the Ministry of Civil Aviation. The Commissioner of Railway Safety also investigates railway accidents/mishaps independent of Railways. This mechanism ensures independence while retaining the core **skillsknowledge** required to audit railway safety operations.

21. Apart from specifying the jurisdiction of the Authority, it is also intended to empower the authority with powers of enforcement. It is proposed that the scope of the Authority would cover–:

21.1 Tariff Determination

- (i) Streamlining the tariff determination mechanism and fixing tariffs rationally based both on cost recovery principle and what the traffic can bear is an absolute necessity for the Railways. This will help reduce the cross-subsidy and can improve the market share in freight.

- (ii) The Authority would recommend passenger and freight tariffs, considering the cost structure (all direct and indirect costs such as pension liabilities, debt servicing, replacements and renewals), productivity parameters, market driven demand and supply forces and future investments. In cases where the Government does not accept the suggested tariffs, Indian Railways would need to be compensated appropriately perhaps through increased allocations in the Gross Budgetary Support or through a suitable mechanism. This would bring in transparency and consistency in tariff setting, a fundamental parameter to encourage private participation and consumer satisfaction. While determining tariffs, the authority should consider the requirement of sufficient surpluses so as to ensure the financial viability and long-term sustainability of the Indian Railway system.
- (iii) In the event the projected revenues do not materialise as considered by the authority at the time of tariff determination, the Ministry of Railways reserves the right to approach the Authority for revision of tariffs as a Party and not as a policy directive.
- (iv) An important pre-requisite for determination of tariffs is the availability of an efficient accounting system and a transparent costing mechanism.

21.2 Ensuring fair play & level playing field for private investments in Railways

- (v) The Authority would ensure compliance to stated performance/service obligations by the private parties and Indian Railways within the parameters of the framework of policies and agreements including rolling stock maintenance agreements without sacrificing the principle of competitive neutrality. In case of violation of these performance standards, Authority would suggest mandatory action to be taken by either parties and impose penalties for violations of obligations.
- (vi) Ensuring level playing field is a fundamental requirement to encourage wider investor participation. In this regard, the Authority would approach and/or the Competition Commission of India be authorised to penalise cartelisation, abuse of dominance and other unfair market mechanisms.
- (vii) Concessions agreements or contracts signed between Indian Railways or its entities and private entities for delivery of projects and services would normally address tariff determination and performance standards issues. The Rail Development Authority may suggest amendments to such standard documents which would enable creation of an appropriate framework that would eliminate unintended outcomes. It would also address matters of interpretation of rules/terms of agreements and related issues among licensees and between licensees and IR subject to review before the appellate authority.
- (viii) The Authority would also be authorised to determine track access charges and ensure fair, reasonable and non-discriminatory access on its network and the Dedicated Freight Corridors.

21.3 Efficiency and Performance Standards

Comment [PSM9]: Not clear, as this is a pre requisite and will be needed by Railways in its tar submissions to the Regulator

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Comment [PSM10]: This is necessary to protect the integrity of the economic governance system India. CCI is an economy wide regulator to deal with all types of anticompetitive practices. In cases in Railways brought up before the CCI, they will be required to mandatorily consult the Rail Authority and vice versa.

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- (ix) Passenger and freight related key efficiency, service standards of relevance to the consumers and commensurate with the tariff levels shall be determined by the Authority in consultation with the Railways to achieve higher efficiency and ensuring better service standards. This should aim at continual improvement in efficiency metrics of Indian Railways. Constraints of the service provider shall be accounted for before determining standards. Adequate opportunity to improve current efficiency standards would also be provided. Deviation in standards will be actionable in terms of penalties and cancellation of licenses (in case of private operators wherever applicable).

21.4 Dissemination of information

- (x) The Authority would collect, analyse and disseminate information and statistics and forecasts concerning the rail sector in India and, in particular, on matters affecting consumer interest. The Authority may also require the licensees to collect and publish such data. He would provide for the publication of reports and investigations and ensure that any decision taken by the authority be disseminated promptly by way of a publicly available document so as to invite public comments.

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Structure of Rail Development Authority

Legal Status

22. All the six sectoral Regulators in the country have been accorded a statutory status. They all have the sanction of the Parliament albeit through different routes. While the Pension Funds Regulatory Development Authority became functional in 2003 through an Executive Order, the Act itself was passed 10 years later in 2013. All other regulatory bodies have been made functional post the passing of the enabling statute.
23. Hence it is proposed that the Rail Development Authority may be established through a legislation by adding a Chapter amending the relevant section of in the Railways Act. A new chapter called 'Rail Development Authority of India' will be added vesting the authority with powers necessary to discharge the requisite function.
24. The Rail Development Authority would be an independent body, housed outside the Ministry of Railways but funded through the annual railway budget sanctioned by the Parliament. The approved Budget would be placed at the disposal of the regulatory authority. It would also be permitted to raise arrange funds through adjudication fees, penalties and fines collected levied and any other source as specified in the proposed Act.
25. Pending the legislative changes, making the Rail Development Authority functional through an executive order and subsequently strengthening it through the legislation process can be an option.

Appellate Authority

Comment [PSM11]: Very good move which will have a spillover effect on other regulators who are 'controlled' by line Ministries. 1. In a draft bill on Regulatory Reforms being steered by NITI Aayog proposed that independent economic regulators will be accountable directly to the parliament. 2. If this is not feasible then the Ministry under which the Rail authority will function should be specified in the CN. 3. If this is done then should not its budget also come from the supervisory ministry rather than the Railways. We are not aware as to how the funding for CRS is coming from: Railways or Civil Aviation.

26. Given the role and mandate of the Development authority, it is proposed to set up an Appellate body. The role, structure and composition of the Appellate body could be similar to such bodies set up by the Government in telecom and electricity sectors.

Comment [PSM12]: No need to set up an independent appellate authority. The same function can be performed by the Competition Appellate Tribunal (COMPAT), as is being done in UK where COMPAT is the appellate authority for all sector regulators and Competition Commission. As it is the Supreme Court has opined that the number of tribunals must be rationalised.

Composition of Rail Development Authority

27. The Rail Development Authority will consist of Chairman and four other members. The Chairman will be a person with high integrity and vast experience on Regulatory Affairs from amongst persons who have special knowledge of, and professional experience in railways, infrastructure sector, finance, law, and management or consumer affairs.
28. There shall be a selection committee for search and selection of the chairperson and members. The constitution of selection committee shall be as follows:
- (a) Cabinet Secretary of the Central Government;
 - (b) a member of the Union Public Service Commission (UPSC) to be nominated by the UPSC chairperson;
 - (c) the chairperson of Rail Development Authority and where there is no such chairperson, the senior most member thereof; (only for members of the authority)
 - (d) Chairman, Railway Board.
29. The Authority will be free to decide on its internal organisation and mode of manning the same with due regard to financial propriety and scope of work.

Comment [PSM13]: This is a very poor composition and needs overhauling.

Comment [U14]: Selection Committee needs to be made more representative of the community. At times it is sad to see that such regulatory bodies do even have single members who are in the position to represent consumer's interest. The selection committee should include the following:

1. one person from academia/research institutions having experience of not less than twenty years in economic regulatory issues.
2. one person from civil society having experience of not less than twenty years in consumer related issues

Implementation Roadmap

30. Public and stakeholders' comments will be called for on this Concept Note. These would be analysed within 45 days and a Bill would be formulated and necessary approval process initiated. The implementation would be carried out in phases. In the first phase, an independent body would be set up by an executive order to address issues pertaining to SPVs, Container train operators and other parties governed by Concession Agreements/Licence Agreements.
31. In the second phase, after the legislative/statutory process is over, the Authority would be set up with the scope of work outlined in para-above.
32. Comments on this concept note may be emailed at railwaydevelopmentauthority@gmail.com by 30th January 2016.

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