

European passenger rail services in transition

The Fourth EU railway package brings changes and new challenges to passenger rail authorities

European Union, policies, public service obligations, rail markets

In December 2016, the European Parliament adopted the market pillar of the EU's Fourth railway package. In combination with its technical pillar, the package aims at harmonising the EU railway policies for improving the competitiveness and attractiveness of railways and for a further development of the single European railway area [1]. This article describes the amendments of Regulation (EC) 1370/2007 by Regulation (EU) 2016/2338 and gives guidance to competent passenger rail authorities on the decisions to take for governing passenger rail services, the related tasks and their implications when it comes to organising and awarding a public service contract (PSC).

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Since its coming into force in 2009, Regulation (EC) 1370/2007 has been the frame for public service obligations (PSO) and the subsequent grant of compensations or exclusive rights in the field of public passenger services by rail and by road. Its provisions are of key importance for Europe's transport sector: Most of the public passenger railway transport in the EU has been, and apparently still is today, carried out under PSO (respectively PSC) [2]. Despite the earlier liberalisation of rail freight and cross-border passenger rail services, domestic passenger railway services have not been opened for mandatory competition yet, and many domestic public service contracts are still awarded directly without any bidding

process [3]. It is important to note the reasons behind this situation: A significant number of competent authorities in EU's Member States is not only responsible for organising and financing the services. Some of the authorities are at the same time the owner of an incumbent railway undertaking. Direct awards of public service contracts have temporarily helped them to avoid a serious restructuring of these undertakings. Other competent authorities have less strong links to incumbent railway undertakings, e.g. those authorities organised on the regional level (*figure 1*).

During the preparation of the Fourth railway package proposal, the European Commission intensively studied the benefits of competition in the railway market and

opted for making these positive experiences accessible to passengers in all member states of the EU [4]. Henceforward, the Fourth railway package will open domestic passenger railway markets in the EU's Member States, starting from the change of timetables in December 2020 [3]. Furthermore, the amendment of Regulation (EC) 1370/2007, carried out by Regulation (EU) 2016/2338, introduces the awarding of PSC for public passenger rail transport on the basis of a competitive tendering procedure as a general rule.

Including the amendments of Regulation 2016/2338, Regulation 1370/2007 now contains the following milestones [5]:

- Until 02 December 2019, Member States shall take measures to gradually comply with Article 5 (on the award of public service contracts) in order to avoid serious structural problems particularly related to transport capacity;
- Between 25 December 2020 and 25 June 2021, Member States shall provide the Commission with a progress report, highlighting the implementation of any award of public service contracts that comply with Article 5;
- The duration of contracts directly awarded in accordance with Article 5(6) between 3rd Dec. 2019 and 24th Dec. 2023 shall not exceed 10 years;
- Article 5 (6) which allows for a direct award of public service contracts concerning rail services will cease to apply as of 25 December 2023.

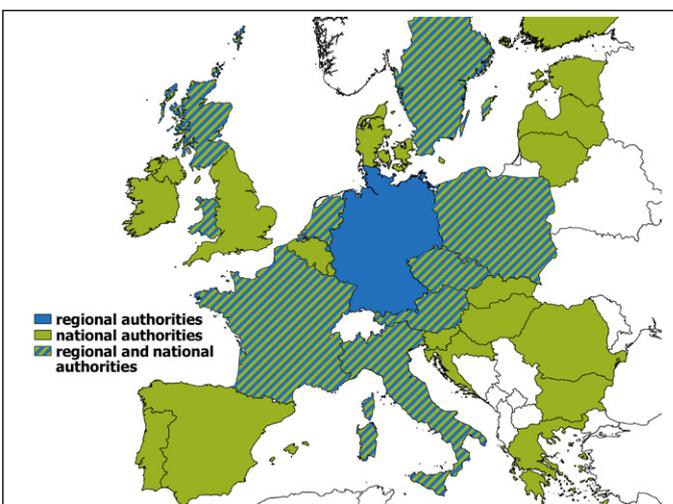


Figure 1: Competent passenger rail authorities in the EU member states
Source: KCW

These milestones mark the further advance of the liberalisation of European railway markets.

At the same time the amended Regulation still leaves exemptions that will enable many competent authorities to decide whether to contract railway services competitively or to directly award the services as Article 5 defines several (new) exceptions for direct awards.

The exemptions to competitive tendering of rail services of the amended PSO regulation now include the following situations:

- A maximum threshold of an annual value of EUR 7,500,000 or the annual provision of 500,000 train kilometres is not exceeded [6];
- The competent authority considers a direct award to be justified due to the relevant structural and geographical characteristics of the market and network concerned and such a contract would result in an improvement in the quality of services or cost-efficiency, or both, compared to the previously awarded public service contract. Member States shall be deemed to fulfil this condition when
 - the maximum annual market volume is less than 23 million train-km (see table 1) when the amendment comes into force, and
 - where just one competent authority at the national level exists (see figure 1) and
 - where only one public service contract is covering the entire network [7].
- Exceptional circumstances justify a direct award in order to optimise the provision of public services. The amended Regulation names as such exceptional circumstances a too large number of competitive tendering procedures that are already being run which could affect the number and quality of bids likely to be received or changes to the scope of one or more public service contracts are required in order to optimise the provision of public services [8];
- Emergency measures taken by the competent authority in the event of a disruption of services or the immediate risk of such a situation [9];
- A regional or even local competent authority (an authority which does not act on the national level) provides the services itself or awards a service contract directly to a legally distinct entity over which it exercises control [10].
- A competent authority may also award a PSC directly to an operator managing at the same time the entire or major parts of the infrastructure where the relevant passenger services are provided. For this

Member State	Million train-km	Year of reference	Source	
DE	Germany	803	2014	[20]
UK	United Kingdom	508	2014	[20]
FR	France	412	2014	[20]
IT	Italy	286	2014	[20]
ES	Spain	174	2014	[20]
NL	Netherland	144	2014	[20]
PL	Poland	135	2014	[20]
CZ	Czech Republic	122	2010	[21]
SE	Sweden	116	2014	[20]
AT	Austria	109	2014	[20]
BE	Belgium	84	2014	[20]
HU	Hungary	84	2014	[20]
RO	Romania	60	2014	[22]
DK	Denmark	51	2014	[20]
SF	Finland	36	2014	[20]
SK	Slovak Republic	32	2014	[20]
PT	Portugal	31	2010	[21]
BG	Bulgaria	21	2014	[20]
IE	Ireland	17	2010	[21]
HR	Croatia	15	2014	[20]
GR	Greece	11	2014	[20]
SI	Slovenia	10	2014	[20]
LU	Luxembourg	8	2014	[20]
LV	Latvia	6	2014	[20]
LT	Lithuania	5	2010	[21]
EE	Estonia	5	2014	[20]

Table 1: Market volume of rail passenger services in the EU Member States. To the extent known, the given numbers refer to PSO and Non-PSO services within the states.

purpose infrastructure must be exempted from the regulations on separation and infrastructure charges of Directive 2012/34/EU [11].

Exemptions to be justified

What, at first glance, seems to be an extensive freedom of decision for competent authorities either in favour of or against competition will be in fact in most of the cases limited either by the required justifications or the maximum duration of directly awarded contracts.

For instance, recital 21 of the amended Regulation stipulates for exceptional circumstances that

- a) the circumstances have to be indeed “exceptional”,
- b) the new contracts may be directly awarded only “temporarily” and
- c) these contracts “should not be renewed to cover the same or similar public service obligations”.

Given the fact that any competitor of the (incumbent) operator favoured by the direct award may appeal against the decision of a competent authority to directly award a public service contract and that the justifications are carefully examined during such

a proceeding, competent authorities might want to substantiate any of their decisions by specific market studies focussing on their relevant market and the issue addressed. In the case of exceptional circumstances it could for example be helpful to demonstrate that competent authorities in similar markets regularly receive only a limited number of bids and that the result of such procedures with limited competition is close to a well negotiated direct award.

A more complex approach is necessary if a competent authority wants to justify a direct award with “the relevant structural and geographical characteristics of the market and network concerned” [12] and needs to negotiate the figures and performance measuring methods with the incumbent undertaking. In this case it would be extremely helpful for the authority to know the cost and production structures of comparable undertakings in detail.

A necessary condition to be met for a direct award of a contract under exceptional circumstances is furthermore the implementation of specific performance indicators as well as effective and deterrent measures to be imposed in case the railway undertaking fails to meet the performance requirements [7]. Reasonably, this require-

ment should take into account the positive experiences made in the EU so far, even if some allowances for the specific situation of each competent authority will be necessary. Important issues include the technical condition of the infrastructure and the rolling stock to be used, the density and the connections within the public transport network and the expectations of the passengers regarding the quality of transport.

Preparation of awarding procedures

Concerning awarding procedures, the amendment of the PSO regulation brings considerable changes for those authorities that so far have not yet competitively tendered their services and will be forced to open or are opening their market by choice. In order to award an economically favourable contract, a competent authority in general will have to execute the following preparatory steps:

- Identification of networks which enable railway undertakings (and in consequence the authorities) to benefit from operation synergies;
- Definition of the duration, scale and scope of the services to be tendered, including lot sizes if appropriate;
- Definition of the type of contract: net costs vs. gross costs or hybrid forms;
- Planning and optimisation of the to be tendered services;
- Modelling of the expected costs;
- Definition of a quality management system with efficient performance indicators (punctuality, capacity, failure ratios, etc.);
- Implementation of an appropriate remuneration system;
- Implementation of an appropriate risk diversification;
- Guaranteeing access to production resources (rolling stock, workshops, sale systems).

The last three steps are of particular importance for competent authorities in order to achieve improvements in the efficiency of the services: With increasing market transparency and reasonably calculable risks, more undertakings are going to participate in a call for tenders. By designing the market, the authorities become the key players of passenger rail transport.

In addition to the specific justifications of direct awards of public service contracts, all competent authorities that operate on Member State level will have to align their procedures to a number of further provisions, especially:

- The development and description of measures to gradually comply with Article 5 [13]

- To ensure an efficient and rapid review of the decision on the type of award [14];
- The provision of a **progress report** by 25th June 2021 [13];
- The assessment of measures to ensure effective and non – discriminatory access to suitable rolling stock [15] and
- The compliance with the rules applicable to compensation [16].

Conclusion and Outlook

The amended PSO regulation leaves no doubt that the European legislator considers the opening of the market as a means to achieve better services for the user [17] and is eager to enhance quality, transparency, efficiency and performance of passenger rail services [18]. It is true that the introduction of competitive tendering increases the amount of work on the side of the authorities and forces the incumbent to adapt to the new situation. Nevertheless, with the implementation of the Fourth railway package these changes are unavoidable.

The authors of this article encourage all competent authorities that are not yet proficient in the application of the PSO regulation, and in tendering especially, to get in a close dialogue with the European Commission on the challenges triggered by the Fourth railway package, with other authorities or with external experts specialised in the field of public service contracts. Such exchanges and external expertise may help to comply with the amended regulation and to minimise the risk of legal uncertainties of the contracts to be awarded in future. ■

IN ADDITION

How to avoid hard cuts

Even in a country like France which has been seen as closed for PSC competition in public rail transport for a long time, things are changing, mainly caused by the dissatisfaction with the performance of the incumbent operator: From 2019 on, an “experimentation phase” on tendering in French regional rail transport is envisaged by the French state and by the regions, which are the competent authorities for regional train PSO services in France: On the one hand, such “experimentation” can give any stakeholder the chance to acquire first experiences in the field of competitive awarding, resulting in tests of forms of governance and regulatory adaptations if appropriate. On the other hand, a transition phase of some years shall avoid hard cuts, before competitive awarding becomes mandatory [19]. Depending on the results of the French presidential election, that might be even quicker than initially intended.

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[6] Article 5 (4) of Regulation (EC) 1370/2007 amended by Regulation (EU) 2016/2338

[7] Article 5 (4a) of Regulation (EC) 1370/2007 amended by Regulation (EU) 2016/2338

[8] Article 5 (3a) of Regulation (EC) 1370/2007 amended by Regulation (EU) 2016/2338

[9] Article 5 (5) of Regulation (EC) 1370/2007 amended by Regulation (EU) 2016/2338; the substance of this part of the Regulation has not been changed by the Regulation (EU) 2016/2338.

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[12] Article 5 (4a) lit. (b) of Regulation (EC) 1370/2007 amended by Regulation (EU) 2016/2338

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