



MOBILITY AND TRANSPORT

Workshop on "Competitive tendering of public service contracts for rail passenger transport: Meeting the challenge"

Brussels - 30th May 2018

Proceedings

These proceedings summarise the main messages passed at the workshop and are not meant to constitute exhaustive minutes. They can be complemented by the slides prepared by the speakers and the introductory speech and Q&As, which are also published.

Legislative framework: the fourth railway package

The "market pillar" of the fourth railway package, adopted in December 2016, is the latest step in the opening of the rail passenger transport market.

Directive 2012/34/EU as amended by the fourth railway package, prescribes that, from 1 January 2019, railway undertakings shall be granted the right of access to railway infrastructure in all Member States, thereby putting an end to the remaining monopolies¹.

Regulation (EC) n°1370/2007 as amended by the fourth railway package establishes the principle of the competitive tendering of rail public service contracts.² This principle will fully apply from 3 December 2019. The unconditional possibility of directly awarding public service contracts is allowed until 24 December 2023. After that date, the direct award procedure will only be allowed in limited and well-defined circumstances listed in Article 5 of Regulation (EC) n° 1370/2007, for example when the direct award is justified by structural and geographical characteristics of the market or network, and if the contract results in an

¹ Article 10(2) of Directive 2012 /34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area, as amended by Directive (EU) 2016/2370 of the European Parliament and of the Council of 14 December 2016.

² Article 5(3) of Regulation n°1370/2007 of the European Parliament and of the Council of 23 October on public passenger transport services by rail and by road, as amended by Regulation (EU) 2016/2338 of the European Parliament and of the Council of 14 December 2016.

improvement in quality of services or cost-efficiency, in comparison to the previous one. The competent authority has to publish its substantiated direct award decision and inform the Commission accordingly.

In application of the amended Regulation (EC) N°1370/2007, and in order to contribute to fair and non-discriminatory tendering conditions for all railway undertakings, public service contracts now require public transport operators to provide competent authorities with the information necessary for the preparation of the tender (e.g. passenger demand, fares, costs and revenues). Competent authorities must then share the information with all interested parties during a tendering procedure.³

Additionally, with a view to launching a competitive tendering procedure, competent authorities must now assess whether measures are necessary to ensure effective and non-discriminatory access to rail rolling stock. In compliance with State aid rules competent authorities may take suitable measures to ensure such access.⁴

Experience in the use the competitive tendering procedure so far

According to Member States with experience in the competitive tendering of public service, this procedure brings a certain number of benefits.

Institutionally, competitive tendering can result in a higher level of responsibility, a stronger commitment of the local and regional Public Transport Authorities ("PTAs") and a strengthening of their position.

Competition can also lead to a **reduction of costs**, as illustrated by a comparison between France (no tender) and Germany (70% of contracts are tendered in 2015): the total cost of providing rail public transport service is EUR 25.50/ train-km in France, against EUR 15.70/train-km. Staff, maintenance and ticket sale costs are significantly lower in Germany. As a result, in the first award period, the use of competitive tendering generally results in a significant reduction (above 20%) of compensation payments for the discharging of public service obligations. In France, subsidies amount to EUR 19,60/train-km against EUR 9,60/train-km in Germany. It also appears that these savings are usually not returned to the general budget but are reinvested in more and/or better transport services.

Competitive tendering has also a positive impact on the **quality of services**: competitors deliver new technical solutions and usually provide new rolling stock. Thanks to the perceived improvement in quality, Member States which opened their markets have witnessed a significant increase in the number of passengers (e.g. + 48% between 2002 and 2016 in Germany).

There can be drawbacks as well: punctuality is a concern in Sweden, and so is a recent decrease in the average speed of trains (mainly due to capacity constraints). While the

³ Article 4(8) of Regulation n°1370/2007.

⁴ Article 5a of Regulation n°1370/2007.

franchise system in the UK has brought significant benefits in terms of safety, increase in number of passengers and reduction of costs, it is also experiencing difficulties, such as for instance a declining interest in participating in bidding procedures, and the failure of a few franchises.

Lessons learnt and best practices on competitive tendering of public service contracts

Politically, it is essential to ensure the success of the first tendering procedures. The following factors need to be carefully taken into account:

Political and social context

Before launching a tendering process, a prerequisite is to establish a **good communication** with the undertakings, incumbents included, staff concerned and the public. Stable relationship between politics and administration and communication with the users/consumer associations are essential to create trust among the actors in the award process and to manage expectations.

Several PTAs underlined the importance of social dialogue with the trade unions and employees: a change of operator following a competitive tendering procedure creates uncertainty for the employment and for working conditions.

Characteristics of the award procedure

It is essential to set a **realistic timeline** for the various steps of the award procedure. A competitive tendering procedure for a service contract in Germany typically takes up to 3 to 4.5 years. The process may be longer in cases of an appeal before the courts, or other regulatory bodies: the tendering of the public service contract in the South Bohemia region was delayed by three years following legal action brought by the incumbent before the Czech competition authority. Special care must thus be paid to ensure the procedure's full compliance with the legal framework. The process can also take longer if specific measures have to be taken to ensure access to rolling stock (see below).

When planning the timing of the tendering procedure, coordination with other PTAs is also recommended, in order to avoid that too many procedures are launched at the same time. Some centralisation of the PTAs' agenda at the level of the Member States may be advisable, and does take place in Sweden.

PTAs must also give careful considerations to the **selection criteria and evaluation procedure**. In Sweden, the award decision is based on the most economically advantageous method is applied, where 70% of the mark is given to price and 30% to quality.

Characteristics of the contracts

The tendered contracts/lots must be of an **appropriate size**. When defining the geographical remit of the contract, PTAs should take account of the potential level of supply, the location

of service facilities and the physical and geographical characteristics of the network (e.g. network largely developed along the coast in Region Provence-Alpes-Côte d'Azur). It may also be advisable to experiment with competitive tendering procedures and gain experience on smaller lots. Potential operators can also provide their input on the definition of the scope of the lots in the context of a call for expression of interest, as experienced in Region Provence-Alpes-Côte d'Azur.

The **optimal duration** of the contract also needs to be carefully considered. Shorter contract periods may be advisable at the beginning: in Sweden, contract periods have increased from 1-3 years in first years to 5-8 years now. On the other end, contracts have to last long enough to allow amortisation of set-up and investment operators' costs. Among the PTAs opening to competition, the region of Val d'Aoste has opted for a five year contract while the region of South Moravia plans to launch a 12-15 year contract in 2013.

It is also important to find the **right allocation of risk** between the PTA and the operator. To that end, the PTA has the choice between gross cost contracts and net cost contracts. Under a gross cost contract, the operator is remunerated by the public contribution. Under net cost contracts, the operator is remunerated with the ticket sale and other revenues and possibly by a complementary compensation payment fixed by the public transport authority. The operator takes the commercial risks.

When they use the competitive tendering procedure for the first time, it may be advisable for PTAs to take a bigger share of the risk and to opt for gross cost contracts. For its first experience with competitive tendering, the Region of South Moravia is also opting for the gross cost contract, as it allows for a greater level of control by the PTA over tariff setting.

On the other hand, by putting more risk on the operator, net gross contracts give more incentive to operators to improve services, and some PTAs opening to competition, such as the Region of Val d'Aoste, have already opted for that type of contracts.

There are other tools to incentivise operators to reduce costs or to improve performance, such as the scope of indexation of costs (full or partial) and bonus-malus incentive schemes.

Once the contract is in place, PTAs must pay great attention to **monitoring its fulfilment**. That implies introducing clear and well-defined criteria in the contract, relating to punctuality, reliability, security, cleanliness and condition of rolling stock, emergency management, customer information and orientation.

When designing the contract, PTAs should also consider **multi-modal** mobility solutions, e.g. by combining train and bus services under one contract. They should also consider agreements with neighbouring PTAs in order to ensure **cross border** public transport. The concession agreement in the Province of Limburg provides good solutions on both aspects.

Access to information and means of production

The PTA must also ensure that all interested parties have access to all the **information** necessary for the preparation of the bids, as required by Regulation n°1370/2007 as amended

under the fourth railway package. According to some PTAs, such as the Region Provence-Alpes-Côte d'Azur, obtaining such information from the incumbents is problematic. In order to overcome this obstacle, national legislation needs to be specific in detailing the type of information to be provided. The experience of Region Val d'Aoste shows that consulting other stakeholders can also help to get the information that the incumbent would not provide.

Another issue relating to non-discrimination is access to essential equipment, and notably **rolling stock**. In Member States that have not yet opened their markets, existing rolling stock is generally in the hands of the incumbents. Purchasing rolling stock raises serious challenges as considerable capital investment is required. These costs can be even higher if the contract requires the provision of new rolling stock and/or the respect of specific technical standards and investment costs for the amortisation of this equipment with a 30-35 year life-time cannot be amortised over one public service contract (maximum length 22,5 years).

PTAs thus have an important role to play: under the new provisions of Regulation n°1370/2007, when launching a competitive tendering procedure, they must assess whether it is necessary to take measures to ensure non-discriminatory access to rail rolling stock and they may take such measures. Among the possible solutions listed in the regulation, PTAs may acquire rolling stock, provide guarantees covering their financing or create rolling stock pools jointly with other competent authorities.

In Member States with long standing experience, such as Germany and Sweden, PTAs do often provide rolling stock. Newcomers follow the same path: the regions of South Moravia in the Czech Republic and Kujawsko-Pomorskie in Poland have decided to purchase the rolling stock to be used for the execution of their respective regional public service contracts. A combination of different measures is also possible: for its forthcoming contract, the Region of Val d'Aoste will purchase part of the rolling stock, the remaining equipment will be leased from the incumbent or provided (leased or purchased) by the winning bidder.

In order to ensure access to rolling stock, PTAs can rely on the assistance of the **European Investment Bank**. It has a long-standing experience in the financing of rolling stock, essentially for the execution of public service contracts. Such financing can be provided for the purchase of the rolling stock by (mostly regional) PTAs, by rolling stock operating companies (see below) or by the rail operator itself. When it does not purchase the rolling stock, the PTA can provide a redeployment guarantee ensuring that, at the end of the public service contract, the financed equipment will be leased to the winner of the new contract. In addition to providing financing, the EIB proposes to disseminate its experience in this field to PTAs preparing for the implementation of the fourth railway package, including through its European Investment Advisory Hub.

Instead of directly purchasing rolling stock, PTAs or rail operator can lease it from rolling stock operating companies (**ROSCO**), many of which are members of the European Passenger Train and Traction Operating Lessors' Association (EPTTOLA). Leasing from ROSCO can provide certain number of benefits. It's off balance sheet financing for the PTA and risk vests with the ROSCO. ROSCOs are experienced buyers; they can provide technical

expertise for rolling stock maintenance and promote standardisation of rolling stock when appropriate.

Access to other means of production must also be ensured. This is notably the case of **service facilities** such as maintenance workshops. Non-discriminatory access to them is regulated by Directive 2012/34/EU, but certain PTAs, such as the Region of Val d'Aoste, have identified the access to such facilities as problematic when they are owned by the incumbent. PTAs may consider owning (some of) these services facilities.

Access to the appropriate **workforce** is also an element to be taken into account: in certain Member States, such as Sweden, competitive and expanding markets are experiencing shortages of staff. Transfers of staff following a change of public transport contractor may be necessary but can raise some issues. In order to address it, Sweden recommended that transferred employees should be offered employment under the same or similar conditions and that an existing collective agreement should never be downgraded. Finally, non-discriminatory access to the **ticketing distribution system** should also be ensured.

Role of other stakeholders

The role of **regulatory bodies** and **rail infrastructure managers** is unanimously acknowledged. Rail infrastructure managers must ensure a smooth and non-discriminatory access to the rail infrastructure, for example, through efficient coordination and planning of infrastructure works. The lack of equal treatment by the infrastructure manager in its coordination function and in the work planning on the network was identified by public transport operator Transdev as obstacles to effective market opening in Germany.

Ensuring non-discriminatory access to rail infrastructure and service facilities is one of the main functions of the **rail regulatory body**. Some rail regulatory bodies have proactively supported the implementation of the Fourth Railway Package. In 2015, the Italian Transport Regulatory Authority ("ART") adopted a decision on regulatory measures for tendering schemes for the award of transport services, which lays down rules and recommendations on access to essential assets (including rolling stock) and on essential information to be made available by PTAs. In 2017, the ART adopted a decision on the methodology to identify the appropriate scope of the public transport service and the most efficient financing arrangements.

Other regulatory bodies have a key role to play, too. The opening of rail market to competition cannot fully deliver on its potential if the market is distorted by anticompetitive practices. **Competition authorities** can investigate and remedy these practices, which can include bid-rigging, whereby firms agree in advance who will win the tender, or predatory pricing by an incumbent to undercut competitors and win the tender. In the experience of Transdev, such practices may significantly distort the level-playing field and, as a result, the willingness to take part in tendering procedures.

PTAs should also be aware of their obligation to comply with the EU State aid rules, which are applied by the Commission (DG Competition) and national courts. To order to avoid

granting (and having to recover) incompatible State aid, PTAs should avoid manifest errors in the specification of public service obligations and their scope of application, design a well-defined compensation mechanism, control that no overcompensation is paid to the operator of a public service contract and ensure that the award procedure is properly conducted.

Follow-up

Participants will receive a questionnaire on their needs and suggestions on follow-ups. Possible options include:

- establishing a web-hosted information platform between competent authorities which could freely exchange best practices,
- holding bilateral meetings with competent authorities to address issues of interpretation of EU law,
- organising a future workshop on more specialised topics related to rail tendering such as ticketing distribution systems or cross-border public service contracts.

Summary: Ten Takeaways

1. Ensure a reliable **communication** to the undertakings and to the public. This is essential to create trust among the actors in the award process and manage the expectations.
2. Set a realistic **timeline** for the various steps of the award procedure —tendering takes time. Prepare early, and prepare thoroughly to ensure compliance with the regulatory framework in order to limit legal risks (e.g. the annulment of an award).
3. Correctly identify the **scope** of the public service contract. To that end, you need a good knowledge of your market: demand, users' needs, existing and potential commercial offer.
4. Provide all essential **information** needed for railway undertakings to be able to submit realistic bids and to **create a level playing field** among them.
5. Facilitate **access to all essential means of production** such as the infrastructure, rolling stock, maintenance workshops and staff.
6. Use test pilots and consider starting with **less complex and smaller networks/lots** to give both sides time to learn.
7. Calculate the estimated costs and revenues to be able to reach a realistic balance between your public service objectives and your budget constraints.
8. Strike the **right balance** between providing efficiency incentives to the operator and ensuring its stability and service continuity.
9. Set precise service quality standards and **monitor** them to ensure that the terms of the PSO contract are complied with.
10. All actors must play their full role in optimising rail services. This applies to the competent authorities and regulatory bodies and to the **infrastructure managers**.