



Study on the implementation of Regulation (EC) N° 1370/2007 on public passenger transport services by rail and by road

Final report

October 2010

Preliminary notes:

- *With effect from 1 December 2009, the Treaty establishing the European Community ('EC') has become the Treaty on the Functioning of the European Union ('TFEU'). References to Articles of the TFEU should be understood as references to Articles of the EC Treaty, according to the table of equivalence, where appropriate. The TFEU also introduced certain changes in terminology, such as the replacement of 'Community' by 'Union', 'common market' by 'internal market' and 'Court of Justice of the European Community' by 'Court of Justice of the European Union'. The terminology of the TFEU will be used throughout this study.*
- *The study relates to a matter which is constantly and rapidly evolving. Therefore, is it inevitable for some information included below to be slightly out of date (e.g. the new French Regulation issued on 24 August 2010).*

Notice: the views expressed in this report are those of the authors, not necessarily those of the Commission.

Executive Summary

Introduction

Having safe, efficient and high-quality public transport services for EU citizens is an important goal of the European Union.¹ Because inland public transport had become structurally loss-making in the 1960s, Regulation 1191/69² and Regulation 1107/70³ were introduced in order to ease the carriers' burden of providing public transport by imposing the termination of public service obligations (hereinafter, 'PSO') or the right for compensation. In the 1990s, legislation was amended to allow for the introduction of public service contracts (hereinafter, 'PSC') as a means of ensuring adequate public transport services. However, this legislation allowed Member States to exclude from its application urban, suburban and regional passenger transport services. In addition, the way PSC were to be awarded was not addressed by this legislation. Nonetheless, mandatory requirements for award procedures are provided by Public Procurement Directives, where applicable, for the sectors affected by the application of such legislation. The application of the legislation led to some uncertainties with respect to the state aid regime relating to PSC.⁴

Against this background, the Commission proposed a new regulation in 2000, amended in 2002. However, a compromise could not be found. Hence, the Commission introduced a revised proposal in 2005, which became Regulation (EC) N° 1370/2007 on public passenger transport services by rail and by road (hereinafter, 'Regulation 1370/2007').⁵

Regulation 1370/2007 came into force on 3 December 2009 with some provisions governing the transition towards the new award regime.

Given the considerable complexity of Regulation 1370/2007 and the various ways in which it can be implemented, the Commission commissioned this study to have a clear overview of the way Member States and, within Member States, competent authorities for the organisation of public transport, apply or intend to apply Regulation 1370/2007 and to give guidance on best practices in implementing Regulation 1370/2007.

¹ See Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Urban Mobility, COM(2009) 490 final. See also White Paper of 12 September 2001 'European transport policy for 2010: time to decide'.

² Council Regulation (EEC) 1191/69 of 26 June 1969 on action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway, [1969] OJ Spec Ed I-276.

³ Council Regulation (EEC) 1107/70 of the Council of 4 June 1970 on the granting of aids for transport by rail, road and inland waterway, [1970] OJ Spec Ed II-360.

⁴ See in particular Case T-157/01 *Combust* [2004] ECR II-917, noted by L. Hancher (2004) EStAL 455-460 and Case C-280/00 *Altmark* [2003] ECR I-7747.

⁵ [2007] OJ L 315/1.

The purpose of this study is to allow the Commission to facilitate dialogue with Member States and stakeholders, to identify difficulties in the implementation of the Regulation and to search for possible solutions. An exchange of best practices relating to defining, awarding and implementing PSC should be generated by the study. Such objective is in line with the Action Plan on Urban Mobility.⁶

Following the tender specifications, the study focussed on the following Member States: Austria (AT), Belgium (BE), Czech Republic (CZ), Germany (DE), Denmark (DK), Spain (ES), France (FR), Hungary (HU), Italy (IT), Lithuania (LT), The Netherlands (NL), Poland (PL), Portugal (PT), Sweden (SE) and United Kingdom (UK).

The study is based on several sources of information:

- broad consultation of stakeholders on the existing and prospective practices in organising public transport as well as on their views on the current situation in the public transport sector,
- desktop research and technical legal analysis.

The stakeholders consulted were the national transport ministries and regional/local competent authorities, public transport operators, National Regulatory Bodies, National Competition Authorities, consumers' organisations and European associations of those stakeholders. The consultation involved questionnaires containing both descriptive and evaluative questions. However, the response rate has generally been rather low.

Status of regulatory and contractual practices relating to Regulation 1370/2007

It appears that the way public transport is organised varies considerably from Member State to Member State and within a Member State from one competent authority to another. Therefore, the overview provided in this study of the current state of play in regulatory and contractual practices in public transport is not exhaustive, but rather constitutes an illustrative sample.

Regulatory practices

Regulation 1370/2007 directly applies in the Member States. However, given that the previous Regulation did not address the award procedure and the diverse ways in which Regulation 1370/2007 can be implemented, regulatory practices in Member States vary considerably.

The main variations in regulatory practices relate to the existence of general rules, the definition of PSO, the award procedure of a PSC and the review mechanism of such award as well as the options open to competent authorities as regards the way to award PSC, the public transport operator and the compensation method.

⁶ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Action Plan on Urban Mobility, COM(2009) 490 final, 5.

General rules In some Member States, there are general rules fixing maximum tariffs for public transport services. When they have been adopted, they have not in general been accompanied by a decision to exclude them from the scope of Regulation 1370/2007. However, the compensation for such maximum tariffs generally covers the difference between the normal price and the reduced ticket price and not the formula in the Annex to the Regulation.

Definition of PSO In some Member States, PSO have been specifically defined in the legislation either simply to reiterate the abstract definition contained in Regulation 1370/2007 (or Regulation 1191/69), or to set out strategic objectives relating to continuity, regularity, environmental objectives, quality, accessibility and reasonable price.

Award procedure and review mechanism The possible legal grounds for the award of PSC are the Public Procurement rules (stemming from the transposition of the European Public Procurement Directives), specific transport legislation or legislation relating to concessions or to public service in general. The legal ground for the award of PSC varies according to the nature of the contract. However, it appears that 'service contracts' in the sense of the Public Procurement Directives are not always awarded on the basis of these rules. Similarly, it seems that the other PSC are not always awarded on the basis of the general Treaty rules (transparency and non-discrimination).

The review mechanism of an award procedure depends on the legal ground used to award PSC. Discrepancies exist between the review mechanisms in place. Where the Public Procurement rules are applied, their remedies will also apply. Where other grounds have been used, sometimes a review mechanism comparable to the Public Procurement remedies applies, sometimes the general administrative or judicial review applies. As stated in the preamble of Regulation 1370/2007, the review mechanism in place should be comparable, where appropriate, to the Public Procurement remedies. Often, the general review mechanisms are not as rapid and effective as the Public Procurement remedies.

Freedom to choose the award procedure, the operator and the method for compensation In general the legislation in force in Member States does not stipulate the choice of award procedure, operator and method for compensation. However, in some Member States, the operators are designated by law, precluding the competent authority from effectively choosing the operator and the way it awards the PSC. In some other Member States, the principle

of competitive tendering procedure is established.

It also appears that various elements contained in Regulation 1370/2007 have generated or will/should generate legislative reforms. In some Member States, legislation has been adjusted according to Regulation 1370/2007. The adjustment appears sometimes to constitute a duplication of Regulation 1370/2007. It also leads in some Member States to recognition of the principle of competitive tendering and to the introduction of the possibility of awarding contracts directly to internal operators or for heavy rail services. Although the legislation has not been adjusted yet, in some Member States consultations on the implementation of Regulation 1370/2007 have started.

In the railway sector, the implementation of Regulation 1370/2007 has some links with Regulation 1371/2007 on rail passengers' rights and obligations and with Directive 2007/58 on the opening up of international rail passengers' transport services.

Regulation 1371/2007 sets out various passengers' rights which can act, according to economic literature, as an incentive for providing a quality service. Such incentive does not have to be managed by the competent authority and does not rely on public money. Therefore, the application of Regulation 1371/2007 helps to implement Regulation 1370/2007 correctly. However, it appears that many Member States have granted exceptions to the application of Regulation 1371/2007 on passengers' rights and obligations.

Directive 2007/58 confers upon railway undertakings access rights to international passenger railway services, including cabotage. To preserve public service, the Directive provides that the cabotage can be limited if the economic equilibrium of PSC would be compromised by the international service. Before deciding on such limitation of the access rights, the regulatory body must undertake an economic analysis on the basis of pre-determined criteria. These criteria have been listed in some Member States, either by law or by the regulatory body.

Contractual practices

It appears that organising public transport through contracts is a widespread practice. However, sometimes contracts still need to be concluded. Sometimes, PSC are concluded but are not enforced.

Despite the entry into force of Regulation 1370/2007 and the direct application of its provisions – except on the award procedure – many contracts have not yet been adjusted to the Regulation. This has, however, to be seen in context, as there are some contracts which will expire soon and the competent authority intends to rely on Regulation 1370/2007 for the drafting of the next PSC.

As with the regulatory practices, contracts are of a great variety too. These patterns were analysed through the main elements of Regulation 1370/2007 which cover the definition of PSO, the scope and

basic features of PSC, the way the PSC have been awarded and the compensation for the discharge of PSO.

PSO

PSO appear to be defined at different stages of the contracting process (before the contracting phase, at the stage of the issuance of the tender documents or, at a later stage, when contracting).

Further, it appears that PSO cover various concepts ranging from strategic, policy objectives to detailed service design. In general the pure strategic goals are defined by the competent authority alone (or by law), at an early stage. The concrete PSO are either defined in general terms by the competent authority (*functional service design*), sometimes further detailed by both parties or the operator, or in a detailed manner (*constructive service design*).

The stage during which PSO are defined and the degree of detail of the PSO defined by the competent authority are indicators of the potential leeway open to public transport operators to design public services themselves, possibly taking into account parameters such as consumers' demand, etc.

The rewards granted by the competent authorities for discharging PSO are those provided in Regulation 1370/2007, namely compensation and exclusive rights. In addition, competent authorities also point to the transfer of risk to the public transport operator as a reward for discharging PSO. The transfer of risk could range from no risk, via transfer of production risk, to transfer of both cost and revenue risks. In legal terms, PSC whereby no risk or only the risk of production is transferred to the operator are 'service contracts'. Contracts whereby the revenue risk is transferred to the operator are 'concessions'.

PSC

In general, PSC contain some of the mandatory content stipulated in Regulation 1370/2007. When the elements of the mandatory contents are provided for in PSC, they raise the following issues:

- PSO are not always sufficiently defined to spell out the relation with the compensation or exclusive rights received.
- The geographical area covered by the PSC is in general stipulated and relates either to a whole territory or to specific routes/networks.
- PSC do not always contain the parameters on the basis of which compensation payments are made, and sometimes merely contain

a lump sum. Where the parameters are stipulated, they often relate to a specific formula.

- PSC are not always explicit regarding the extent and nature of exclusive rights conferred. When granted, exclusive rights relate either to a territory or to 'specific services', or both.
- Cost allocation arrangements are not always addressed. When addressed, they often fail to deal with the allocation of costs between PSO and commercial services.
- Revenue allocation arrangements in PSC address the question of the transfer of risk to the operator. Where the revenue accrues to the competent authority, the PSC are generally gross cost contracts ('service contracts' in the sense of the Public Procurement Directives). Where the revenue is kept by the operator, the PSC are generally net cost contracts ('concessions').
- The duration is generally provided by the PSC and is in line with Regulation 1370/2007. However, when PSC allow extensions, they go beyond what is permitted under the Regulation.
- Quality standards often appear in PSC and take various forms.
- PSC do not always address subcontracting questions. Where they do, they often permit subcontracting subject to the approval of the competent authority.

Award

PSC are awarded:

- Directly:
 - o To an internal operator. Internal operators are often wholly owned by at least one competent authority. However, the geographical territory of their public transport activities is not always clear.
 - o To a third party. Directly awarded PSC do not only relate to railway services; sometimes they are also awarded directly for road transportation.
- After a competitive tendering procedure.

Compensation

- Where PSC have been awarded after a competitive tender, it is often considered by the competent authority that there is no issue of overcompensation. However, in some PSC specific attention is paid to the avoidance of overcompensation.

Where PSC have been directly awarded, the calculation of the compensation granted is not always clear. However, some PSC

already contain a formula determining the net financial effect of delivering PSO. The net financial effect is not always assessed against the costs as if the PSO were not provided. Assessment is sometimes made against reasonable costs or historical costs.

In both cases (direct or competitive award), there are two trends. On the one hand, the compensation is determined *ex ante* without *ex post* regularisation based on the actual costs. On the other hand, compensation is based on the actual cost incurred in the discharge of PSO. In such a case, the compensation is either determined *ex ante* with *ex post* regularisation based on the actual costs incurred or determined *ex post*, only once the actual costs are known.

- Current contracts do not always address the issue of cross-subsidies within the undertaking providing both PSO and commercial services. When they do, they often require accounting separation and sometime provide for specific cost allocation arrangements.
- Incentives for quality services and effective management are sometimes provided for PSC. They often relate to risk, bonus-malus systems and penalties.
- As to the management of unforeseen events in the course of PSC, the remedies relate to the adjustment of the contract, the termination of the PSC and additional compensation.

Issues raised by the implementation of Regulation 1370/2007

The survey conducted in this study emphasises the various issues raised by the implementation of Regulation 1370/2007. The results of the survey can be summarised as follows:

Institutional stakeholders' views

Competent authorities, when they expressed specific comments, often highlighted interpretation problems relating to certain provisions of Regulation 1370/2007 (transition, publicity requirements,

possible negotiations in the tendering process). Some authorities have expressed concerns regarding the scope for awarding contracts without competitive tendering processes.

Public transport operators' views

Public transport operators emphasise legal uncertainties. However, they generally advocate the application of Regulation 1370/2007 which should enhance transparency. The weaknesses of the current national/regional legislation as reported by public transport operators relate to the absence of the application of Regulation 1370/2007, undercompensation, the existence of several competent authorities in the same territory, short-term financial frameworks, disadvantages *vis-à-vis* other means of transport, insufficient powers of regulatory bodies, lack of fair competitive process, lack of effective review procedures and lack of incentives to provide efficient and quality services.

Regulation 1370/2007 is said to create many interpretation problems. These questions mainly concern the definition of the internal operator, the rule of confinement of such internal operator, the rules applicable to the award procedures (Public Procurement Rules or Regulation 1370/2007), undercompensation, the transitional period regarding the contracts awarded before the entry into force of Regulation 1370/2007, subcontracting and the concept of 'exclusive rights'.

Public transport operators also specify what, in their view, constitutes an adequate reward for providing public transport services, what they consider as being a burden and what they would recommend as best incentive for them to provide efficient services.

Adequate rewards, compensation and exclusive rights can all be granted, however many public transport operators also highlight the relevance of clear contracts with the competent authority. Public transport operators often consider that such contract should cover a long-term period, and be clear, fair and enforceable. Some public transport operators also indicate that pursuing business opportunities in a competitive environment acts as a reward for them, as would revenues generated from the sale of tickets or from commercial ancillary activities.

The burdens mentioned by the public transport operators relate to the PSO in general. However, some particular burdens have been highlighted such as delays in the payment of compensation or the limited possibility to reinvest income.

Regarding the best incentives for providing efficient and quality services, public transport operators mentioned the same elements as the rewards for discharging PSO (PSC, exclusive rights and compensation). However, they also highlighted that net cost contracts (concessions) could incentivise them to reduce their costs and attract more passengers. They also mentioned the incentivising power of appropriate risk allocation, profits, room for private initiatives, creativity, innovation, flexibility,

possible reinvestment of surplus funds in public transport, support measures for the modal shift and sustainable transport policies.

With respect to avoiding cross-subsidies, transparency was mentioned as the most important tool. The cost-allocation method was also mentioned.

Understanding competition issues

The general Treaty rules, including on competition, apply to transport. Therefore, National Competition Authorities have also been consulted to investigate possible competition cases in the public transport sector. Some cartel situations were reported (in general, market allocation by virtue of bid-rigging in a tender process). Some cases of abuse of dominant position were also reported. Finally mergers are likely to further develop with the creation of some large international undertakings.

These competition issues obviously interplay with the objectives pursued by Regulation 1370/2007 and should therefore continue to be monitored.

Assessment

Review of current regulatory and contractual practices vis-à-vis Regulation 1370/2007 led to a list of issues which the Commission ought to clarify further: the definition of PSO, the concept of 'exclusive rights', the rule on compensation (under- and overcompensation), subcontracting, the definition of the internal operator, the rule of confinement of the internal operator, the rule of cross-subsidisation and the transitional rules.

Given the variety of implementation of Regulation 1370/2007, this report has had to rely on the stakeholders' views – as summarised above and reviewed in detail below - on existing legal literature and sometimes on economic assumptions in order to determine the best practice.

The analysis led to conclude that in general, few current practices apply *all* principles contained in Regulation 1370/2007 (sometimes even exceed them). However, Regulation 1370/2007 is poorly implemented in many of the current contracts. The failures in the implementation relate mainly to the mandatory content and the compensation rules. Implementation does not show a coherent picture, even within one and the same Member State (given that competent authorities adopt different practices). It is impossible to determine the Member States which have, and those which have not yet, integrated the Regulation's principles in their contracts. Although the award procedure is subject to transitional provisions, PSC were not always awarded conforming to the applicable rules at the time of the award (Public Procurement Directives as transposed in national legislation or general Treaty rules of transparency and non-discrimination). Therefore, it was not possible to identify a single contract or

piece of legislation as the best practice. Rather, best practices are presented for each main item of Regulation 1370/2007.

PSO

Competent authorities have a wide margin of discretion to define what they regard as PSO, provided they do not commit manifest error. In principle, the competent authorities would not make a manifest error if they define PSO as to establish a coherent transport system and to ensure the continuity of public transport services. Such coherent transport system could include profitable routes.

Policy aims relating to PSO should be determined by the authority for the sake of the public interest. Best practices in this respect relate to legislation defining policy aims for public transport.

Clear definition of PSO constitutes a monitoring tool for the conferral of exclusive rights, and the grant of compensation and possible cross-subsidies. However, allowing the operator some freedom in the design of the services may result in a better use of the available skills. Best practices are identified when the competent authority gives some freedom to the operator in the design of the contract services. The services would be precisely designed and subject to the competent authority's approval. The result of such process would be enshrined in the PSC.

Rewards for PSO

A reward is the counterpart for providing PSO services. They may take various forms: compensation (financial or other) and exclusive rights. Compensation is examined below. The definition of exclusive rights in Regulation 1370/2007 refers to certain public transport passenger services on a particular route or network or in a particular area. For the sake of interconnectivity of services and for compliance with Directive 2007/58, the interpretation of exclusive rights should not completely deny a geographical area to other operators. Therefore, best practice would be to confer exclusive rights which would protect the operator but not impede the pursuit of services for purposes other than contract services on the contract routes.

PSC or general rules

Compensation and/or exclusive rights granted in exchange for the discharge of PSO are to be governed by PSC. PSC are widely interpreted under Regulation 1370/2007 and may even cover an individual decision of the competent authority. However, it was shown that a contract in due form concluded between two parties may have an incentivising power to provide services of better quality and more efficient than without contract. Best

practices are to be found where the competent authority concludes a contract in due form with the operator.

By derogation, general rules establishing maximum tariffs may be adopted. They should apply to all operators. These general rules may have the advantage of easing connections. Best practices would then relate to general rules which pursue the objective to facilitate the use of public transport.

Parameters for compensation

Parameters for compensation are to be set out beforehand in an objective and transparent manner to avoid overcompensation. With regard to general rules and PSC awarded directly to a public transport operator, the parameters must comply with the formula in the annex. Best practices are detected in contracts effectively containing a formula from which it is possible to reconstitute the elements of the compensation.

Cost allocation arrangements

PSC must contain the cost allocation arrangements. These arrangements should clearly list the admissible costs for compensation as a best practice. To avoid illegal cross-subsidies, the PSC must also contain the cost-allocation arrangements between PSO and commercial services if any. When the PSC have been directly awarded, such arrangements should reflect the annex according to which accounts must be allocated in order to 'at least' attribute variable costs, some portion of fixed costs and assets.

Revenue allocation arrangements

Regulation 1370/2007 would seem to require that PSC state who bears the risks, at least implicitly, through the requirement to state the revenue allocation arrangements. This is necessary to monitor the compensation. Best practices are arrangements clearly stating how the revenues are allocated between the parties and how this allocation will impact on the compensation.

Subcontracting

Regulation 1370/2007 allows public transport operators to subcontract part of their services delivered pursuant to PSC. This could be viewed as requiring the public transport operator which was awarded the contract to perform the major part of the services subject to the PSC. That would mean that where PSC only relate to the operation of public transport services, the operator is required to perform the major part of the services. Where PSC also cover design and construction, the performance of public transport services could be fully subcontracted, provided the operator which was awarded the contract effectively works on the design and construction. For

PSC that only cover the operation of public transport, best practices are identified where a pre-determined portion of services (less than 50%) is allowed for subcontracting.

Award

The rules governing the award of PSC depend on the nature of the contract to be awarded. If the contract qualifies as a service contract pursuant to the Public Procurement Directives, the award procedure will also be determined on the basis of those Directives (e.g. open, restricted or negotiated). In all other cases (e.g. concessions, licences, permissions, etc.), the Regulation would apply. However, it appears that the competitive tender procedure to follow under Regulation 1370/2007 would *de facto* resemble the one followed under the Public Procurement Directives. This finding does not prevent the competent authority from choosing the relevant procedure (e.g. direct award or competitive tender, possibly with negotiations).

In principle, PSC must be awarded after a competitive tender. It is often recognised that the competitive tendering process can lead to more attractive services at lower costs. Therefore, best practices relate to PSC awarded after a competitive tender, even if the results do not rely on the cheapest or most economically advantageous offer, but on a negotiation with the bidders.

The exceptions to competitive tendering, in particular for heavy rail, are to be interpreted strictly. Furthermore, these exceptions may be used by the competent authorities only if not prohibited by national law. Finally, to be in line with Regulation 1370/2007, recalling the general principles of transparency and non-discrimination, direct award should be subject to being advertised. These are the elements found in the best practice for direct award.

Internal operators

Internal operators under Regulation 1370/2007 are legally distinct entities over which the competent authority exercises similar control to that exercised over its own departments. There is no requirement for the competent authority to be 100% the owner of the operator so as to allow the creation of Public Private Partnerships.

Internal operators must perform their public passenger transport activity within the territory of the competent local authority and must not take part in competitive tenders outside that territory ('geographic specificity').

Hence, best practices relate to entities over which the authority exercises similar control as over its department, although allowing private capital, and which do not participate in tenders outside the territory of the competent authority, unless it is for services not relating to the operation of public transport.

Transitional period

Regulation 1370/2007 came into force on 3 December 2009 and its provisions directly apply to the current PSC, except the provisions on the duration of contracts for PSC awarded before the entry into force of the Regulation.

The transitional period of 10 years following the entry into force of the Regulation (ending on 3 December 2019) only relates to the award procedure and not to the other provisions of Regulation 1370/2007. Therefore, best practices are identified where competent authorities have amended ongoing contracts to adjust them in line with Regulation 1370/2007.

Compensation

Overcompensation is prohibited, be it in the remit of directly awarded PSC or PSC awarded after a competitive tender. The net financial effect of discharging PSO, and which may be compensated, must be assessed, when the PSC have been directly awarded, on the basis of the costs of the operator as if there were no PSO. Therefore, best practices are PSC in which a comparison with the market price is made to assess the price of the operator. For PSC awarded after a competitive tender, the financial effect would seem to be the difference between the price of the bid (market price) and the actual variations.

Incentives for efficiency and quality of the services could be given through a reasonable profit.

It seems, from the Commission's decisional practice, that Regulation 1370/2007 should be interpreted as requiring an *ex post* mechanism of restitution in the event the estimated compensation would exceed the actual costs incurred.

Where the public transport operator has had no choice in the definition of PSO (because it was directly awarded PSC or because it is subject to general rules), the operator should not be undercompensated. It should receive an appropriate reward (be it a compensation where the costs

incurred cannot be recovered or an exclusive right). Identified best practices relate to legislation obliging competent authorities to give a fair remuneration for the PSO that they require.

Cross-subsidisation from services rendered under PSO to commercial services is prohibited. Best practices cover practices where separation of accounting is required and where a specific cost-allocation arrangement is provided.

Review mechanism The award of a contract (either directly or after a competitive tender) must be subject to a review mechanism easily available to interested parties. The mechanism must be rapid and as effective as the Public Procurement Remedies. Therefore, best practices are identified in Member States in which these remedies (or comparable remedies) are applicable, even for concessions, in principle, not subject to the Public Procurement Directives.

Railway legislation Criteria to determine whether the economic equilibrium of PSC would be compromised must be determined prior to any assessment of such equilibrium. Best practices are found in Member States where the Regulatory Body or the legislation has set out such criteria.

Passengers' rights are able to act as an incentive to provide quality services without necessitating public intervention. Therefore, best practices are identified in the Member States which have not exempted public transport from the application of Regulation 1371/2007 and where passengers' rights are required for other means of transport.

Recommendations

The present study proposes recommendations to the Commission and the Member States.

To address the interpretation problems raised by Regulation 1370/2007 and the uncertainties regarding the enforcement of the compensation rules by the Commission, we would recommend the Commission to adopt a measure of 'soft law', in the form of guidelines.

These guidelines would need to set out the Commission's interpretation of the concepts and the rules in Regulation 1370/2007 and its position on the enforcement of the state aid rules. In particular, the guidelines would need to do the following:

<i>Definition of PSO</i>	Clarifying the extent to which the competent authorities must define the service under PSO.
	Recalling the wide margin of discretion of competent authorities and possible limitations.
<i>'Desire for efficiency'</i>	Adopting an interpretation whereby the operator is encouraged to become more efficient rather than one whereby the competent authority could only have recourse to an operator which is deemed efficient against a certain benchmark.
<i>'Exclusive rights' and correlation with Directive 2007/58</i>	Favouring a precise definition of the service which can benefit from exclusive rights.
<i>Subcontracting</i>	Distinguishing between cases where the public transport operator is in charge of only the performance of the passenger transport services and cases where it is in charge of more than that. In the former, the public transport operator has at least to perform a major part of the passenger transport service itself. In the latter, the PSC's remit would at least extend to the design of the services, so that the performance of the transport services could be subcontracted.
<i>Applicable rules to the award procedure</i>	Recalling the principle according to which the award of service contracts in the sense of the Public Procurement Directives is governed by those Directives and the award of other PSC is governed by Regulation 1370/2007.
<i>Internal operator</i>	Further clarifying the extent to which the competent authority has to exercise control over its internal operator.
	Confirming the principle of geographic specificity and its scope limited to public transport passenger services.
<i>Monitoring compensation</i>	Confirming the two stage analysis.
	Confirming the <i>ex post</i> test for overcompensation and the requirement for a regularisation mechanism (based on the actual costs incurred) over a certain period of time to be determined, account being taken of necessary incentives.

Interpreting the 'reasonable profit' by referring to the Commission's Decisional practice as to allow the taking into account of incentives for efficient and quality services.

Cost allocation

Clarifying the possible methods available.

Compensation

Monitoring compensation following a two stage examination consisting of the determination of the existence of state aid and, if so, a decision on compatibility with the internal market.

Cross-subsidies

Describing the circumstances in which cross-subsidies are prohibited / allowed.

Undercompensation

Recalling the principle of contractual freedom applicable to PSC awarded after a competitive tender.
Confirming the need to adequately reward the discharge of PSO in all cases.

Transitional period

Clarifying the Commission's position.

The present study also recommends the Member States and/or competent authorities:

Raising legal certainty and stability

Possibly by applying the Public Procurement rules to award procedures of concessions of public transport and other PSC not covered by the Public Procurement Directives or the future envisaged legislative initiative on service concessions.

Securing the provision of public transport

Possibly by favouring an *ex ante* intervention, during the contracting process, through Public Procurement Rules (e.g. abnormally low bids) to avoid problems in the course of the contract.

Possibly also by effectively compensating or otherwise rewarding the discharge of PSO.

By defining the criteria to determine when the economic equilibrium of PSC could be considered as compromised which would in turn justify a limitation to access rights (competition *on the track/road*).

Giving appropriate incentives

By adequately defining the PSO.

for efficient and quality services

By considering derogations to Regulation 1370/2007 on rail passengers' rights and obligations in the broader context of transport policy.

By adequately allocating risk.

By concluding fair and transparent PSC.

Avoiding overcompensation and illegal cross-subsidisation

By requiring accounting separation.

By determining the cost allocation method.

Securing competition

Possibly by defining priorities for the National Competition Authorities.

List of the main abbreviations

EU Member States

AT	Austria
BE	Belgium
BG	Bulgaria
CY	Cyprus
CZ	Czech Republic
DE	Germany
DK	Denmark
EE	Estonia
EL	Greece
ES	Spain
FI	Finland
FR	France
HU	Hungary
IE	Ireland
IT	Italy
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	The Netherlands
PL	Poland
PT	Portugal
RO	Romania
SE	Sweden
SI	Slovenia
SK	Slovakia
UK	United Kingdom

Other abbreviations used

CER	Community of European Railway and Infrastructure Companies
EMTA	European Metropolitan Transport Authorities
EPF	European Passengers' Federation
EPTO	Association of the European Passenger Transport Operators
EU	European Union
IM	Infrastructure Manager

IRU	International Road Transport Union
MS	Member State
NC	National Courts
NCA	National Competition Authority
OA	Organising Authorities
PSC	Public service contracts
PSO	Public service obligations
PT	Public transport
RB	Regulatory Body
RU	Railway Undertaking
UIC	International Union of Railways
UITP	International Association of Public Transport
UTP	Union des Transports publics et ferroviaires