

POSITION PAPER

Initial Views on European Commission Guidelines on the Interpretation of the Public Service Regulation

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COMMUNITY OF EUROPEAN RAILWAY AND INFRASTRUCTURE COMPANIES - COMMUNAUTÉ EUROPÉENNE DU RAIL ET DES COMPAGNIES D'INFRASTRUCTURE - GEMEINSCHAFT DER EUROPÄISCHEN BAHNEN UND INFRASTRUKTURGESELLSCHAFTEN



I. INTRODUCTION

Regulation 1370/2007 on public passenger transport services by rail and by road¹ has been applied in the European Union since 3 December 2009. One year after its application, the European Commission ordered a study from external consultants on its effective implementation in the EU, which was delivered in October 2010². In their study, the Commission's consultants recommend that the European Commission clarifies a certain number of issues through the adoption of Guidelines.

In this paper, CER expresses initial views on a number of issues of concern some of which may have been flagged by the consultants.

Before outlining specific issues of concern, CER would like to restate the basic rule set in article 1 of Regulation 1370/2007, i.e. any public service obligation (PSO) has to be compensated³. Today, despite this basic rule, there are still PSO Rail undertakings (RUs) under or un-compensated⁴. This is an unacceptable situation the Commission has to address promptly.

Furthermore, it is important to underline that PSO traffic is a commercial activity: it is not because it is financed by public authorities that it must be considered negatively or not driven by commercial purposes and factors.

As with any commercial activity, it calls for various elements: quality of service; efficiency/value for money; and reward for good performance.

As a consequence, reasonable profit MUST be a reality and not only an option. The same applies to on-time payment.

CER also wishes to draw the attention of the European Commission to important interpretation discrepancies between the different language versions of the Regulation. Examples are provided in Section VII of this paper. These discrepancies already lead to diverging interpretations at national level.

¹ Regulation 1370/2007 of 23 October 2007 - hereafter "*the Regulation*".

² Study conducted by DLA Piper on the implementation of Regulation (EC) N° 1370/2007 on public passenger transport services by rail and by road, October 2010. It can be found at http://ec.europa.eu/transport/rail/studies/index_en.htm

³ In 2007, government payments for public service obligations across the EU-27 were worth just over EUR 20 billion per year. These payments covered approximately 30%-50% of total operating costs related to Public Service Operations. See *Public Service Rail Transport in the European Union: an Overview*, CER, November 2011.

⁴ This applies even when different methods have been used to allocate them the Public Service Obligation.

II. SCOPE OF GUIDELINES

Consistency in the application of the Regulation by the Commission and legal certainty are expected: the Guidelines, being the interpretation by the Commission of the Regulation, must clarify a certain number of issues. For example, it is important that the application of the Regulation takes due account of its transitory provisions and this Regulation is not applied retroactively: indeed, contracts on PSO concluded before the Regulation came into effect are to be evaluated on the basis of legal practice at that time, including in particular Regulation 1191/69/EC. Otherwise, this would be in breach of the legitimate expectations of the competent authorities as well as the Railway undertakings.

It is also important that the **current flexibility** allowed by the Regulation is preserved and that the **subsidiarity principle** is respected. In other words, the Guidelines must not be so detailed that they take away this basic principle of the Regulation⁵. That would go against the clear political will of both the Council and the EP when negotiating and adopting the Regulation.

Furthermore, it would contradict the rulings of the European Courts that underline the wide discretionary power of the Member States in public services.

Finally, the interpretation given by the Commission to the Regulation must address correctly the **specificities of the land transport sector and in particular the Railway specificities**⁶: market development, staggered opening of markets, and long-term financial commitments.

There is no point in an implementation and application of the Regulation that does not take them appropriately into consideration.

III. UNDERCOMPENSATION

There is a need for **urgent measures** to be taken by the European Commission regarding assessment of the economic and financial situation of some Member State Railway and PSO operators.

Leaving PSO RUs undercompensated puts in danger the entire operations of the RU (PSO and non-PSO) and often the whole railway activity.

Besides hindering operations and improvement in services, and making cost reductions impossible, undercompensation of PSO RUs enhances market distrust and does not invite new operators to take part in future PSO tendering procedures. Without a **fair appropriate and proportionate compensation** of the PSO there will be no interest in PSO from operators.

⁵As can be found, for example, in the article regarding PSO definition.

⁶ Such as when addressing the issue of the length of the PSO contract

IV. DEFINITION OF PSOs

There is a need to highlight that while design of the PSO is a local issue, the ways to finance it have to be addressed by the EU. The **flexibility** has to be preserved so as to allow the possibility for the Member State (& the operator) to adapt PSO design to specific and local needs. The importance of **preserving Member States' specificities** is enhanced by the current absence of legal certainty and clarity in the application of the Regulation.

The current uncertainties around PSO definition are also created by the absence of a systematic use of **PSO Contracts** (hereafter "**PSC**"). As a rule, PSOs are to be awarded through PSCs. By so doing, the correct and fair application of the Regulation will be easier to assess and more legal certainty will be provided. For example, the insertion in the PSC of quality aspects which can thus be negotiated and agreed between the competent authority and the RU, allows for some exemptions related to passengers rights as provided by Regulation 1371/2007/EC.

Special attention has to be given to the duration of the PSC which requires a lot of flexibility: as foreseen by Article 4.3 and 4.4 of the Regulation, the length of the PSC is a matter for the competent authority where a large variety of elements have to be taken into consideration. Some of these are closely related to competent authorities' major policies, while others are **specific to the land transport sector**, such as the need to amortize non-transferable fixed assets⁷.

Lastly, when a competent authority endeavours to put an end to existing rail PSO activities or to replace them by road PSOs, a public consultation has to be undertaken in order to take into due consideration the interests of both users and providers.

V. ADEQUATE COMPENSATION

All PSO activities have to be correctly and fairly rewarded through compensation: financial compensation and/or exclusive rights can be jointly or individually used. **Three main options** are currently available and shall remain at the disposal of the competent authority: either one of the two (financial compensation or exclusive rights) or both solutions together. It is up to the competent authority when designing the PSO to define the appropriate and proportionate level of compensation needed.

Issues relating to the assessment of the level of compensation are numerous. At this stage of the discussions on future Guidelines, CER only wishes to draw the attention of the Commission to one important aspect: the necessary ***ex ante* evaluation of the compensation** for the contract in question. The assessment of the compensation level for PSOs should be made in accordance with the general principles laid down by the

⁷ E.g. rolling stock: a short PSC duration can induce a compulsory transfer of the rolling stock at its end when there is a change of PSO provider, while an adapted duration of PSC to the amortization cycle of the used material will not induce such a transfer. PSCs that demand for new rolling stock at the start of the PSC or during its duration also demand rules for the use and funding of the rolling stock after expiration of the contracts. That can be done by guarantees for re-use or the possibility to sell or rent the rolling stock to the new operator. There must also be a possibility that RUs remain the rolling stock owners.

European Commission with regard to Services of General Economic Interests⁸. In substance, and in line with flexibility and subsidiarity as mentioned in chapter II above, the Commission has to acknowledge such an *ex ante* evaluation based upon the actual cost-level of the RU at the start of the contract. Such an approach requires special efforts for the operator with regard to cost reduction and quality intensification. Moreover, in the valorisation rules of the compensation, the incentives for cost reduction shall be regarded over the duration of the contract.

In turn this generates other long-term positive effects on the economy, and in particular it creates an **increase of social welfare** by promoting services which are cheaper, of higher quality and more efficient in the interest of all stakeholders, public authorities, consumers and railway operators:

- (i) the calculation of costs for subsequent contracts can directly be based on the **lower cost level** reached by the cost reductions and consequently require lower subsidy from public authorities in the medium term which is positive for public budgets.
- (ii) the customer also directly benefits from the **increase of welfare** generated by higher quality and an enlargement of the range of services by the undertaking.
- (iii) finally, by anticipating and incorporating the **efficiency gains** it can be expected to make over the lifetime of the contract, the railway operator can ensure that a reasonable profit is guaranteed for the overall contract on condition it provides an efficient service over the entire duration of the contract. It therefore has strong incentives to provide efficient services.

Beside ex-ante evaluation of the compensation, **adequate monitoring** is also needed - this enhances **transparency** and **builds trust** with other market stakeholders and competent authorities. It will create **incentive effects on the behavior of RUs** both to make and improve economies of scope and to avoid unnecessary and burdensome administrative procedures. However, efficiency gains have to be achieved without prejudice to the quality of the service provided. In this respect, **ex-post review** of the compensation should apply only when there is any complaint about the operator's behaviour and services.

Furthermore, as stated in the EU-framework for Services of General Economic Interest (SGEI) , such an overcompensation check would be confined to verifying that the level of profit is reasonable from an *ex ante* perspective.

⁸ Formally, this framework does not apply to the transport sector. However the contained principles may be applied by analogy, particularly in view of clarifying the PSO Regulation.

VI. APPLICABLE RULES TO THE AWARD⁹

Open tendering and direct award are currently both used in the land transport sector: both have their value and role in specific situations. This flexible approach without any *a priori* exclusion of an award mechanism allows for a better case-by-case approach, where a one-size-fits-all approach can be detrimental to customers' need and other policy objectives that a competent authority may have for the Railway.

Direct award, provided it is done in a transparent and fair manner, does not entail more problems or competitive risks than competitive tendering¹⁰. Moreover, promoting **quality and (cost) efficiency** can very easily be achieved through direct award: incentive tools can be agreed between the competent authority and the Railway operator and achieving them can be an element influencing the compensation scheme. Settling a *Service Level Agreement* (SLA) is always possible when using direct award: by so doing, quality levels and other aspects can be defined or measured¹¹, and quantitative and qualitative objectives can be set. The same applies to some other objectives such as **subcontracting possibilities and rules** or **personal training requirements**. In order to enhance transparency, some requirements can be imposed before using direct award mechanism as a result of prior public consultation: the competent authority carries out a public consultation (or uses any other appropriate instrument) to take the interests of users and providers into account, before entrusting a public service obligation to a certain provider.

Also, in some circumstances, direct award is the more appropriate tool: direct award can be the means of awarding PSO in case of renewal if some pre-set conditions are met: e.g. performance objectives attained by the current PSO operator and/or improvement of service quality objectives.

⁹ No application of Public procurement directives and rules for PSO as a rule (nor of concession directive).

¹⁰ Moreover it is foreseen by the Altmark ECJ decision and the related SGEI legal doctrines developed by the European Commission afterwards. In such a case, Altmark 2° part of criterion 4 applies :*where the beneficiary is not chosen pursuant to a public procurement procedure, the level of compensation granted must be determined on the basis of an analysis of the costs which a typical undertaking, well run, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit.*

¹¹To ensure an innovative, dynamic and efficient Rail sector that genuinely is interested in improving market share implies both the Competent Authority fixing the quality requirements at the outset and, in order to increase the efficiency of the impacts of the incentives for the RUs, the possibility for the RUs of raising quality beyond what is formally requested by the Competent Authority and to rip the benefits of these additional improvements.

VII. PROTECTION OF STAFF (Art. 4 (5) and recitals N° 16. and 17)

In the context of competitive tendering of public service contracts, Article 4(5) and recitals 16 and 17 of the Regulation provide for the possibility to grant staff previously taken-on in the related PSC certain social rights.

CER believes that the wording of this article could be clarified. CER calls upon the Commission to provide **enhanced clarity** so as to make sure that social conditions are addressed by competent authorities in an appropriate manner.

CER understands that article 4(5) read in conjunction with recitals 16 and 17 does not impose to the competent authority only one possibility when it comes to safeguarding social rights of certain workers. Therefore, on the basis of European and national legislation in force, as confirmed by the Regulation, the competent authority has different options, namely:

- the requirement to transfer from the old to the new operator the staff previously taken on to provide the services with “the rights to which they would have been entitled if there had been a transfer within the meaning of Directive 2001/23/EC”
- the requirement of certain social standards for all employees involved in the service of the new operator (possibly related to a company collective agreement or a collective agreement for the respective market segment or to other existing legal regulations).

The competent authority could also decide to apply a combination of both cases listed above or not to impose any social requirement.

In consideration of these various options, CER considers crucial **certainty and transparency**: it is essential that the competent authority at the beginning of the tendering process must state clearly which decision was taken: This information is absolutely necessary for a potential bidder, but also for the employees concerned.

Moreover, CER wishes to draw the attention of the Commission to the different wording of article 4(5) as well as article 4(6) in the different EU translations (in particular German, French and English). The **difference in wording** is likely to create serious legal uncertainty throughout the EU.

Disclaimer

Community of European Railway and Infrastructure Companies (CER) AISBL

Avenue des Arts 53
B-1000 Brussels
Belgium

Tel +32 2 213 08 70
Fax +32 2 512 52 31
contact@cer.be

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