



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

Final report

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

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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 Therefore, it is inevitable for some information included below to be slightly out of date (e.g. the new French Regulation issued on 24 August 2010).*
- *The consultant would like to thank the stakeholders for their valuable contribution to the study as well as Axel Gautier, Associate Professor at the University of Liège, for his help in analysing certain economic concepts, and OXERA for their comments on certain economic issues raised by Regulation 1370/2007.*

Executive Summary

Introduction

Having safe, efficient and high-quality public transport services for EU citizens is an important goal of the European Union.¹ Inland public transport having become structurally loss-making in the 1960s, Regulation 1191/69² and Regulation 1107/70³ eased 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, these rules were 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 new rules did not address the way PSC were to be awarded. Mandatory requirements for award procedures are however provided by Public Procurement Directives, where applicable. The application of the rules 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, and amended its proposal 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 European Commission awarded current study to gain a clear overview of the application by Member States and, within Member States, by competent authorities for the organisation of public transport, of Regulation 1370/2007, and to give guidance on best practices in implementing said Regulation.

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 *Combus* [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.

This study aims to enable 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. In line with the Action Plan on Urban Mobility,⁶ the study also intends to exchange best practices relating to defining, awarding and implementing PSC.

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. It is of note that the response rate has generally been rather low.

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

It would appear 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 given 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

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.

open to competent authorities as regards the way to award PSC, the public transport operator and the compensation method.

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 bases for the award of PSC are the Public Procurement rules (resulting 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 basis for the award of PSC varies according to the nature of the contract. However, it would appear that 'service contracts' in the sense of the Public Procurement Directives are not always awarded on the basis of these rules. Similarly, it would seem 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 basis 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, In general the legislation in force in Member States does not stipulate the choice of award procedure, operator and method for compensation.

the operator and the 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, competitive tendering procedures operate.

It would also appear that various elements contained in Regulation 1370/2007 have generated or will /ought to generate legislative reforms. In some Member States, legislation has been adjusted according to Regulation 1370/2007, sometimes in pure copy /paste fashion. In still others it has led to the 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. Finally, in some Member States consultations on the implementation of Regulation 1370/2007 have started, with no changes yet implemented.

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 funds. Therefore, the application of Regulation 1371/2007 helps to implement Regulation 1370/2007 correctly. However, it would appear 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 were to 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 would appear that organising public transport through contracts is a widespread practice. However, in other instances contracts have not yet been concluded. Moreover, agreed PSC contracts are not always 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. Following 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 would appear 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 specific PSO are either defined in general terms by the competent authority (*functional service design*), sometimes further detailed by both parties and 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 carrying out PSO are those provided for 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 carrying out 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 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 carrying out 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 in 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 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 would appear 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 carrying out 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 would seem, 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</i>	Recalling the principle according to which the award of service

<i>procedure</i>	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>	<p>Further clarifying the extent to which the competent authority has to exercise control over its internal operator.</p> <p>Confirming the principle of geographic specificity and its scope limited to public transport passenger services.</p>
<i>Monitoring compensation</i>	<p>Confirming the two stage analysis.</p> <p>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.</p> <p>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.</p>
<i>Cost allocation</i>	Clarifying the possible methods available.
<i>Compensation</i>	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.
<i>Cross-subsidies</i>	Describing the circumstances in which cross-subsidies are prohibited / allowed.
<i>Undercompensation</i>	<p>Recalling the principle of contractual freedom applicable to PSC awarded after a competitive tender.</p> <p>Confirming the need to adequately reward the discharge of PSO in all cases.</p>
<i>Transitional period</i>	Clarifying the Commission's position.

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

<i>Raising legal certainty and stability</i>	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.
<i>Securing the provision of public transport</i>	<p>Possibly by favouring an <i>ex ante</i> intervention, during the contracting process, through Public Procurement Rules (e.g. abnormally low bids) to avoid problems in the course of the contract.</p> <p>Possibly also by effectively compensating or otherwise rewarding the discharge of PSO.</p> <p>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 <i>on</i> the track/road).</p>
<i>Giving appropriate incentives for efficient and quality services</i>	<p>By adequately defining the PSO.</p> <p>By considering derogations to Regulation 1370/2007 on rail passengers' rights and obligations in the broader context of transport policy.</p> <p>By adequately allocating risk.</p> <p>By concluding fair and transparent PSC.</p>
<i>Avoiding overcompensation and illegal cross-subsidisation</i>	<p>By requiring accounting separation.</p> <p>By determining the cost allocation method.</p>
<i>Securing competition</i>	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

This study was prepared in response to a request for the assignment (TREN/A3/154-2009) under an EU Commission DG TREN Framework Contract (TREN/R1/350-2008 lot 1) on the provision to the Commission of services of legal assistance in the field of energy and transport policy.

This legal study provides a descriptive overview of the current regulatory choices and practices related to public service obligations, public service contracts, the compensation of public service obligations, the award of public service contracts, the duration and other procedural aspect relating to public service contracts and the legislative reform at national level in the EU Member States as well as an overview of the assessment of best practice related to these issues and conceptual proposals for the organisation of the final workshop.

This study is structured as follows:

- (1) In a first chapter, an introduction will be given, describing the context of the study, its objectives and the methodology.
- (2) Chapter 2 describes the status of regulatory and contractual practices relating to Regulation 1370/2007.
- (3) Chapter 3 lists the issues relating to the implementation of Regulation 1370/2007. It reflects the views of stakeholders and describes the potential competition problems.
- (4) Chapter 4 assesses what is required from a practical point of view in terms of best practice for the introduction of an efficient market for the discharge of public service obligations according to Regulation 1370/2007.
- (5) Chapter 5 makes recommendations on the implementation of Regulation 1370/2007.

1. Introduction

This chapter describes the context and the objectives of the study as well as the approach and methodology followed to fulfil the tender specifications.

1.1 Context of the study

Having safe, efficient and high-quality public transport services for EU citizens is an important goal of the European Union.⁷ Because inland public transport had become structurally loss-making in the 1960s, Regulation 1191/69⁸ and Regulation 1107/70⁹ were introduced in order to ease 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 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. The application of the legislation led to some uncertainties with respect to the state aid regime relating to PSC.¹⁰

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 (referred to in this study as 'Regulation 1370/2007').¹¹

Regulation 1370/2007 relies on the principle of competition *for* the market, as opposed to competition *on* the market. As a general principle, an authority that decides to grant operators exclusive rights and/or compensation in return for the discharge of PSO, concludes PSC. In principle, such PSC are to be awarded after a competitive tender procedure. The Regulation provides for several derogations from this principle. First, local authorities can provide public transport services themselves, or directly award PSC to an internal operator. Second, where the public service is to be provided by a third party, the principle of competitive tendering enjoys three derogations, leading to PSC being awarded directly if: (i) the contract's scope is below determined ceilings (*de minimis rule*), particularly defined in the

⁷ 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'.

⁸ 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.

⁹ 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.

¹⁰ 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.

¹¹ [2007] OJ L 315/1.

case of small and medium undertakings (ii) in cases of emergency and (iii) for public transport by heavy rail. The Regulation sets out rules on the compensation for providing public transport services (with a view to avoiding overcompensation) and lays down mandatory content of PSC. Regulation 1370/2007 enhances transparency by imposing upon competent authority publicity obligations.

Regulation 1370/2007 allows the adoption of general rules *in lieu* of PSC where PSO aim at establishing maximum tariffs for all passengers or for certain categories of passenger. Such general rules must also contain mandatory content and avoid overcompensation.

Regulation 1370/2007 came into force on 3 December 2009. However, the application of the principle of competitive tendering for the award of PSC can be postponed until 3 December 2019, for contracts not subject to public procurement Directives, to allow Member States to ensure the transition. During this transitional period, Member States shall adopt measures gradually to comply with this principle. Contracts awarded before the entry into force of Regulation 1370/2007 may continue, without being renewed, for a certain period of time, determined according to the date of award (before 26 July 2000 or as from 26 July 2000 and 3 December 2009) and the award procedure (fair competitive tender or other), provided these contracts have been awarded in accordance with European and national law.

1.2 Objectives of the study

1.2.1 Purpose of the study

Given the considerable complexity of Regulation 1370/2007 and the various ways in which it can be implemented, the European Commission awarded current study to gain a clear overview of the application by Member States and, within Member States, by competent authorities for the organisation of public transport, of Regulation 1370/2007, and to give guidance on best practices in implementing said Regulation.

Having a clear overview of the application of Regulation 1370/2007 includes the need to have a clear picture of the way Member States implement the provisions on the mandatory content of PSC and on compensation as well as the other features contained in PSC or, where they exist, the content of the general rules.

According to the tender specifications, the study had to focus on the following Member States:

- Austria
- Belgium
- Czech Republic
- Germany
- Denmark

Spain
France
Hungary
Italy
Lithuania
The Netherlands
Poland
Portugal
Sweden
United Kingdom

This study aims to enable 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. In line with the Action Plan on Urban Mobility,¹² the study also intends to exchange best practices relating to defining, awarding and implementing PSC.

1.2.2 Tasks

To attain these objectives, the following tasks were included in the tender specifications:

To collect information on and to assess, at least, the following issues for road and rail and other guided transport:

A. PSO

- the way competent authorities in Member States define PSO and ensure their discharge (e.g. type of PSO obligations imposed and relative economic justification and type of reward offered by transport authorities, namely financial payments and/or exclusive rights);

B. PSC

- the basic features of PSC (e.g. mandatory content, ancillary clauses, terms on the quality of the service, clauses allowing changes in case of exceptional circumstances); or, alternatively
- the nature and scope of general rules;

C. Compensation of PSO

- how competent authorities in Member States tackle the issue of avoiding overcompensation (including parameters on the basis on which compensation shall be calculated);
- how competent authorities in Member States tackle the issue of avoiding cross-subsidies to undertakings which are active in both commercially viable and PSO services (e.g.

¹² 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.

- identification of non-profitable transport routes, incidence of compensation on total revenues from the selling of tickets);
- whether and how in the formulation of PSC competent authorities in Member States cater for the effects of unforeseen, significant external events (such as severe economic recessions) that have an impact on the economic equilibrium of PSC;
- D. The award of PSC
 - the extent of the recourse to the award of the service to internal operators;
 - the basic features of such internal operators (statutes, ownership, field of activity in terms of territory/services covered);
 - the extent of the recourse to direct awards and tender procedures;
 - the extent of subcontracting;
- E. Duration and other procedural aspects relating to PSC
 - the duration of PSC (with reference to already existing contracts and to the rules on time limits for contracts whose award procedure will start after 3 December 2009);
 - the review-appeal of the award procedures concerning PSC;
 - the transparency/publication requirements relating to such procedures;
- F. The legislative reform at national level

if and to what extent the entry into force of the Regulation has led to a reform of the national legislation applying to PSO and PSC for road and rail passenger transport.

1.3 Approach and methodology

The study is based on several sources of information:

- a broad consultation of stakeholders so as to investigate the existing and impending practices in organising public transport as well as to collect their views on the current situation in the public transport sector;
- desktop research and technical legal analysis.

The study constitutes a legal report on the implementation of Regulation 1370/2007, taking into account existing legal and economic literature. However, the consultant expertise does not extend to discussing economic considerations and proceeding to economic evaluations.

1.3.1 The process of collecting data

Data collection was the main challenge of the present study. This data collection was realised through contact with relevant stakeholders. Contacts took the form of questionnaires to stakeholders and interviews with their European associations.

In view of the large amount of stakeholders as a result of the study covering national/regional/local

public transport services, the stakeholders to be consulted for the study were limited to a representative sample per category and per country. They were identified as follows (groups of stakeholders):

- Competent authorities for organising public transport services
 - o National transport ministries as competent authorities for organising public transport by (heavy) rail (one per country).
 - o Regional/local competent authorities for organising public transport and/or their associations (at least one per country).
 - o Large cities (the capital and in some countries other cities).
- Operators of public transport services and/or their associations
 - o Railway undertakings (heavy rail), both private and public (the national RU and at least one private operator of public services, if any).
 - o Bus/tram/metro operators, both private and public (one public and at least one private per country, if any).
- National regulatory bodies (one per country).
- National competition authorities (NCA) (one per country).
- Consumers' associations (one per country in some EU Member States).

However, in view of the way in which some of the associations function, the consultant received several contributions from single stakeholders.

Regional/local competent authorities (or their association), operators of public transport services (or their association) and consumers' associations were identified with the help of European associations (UITP, CER, IRU, EPTO, EMTA and EPF). The brochure issued by the UITP, 'Organisation and major players of short distance public transport', was also helpful.¹³

This selection does not cover exhaustively all practices. Nevertheless, it covers most well-established practices.

Given the relatively short time frame for conducting such a broad survey, the identification of some stakeholders occurred in parallel with the distribution of the questionnaires.

1.3.2 The objectives of the data collection

The questionnaires were specifically drafted for each group according to the information expected from each of them. All questionnaires contained thorough evaluative questions allowing the stakeholders to give their opinion on the advantages/disadvantages of the current situation and their

¹³ UITP document dated February 2006, as well as its update of 2010.

possible recommendations as well as any other comment they would have wished to make. In other words, stakeholders were not limited in their analysis to what the contractor and the Commission viewed as being the preponderant issues. The first sections of chapter 3 are dedicated to the stakeholders' views and may be seen as a forum for further discussion. The consultation was pursued as follows:

- The regulatory state of play as well as current practices was sought from the **competent authorities** consulted and to a lesser extent from the operators of public transport. The questionnaire sent to the group of stakeholders comprising the competent authorities contained mainly **descriptive** questions (see annex IV). This questionnaire was designed to elicit a detailed description of the current state of play and future evolutions.
- The questionnaire sent to the **operators of public transport services** (see annex V) rather aimed to identify the best practices. It sought *inter alia* to gather the relevant information on the current practices (e.g. on the way that illegal cross-subsidisation is avoided). Through more prospective questions, the best incentives and the most efficient ways to provide public transport services were investigated.
- A questionnaire was sent to the **national competition authorities** (NCA) (see annex VI). The questionnaire sought to obtain relevant information on possible anti-competitive behaviours relating to PSC, if any, and possible remedies.
- A questionnaire was also sent to **Regulatory bodies** (RB). The questionnaire (see annex VII) had as its objective to investigate to what extent the Regulatory bodies set up on the basis of Article 30 of Directive 2001/14/EC¹⁴ are competent for public service and if so whether they are also competent for other means of public transport than railways. Another objective was pursued through descriptive questions on the way Regulatory bodies define and assess the economic equilibrium of PSC and on possible decisions relating to PSC.
- The questionnaire addressed to the **consumers' associations** (see annex VIII) contained both descriptive and evaluative questions. Through descriptive questions, it was investigated whether consumers participate in the adoption of PSC. Through evaluative questions, consumers' opinions were requested regarding the quality of public transport services.

¹⁴ Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure, OJ [2001] L 75/29.

1.3.3 Results of the data collection

Stakeholders

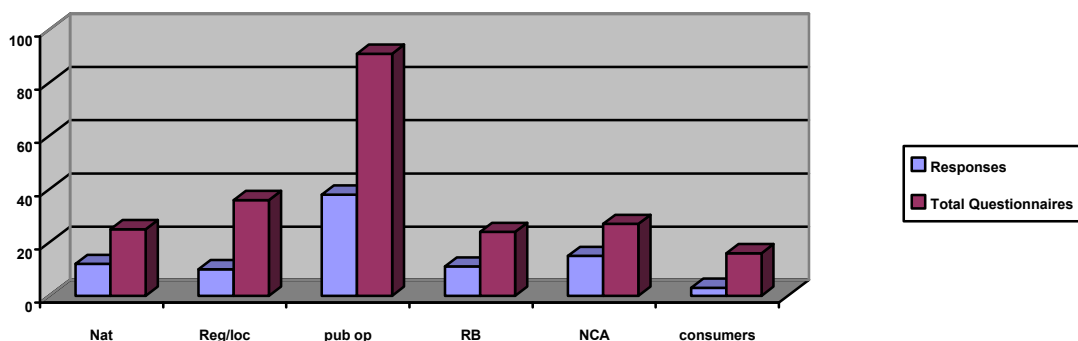
219 questionnaires were distributed as follows:

- Competent authorities for organising public transport services
 - o National transport ministries as competent authorities for organising public transport by rail: 25 (all EU Member States having a railway infrastructure)
 - o Regional/local competent authorities for organising public transport and/or their associations: 36
- Operators of public transport services and/or their associations: 91
- National regulatory bodies: 24 (all the EU MS having a railway infrastructure except Ireland)
- NCA: 27
- Consumers' associations: 16

Response rate

The response rate is given by comparison with the number of stakeholders consulted, and not necessarily in absolute terms. Hence, when the consultant received several contributions from a single stakeholder consulted (being an association), this translates as one contribution in the response rate.

- Competent authorities
 - o National (Nat): 12/25
 - o Regional/local (Reg/loc): 10/36
- Public transport operators or their associations (pub op): 38/91
- National regulatory bodies (RB): 11/24
- National competition authorities (NCA): 15/27
- Consumers' associations (consumers): 3/16



Representation of stakeholders

In general, the response rate has been rather low. Many stakeholders have indicated that the deadlines given for a large survey on a sensitive matter were too short.

1.3.4 Handling of the data

The information received from the stakeholders was compiled and analysed by DLA Piper. Information received from public operators has been made anonymous.

The present study also makes use of available expertise such as the 2008 NEA study on contracting practices in urban transport.¹⁵ However, the expertise of the consultant does not extend to updating or discussing this study.

¹⁵ NEA, Study on '*contracting in urban public transport*' [2008], commissioned by the Commission.

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

This chapter describes the current status of regulatory and contractual practices relating to Regulation 1370/2007. It is based on the primary source of information received from the competent authorities and on desktop research. For a table summarising and comparing the answers received, see annex IX. In section 2.1, the regulatory practices relating to the matters dealt with in Regulation 1370/2007 in the Member States are investigated. In section 2.2, an analysis of current contracts is given.

Until the adoption of Regulation 1370/2007, public transport was governed at European level by 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.¹⁶ This Regulation 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. The application of the legislation led to some uncertainties regarding the State Aid regime relating to PSC.¹⁷ Despite the adoption and entry into force of Regulation 1370/2007, the situation created by the old Regulations still exists in the Member States.

2.1 Overview of the current regulatory practices in public transport

This section provides an overview of the current state of play in regulatory practices. The information has been gathered from competent authorities and from desktop research, when the information was available, with a special focus on the Member States selected in the tender specifications.

2.1.1 Scope of application of Regulation 1370/2007

This section reviews whether the scope of Regulation 1370/2007 has been extended to inland waterways in national legislation, as prescribed by Article 1(2) of Regulation 1370/2007 (a). This section also describes the cases in which the EU Member States have set out general rules and whether these rules have been excluded from the scope of the regulation (b).

a) Inland waterways

Regulation 1370/2007 applies to public passenger transport by inland waterways in CZ, PL and IT, and

¹⁶ [1969] OJ Spec Ed I-276.

¹⁷ See in particular Case T-157/01 *Combus* [2004] ECR II-917, noted by L. Hancher (2004) EStAL 455-460 and Case C-280/00 *Altmark* [2003] ECR I-7747.

to passenger transport between the mainland and the islands of Vlieland, Terschelling, Ameland and Schiermonnikoog in NL. In NL, when Regulation 1370/2007 does not apply to inland waterways, the general Treaty rules shall regulate the transport on inland waterways.

b) General rules

In some EU Member States, general rules establishing maximum tariffs have been issued at national/regional level either for local public transport (DE, EN, ES, HU, IT, NL, UK, LV, PT) or only for railway services which are the responsibility of the national competent authorities (RO, SK):

- Maximum tariffs are targeted at specific social groups in ES, HU, NL, LV, PT, UK, SK and, where they exist, in DE (the elderly, children, students, groups).
- Maximum tariffs are set for all passengers in ES, HU, PT and RO.

These general rules have not (yet) been excluded from the application of Regulation 1370/2007. It is to be noted that in PL, under the Act on Prices (Article 8), the town council (in cities - municipal council and provinces - the council of the provinces) is competent to establish a maximum tariff which applies to services of collective transport and taxi transport in the territory of the respective self-governed unit. Such maximum fares can be considered as a general rule in the sense of Regulation 1370/2007 (as they apply to all operators) but since there is no compensation system provided, they are considered as not falling under the Regulation.

These general rules were usually adopted before the adoption of Regulation 1370/2007 although they appear to fit within the Regulation.

Another important element relating to general rules, concerns the compensation of the PSO. Compensation for maximum tariffs set out in general rules should follow the same principles as compensation under directly awarded PSC, according to Regulation 1370/2007. However, general rules often allow for compensation of the difference between the tariff of a normal ticket and the imposed tariff, without necessarily fulfilling the rules contained in the Regulation. In ES, maximum tariff obligations are compensated through a price calculated per KM or per hour.

Finally, the question may arise as to the qualification under Regulation 1370/2007 of legislation providing for general tariff reductions to the tariff applied by the operators. For instance, in PL various categories of passenger (students, veterans, children under the age of four, etc.) are entitled to a tariff reduction (100, 49, 37% etc.). The reference tariff is the price of the ticket, which is established by operators at their sole discretion. Such reductions cannot be considered as imposing a maximum tariff, but do constitute an obligation which may impact the financial structure of a company. In PL, such tariff reductions are entitled to compensation. The amount of the said compensation is equal to the difference between the value of sold tickets (calculated without tariff reduction) and the total value

of sold tickets with application of the tariff reduction (i.e. on lost income basis).

2.1.2 PSO

This section reviews whether Member States have adopted legislation setting out PSO for public transport.

In some Member States, statutes provide a definition of PSO (e.g. AT, BE, CZ, FR, HU as regards road transport, LT, PL in the draft of the new legislation and SK).

- Definition of PSO contained in legislation generally refers to strategic objectives in terms of public transport (i.e. the goals to be achieved). Such definition then relates to continuity, regularity, capacity, quality, accessibility, reasonable price, intermodality, etc. (e.g. BE, CZ, DE, FR, LT before Regulation 1370/2007, PL with the future legislation and PT).
- In some countries, the definition does not relate to any content, and merely repeats the definition contained in the Regulation (either 1370/2007 if the legislation has been adapted or 1191/69 in the other cases) and refers the content of the PSO to the competent authority (e.g. AT, HU, IT, LT after Regulation 1370/2007 and PL).

In ES, the legislation does not give any definition of PSO but considers that public transport services exist for all road transport services operated by a third party in exchange for a pecuniary retribution.¹⁸ Such transport services are then subject to a concession allowing the operator to operate public transport. Such concession imposes a determinate schedule and periodicity as well as the coverage of certain routes and the provision of interconnection between transportation networks.

In DE, PSO are also defined in such intermediary act, with a licence to provide public transport (see annex II).

2.1.3 Award of PSC

This section reviews how Member States deal with the award procedure of PSC.

The basis on which PSC are awarded in EU Member States is not always clear.

In general, the award procedure seems to be based on various legal bases:

- Public Procurement rules (e.g. AT, ES, FR, IT, PL, PT, NL, SE and UK).
- Specific transport legislation (e.g. AT, BE, DE, HU, IE, LT, PL, where the draft law on public

¹⁸ Ley 16/1987 of 30 July regulating land transport.

transport refers to the Public Procurement rules and to the rules on concessions when the PSC are awarded to a third party and SK for railways).

- Outside the Public Procurement rules (e.g. in PL, on the basis of the Act on Concessions and in FR as regards '*délégations de services*' which are concessions¹⁹).

The legal basis for the award of PSC varies according to the nature of the contract. It would appear that in a single Member State, the applicable rules for the award of PSC may vary according to the nature of the contract in question (concession or other). For instance, in France, 3% of urban public transport networks were awarded following the Public Procurement rules and 80% following the *Loi Sapin* on concessions ('*délégation de service public*').²⁰ In the UK, the Public Procurement rules also apply especially when the competent authorities take the revenue risk. The rules transposing the Public Procurement Directives served as a basis to award PSC, for instance in AT/VOR, IT, NL and PL for urban transport. It is observed that some EU Member States apply the Public Procurement rules even for concessions which are excluded from the Public Procurement Directives (e.g. NL). By contrast, it would appear that the applicable rules were particular to the public transport sector in some Member States (e.g. LT, DE, PL for railways and SK).

Depending on the applicable rules, PSC are awarded either after a competitive tender (with or without negotiation) or directly. For instance, in FR, following the Public Procurement rules, PSC would be awarded to the most advantageous offer or the offer at lowest price. Following the *Loi Sapin* on '*délégation de service public*', however, after advertising and a competition between the candidates, the authority freely negotiates and chooses its contractor. There are also some EU Member States in which the recourse to an internal operator would not be allowed (e.g. UK) or only allowed subject to a non-binding preliminary opinion of the NCA (e.g. IT).

It is worth noting that, in IT, public tendering may also lead to the creation of public-private partnerships by designating the private operator which purchases at least 40% of the shares of the joint-stock publicly owned operator and takes on some specific operative tasks in managing the public service. The minimum share of private participation is determined by law.

Where specific legislation has been adopted, it would appear that 'service contracts' in the sense of the Public Procurement Directives are not always awarded on the basis of these rules. Similarly, it would seem that the other PSC are not always awarded on the basis of the general Treaty rules (transparency and non-discrimination).

¹⁹ Article 38 of the so-called '*Loi Sapin*' (Loi n°93-122 du 29 janvier 1993 relative à la prévention de la corruption et à la transparence de la vie économique et des procédures publiques).

²⁰ UITP, 'Organisation and major players of short-distance public transport; New developments in the European Union', 2010, 28.

2.1.4 Review/appeal procedure

This section examines how Member States have enabled operators to challenge the decision of awarding PSC in their legislation.

The analysis shows that there are many review/appeal procedures of the award procedures concerning PSC. These procedures will depend on the nature of the contract in question, and since various rules for the award may apply even in a single Member State, complaints relating to the award of a PSC will be subject to various appeal procedures:

- General judicial or administrative review (e.g. AT, DE, DK, HU, NL, PL).
- Public Procurement review mechanism (e.g. AT, DE, DK, ES, HU, IT, LT, LV, PL, PT, SE and SK).
- Other specific procedures (before a transport tribunal in GB which is planning to transfer the competence to the Upper Tribunal).

It would appear that the general judicial or administrative review mechanism often applies to contracts awarded outside the Public Procurement rules. In general, this mechanism does not present the same advantages as the Public Procurement remedies (slower and no automatic suspension of the award procedure). The Public Procurement remedies can be considered, as stated in the recitals of Regulation 1370/2007, as a yardstick to evaluate the effectiveness of a review mechanism, since they have the advantage of a rapid procedure and the possibility of suspending the award procedure.

Some competent authorities have questioned whether their national review procedures constitute an 'effective legal protection' as provided for under Recital 21 of Regulation 1370/2007 when it comes to concessions which are outside the scope of Public Procurement rules.

In some EU Member States, it would appear that even if it is possible to challenge the decision to entrust a particular company with PSO, it would however be difficult to challenge the choice of the operator when it is designated by law (e.g. in BE).

2.1.5 Transparency

As for the appeal procedure, the analysis shows that the transparency/publication requirements for the award procedure of PSC generally vary according to the nature of the prospective contract, although such requirements appear to be fairly aligned in a single Member State:

- Publication according to the requirements of Public Procurement rules.
- Application of Article 7 of Regulation 1370/2007.
- Publication in the national gazette.

- Double publication (e.g. in FR, general journal for legal announcements and a specific journal for the economic sector concerned).

It is also to be noted that where PSC are directly awarded (including because the operator is already chosen by law) the competent authorities have often considered that transparency/publication requirements were not applicable in their case. They appeared to believe that the direct award of PSC to a public transport operator at present does not involve any particular transparency/publication requirements, whereas it is specifically the objective of Regulation 1370/2007 to allow direct awards, provided that sufficient transparency is ensured as to comply with the Treaty principles.

2.1.6 Leeway of competent authorities

The current section looks at the leeway accorded to competent authorities in applying Regulation 1370/2007.

Freedom of choice of operator in national legislation

- In general, competent authorities have the freedom to choose their public transport operator.
- The operators are however determined by law in FR as regards railway services, in PT as (Lisbon and Porto) and in BE.

Freedom of choice of award procedure in national legislation

- In general, competent authorities have the freedom to choose the way they will award PSC. This is the case for instance in AT, CZ, DE, ES, FR, IE, LT, NL, PL, UK (but with some exceptions) and in certain cases HU, where there is a possibility to make direct award.
- Where the public transport operators are designated by law (be it regional or federal), it would appear that competent authorities may not issue competitive tenders.
- In IT, direct award of regional rail services or to an internal operator is an exception to the principle of public tendering. However, public tendering can be used to designate a private operator which: (a) purchases at least 40% of the shares of the joint-stock publicly owned company providing the services; (b) takes on some specific operative tasks in managing those services.
- In some Member States, there is an obligation to proceed to an open and competitive tendering (e.g. in SE and UK).

Freedom of choice of compensation method in national legislation

- In some Member States, the choice of the method of compensation is left to the competent

authority (e.g. AT, BE, DE, ES, FR, HU, IE in the future, IT, NL, SK and UK).

- In other Member States, the choice of the method to compensate for the discharge of PSO is limited (e.g. CZ, where the compensation must be paid following the financial model submitted by the operator, LT in the road sector, where only financial compensation exists with the exclusion of other types of reward, PL and SE, where the conferral of exclusive rights will be prohibited as of 2012).

2.1.7 Legislative reform

Regulation 1370/2007 is of direct application and does not necessitate any transposition in the Member States. However, in some Member States, current legislation is not in line with the principles set out in Regulation 1370/2007. Therefore, this section intends to see if, and to what extent, Member States have envisaged a modification of their legislation following the adoption of Regulation 1370/2007.

- Some Member States have adjusted their national law to the new Regulation (AT, CZ, IE, IT, HU, LT, NL, RO, SE, SK and LV). For instance:
 - o In IT, legislative reforms occurred between 2007 and 2009 for a more systematic recourse to competitive tenders and for a better framed recourse to internal operators.
 - o In NL, it was emphasised that recourse to internal operators was possible.;
 - o In PT, legislative reform was brought to the law 1/2009 regulating Public Transportation in Metropolitan Areas (Lisbon and Porto) to establish a model of regulated competition between tenderers in the public transport sector.
- Some Member States have not acted since the new Regulation has been adopted (e.g. BE, DE, ES, FR, except for the 'Grand Paris' Project, SE and UK):
 - o In DE, the Länder have adopted guidelines on their interpretation of Regulation 1370/2007 in awaiting national legislative reforms.
 - o In the UK, it is considered that the current legislation is stricter than Regulation 1370/2007 so that there is no need for any legislative adaptation.

It is to be noted that whilst legislation has not necessarily been adopted to implement Regulation 1370/2007, some Member States have started consultations. This is for instance the case of FR where a Senator (Mr Grignon) has been charged with the evaluation of the consequences and modalities of a possible opening up of the regional railway transport market. This is also the case in PT where, following Decree 32/2009 of the Ministry Transport, information is currently being collected with a view to enquiring about how to implement Regulation 1370/2007. There is also draft legislation in PL.

2.1.8 Particular aspects relating to railways

Regulation 1370/2007 cannot be seen as a stand-alone piece of legislation. Regarding railways, this Regulation should be read and analysed together with the Regulations and Directives adopted in the railway packages and in particular Regulation 1371/2007 on rail passengers' rights and obligations²¹ and Directive 2007/58 on the opening up of international rail passenger services.²²

Regulation 1371/2007 on rail passengers' rights and obligations relates to Regulation 1370/2007 in the sense that it sets out minimum quality standards for the provision of railway services and, as will be seen below, can act as an incentive for Railway Undertakings to deliver quality services. Therefore, the application of Regulation 1371/2007 can help correctly to implement Regulation 1370/2007.

Directive 2007/58 on the opening up of international rail passenger services relates to Regulation 1370/2007 in the sense that it opens up services (international services, including cabotage) which have the potential to overlap to a certain extent with PSO services. With a view to preserving the public service, Directive 2007/58 allows some restriction to the access right for international services, including cabotage, where such services could compromise the economic equilibrium of the PSC.

²¹ Regulation (EC) No 1371/2007 of the European Parliament and of the Council of 23 October 2007 on rail passengers' rights and obligations (Regulation 1371/2007).

²² Directive of the European Parliament and of the Council of 23 October 2007 amending Council Directive 91/440/EEC on the development of the Community's railways and Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure, [2007] OJ L 315/44–50 (Directive 2007/58).

Exemptions under Regulation 1371/2007 on rail passengers' rights and obligations

**Regulation 1371/2007 on rail passenger rights
Summary Table - Information on national exemptions (situation as of 28 March 2011)**

Country	Domestic Rail Services			Urban, suburban and regional services			International rail services beyond external EU borders		
	Yes		No	Yes		No	Yes		No
	Exemptions	Time-limit		Exemptions	Time-limit		Exemptions	Time-limit	
Austria			x	As regards urban services - all provisions of the Regulation except for those provided in Art 2(3); as regards suburban and regional services - Art 13(2), 16, 17, 18(2), 18(4), 27(3), 28 as well as Art 8(1), 8(2), & 15 in certain cases	unlimited				x
Belgium	Part II of Annex II	5 years		Part II of Annex II	5 years				x
Bulgaria	All provisions of the Regulation except for those provided in Art 2(3)	5 years		All provisions of the Regulation except for those provided in Art 2(3)	5 years		All provisions of the Regulation except for those provided in Art 2(3)	5 years	
Czech Republic	Art 8, 10, 17 18(2)(a) and (b), 18(3), Annex I Art 7(2)(b), 17(2)(b), 24(3)(b), 32, and Annex II	5 years				x			x
Denmark			x			x			x
Estonia	Art 8, 10, 13, 14, 15, 16, 17, 18(2), (4) and (5), 20(2), 21, 22, 23, 24 and 25	5 years		Art 8, 10, 13, 14, 15, 16, 17, 18(2), (4) and (5), 20(2), 21, 22, 23, 24 and 25	5 years		Art 8, 10, 13, 14, 15, 16, 17, 18(2), (4) and (5), 20(2), 21, 22, 23, 24 and 25	5 years	

Finland			x	As regards regional services limited to Helsinki Metropolitan Region (Helsinki-Kirkkonummi, Helsinki-Karjaa, Helsinki-Vantaankoski, Helsinki-Riihimäki, Helsinki-Lahti and Lahti-Riihimäki) and only related to Art 10, 17 and 18(2)(a) and (b)	unlimited		Only those related to services to/from Russia	5 years	
France	All provisions of the Regulation except for those provided in Art 2(3)	5 years		All provisions of the Regulation except for those provided in Art 2(3)	unlimited				x
Germany			x	Art 8 (2), Art 15 - 18 (modifications), 18 (2) a), 27 (3), 28, 29 (1), and for services run mainly on account of their historical significance or for the purposes of tourism	unlimited				x
Greece	Art 13, 15, 16, 17, 18 and 28	5 years		Art 13, 15, 16, 17, 18 and 28	5 years		Art 13, 15, 16, 17, 18 and 28 related to services to Serbia, other countries via FYROM and Turkey	5 years	
Hungary	Art 8(2), 10(1), (2) and (4), 17, 18(2)(a) and (b), 18(5), 21(1) and 23	5 years		All provisions of the Regulation with the exemption of what established in Art 2(3)	5 years		Art 10(1), (2) and (4), 18(2)(a) and (b), 18(5), 21(1) and 23	5 years	
Ireland	All provisions of the Regulation except for those provided in Art 2(3)	5 years		to be determined			not applicable		

Italy			x			x			x
Latvia	All provisions of the Regulation except for those provided in Art 2(3)	5 years		All provisions of the Regulation except for those provided in Art 2(3)	5 years		Not applicable to the services with the Russian Federation	5 years	
Lithuania			x	Art 22, 23 and 24	5 years		x	5 years	
Luxembourg			x	All provisions of the Regulation except for those provided in Art 2(3)	unlimited				x
Netherlands			x			x			x
Poland	All provisions of the Regulation except for those provided in Art 2(3) as well as Art 4, 5, 8(1), 16, 21(2), 22, 23, 24, 27, 28 & 29	until 30.06.2011		All provisions of the Regulation except for those provided in Art 2(3) as well as Art 4, 5, 8(1), 16, 21(2), 22, 23, 24, 27, 28&29	unlimited		All provisions of the Regulation except for those provided in Art 2(3) as well as Art 4, 5, 8(1), 16, 21(2), 22, 23, 24, 27, 28&29	until 30.06.2011	
Portugal	All provisions of the Regulation except for those provided in Art 2(3) as well as Art 8, 10,13-17, 18(2), 20(2), 27, 28, as well as art.6-14 &32 of Annex I, Annex II, Annex III	5 years		All provisions of the Regulation except for those provided in Art 2(3) as well as Art 8, 10,13-17, 18(2), 20(2), 27, 28, as well as Art.6-14 &32 of Annex I, Annex II, Annex III	5 years				
Romania	All provisions of the Regulation except for those provided in Art 2(3)	5 years		All provisions of the Regulation except for those provided in Art 2(3)	unlimited		x	5 years	
Slovenia			x			x			x
Slovakia	Art. 8,13, 15, 17, 18, 21, 22, 23, 25, 28	5 years			unlimited				x
Spain	Art.10, 21-24&27	5 years		Art.10, 21-24&27	5 years				x
Sweden			x			x			x

UK	All provisions of the Regulation except for those provided in Art 2(3)	5 years		to be determined					x
Norway			x			x			x

Source: this table has been reproduced from the website of DG Move.²³

Application of Directive 2007/58 - Criteria for economic balance

Pursuant to Directive 2007/58, Railway Undertakings benefit as of 1 January 2010 from an access right to international railway passenger services (except in countries where international services represent more than half of the total turnover for passenger services in that country). This right includes the right to pick up passengers at any station located on the international route and drop them off at another, including stations located in the same Member State. The Directive further provides that Member States may limit this right of access on services between a place of departure and a destination which are covered by one or more public service contracts. However, according to the Directive, such limitation may not have the effect of restricting the right to pick up passengers at any station located on the route of an international service and to drop them off at another, including stations located in the same Member State, except where the exercise of this right *would compromise the economic equilibrium of a public service contract*.

The Directive provides that the criteria to determine whether the economic equilibrium of PSC could be compromised are to be set out in advance. Recital 12 of the Directive gives some guidance on the possible content of such criteria by referring to the impact on the profitability of any services which are included in PSC, including consequential impacts on the net cost to the competent public authority that awarded the contract, passenger demand, ticket pricing, ticketing arrangements, location and number of stops on both sides of the border, and timing and frequency of the proposed new service. The European Commission intends to issue an interpretative communication to help Member States or Regulatory Bodies in the definition of these criteria. On the basis of such criteria, it is up to the RB to make the assessment of such compromise on the economic equilibrium of the PSC. Therefore, the following paragraphs examine the way Member States/Regulatory Bodies have set out the criteria to determine the cases in which the economic equilibrium of PSC could be compromised and how Regulatory Bodies intend to proceed to the assessment of such criteria.

To determine whether the economic equilibrium of a rail PSC would be compromised, criteria, if any, are either defined by law or by the RB. In PL, criteria have been set out in a specific legislation. These criteria relate to various features of the public service (frequency, connections, number of seats,

²³ <http://ec.europa.eu/transport/passengers/rail/doc/summary_table.pdf>

speed, tariffs, profitability, etc.).

In some Member States, there is a serious intention to set out such criteria but the particular legislation has not yet been adopted (e.g. in FR and in BE, the legislation provides that the modalities will be defined in a Decree.²⁴ In NL, there is draft legislation but the forming of the Government has delayed its adoption).²⁵ Some competent authorities mentioned that these criteria are still to be determined (e.g. AT).

In SE, it is considered that no restriction to access should occur so that there is no need to set out such criteria. In DE a similar reasoning is held. During the discussion of the 4th amendment to the general railway act (*Allgemeines Eisenbahngesetz*) transposing Directive 2007/58, it was considered that since PSC cover close-range services, international services would not overlap with the services provided under PSC.

In some other countries, the prior determination of the criteria to be used for assessing whether the economic equilibrium of PSC would be compromised is the responsibility of the RB. In PT, the Law 20/2010 requires that the economic equilibrium would be seriously compromised in a decision restricting access rights. In the UK, it is the RB, the Office of Rail Regulation (ORR), which has set out criteria.²⁶ To consider that the economic equilibrium of PSC has been compromised, there needs to be a material impact on those PSC (moving outside the expected range). This takes account of the expected range of movement in the value of PSC over time, and also recognises the intention of the Directive to encourage competition in the market for international passengers. According to ORR, the impact on the economic equilibrium of PSC must not be small. The evaluation of ORR will be based on the following criteria:

- profitability of incumbent franchised passenger operator or concession operator;
- likely scope for competitive responses by franchised passenger operator or concession operator;
- to the extent relevant, likely impact on the future value of the PSC when next retendered;
- impact on the long-term profitability of the most profitable routes within the PSC;
- specific new costs likely to arise within the operation of the PSC; and
- likely impact on performance costs of the PSC as a result of the new international passenger service.

²⁴ For FR, see Article 17-2 LOTI and for BE, see Article 78 of the Law of 26 January 2010 (Loi modifiant la loi du 4 décembre 2006 relative à l'utilisation de l'infrastructure ferroviaire et la loi du 19 décembre 2006 relative à la sécurité d'exploitation ferroviaire, en ce qui concerne principalement la certification de personnel de sécurité et la maintenance des véhicules).

²⁵ Voorstel van wet tot wijziging van de Spoorwegwet, de Wet personenvervoer 2000 en de Wet of the economische delicten ter implementatie van de richtlijnen 2007/58/EG, 2007/59/EG en 2008/110/EG, dated 25 May 2010, the preparatory works of which refer to the adoption of a ministerial decree to determine the criteria.

²⁶ ORR guidance on the assessment of new international passenger services, text available at: <<http://www.rail-reg.gov.uk/upload/pdf/399.pdf>>.

The question of an exemption for particular international rail passenger services or journeys did not arise in IE. It is to be noted that IE benefits from derogation from Article 30 of Directive 2001/14 (requiring the setting up of a RB). However, following the transposition of Directive 2007/58, the national legislation provides for the establishment of a panel to determine the principal purpose of a proposed passenger rail service and if the economic equilibrium of any existing rail PSC would be compromised.

Levy

Directive 2007/58, without prejudice to the possibility of restricting access rights as a means to preserve PSO, permits Member States to '*authorise the authority responsible for rail passenger transport to impose a levy on railway undertakings providing passenger services*' for domestic routes which are in its jurisdiction.²⁷ It is here investigated to what extent Member States have recourse to such method of financing their public transport service.

Many RB have answered this question by referring to the infrastructure charges. It would appear from the contributions that the imposition of a levy for the financing of PSO is envisaged and under discussion in RO. FR might also intend to apply such levy.

2.2 Overview of the current contractual practices in public transport

This section provides an overview of the current state of play in selected contractual practices. The information has been gathered from competent authorities and from desktop research, when the information was available. Some competent authorities consider their PSC as being confidential and refused their disclosure (this was the case of the competent authorities contacted in AT, PT, ES and in DE for railway services). Since the contractual practices differ from one competent authority to another, even in a single Member State, this section presents various possibilities for all the elements listed in section 1.2.2, without attributing them to a particular contract. However, for a synthetic overview of examples of contracts examined against Regulation 1370/2007, please see annex III.

2.2.1 Introduction

Organising public transport through contract is a widespread practice. However, some public transport is organised outside any contractual relationship. This might be the case where the public transport operator is publicly owned (e.g. in LT for railway services). It is also to be noted that although contracts exist, some stakeholders have to consider such contract as not binding because of the lack of enforcement.

²⁷ Article 1(8), new Article 10(3)(f) of Directive 91/440/EEC.

Where contracts exist, the typical contractual organisation models have been summed up as follows in the study on 'Contracting in urban public transport'.²⁸

- In-house operators or publicly owned operators benefiting from exclusive rights (either *de jure* or *de facto*). The study provides the following illustration: the French 'régies' and the German 'Stadtwerke' (see annex II):

'The French public transport law (outside the Paris region), which is based upon the principle of authority initiative, gives the transport authority the first right to create passenger transport services. In doing this it also gives the authority the right to decide whether these services will be provided directly by the authority (own production or own company with specific public status) or whether the services will be delegated to a different manager (using a specific awarding procedure). The German public transport law, which is based upon the principle of market initiative, gives the first right to create passenger transport services to any operator in the market, but submits this right to an authorisation procedure. This does not give any specific legal right of first initiative to authority owned companies. Both regimes, when dominated by authority-owned companies, are often confused as in both cases one publicly owned company provides all services. They are however legally speaking fundamentally different and this is crucial when reforms are being considered (e.g. the introduction of new contracting and awarding mechanisms) as it determines the way in which and the ease with which reforms can be implemented'.

- Route contracting whereby a competent authority determines a number of transport and social objectives which serve as a planning framework for its own transport department.²⁹ The department organises the contracting out of the realisation of the services planned. According to the study, *'[c]ompetitive tendering procedures are used and operators are submitted to gross-cost contracts'*.³⁰ The study underlines that this organisational form is also known as the 'Scandinavian model' or the 'London model' as it is observed amongst other places in the Copenhagen, Stockholm and London areas (see annex II).
- Network contracting consists of giving (re-)design freedoms to transport operators.³¹ According to the study, this organisational form is often called the 'French model', as it is mainly used in France (see annex II). The study further observes that in most contracting cases, the operator is subject to both the production cost risk and the revenue risk. In many cases, additional quality and target incentives are added.

²⁸ Ibid., 16.

²⁹ Ibid. 20.

³⁰ Ibid.

³¹ Ibid. 22.

- Free market initiative exists where profitable services appear autonomously out of a market process, although some subsidy might be necessary.³² According to the study, such subsidisation compensating PSO and allocated in proportion to the achieved results (e.g. the number of transported aged citizens) actually stimulates the free market to provide more services. Regulation may still be needed for such market-initiative systems to function properly. This organisational form is largely used in the UK, outside London (see annex II).

Although Regulation 1370/2007 – relying on the principle of contractualisation – entered into force on 3 December 2009, it would appear 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.

2.2.2 PSO

This section reviews the way the competent authorities define PSO and how they ensure their discharge.

PSO are being defined at different stages in the contracting process. Often some PSO are defined by law (see section 2.1.2). PSO are also defined at the stage of issuing the **tendering documents** and/or at a later stage, **when contracting** with the operators. It is also observed that the precise PSO (timetable, routes, stops, etc.) are defined after the contracting phase, through a transport plan which is approved by the authority and/or annexed to the contract or freely by the public transport operator.

The moment when, in the contracting process, the PSO are defined is relevant as it gives an indication of the possible involvement/influence of public transport operators in defining PSO. Such possible involvement/influence can be considered as an incentive to provide efficient services and deliver quality.³³ Indeed, where the operator has some risks transferred to it, its possible influence on the definition of PSO may allow it to manage those risks.

Some competent authorities define (some) PSO in a detailed, descriptive manner (often qualified as '**constructive design**' or 'rigid tendering' in opposition to 'functional design'). In such a case, the PSO often relate to the transport timetable, and the specific routes and stops, etc. Some competent authorities define (some) PSO in a broad, general way (often qualified as '**functional design**' or 'non-rigid tendering'). In such a case, the PSO often relate to minimum frequencies, punctuality, quality, capacity, etc.

³² Ibid. 24.

³³ Study on 'Contracting in urban public transport'. This is also the view of several operators of public transport.

As the data show, PSO may be defined in different documents according to the nature of the PSO. Where the obligations stated are strategic and general, these obligations are rather defined by law or in a separate decision. By contrast, where there are obligations relating to the tactical or operational level, those obligations are defined in the tender document or in the contract, in either a detailed or broad manner.

The degree of detail of PSO at the different stages of the award procedure is relevant as it gives an indication of the extent to which the public transport operator is free to organise its public service related activities. Sometimes, the actual organisation of public transport is effected by the public operator and annexed to the PSC, or approved by the competent authority. Sometimes, the freedom to concretely organise the public service is left to the public transport operator with no further intervention of the competent authority. In this last case, the public transport operator is given a budget with which to achieve maximum benefit.

Reward for carrying out PSO

Regulation 1370/2007 defines PSO by reference to a reward. In addition, the application of the Regulation is triggered if the competent authorities intend to provide to the public transport operator compensation and/or exclusive rights.

It would appear that, in most of the cases, competent authorities grant financial **compensation** as a reward to discharge PSO. There was also an example of a contract (between the Municipality of Rome and ATAC S.p.A., in IT) where the internal operator receives, in addition to financial compensation for the reduced tariffs, the right to use the Municipality's advertising space. Exclusive rights are also largely used by competent authorities as a reward to discharge PSO. However, it would appear that, in some Member States, such reward is prohibited (see section 2.1.2).

Besides these two rewards explicitly referred to in Regulation 1370/2007, competent authorities also referred to **risk** as a reward for carrying out PSO:

- Transfer of only the production/cost risk to the public transport operator (often referred to as '**gross cost contracts**' in public transport jargon).
- Transfer of both the production/cost and commercial/revenue risks to the public transport operator (often referred to as '**net cost contracts**' in the public transport jargon or '**concessions**' in legal texts).

From the answers received and the PSC analysed, it would appear that a combination of 'rewards' is often used.

2.2.3 PSC

This section examines the scope and the content of current PSC.

Scope of PSC

The scope of PSC ranges from the whole **network** to **routes**, with an intermediary contracting of a bundle of lines. The contracts concern either a particular means of transport or an integrated offer covering several means of transport.

PSC also relate to domestic and, possibly, international services.

Basic features of PSC

The present section only examines the clauses of PSC which are relevant for the implementation of Regulation 1370/2007 (in particular, the mandatory elements referred to in Article 4). It does not cover all possible clauses contained in PSC.

PSO and geographical area

PSO are generally defined in the PSC. However, the precise service for which compensation and/or exclusive rights are granted is not always described in the contract.

The geographical area covered is generally determined in the PSC. Sometimes it refers to a whole territory (e.g. concession in NL) and sometimes to specifically defined routes/networks.

Parameters of compensation and nature and extent of exclusive rights

PSC do not always establish in advance in an objective and transparent manner the parameters on the basis of which the compensation payment, if any, is to be calculated. This might be the case of both PSC directly awarded and PSC awarded after a competitive tender. Some PSC merely contain a lump sum as compensation. Sometimes it is specified that the lump sum stems from historical compensation, updated in line with the inflation rate.

Where PSC contain such parameters, they would generally contain a specific formula which enables calculation of the amount of the compensation.

Regarding exclusive rights, they are not always explicitly conferred on a public transport operator. This

is the case when the operator is granted a legal monopoly by a legal designation, with no possible access rights to other operators.

Exclusive rights, although explicitly conferred upon a public transport operator, are not always clearly defined and it is difficult to understand their extent.

In some PSC, the nature and extent of the exclusive rights are stated. When it is the case, various possibilities exist:

- Some competent authorities prefer to confer special rights whereby competition in the same network/for the same services would be possible to a certain extent (e.g. 25%, following an arrangement between the parties, etc.).
- Some PSC confer exclusive rights for the whole territory of the competent authority, without any possibility for competition.
- Some PSC limit the exclusive rights to the service contract, which allows competitors to operate different services on the same line.

Arrangements for the allocation of costs

Some PSC list the costs related to the provision of the PSO services which are entitled to be compensated. However, PSC do not often contain rules on how the costs are to be allocated where the operator is active in both PSO services and commercial services.

Arrangements for the allocation of revenue

Another important consideration in the compensation of PSO under PSC is the risk allocation. As regards risks, in public transport the main risks relate to cost and revenues:

- Cost risks refer to³⁴:
 - o Operational cost risks: who carries the risk for possible variations of the cost of operating the services?
 - External risks that cannot be influenced by the operator or risk that can be influenced by the operator but only indirectly.
 - Internal risks that can be influenced by the operator.
 - o Investment risks: who carries the risk for the property and value of assets (infrastructures and vehicles)?
- Revenue risks: who carries the risk related to the amount of revenue expected from passenger revenues?

The following main categories are observed (although many other intermediate possibilities exist).³⁵

- no risk transferred to the operator (simple 'management contract');
- only the production risk is transferred to the operator (simple 'gross cost contract');
- both the production and the revenue risks are transferred to the operator (simple 'net cost contract').

The study explains that the risk transferred to the operator may constitute an incentive for it to provide efficient services. Additional risks may then exist such as risk surrounding additional incentives related to performance and risks of operational complexity related to the complexity of a network, of a new vehicle, etc.

According to the economic literature, the risk allocation chosen leads to a specific contract payment between authority and operator.³⁶ In the case of a **management contract**, the payment represents a management **fee** for the management of the network. In the case of a **gross cost contract**, the payment represents the **expected production cost** for the services contracted, including a fair profit. In the case of contracts where the operator bears both risks (such as in **net cost contracts**), the payment represents the **expected balance of production costs minus revenues**. Various incentive contracts allow revenue risk to be shared between the parties (e.g. gross cost contracts with revenue incentive, net cost contracts with shared revenue risk).³⁷ According to the economic literature, 'payment' is to be given a wide meaning, depending on the economic circumstances:

- A payment from the authority to the operator in case of an expected need for public co-financing.
- No payment between operator and authority in case revenues are expected to balance costs.
- Payment from the operator to the authority in case of an expected surplus with regard to the operation of the services.

Duration

In general, PSC contain a clause stating their duration. The duration of existing contracts varies considerably from one Member State to another but is, for most of them, below the maximum duration allowed under Regulation 1370/2007. However, PSC sometimes provide for a possible extension. The extension can be of the same duration as the initial contract, or of a shorter period. When so provided, there are no specific conditions in which extension can be envisaged, going beyond the terms of Article 4(4) of Regulation 1370/2007.

³⁴ Ibid., 59.

³⁵ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 43, available at: <<http://mpira.ub.uni-muenchen.de/2253>> and NEA, 13.

³⁶ Ibid., 62.

³⁷ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 43, available at: <<http://mpira.ub.uni-muenchen.de/2253>>.

However, in some countries, existing contracts have been secured for the maximum transitional period allowed in Article 8 of Regulation 1370/2007. This is the case in FR which has, by law, fixed the current PSC for the region of Ile de France until 31 December 2024 for road transport services, until 31 December 2029 for tramway services and until 2039 for metro services and other guided means of transport (such as suburban trains).³⁸

Duration of contracts post 3 December 2009

- The duration of PSC awarded after 3 December 2009 would be in some EU Member States as set out before that date.
- Some other competent authorities highlighted that future contracts will be established in accordance with Regulation 1370/2007.

Quality standards

There are various possibilities regarding the integration of quality standards in PSC. In general, PSC contain quality standards or a reference to basic quality principles (sufficient capacity, cleanness, comfort, etc.) to be further developed by the operator. It was also observed that, in some PSC, there is a requirement to obtain certification for the quality of the services.

Subcontracting

It is observed that subcontracting is not always addressed in the PSC. When the topic is addressed, the contract often stipulates that subcontracting is possible subject to the approval of the competent authority. It is also sometimes prohibited or, by contrast, compulsory. A few contracts specifically state the part which can be subcontracted.

Whereas in some countries the possibility to subcontract is enshrined in the law (e.g. LV), in some others subcontracting depends on a decision of the competent authority (e.g. IT and BE).

2.2.4 Award

Throughout this section, the way competent authorities currently award PSC or have recourse to an internal operator is analysed as well as the intended changes in such practices.

There are two main types of award:

³⁸ Ordonnance n°59-151 du 7 janvier 1959 relative à l'organisation des transports de voyageurs en Ile de France, modifiée par la Loi n°2009-1503 du 8 décembre 2009 relative à l'organisation et la régulation des transports ferroviaires et portant diverses dispositions relatives aux transports, Article 5.

- Direct award to:
 - o an internal operator;
 - o a third party.
- Competitive tendering process.

The geographical coverage of the PSC, and in particular whether the principle of geographic specificity is generally respected by internal operators, was not always clear from the answers received. However, it would appear that some internal operators are also prospecting for other geographical markets.³⁹ Some other internal operators also expressed their intention to expand their activities outside their territory, but only for consulting services or services not related to the operation of public transport.⁴⁰

Award procedure before 3/12/2009

In some Member States, Regulation 1370/2007 has, or will have, meant as a consequence that competitive tendering will be more often used. In some other Member States, the exceptions to competitive tendering are fully exploited. There are also Member States in which the possibility of awarding PSC directly either in the heavy rail sector or to internal operators has been or will be introduced.

The table below is only given as an example since it relies on the affirmed intention of the competent authorities and does not rely on possible future legislation. In addition, as mentioned above, there are various practices in a single Member State, so it is not possible to generalise.

³⁹ See for instance, Les Echos of 6 May 2010, 'La RATP estime avoir la taille suffisante au niveau mondial' and La Tribune of 31 May 2010 'La Commission veut rogner le monopole de la RATP sur le métro et les RER parisiens'.

⁴⁰ See for instance, STIB/MIVB press release: 'La STIB signe un accord de partenariat avec son homologue de Wrocław, en Pologne'.

	After 03/12/2009	Direct award	Competitive tender
Before 03/12/2009			
Direct award		BE NL (Rail, Amsterdam, Rotterdam and The Hague) LV SK FR (rail) DE CZ (rail)	DE (Paderborn, Höxter, Goettingen, possibly in City of Halle, City of Leipzig as of 31/12/2028) IT as of 31/12/2010
Competitive tender		possibly in NL possibly in DE possibly in PL	AT at local level and in discussion at national level DE (e.g. Bergstrasse county, Rhein-Neckar Kreis) NL (majority of concessions), SE UK IT (30% of PSC) FR (road and local level outside Ile-de-France) CZ (road)

Internal operators

- Internal operators are often (near to) 100% the owners of the competent authority or one competent authority of a group of competent authorities. In IT, internal operators often take the form of joint-stock companies, whose shares are owned by the competent local authorities.
- Subject to the comment that answers were not always clear as regards the principle of geographic specificity applicable to internal operators, it can be said that internal operators appear generally to operate public transport services only in the territory of the competent authority.

Reciprocity clause

Regarding the formulation of Article 8(4), we have not received information on the intention of competent authorities to apply this reciprocity clause. Indeed, that provision allows competent authorities in the second half of the transitional period to exclude from participation in the award of PSC by invitation to tender those public service operators which cannot provide evidence that the value of the public transport services for which they are receiving compensation or enjoy exclusive rights granted in accordance with Regulation 1370/2007 represents at least half the value of all the public transport services for which they receive a reward. To do so, the competent authority does not need to make a specific public announcement but only needs to inform the Commission of its intention at least two months before the invitation to tender.

2.2.5 Compensation

This section aims to describe the way competent authorities compensate for the discharge of PSO and how they calculate the amount of such compensation, as well as the way compensation takes unforeseen events, effective management and quality of the services into account. This section also examines how the competent authorities manage to avoid cross-subsidies where the public transport operator is active in both commercial services and PSO services.

On the one hand, financial compensation constitutes one of the rewards which make public transport operators consider providing PSO. On the other hand, overcompensation may have a distorting effect on the market, so that it is prohibited. Observing practices, this equilibrium seems to be pursued in various manners across Member States and even within a single Member State from one competent authority to another. Here are a number of approaches towards the grant of financial compensation:

- In the case of PSC awarded after a competitive tender:
 - According to some competent authorities, competitive tendering ensures the absence of overcompensation. The justification relied on is that there cannot be any overcompensation where the contract has been awarded after a competitive tender since the contract is then based on the market price. Observing such contracts, it would appear that the conditions for the provision of public transport are often clearly defined as to allow the competent authority to effectively verify that the price it pays corresponds to the services it requests.
 - Some competent authorities would nevertheless pay specific attention to the level of compensation. There are examples of PSC based on the principle of no better and no worse off (e.g. UK) or by applying the Annex to Regulation 1370/2007 (e.g. in PL if the contract has not been awarded following the rules on concessions).

- In the case of PSC awarded directly:
 - Some PSC do not provide for the parameters of compensation and it would not be possible to reconstitute the elements on the basis of which the compensation, in the form of a lump sum, has been granted.
 - Some PSC contain the formula as described in the Annex to Regulation 1370/2007 or a comparable formula. The objective of the formula used is to determine the financial effect of the discharge of PSO.
 - Not all PSC pose constraints on the level of costs of the public transport operator. Sometimes, the costs of the operator are accepted as such.
 - Sometimes there would be a reference to 'reasonable' costs, which are the ones entitled to be compensated (e.g. under the HU Railway Act).
 - Few competent authorities, in assessing the financial effect, make a comparison between the situation where the PSO are met and the situation which would have existed if the obligation had not been met. There are also examples to be found of benchmarks with a comparable undertaking for the assessment of the financial effect.

- There are two general trends in the payment of compensation:
 - The compensation is determined *ex ante* and is not adjusted afterwards on the basis of the actual costs incurred. For directly awarded PSC, estimate of costs often relies on historical costs, as updated in line with inflation and possibly transport trends. For publicly awarded PSC, the determination of the compensation is based on the price proposed by the bidder that won the contract (either on the basis of the most beneficial offer or on the basis of the lower cost).
 - It is also observed that compensation is based on an estimate and paid in advance,

but then is 'regularised' at the end of a certain period on the basis of the actual costs incurred. This 'regularisation' often implies a reimbursement of the overcompensation from the public transport operator to the competent authority where the actual costs incurred are lower than expected (because the number of passengers is higher, or because the operator reduced its production costs). It may also imply an additional payment for the undercompensated PSO by the competent authority where the actual costs are higher than expected. However, it would appear that additional payments in the case of undercompensation are in general less automatic than reimbursement of overcompensation under the contractual clauses. Compensation could also be disbursed *ex post* on the basis of the actual costs incurred. In such a case, the reference period used to examine the actual costs incurred is relatively short (a month).

Compensation for PSO also raises the question of cross-subsidies where the public transport operator provides not only PSO services but also commercial services. In general, it is required from the operator to make a distinction in its accountability between the services which are rendered under PSO and other services ('accounting separation'). Such requirement would often stem from the legislation rather than from the contract. Furthermore, few PSC contain cost-allocation arrangements, determining the costs linked to the provision of PSO to be taken into account for the compensation. Such cost-allocation arrangements allow the competent authority to verify in the accounts of the public transport operator whether the compensation received for the discharge of PSO effectively corresponds to the costs incurred.

Management of unforeseen events affecting the economic equilibrium of the PSC

The economic equilibrium of PSC is a concept which is used in Directive 2007/58 but not defined (see section 2.1.8). However, according to the recitals of the Directive, it is understood that the economic equilibrium of PSC relates to their profitability, costs for the competent authority, passenger demand, ticket pricing, etc.

Observing the contractual practices, it would appear that unforeseen events affecting the economic equilibrium of PSC are not always addressed. When they are dealt with, various remedies are provided. The remedies range from termination of the contract to the definition of the possible remedies, and include the adjustment of the content of the PSC (the compensation and/or the PSO) and revision of the duration of the contract. In some Member States, termination is prohibited for the sake of continuity. It is also observed that, in some Member States, unforeseen events affecting the economic equilibrium of the contract is a risk borne by the public transport operator.

Management and quality ensured through the compensation method

Annex to Regulation 1370/2007 requires that, where PSC have been awarded directly or where general rules would apply, the compensation method will promote effective management and quality services.

This objective is currently achieved through various tools:

- As underlined above, risk can act as an incentive to provide efficient and quality services. The greater the risk, the greater the incentive to reduce costs, and possibly compensations.
- Similarly, responsibility of the public transport operator in the definition of PSO can also act as an incentive to be more customer oriented.
- Passengers' rights provided for in a contract.
- Penalties in the event of a breach of the contract.
- Bonus-malus systems linked to quality performances.
- Reasonable profits.
- Subsidy caps to force the undertaking to increase X-efficiencies.

2.2.6 Consequences of the entry into force of Regulation 1370/2007 on existing PSC

- Some competent authorities have adopted new contracts.
- Some competent authorities are engaging in modifications/renegotiation of current contracts:
 - o Sometimes, the objective is to review contracts that are likely not to meet the standard of a 'fair competitive tendering procedure' and which expire soon.
 - o Sometimes the adaptation relates to the duration as indicated in Article 4 of Regulation 1370/2007.
 - o Sometimes the adaptation relates to the compensation requirements set out in Regulation 1370/2007.
- Many competent authorities do not intend to modify or renegotiate the current contracts.

It is to be noted that some competent authorities appear to consider that contracts adopted before the entry into force of Regulation 1370/2007 are governed by previous legislation and are not subject to the application of Regulation 1370/2007, despite the fact it is of direct application.

3. Issues raised by the implementation of Regulation 1370/2007

This chapter provides for an evaluation of the problems and challenges linked to the implementation of Regulation 1370/2007, based on the opinion of the stakeholders and on cases raised before national competition authorities (NCA) and regulatory bodies (RB).

In a first section 3.1, a summary of the opinions expressed by competent authorities will be provided. In section 3.2, the opinions of public transport operators will be given. Section 3.3 gives the views of the few consumers' organisations that participated in the study. Section 3.4 reports on cases that have arisen before competition authorities and regulatory bodies, and discusses the relevant European case law.

3.1 Opinion of institutional stakeholders

Some NCA have provided comments on the implementation of Regulation 1370/2007. Their concerns often relate to the interpretation of some particular provisions of Regulation 1370/2007. For instance, interpretation questions were raised regarding:

- The transitional period provided for in Article 8 (e.g. in FR and UK).
- The possible negotiations in a tender procedure according to Article 5(3) (in NL). It is uncertain how far the negotiations can go.
- The publication requirements of Article 7 (in NL, UK and SK). The publication requirements are thought to be cumbersome in countries where no foreign undertakings would apply to PSC (UK Mersey Travel). They are also considered to create legal uncertainties in the event a competent authority changes its mind on the award procedure after having published its intention to award following a particular procedure (NL). They are said to be unclear because they do not state how and where the annual aggregated report should be published. It is further recommended that a standardised form for the publication of the information required under Article 7(2) be issued.

Some competent authorities have also expressed their views on the national legislation to be adapted. IT/Federmobilità suggests granting the task of better defining the modalities for the assignment of exclusive rights to the regions, where these have the heads of power to organise public transport services.

According to the *Bundeskartellamt* (the German competition authority), provisions of Article 5 (2) and (6) of Regulation 1370/2007 raise competition concerns. The *Amt* suggested that the fact that the direct award of public passenger transport services subject to PSO, to a provider which is controlled by the competent local authority without previous competitive award procedures, increases the danger of market foreclosure.

The *Bundeskartellamt* also states that this is particularly true since there is a trend towards remunicipalisation in DE, as a consequence of which it cannot be ruled out that partial privatisations of municipal utilities will be reversed to be able to use the possibility of direct awarding under Article 5 (2) of Regulation 1370/2007. Private market participants have voiced their concern that, in the future, 70% to 75% of all contracts, at least in the area of local public passenger transport by road, will be awarded under Article 5 (2) of Regulation 1370/2007 and therefore without competitive procedure.

The direct award of PSC in the rail sector under Article 5 (6) of Regulation 1370/2007, whose limitations are not clearly defined, also raises competition concerns in the view of the *Bundeskartellamt*. And finally, the exemption under Article 5 (3) from the principle of competitive award procedures is said not to be plausible and favouring an awarding practice that does not adequately consider competition concerns. Therefore, the *Bundeskartellamt* advocates a close monitoring of the application of Regulation 1370/2007.

3.2 Opinion of public transport operators

Some 38 public transport operators or associations of public transport operators have answered the questionnaire (this includes CER, EPTO and UITP).⁴¹ This section describes their views on the implementation of Regulation 1370/2007.

3.2.1 Rewards

In accordance with the replies of the public transport operators, irrespective of their public or private ownership, the three main rewards that made them consider providing public transport services are contracts, compensation and exclusive rights.

- It would appear that the mere fact that the public service is organised through a **contract** constitutes an adequate reward for carrying out public service in the view of some operators. Often, this view has been expressed by operators which are publicly owned. However, a few private operators have also expressed such a view. Where contracts have been considered as a reward for carrying out PSO, the justification given was often that the contract is an essential instrument for financial planning, business control and generally having a clear framework. Some operators considered a specific quality for the contracts (or the general rules) to be a reward for carrying out PSO. Most of them, irrespective of their private or public ownership, invoked as a quality that the contract should have a long-term nature so as to allow long-term planning, in particular regarding investment. Fairness has also been mentioned as a quality

⁴¹ This section also integrates the proposals made by 'bus and coach smart move' in 'doubling the use of collective passenger transport by bus and coach, practical solutions' 1st edn, www.busandcoach.travel and which were deemed relevant to the present analysis.

the contract should have in order to provide an appropriate reward for carrying out PSO. Indeed, a few operators have highlighted their weak bargaining position in comparison with the competent authority.

- Many operators considered compensation and/or exclusive rights as rewards for taking on PSO, irrespective of their public or private ownership. Some operators have emphasised that exclusive rights, if they are necessary, are not sufficient and should be combined with compensation.

Other than the above listed main rewards, the following elements were mentioned as rewards:

- The income generated by ticket sales and public co-financing.
- Revenues generated by commercial activities associated with the provision of public transport services: sales of advertising space, sales of food products and concessions of commercial premises in stations.
- Business opportunity as allowed by competition.

While revenues generated by tickets and by auxiliary activities have been considered as rewards by both public and private companies, competition as a tool for creating business opportunities has been mentioned by private companies.

It was also highlighted that the appropriate reward depends on various factors (size of the operator, type of service and type of contract).

It is to be noted that some publicly owned operators state that their provision of public transport services does not rely upon the consideration of any rewards. These operators provide PSO because they were required to do so.

3.2.2 Burdens

The main burdens mentioned by the public transport operators can be listed as follows:

- Avoidance of cross-subsidisation.
- Bureaucratic approach by central/local competent authorities.
- Coordination with other operators.
- Delays in the payment of compensation/insufficient compensation.
- Efficient information service.
- Infrastructure investment or rolling stock/bus requirements.
- Limited possibility to invest net income.
- No reasonable profit.

- Obligation to be licensed and to have a franchise, which might include some payments from the operator to the authority.
- Obligation to carry certain categories of passenger.
- Obligation to have insurance.
- Obligation to keep stations open.
- Obligation to provide services which are not cost recoverable / Obligation to operate services which are not profitable / Obligation to operate or maintain services which are not commercially viable / Obligation to operate services in areas where the services are used less frequently.
- Obligations concerning technical and performance standards, operation costs.
- Organising the public transport.
- PSO, burdens which are not the ones under market conditions. Adherence to schedule.
- Social and quality requirements.
- Special tariff obligations such as ticketing discounts, free passes, through ticketing, etc.
- Unharmonised tax systems.

On the other hand, the following remedies to the above-mentioned burdens can be listed:

- Compensation.
- Cross-subsidisation from commercial services (e.g. freight) to PSO services.
- Direct award.
- Exclusive rights.
- Gross and net cost contracts.
- Long-term financial arrangements and long-term security.
- Passenger revenues and revenues from local or national public authorities.

Some private operators or associations of private operators state that the burdens depend on the specific public authority or regulatory regime applicable but that they, in general, will be determined by the **risk and reward balance**. They also explicitly state that they are **against cross-subsidy from within other commercial activities to compensate for the burdens of providing a public transport service**, this conferring in their view upon the beneficiary a competitive advantage.

By contrast, operators in favour of cross-subsidisation from commercial activities to services rendered under PSO highlight the benefit of such cross-subsidisation for PSO services. This is also the position

of some competent authorities which might want thereby to reduce the level of required subsidies.⁴²

The analysis, as summarised above, shows that the main burdens are the specific tariff obligations (obligatory discounts, free passes, special fares, etc.), the non-profitable services and the adherence to schedules. These burdens are mainly carried by the rewards that attracted the public transport operators to the public transport service market, being the gross and net contract, the revenues, the exclusive rights and compensation.

Undercompensation or delays in the payment of compensation constitute a problem in some EU Member States. Undercompensation is even considered by CER as the major problem faced by public rail transport in the EU.

This problem can be considered as being structural in Eastern Europe. In the words of some authors, *'[o]ne important change [due to the overthrow of Communist governments] was a sharp reduction in central government subsidy to public transport. Most of the burden of financing capital investment and operating subsidy was quickly shifted to municipal governments'*⁴³ which are not able to finance public transport (see annex II).⁴⁴ This is one of the reasons why some authors advocate a restructuring of authorities in Eastern and Central Europe. CER underlines that such structural problem also exists in some Western European Member States.

Also according to CER, the problem of undercompensation has been aggravated by the financial crisis. While the situation is said to be of particular high concern in certain cases in Eastern Europe, the problem could be qualified as cyclical in some Western countries that have recently been suffering from public service undercompensation.

3.2.3 Best incentives

The following initiatives are considered as giving the best incentives to provide efficient public services:

- PSC. Some operators refer to a specific quality for the PSC to constitute the best incentive to provide efficient services, such as the long-term nature of the contract, its fairness or its stability and clarity. A particular operator highlighted that the competent authorities require

⁴² See also, A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 46, available at: <<http://mpira.ub.uni-muenchen.de/2253>>.

⁴³ See J. Pucher and R. Buehler, 'Transport Policy in Post-Communist Europe', available at: <<http://policy.rutgers.edu/faculty/pucher/PDF%20of%20chapter.pdf>>, 9.

⁴⁴ See A. Schichmann and S. Papadimitriou, 'The need for restructuring of authorities in Eastern and Central Europe' PTI magazine of UITP of November/December 2009.

some passenger transport services without these services being part of the PSC. Some other operators consider that contracts are better incentives than general rules.

- Conferral of exclusive rights, according to some operators, for a whole network.
- (Appropriate/full) compensation / Timely payment of compensation. Some others stated that there should be a clear rule imposing financial compensation for all PSO.

These three best incentives in the view of operators were also the ones which made them consider providing PSO as emphasised in section 3.2.1.

Operators also mentioned the following points as being in their view the best incentives to provide efficient/quality public transport services:

- Efficient risk allocation.
- Increasing the interest of the public transport operator in the benefits/profit.
- Investment in infrastructure or in IT solutions.
- Measures with regard to close-range passenger transport, such as urban planning, for instance as to free space on roads for buses.
- Net cost contracts (some added that this is the best incentive *'if data on passenger ridership and revenue exists which properly reflects the revenue base'*). The reason given by some operators for considering net cost contracts as one of the best incentives to provide efficient public services is that these contracts require less monitoring as the operator is incentivised to both collect revenues and grow customer base. Some operators specify that compensation should be calculated, be it for directly awarded PSC or PSC awarded after a competitive tendering, *ex ante* without the possibility to be reviewed *ex post* the provisions of the services, giving the operators the incentive to reduce the costs and increase the revenues.
- Reinvestment of possible surplus funds accruing from the discharge of PSO in public transport and not in other public services.
- Reports on quality and accounts.
- Room for private initiative, creativity, innovation and flexibility / Responsibility for the operator/autonomy;
- Support by measures of modal shift / Internalisation of external costs so that costs incurred to the society are borne by the undertaking causing them.
- Transparency.

It is worth noting that these incentives were mentioned by both publicly and privately owned operators.

Publicly owned operators also pointed to the following measures as being considered the best incentives in providing efficient PSO:

- A reasonable policy with regard to the applicable tariffs, taking into account the objectives of the public transport policy in general / fixed price for the services.
- Bonus-malus scheme or penalties.
- Monitoring of competition rules.
- Obligation to subcontract as to guarantee a seamless provision of public transport services.
- Sustainable transport policy.
- The opportunity to use the resources in accordance with the demand for public transport services, together with the possibility of resorting to alternative solutions in areas where the demand for public transport is lower.

Privately owned public transport operators also mentioned competitive tendering as the best incentive to provide efficient, qualitative and effective public transport services. An association also pointed at competition 'on the tracks' or 'on the market'.

3.2.4 Avoidance of cross-subsidisation

Operators of public transport mentioned various ways to avoid cross-subsidisation in their view:

- A precise cost-allocation method to avoid cross-subsidisation. However, an operator has pointed out the difficulty (if not the impossibility) of allocating all revenues and costs exactly to designated services due to network effects. Regarding cost allocation, an operator highlighted the need for a clear definition of PSO.
- A private operator favours a client body that would be able to investigate whether the offered prices were based on realistic assumptions.
- Application of the Annex to Regulation 1370/2007.
- Transparency (and, in particular, account separation). This idea is shared by both privately and publicly owned operators. However, some private companies consider that such account separation is necessary only where there is no competitive tendering of the PSC.
- With regard to the need for transparency, compliance with the rules regarding cross-subsidisation should be controlled by a neutral third party auditor and the burden of proof in cases of alleged non-compliance should be reversed, which means more responsibility for the competent authority in terms of compliance.

Aside from these views on how to avoid cross-subsidisation, public transport operators also formulated the following remarks:

- A privately owned operator states that the issue of cross-subsidisation does not arise, since compensation for meeting tariff obligations is never sufficient to generate a surplus.
- An internal operator highlights that there is no cross-subsidisation as it does not engage in

activities other than PSO.

- Full disclosure of funds from public sources is necessary to avoid conferring to the beneficiary a competitive advantage.
- Some privately owned operators also state that state aid to former public monopolies could be tolerated if open to and under fair conditions accessible to all market participants. For this to be possible, transparency and monitoring are key elements.
- Some privately owned operators state that a clear and transparent PSC should be awarded after a formal competition, from which operators in receipt of direct awards are excluded. However, to make such measure effective, such formal competition should not be designed to favour an incumbent operator.

As already emphasised above, two opposite opinions exist:

- Some privately owned operators consider that there should not be any cross-subsidisation from commercial services to services provided under PSO. The only cross-subsidisation which should be tolerated is within PSC (hence between services provided under PSO).
- Some publicly owned operators consider on the contrary that it is legally correct and economically useful to use profits from markets opened up to competition for financing public transport. Several services which could subsidise PSO services were mentioned: from outside the sector, such as energy services opened up to competition, or from within the sector, such as competitive freight services.

It is worth noting that a private operator considers it essential that commercial traffic be allowed in the public transport system with the same rights and obligations as the public service, with a view to offering more services to the customers, which appear to suggest that cross-subsidisation from these services to PSO services or *vice versa* would be beneficial to the passengers.

It is also worth bearing in mind the discussion relating to the possible benefits or drawbacks of cross-subsidisation. As regards railways in particular, CER considers that in almost all EU-12 Member States, PSO are not fully compensated. In such a situation, it is convenient for the competent authority to require the operator to cross-subsidise PSO services with the revenues of freight services, which eventually affects the viability of commercial freight activities.⁴⁵ CER is of the opinion that while such cross-subsidisation should remain a commercial choice for the operator, the fact that it is generally imposed upon the operator by the public authority does not appear to be in line with Regulation 1370/2007 nor with the previous text of Regulation 1191/69.

⁴⁵ Position Paper of CER 'The "financial architecture" for the European rail sector taking stock of the current state of the art', 16 November 2009, 13.

3.2.5 Weaknesses of the current national regulatory framework

All public transport operators that responded have concerns and point out gaps and weaknesses in the current national regulatory framework.

- Absence of clear and consistent rules over time.
- Absence of equal treatment for the different modes of transport in the sense that railway transport benefits from more favourable conditions.

CER underlined the very difficult situation in Eastern and Central Europe where Railway Undertakings are chronically under-financed.⁴⁶ According to CER, undercompensation led Railway Undertakings, in particular in Eastern and Central Europe, to incur unacceptable losses, forcing them into short-term borrowing. CER indicated that Regulation 1370/2007 will lead to more and more competitive tenders, but this evolution will not occur if there is a lack of undercompensation, since operators would not participate in such cases in the tender. This view appears to be confirmed also by private companies which, although they do not suffer from undercompensation, raised concerns in this respect.

- Existence of several competent authorities intervening in the organisation of the public transport service.
 - o In addition, absence of reasonable profit was also mentioned as a deterrent against investment, for instance in the renewal of rolling stock. This would be the case in CZ.
 - o In addition, delays in payment have been reported in RO.
 - o In AT, this appears to lead to competing interests among various authorities involved and to unclear responsibility for compensation between federal and regional authorities.
 - o In DE, the existence of two layers of competent authorities is said by operators to lead to a mismatch between the PSO imposed by the one (the authority granting a licence) and the compensation granted by the other ('*Aufgabenträger*'). This might lead either to over- or undercompensation. This is also considered by the same operators to impede a proper appeal procedure since the decision to grant a licence is to be challenged before competent administrative courts (which can take many years, e.g. *Altmark* took eight years, and which appeals do not verify the validity of the PSC), whereas the decision to grant compensation is to be challenged before competent public procurement chambers and civil Courts of Appeal (which do not verify the validity of the licence). The same operator highlights many legal breaches that such German situation generates (state aid, federal public procurement law, etc.).
 - o In ES, it is reported that the implementation of Regulation 1370/2007 may face some

⁴⁶ Position Paper of CER 'The "financial architecture" for the European rail sector taking stock of the current state of the art', 16 November 2009.

obstacles due to the fact that it relies on both the central government and the regional governments.

- In FR, some operators mentioned that, following Regulation 1370/2007, the legislation has been modified so as to avoid competition. It was also said that the duration of PSC is an issue in FR since current contracts have been secured until end 2024 for road transport, end 2029 for tramway services and end 2039 for metro services and other guided means of transport (such as suburban trains) in Ile de France.
- In IT, it was said that a weakness was the absence of a measure encouraging mergers between operators which leads to a significant number of small private operators and a low number of public transport operators having a significant size.⁴⁷
- Inadequate articulation with regard to planning.
- Insufficient powers conferred upon RB. This was considered to be the case in PL. CER also considers that RB should be strong and independent (hence separate from the national ministries) so as to be able to require, if necessary, from competent authorities the payment of appropriate compensation for PSO.
- It is not clear in which cases the Public Procurement Directives will apply / Lack of a method to define an efficient undertaking to use a benchmark for compensation.
- Lack of an efficient review procedure. In SE, an operator deplored the fact that Public Procurement rules were not applicable to concessions, which leads to the absence of a review procedure.
- Lack of clear rules to encourage private participation in mixed companies.
- Lack of compliance by the competent authority with the financial terms of the current contract.
- Lack of distinction between development and performance of public transport services.
- Lack of incentive due to the recourse to gross cost contracts. This appeared to be the case in SE, but it was also highlighted that new contract models have been introduced including both revenue incentives and quality incentives.
- Lack of measures protecting the economic equilibrium of PSC from cherry-pickers.
- Legal uncertainty with regard to the modalities of the award procedure and the transitional period for awards not complying with Regulation 1370/2007.
- Regulation 1370/2007 is not implemented correctly in Member States where a legal monopoly exists for rail traffic since such monopoly unduly limits the options of the competent authorities to either organise a competitive tendering procedure or to resort to direct awarding.
- Short-term financial framework. This appears not to allow sufficient and uninterrupted financing / Lack of long-term perspective.
- The difference in the system concerned in the different Member States and the implementation of the general rules.

⁴⁷ This view is also expressed in the economic literature. See A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 46, available at: <<http://mpra.ub.uni-muenchen.de/2253>>.

- The funding of purchases of rolling stock on a speculative basis by large, state-owned rail businesses that can be used to bid for tenders in a way that is not open to other bidders.
- The legislation in force is said not to comply with Regulation 1370/2007 (yet). This was said about DE, ES, IE, and NL. In DE, in waiting for a modification of the legislation, the *Länder* have enacted interpretative guidelines on the application of Regulation 1370/2007. It would appear that, in one of the *Länder*, these guidelines give a retroactive effect to Regulation 1370/2007 as regards compensation which is considered by the public transport operator as contrary to the principle of legal certainty.
- The levels of required evidence and the legal costs related to claims.
- The relationship with authorities unwilling to cooperate with other operators other than their in-house operator.
- The willingness of national bodies to structure their regulatory framework to protect incumbent operators.
- Undercompensation. This appears to be a concern in AT, CZ, DE and RO.⁴⁸

Problems in the implementation of Regulation 1370/2007 were also attributed to the Regulation itself:

- It is difficult to understand that Article 4(7) of Regulation 1370/2007 permits the total subcontracting of the service when the planning and the establishment of the services have been allocated and, on the other hand, Article 5(2)(e) prevents the total subcontracting by the internal operator when, in this case, total subcontracting seems more appropriate.
- It is unclear under Article 8(3) of Regulation 1370/2007 what constitutes the *dies a quo* from which to calculate the transitional period.
- It is unclear what is meant by 'internal operator'. In this respect, legal uncertainty was also emphasised as to possible public-private partnerships.
- It is unclear whether the principle contained in Article 5(2)(b) of Regulation 1370/2007 relates only to geographic and/or institutional confinement / It is unclear whether the principle contained in Article 5(2)(b) of Regulation 1370/2007 relates also to consulting activities and would then preclude internal operators from providing consulting services abroad.
- The definitions under Regulation 1370/2007 and their possible interpretations are a source of legal uncertainty.
- The possibility that companies with mixed capital (private and public) can be considered as an internal operator is a step backwards in comparison with the case law of the ECJ (e.g. *Stadt Halle*).
- Uncertainties as to the existence of several competent authorities.
- Uncertainties as to the interpretation of exclusive rights.

⁴⁸ It is to be noted that, in Hungary, a decrease of resource available for compensation has also been reported. This was due to the changes in responsibilities (decentralisation) whereby financing has suffered due to the lack of appropriate resources of local governments. However, in Hungary, it was considered that performance has not fallen in a significant manner. See UITP, 'Organisation and major players of short-distance public transport; New developments in the European Union', 2010, 41.

- While there is a ceiling above which no compensation can be paid, there is no corresponding floor. This means that there is a prohibition with regard to overcompensation, but there is no real obligation to compensate.

Although not directly linked to the existing regulations, an association of operators expresses concern with regard to the fact that public monopolies or ex-monopolies are benefiting from a dominant position that could impair the tendering process and distort fair competition.

3.2.6 Proposals

In accordance with their remarks concerning the gaps and weaknesses, the following main suggestions were made by public transport operators to improve the current regulatory framework and, more generally, the situation:

- Actions by the Commission in case of any breach of Regulation 1370/2007, combined with an annual review of the implementation and possible naming and shaming.
- Articulation of the legislation between Member States in terms of reciprocity / Prior discussion on the definition of the general rules by the Member States.
- Assistance of the Commission in the implementation process of the Regulation.
- Clear definitions of the competencies at the different authority levels.
- Clear state-aid regime.
- Commission should investigate the current PSO compensation framework in all the European countries in order to avoid overcompensation and, as a consequence, cross-subsidisation.
- Competitive tendering.
- Complete equity of the competition conditions concerning the costs of operators.
- Creation of an obligation for the public transport authorities to compensate for economically non-viable PSO imposed on an operator.
- Creation of easy access principles for claims.
- Distinction between concessions and competitive tendering, and only exceptionally a licence for direct awards (only for internal operators strictly defined and in accordance with a *de minimis* rule) and preservation of the interest of the Small Medium Enterprises.
- European control and/or regulation of railway activities or a coordination of the RB.
- Financial, geographical and temporal limits on direct awards.
- Full compensation.
- Guidelines:
 - o To provide more certainty with regard to the tender procedures.
 - o To improve the EU definitions and interpretations (*'internal operator'*, *'reasonable profit'*, etc.).

- DG Competition could assist the public transport sector by providing some useful practical guidance as to the implementation of the special transparency requirements, this potentially in the form of an Interpretative Communication or a Commission Recommendation.
- Index linking of compensation and tariffs, with the possibility of fixing the fare structure according to the imposed social limit.
- Limitation of the scope of Regulation 1370/2007 to cases where exclusive rights or compensation are granted in exchange for PSO within the framework of PSC.
- Modification of national law.
- Monitoring of the implementation of Regulation 1370/2007.
- More power for authorities to negotiate on pricing, without compromising the profitability for operators.
- Need to protect the financial balance of PSC in a situation where newcomers are interested in the 'cherry-picking' of interesting routes, which can include regional routes or services with an impact on regional services.
- Priority of services rendered on a commercial basis but with measures to ensure that undertakings do not limit their activities to profitable lines.
- Progressive implementation of Regulation 1370/2007;
- Provide long-term perspective as to allow planning.
- Strengthening of the powers of the RB.
- Strict requirements for governmental bodies to declare the amount and nature of any subsidy paid to public transport operators.
- The introduction of a new business model. Concession agreements should foresee a high enough trip volume-based remuneration to the operators to stimulate their business performance and their willingness to invest in new products and services for customers. These agreements should run for longer periods.
- The possibility that the competent authorities can secure the supply of services that cannot be rendered on a commercial basis.
- The rules on what is and what is not permitted under a direct award regime should be tightened.
- Transparency of funding.

3.3 Opinion of the consumers' organisations

The following section can not be considered as providing an exhaustive picture of the opinion of the consumers' organisations ('CO') since only a few contributions were received. Consequently, this section can merely be seen as an illustrative example of the possible concerns of CO.

3.3.1 Involvement of the CO in the adoption of PSC

The *Fédération Nationale des Associations d'Usagers des Transports* (FNAUT) which is a CO in FR, is not involved directly in the drafting of PSC. There only exist some line committees (*'Comités de ligne'*) in which the CO has an advisory role.

Whereas in the NL, there is a legal obligation to seek advice from CO (such as *Vereniging Reizigers Openbaar Vervoer*, ROVER) with regard to the schedule of requirements for new PSC and changes in the existing PSC that relate to timetables, fares and other subjects of interest to the passengers. The PSC have to contain a list of subjects about which the public transport operators are obliged to seek the advice of the CO. Despite the non-binding nature of the advice of the CO, the public transport operators or the transport authorities that decide not to follow the advice have to motivate that decision.

In the UK (*East Suffolk Traveller's Association*, ESTA), the competent authorities consult the CO. The bidders themselves also contact and meet with the CO.

3.3.2 Report of satisfaction measures on quality and the price of public transport services

In NL the following satisfaction measures were gathered by ROVER for rail services (on a scale of 1 to 10):

- General customer satisfaction: 7 or higher.
- Punctuality and delays: 5.6.
- Price-quality ratio: results were kept private but are expected to be relatively low.

For other public transport services in NL, the same score applies with regard to general customer satisfaction. For information in the case of delays and the price-quality ration, the scores are lower, with an average of 4.6 and 5.2 respectively.

FNAUT claims to have no means to carry out a comparative study to investigate the satisfaction of consumers.

ESTA, in turn, states that conducted surveys show a high level of satisfaction in passenger comfort and staff helpfulness. The most common complaints tend to be about delays, lack of information (especially at bus stops), the frequency of the train services and the lack of bus/train coordination.

3.3.3 Weaknesses/gaps in the current national regulatory framework

The following weaknesses and gaps were mentioned by the contributing CO:

- In NL, international services can run without a concession, which leads to a lack of consultation of the CO for those services. This means that the prices for those services are frequently higher while the service frequencies are lower than for domestic services, and that the fares and timetables are decided upon solely by the operators (NL).
- Lack of interregional coordination in general (NL).
- Lack of competition for the *Transport Express Régional* (TER), in FR. FNAUT is favourable to trying out opening up to competition on low traffic lines (secondary lines in the main rail network). Two options are possible: (1) several operators coexist on the same line or (2) a competitive tendering procedure is organised for a line, a group of lines or a specific geographic area.
- Regional trains do not have the right to continue on the national railway network due to exclusive rights and regional authorities therefore do not have a say over local trains on the national railway network (NL).
- The absence of an independent authority to decide on conflicting views (the Dutch Parliament wants to create such an authority) (NL).
- The lack of application of the obligation to consult the CO to the international services (especially with regard to the new high speed line to BE) (NL).
- The lack of national coordination with regard to fares. Only a few national payment systems, like the OV-chipcard, were introduced, this while the responsibility for fares is decentralised. Therefore existing fare integration will be phased out, which will lead to increased prices (minimum fare for each operator) (NL).
- The unreliability of bus services since they can be changed at short notice (ESTA).

3.3.4 Measures for improvement

The contributing CO highlighted the necessary measures for improvement as follows:

- Gaining control over several risks such as the excessive complexity of information and e-ticketing and the scattered nature of ticket offices in train stations and exchange facilities (FR).
- Introduction of a new independent authority in case of conflicting views (for example, between neighbouring regions) (NL).
- The formulation of specifications applicable to all operators such as tariff setting, information, minimal railway service, quality of service and travellers' rights (FR).
- The undertaking of credible research into passengers' needs, and this in cooperation with the voluntary sector and/or Passenger Focus (ESTA).

3.3.5 Comments

The following additional comments were made by ROVER with regard to the public transport services

in NL:

- An independent and impartial body should handle the ticket sales and provide journey planners. The operators should be obliged to deliver their timetable data to that body (in a standardised format).
- Cross-border cooperation between competent authorities should be compulsory or at least encouraged as much as possible, and this to prevent services simply terminating at the borders of a region.
- Legislation should not distinguish between services solely on the basis of a service being cross-border or not.
- The consultation of CO should be compulsory when specifications of a franchise are drawn up or when changes in an existing franchise occur with regard to the timetables, fares and other passenger-related matters. ROVER stresses that this is already mainly the case in NL but not in all the Member States.

3.4 Understanding competition issues linked to public transport

This section looks at the application of competition rules in the public transport sector and aims to understand the issues which may impede the implementation of Regulation 1370/2007.

3.4.1 Competition rules specific to transport

Regulation 169/2009 provides for some specific derogation from the general competition rules due to the **distinctive features of transport**.⁴⁹ In substance, this Regulation **exempts** from the application of Article 101 TFEU technical agreements having as their object or effect the application of **technical improvements** or achievement of technical **cooperation**.⁵⁰ Hence, agreements improving the quality of public services such as organising through ticketing, coordinating timetables for connecting routes and tariffs, etc. would not be regarded as potentially illegal agreements. Similarly, Regulation 169/2009 provides for exemptions for groups of small and medium-sized undertakings.

As regards **state aid**, before the entry into force of Regulation 1370/2007, Regulation 1191/69 provided for categories of state aid exempt from the prior notification obligation and Regulation 1170/70 provided for specific cases in which Member States were allowed to take measures in order to coordinate the transport services or to impose PSO pursuant to Article 93 TFEU other than under Regulation 1191/69.

⁴⁹ Council Regulation (EC) No 169/2009 of 26 February 2009 applying rules of competition to transport by rail, road and inland waterway, OJ [2009] L61/1.

⁵⁰ This is the case when these technical improvements or cooperation is by means of standardisation; exchange or pooling of staff; equipment; vehicles or fixed installations; organisation an execution of successive, complementary, substitute or combined transport and the fixing of inclusive rates; the use of the routes which are most rational from the operational point of view; the coordination of transport timetables for connecting routes; grouping of single consignments; establishment of uniform rules as to the structure of tariffs and their conditions of application, provided such rules do not lay down transport rates or conditions.

Regulation 1191/69 gave a **right to obtain compensation** for the discharge of PSO. Subject to specific compensation procedures, the compensation was considered as compatible with the common market and did not have to be notified beforehand to the Commission.⁵¹ PSC were to provide for transport service details including *'the price of the services (...), which shall either be added to tariff revenue or shall include the revenue, and details of financial relations between the two parties'*.⁵²

Council Regulation 1107/70 **exhaustively** listed the specific cases in which Member States were allowed to take measures in order to coordinate the transport services or to impose PSO in the sense of Article 93 TFEU.⁵³ Other than those described in Regulation 1191/69 and Council Regulation (EEC) 1192/69 of 26 June 1969 on common rules for the normalization of the accounts of railway undertakings,⁵⁴ the cases concerned for instance compensations of tariff obligations and compensation for the discharge of services imposed on undertakings or activities not covered by Regulation 1191/69. All aids within the scope of this Regulation fell under the general rules of the Treaty and had to be notified.⁵⁵ Hence, it was not possible to rely directly on Article 93 TFEU outside those specific cases.⁵⁶

The new Regulation 1370/2007 repeals these regulations. Since it is based on the sole Articles 91 TFEU (transport policy) and 109 TFEU (categories of aids exempt from prior notification), Article 93 TFEU can be relied on directly. Regulation 1370/2007 provides for specific cases in which compensation is compatible with the internal market and is exempt from prior notification.

Hence, Member States may still grant state aid which does not comply with Regulation 1370/2007, on the basis of Article 93 TFEU, if this aid meets transport coordination needs or represents reimbursement for the discharge of certain obligations inherent in the concept of a public service other than those covered by Regulation 1370/2007,⁵⁷ provided the measures are notified to and approved by the Commission.⁵⁸ Article 106(2) TFEU and Article 107(2) and (3) TFEU appear not to be available to public inland transport as Article 93 TFEU is a *lex specialis* in the Treaty.⁵⁹ It is to be noted that the Commission has applied Article 107(3)(c) TFEU to aid in inland transport in the *Wittenberg* case.⁶⁰ This decision seems however to be at odds with the Commission's decisional practice.

⁵¹ Articles 6(2), 10 to 13.

⁵² Article 14(1) and (2)(b).

⁵³ See Article 3.

⁵⁴ [1969] OJ Spec Ed I-283.

⁵⁵ Articles 2 and 5.

⁵⁶ *Altmark* case, paras 107 and 108 and *Combust* case, para 100.

⁵⁷ Recital 37.

⁵⁸ N 604/2005- Public bus transport services in *Wittenberg* [2006] OJ C 207.

⁵⁹ Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, [2005] OJ L312/67, Recital 17.

⁶⁰ N 604/2005- Public bus transport services in *Wittenberg* [2006] OJ C 207.

In any case, Article 9 of Regulation 1370/2007 suggests that aid which has as its objective to **compensate** the discharge of PSO cannot be justified under the Treaty rules if it does not comply with Regulation 1370/2007, since Regulation 1370/2007 has set out specific conditions.⁶¹ Article 9(2) of Regulation 1370/2007 provides that state aid can still be granted for the transport sector pursuant to Article 93 TFEU which meets transport coordination needs or which represents reimbursement for the discharge of certain obligations inherent in the concept of a public service other than those covered by the Regulation.

The position of the Commission on compensation which does not fulfil the Regulation standard might usefully be clarified.

3.4.2 General competition rules

This section relies on information received from the NCA, from RB and on existing case law. From the contributions received from the NCA, it would appear that very few decisions have been issued concerning directly or indirectly PSC in inland transport. It would also appear that, in some Member States, NCA are very active in the sector (e.g. in FR). This appears to be linked to the market opening in a country.

This section is not exhaustive but aims to show the main specific competition issues in the sector of public transport.

a) Prohibition of illegal agreements or concerted practices

Article 101(1) TFEU reads:

'The following shall be prohibited as incompatible with the internal market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market, and in particular those which:

- (a) directly or indirectly fix purchase or selling prices or any other trading conditions;*
- (b) limit or control production, markets, technical development, or investment;*
- (c) share markets or sources of supply;*
- (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;*
- (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.'*

Regarding the principle of competitive tendering set out by Regulation 1370/2007, a particular form of customer allocation between operators in the tendering process, bid-rigging, could potentially occur.

⁶¹ See *Altmark* case, para 105.

In FR, the NCA reported several cases of bid-rigging. For instance, it has adopted a decision on an illegal agreement between Kéolis, Connex and Transdev, which occupied the major part of the French market. The agreement consisted of allocating the national urban public transport market. Under the agreement, the parties did not compete when a public service operated by one of them was put into competition for renewal of the contract. The French NCA considered that the cartel of such oligopoly, together with the monopoly rent financed in the case at stake by public money, constituted one of the most serious anti-competitive practices and imposed in consequence the maximum fine upon each company.⁶²

Another case of bid-rigging was judged in FR. It concerned a tender launched for nine lots. The companies in question had distributed the lots between each other before handing in their bids and excluded some competitors by creating consortia.⁶³

b) Abuse of dominant position

Article 102 TFEU states that:

'Any abuse by one or more undertakings of a dominant position within the internal market or in a substantial part of it shall be prohibited as incompatible with the internal market in so far as it may affect trade between Member States. Such abuse may, in particular, consist in:

(a) directly or indirectly imposing unfair purchase or selling prices or other unfair trading conditions;

(b) limiting production, markets or technical development to the prejudice of consumers;

(c) applying dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;

(d) making the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts'.

It is not in itself illegal for an undertaking to be in a dominant position⁶⁴ and such a dominant undertaking is entitled to compete on its merits.⁶⁵ Incidentally, there are many dominant operators in public transport precisely due to the fact that operators were/are often state monopolies. Undertakings in a dominant position bear however a special responsibility not to allow their conduct to impair genuine undistorted competition on the internal market.⁶⁶

⁶² Décision n° 05-D-38 du 5 juillet 2005 relative à des pratiques mises en œuvre sur le marché du transport public urbain de voyageurs.

⁶³ Décision n° 09-D-03 du 21 janvier 2009 relative à des pratiques mises en œuvre dans le secteur du transport scolaire et interurbain par autocar dans le département des Pyrénées-Orientales.

⁶⁴ Dominance is 'a position of economic strength enjoyed by an undertaking which enables it to prevent effective competition being maintained in the relevant market by giving it the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers' (Case 27/76 *United Brands* [1978] ECR 207, para 65 and Case 85/76 *Hoffmann-La-Roche*, [1979] ECR 461, para 38).

⁶⁵ Communication from the Commission — Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] C45/7, para 1.

⁶⁶ *Ibid.*

A particular stakeholder reported that large incumbent companies having strategic functions such as station management, parking management, train services and bus services, etc. are profiting from a dominant position and have therefore to modify their structure so as to allow fair market access. As an example, the particular stakeholder pointed to a tendering process for urban transport where the railway incumbent, by proposing plans for the main *railway* station management and development, reportedly influenced the decision of the competent authority to award the contract for *urban* transport to its subsidiary.

This example is significant because it shows that *ex post* control of competition rules might not be relied on by market participants, hence the important role for Regulation 1370/2007. Indeed, this case ought to have been brought to the attention of the NCA. The dominant operator could have then been found guilty and damages could have been paid to the plaintiff. With Regulation 1370/2007, the award decision could also have been subject to an effective and rapid review, offering a potential chance for a re-start of the procedure, or at least the adoption of a new decision. If the Public Procurement rules were to apply, the award decision could not have led to the conclusion of the contract before a standstill period during which the decision could have been challenged.

The difference between competition and procurement rules (be they Regulation 1370/2007 or the Public Procurement Directives) not only rests in the outcome but also in the ease of successfully invoking a violation of a rule. In the case given as an example, dominance has to be shown under Article 102 TFEU, which might not always be easy to demonstrate. Whereas, under the Public Procurement rules, the example given might be considered as contrary to the general principles of transparency and non-discrimination, if it can be shown that the award of the contract was not linked to the specific requirements in the tender specifications but to foreign elements, which can be verified in the decision and the report of evaluation delivered by the competent authority.⁶⁷

It would appear that even if the case at hand could be challenged under Article 102 TFEU, it might be interesting for an operator which deems that the competitive tender has not been fair to be able to seek a remedy against the procedure and not only against the dominant firm which has won the PSC. This point shall be examined in section 4.9.

There was a case of **abuse of dominant position** reported in CZ. The bus carrier company by the name of 'Dopravní podnik Ústeckého kraje' (DPÚK) (a public transport operator) provided public transport services under a contract for the Ústí Region. When negotiating the subsequent extensions of the yearly contract, the parties disagreed on the scope of the services and on the level of compensation for the public service. As a consequence, the Ústí Region terminated the contract and stopped all related payments. However, DPÚK continued to provide bus services. The provision of loss-making bus services resulted in financial difficulties for DPÚK which led the company to

⁶⁷ See for instance Case 31/87 *Gebroeders Beentjes BV v State of the Netherlands* [1988] ECR 4635, para 28.

eventually withdraw 64% of the services, which represented about 50% of all public bus services throughout the Ústí Region. The Czech Office for the Protection of Competition recognised that the agreement contained arrangements leading to undercompensation. DPÚK informed the Region of the prospective withdrawal five days in advance, which did not allow sufficient time for the Region to find an alternative operator able to provide the necessary public transport services in its territory. Such termination has been found contrary to Article 14(4) of Regulation 1191/69. That provision provided that any undertaking which intends to discontinue or make substantial modifications to a transport service which it provides to the public on a continuous and regular basis and which is not covered by the contract system or the public service obligation shall notify the competent authorities of the Member State thereof at least three months in advance. The Czech Office for the Protection of Competition came to the conclusion that, by informing the Ústí Region of its intention to withdraw the bus services only five days in advance and by effectively interrupting these services, DPÚK had **abused its dominant position** in the relevant market to the detriment of consumers requesting bus services in the Ústí Region.

This case raises, besides a possible abuse of dominant position, the question of the responsibility of the competent authority in the execution of PSC and in particular as regards compensation for PSO. Indeed, it has been highlighted that, in Eastern Europe, there is an issue of undercompensation for the discharge of PSO (see section 4.7).

In Scandinavia, there were some cases raising the issue of **predatory bidding**.⁶⁸

In Sweden, Connex had won a tender for a net cost contract of operating night trains to northern Sweden. Connex won because of its very low bid in comparison with the incumbent operator. The incumbent operator lodged a claim before the court as it felt that Connex's bid was based on price dumping. However, the NCA decided not to take action after failing to find sufficient evidence to investigate any possible violation of the Swedish Competition Act.⁶⁹ This case did not result in an actual trial but it appeared during the execution of the contract that Connex's bid could not possibly be carried out.⁷⁰

In FI, a suspected case of predatory pricing by HKL Bus Transport Ltd in tenders regarding the Helsinki region bus transport was revealed. The Finnish NCA concluded in its decision that HKL Bus Transport Ltd had no dominant position in that part of Helsinki in the metropolitan area bus traffic which is put out to tenders. The Finnish NCA also concluded that HKL Bus Transport Ltd had not committed pricing below costs.

⁶⁸ For Denmark, see the European Court of First Instance in the *Combus* Case T-157/01 [2004] ECR II-917, note L. Hancher (2004) EStAL 455-460.

⁶⁹ G. Alexandersson, S. Hultén, 'Predatory bidding in competitive tenders: a Swedish case study' [2006] European Journal of Law & Economics, 83.

⁷⁰ *Ibid*, 92.

In Denmark, a case of predatory bidding was ruled by the General Court (previously the European Court of First Instance). Since the examination of the case relied on state aid rules, this case shall be mentioned below.

Public transport, if it can be based on market initiatives, is often subject to price constraints so as to guarantee public services to the citizens. Specific competition issues may appear in markets characterised by powerful players and, in particular, predatory bidding or abnormally low bids. The reasons for such abnormally low bids include:

- (i) to exclude or weaken competitors. In this case, the tenderer offers a price for the discharge of PSO which is low thanks to revenues from other businesses (a particular form of cross-subsidisation) or thanks to a conscious loss;
- (ii) to win a tender while securing recoupment from subsidies. In this event, the tenderer offers a price for the discharge of PSO which is low despite the risk of loss because it is sure that the authority would compensate;
- (iii) because of carelessness or ignorance.⁷¹ It might be that tenderers are not correctly informed owing to either their own fault or the fault of the authority.

Such low bids may have a negative effect on competition and on passengers, if the operator is not able to fulfil its contractual obligations with the level of subsidy agreed.⁷²

As in many cases where competition is introduced, *ex ante* regulation mechanisms could help avoid these possible competition issues.

Public Procurement Directives provide for general remedies when contracting out services to an operator.

Article 55 of Directive 2004/18 specifically deals with '**abnormally low**' bids. On that basis, when it would appear that bids are abnormally low, the authority may reject those bids. Before doing so, the authority has to request in writing details of the constituent elements of the tender relating in particular to the economics of the service provided, the technical solution chosen, the originality of the service proposed, the compliance with the provisions relating to employment protection and the possibility of the tenderer obtaining state aid. Public Procurement rules are not applicable to all PSC concluded on the basis of Regulation 1370/2007. Hence, this remedy is not available as such for all contracts, but could usefully be extended to them as well. This remedy provides a large leeway to the authority, which has the final decision on the abnormal nature of a bid.

In competitive tendering, the authorities often ask for a guarantee to secure the execution of the

⁷¹ G. Alexandersson, S. Hulten, 'Predatory bidding in competitive tenders: a Swedish case study' [2006] European Journal of Law & Economics, 75.

⁷² Ibid., 79.

contract. The guarantee could for instance consist of a percentage of the total amount of the contract. If the operator does not perform the contract as agreed, the authority may replace it and keep the guarantee as compensation for the damage. According to some scholars, such surety bonds may be a way to deter submission of abnormally low or unrealistic bids.⁷³ However, in a sector such as public transport, where continuity of service is an important parameter, the effect of such bond is considered as more uncertain.⁷⁴ The issuing of such bond is not required under the Public Procurement Directives but, in some EU Member States, this has been regulated. Although the effects of such bond are uncertain, it might be recommended to the competent authorities to make bids conditional upon such bond, with a view to limiting possible issues of predatory bids.

Issues relating to access to train stations were also examined (e.g. in FR). Indeed, when train stations are owned and run by incumbent Railway Undertakings, often enjoying a dominant position, it may happen that the access to such facilities is rendered more difficult for other operators.

c) Merger control

On the basis of the Merger Regulation 139/2004,⁷⁵ merger control is a forward-looking process, an *ante* examination aiming at assessing, remedying or even preventing concentrations with anti-competitive effects in the internal market or a substantial part of it.⁷⁶

With the German transport and logistics provider Deutsche Bahn's (DB) agreed purchase of Arriva, Mr Grube, DB's chief executive, stated: '*Liberalisation is starting now and the consolidation process will follow*'.⁷⁷ According to UITP, '*as a general trend a number of smaller private transport operators became public listed companies or found big private investors to enable them to grow their business*'.⁷⁸ The Province of Gelderland in NL pointed out that the local transport operators have already been bought by foreign operators with the tendering process started in that country in 2001,⁷⁹ anticipating Mr Grube's prediction.

In April 2010, after talks between SNCF and Arriva,⁸⁰ DB took over Arriva, the UK bus and train operator. As a remedy for its enhanced market power, DB has indicated that it will sell Arriva's rail activities in Germany to obtain the blessing of NCA.

⁷³ Ibid., 77.

⁷⁴ Ibid., 78.

⁷⁵ Council Regulation (EC) No 139/2004 of 20 January 2004 on the control of concentrations between undertakings (the EC Merger Regulation) [2004] OJ L24/1.

⁷⁶ Faull & Nikpay, *The EC Law of Competition* (2nd edn Oxford University Press, New York 2007) 423 et seq.

⁷⁷ Financial Times of 22 April 2010, 'Takeover of Arriva will set the pace'.

⁷⁸ UITP, 'Organisation and major players of short-distance public transport; New developments in the European Union', 2010.

⁷⁹ See Case No COMP/M.4862 of 2 October 2007. TRANSDEV/ CONNEXION HOLDING.

⁸⁰ Financial Times of 28 January 2010, 'SNCF on European track with Arriva talks'.

Another case concerned SNCF which has acquired Kéolis (and Effia, Kéolis' auditor), a private operator of public transport by bus and related activities, principally in FR, BE (through subcontracting), NL, the UK and some Scandinavian countries.⁸¹ Since SNCF is the railway incumbent in FR and Kéolis was the first public transport operator in urban and interurban land passenger transport in FR, the acquisition strengthens considerably SNCF's presence in the whole public transport chain. Therefore, the French NCA authorised the acquisition subject to commitments from the parties. The commitments adopted related notably to transparent and non-discriminatory treatment of operators as to agreements on connections with a view to not favouring Kéolis, transparent and non-discriminatory access to timetables to all operators, etc.

NCA play an important role in ensuring that the commitments offered by merging operators will effectively avoid competition issues. In this respect, the potential for operators to challenge an award decision (as imposed by Regulation 1370/2007) where they consider that the successful tenderer enjoyed a particular competitive advantage constitutes an important tool to complete the remedies offered by merging companies, if necessary (please see the comment above, under the heading on abuse of dominant position). However, as seen in section 2.2.4, EU Member States have not always established such recourse. Where this recourse exists, it might be for the competence of administrative courts, which are not always acquainted with or aware of competition issues. From that perspective, it might be useful to raise competition awareness among the jurisdictions.

d) Obstruction of public service

Article 106(1) and (2) TFEU reads as follows:

'1. In the case of public undertakings and undertakings to which Member States grant special or exclusive rights, Member States shall neither enact nor maintain in force any measure contrary to the rules contained in the Treaties, in particular to those rules provided for in Article 18 and Articles 101 to 109.

2. Undertakings entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly shall be subject to the rules contained in the Treaties, in particular to the rules on competition, in so far as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Union'.

The Treaty instructs Member States to employ specific caution when granting or maintaining exclusive rights. Since this provision refers to the other general Treaty rules, Article 106(1) TFEU is used in combination with other Treaty rules, while Article 106(2) TFEU serves as a justification rule.⁸²

⁸¹ Décision n° 10-DCC-02 du 12 janvier 2010 de l'Autorité de la concurrence française relative à la prise de contrôle conjoint des sociétés Keolis et Effia par les sociétés SNCF-Participations et Caisse de Dépôt et Placement du Québec.

⁸² From a state aid perspective, it is worth recalling that Article 106(2) TFEU appears not to be an available justification for compensation of PSO in inland transport since Article 93 TFEU is to be considered as a *lex specialis*.

In service of general economic interest (SGEIs), and in particular in public transport, it is sometimes feared that new entrants would focus on profitable segments of the market, leading the public transport operator to increase its prices (practice called 'cherry-picking' or 'cream-skimming'). Therefore, an exclusive right is sometimes granted to the operator of the public service. According to the case law, the grant of such exclusive rights can be justified, but this justification must be proportionate to the aim pursued, according to the proportionality test developed by the European Courts. This test aims to verify whether the measure is (i) suitable (i.e. so as to attain the objective pursued) and (ii) necessary (i.e. there is no other measure available less restrictive to competition to attain the objective pursued).⁸³ This test would be applied by the European Court of Justice more strictly where harmonisation/liberalisation has occurred than where this is not the case.⁸⁴ Therefore, relying on the checks and balances contained in the Treaty, the European Courts applied in cases such as *Corbeau*⁸⁵ or *Electricity Monopoly*⁸⁶ a less rigorous proportionality test for Article 106(2) TFEU⁸⁷ than would be the case for liberalised markets.⁸⁸ This less rigorous test (soft proportionality test) can be defined as being not as strict so as to require Member States to show that there is no measure available less restrictive to competition to cope with the problem of cherry-picking.⁸⁹

Directive 2007/58 opens international railway services up to competition and provides for a specific provision allowing the restriction of competition when the economic equilibrium of PSC would be compromised, following the case law of the European Courts.

Specific application of this EU provision is to be found in particular Member States' legislation. For instance, in EE, according to national law (Public Transport Act, which provides the basis for the organisation of public transport by road, railway, waterway and air traffic), an authority which grants line permits may refuse to grant a line permit if this would interfere with regular services provided on the basis of a line permit granted earlier, **except if the services in question are provided by a single carrier**. In April 2002, the Supreme Court of Estonia rendered a decision, finding that the said interference means also interfering with **commercial** interests of a carrier. In a particular case, the NCA of Estonia came to the conclusion that new line permits could not be granted for reasonable services (i.e. during the day, because of the interference with regular services). The NCA considers

⁸³ C. Barnard, *The substantive law of the EU* (2nd edn Oxford University Press, New York 2007), 81. See also Case C-205/99 *Anafir* [2001] ECR I-1271. For an annotation of the Case, see P. J. Slot, [2003] 40 CMLRev., 159–168.

⁸⁴ J. Holmes, 'Chapter X, The Control of State Action' in Korah Ed., *Competition Law of the European Community* (Lexis Nexis, 2005).

⁸⁵ Case C-320/91 *Corbeau* [1993] ECR I-2533. See also Case C-393/92 *Gemeente Almelo and others v Energiebedrijf Ijsselmij* [1994] ECR I-1477.

⁸⁶ Case C-157/94 *Commission v Netherlands* [1997] ECR I-5699.

⁸⁷ J. Holmes, 'Chapter X, The Control of State Action' in Korah Ed., *Competition Law of the European Community* (Lexis Nexis, 2005). See also M. Dony, 'Les notions de "service d'intérêt général" et "service d'intérêt économique général"', in J.-V. Louis et S. Rodriguez, *Services d'intérêt économique général et Union Européenne* (Bruylant, Bruxelles 2006), 21.

⁸⁸ *Ibid.* See also C. Maczkovics 'The Railways at the Crossroads of Liberalisation and Public Service', (2009) 1 EPPPL, 37.

⁸⁹ J. Holmes, 'Chapter X, The Control of State Action' in Korah Ed., *Competition Law of the European Community* (Lexis Nexis, 2005).

that it is not possible for new carriers to enter the market or even for existing operators to increase their market share: competition is artificially restricted. As regards international railway services, this legislation appears to go further than the possible limitation provided for under Directive 2007/58 when the economic equilibrium of the PSC would be compromised by the provision of transport services by competitors to the public transport operator. However, for other transport services, the principle contained in such legislation does not seem to be contrary to Regulation 1370/2007 which allows the grant of exclusive rights and pursues the objective of competition *off* the tracks/roads rather than *on* the tracks/roads.

As regards railway services, it would appear that the provision on the economic equilibrium of PSC contained in Directive 2007/58 has, in general, not yet been transposed in national law.

Therefore, most of the RB which have answered the questionnaire did not assess the economic equilibrium of PSC (BE, DE, SE, RO, CZ, UK, SK, SI and NL). Notwithstanding the fact that the necessity to assess the economic impact of a new international railway passenger service has not yet occurred, the RB of SI has already developed guidelines for the assessment of the economic equilibrium of PSC and plans to upgrade those guidelines on a case-by-case basis. The RB of SI stresses that there should be single European guidelines to assess the economic equilibrium, and this in the light of the common European Transport network. Very few RB provide a definition of the economic equilibrium of PSC: only UK/ORR, IT/URSF, SK, SI and RO have given such a definition, a definition which is roughly comparable. In IT, a contract would be found compromised if the remuneration no longer covers the cost incurred for the discharge of PSO. A comparable detection tool is applied in SK. The RB of SI states that the economic equilibrium (in a general sense) is the state when a new service in the market for international rail passenger services has a significant impact on the existing PSC. In the UK, a change in the value of the PSC could indicate a change in its economic equilibrium. There is though a need for a material impact on that PSC, moving outside the expected range. In this respect, the Slovakian RB is of the point of view that it is necessary to elaborate in more detail the methodology of assessing an economic equilibrium of contracts or, potentially, provide an explanation of Article 1 of Directive 2007/58/EC. In some EU Member States, this particular provision has not been transposed on purpose, since it is considered as not necessary to intervene where services can be provided by the market (this is for instance the position of SE).

e) State aid control

State aid control as regards compensation schemes for the discharge of PSO is addressed by Regulation 1370/2007. Therefore, this part of the analysis shall only briefly examine the application of the general state aid rules in cases where the state aid scheme appears to be at the margins of what can be qualified as a compensation for PSO.

In Denmark, the *Combus* case⁹⁰ before the European Court of First Instance concerned the Danish public bus transport services whereby local authorities concluded PSC with bus undertakings after a competitive tendering. *Combus*, a bus service operator, had won several tenders by bidding very low prices. As a result of its aggressive tariff policy, it required financial support from the State. The General Court stated that the wording of Article 1 of Regulation 1191/69 ‘introduces a clear distinction between “obligations inherent in the concept of a public service” which the competent authorities are to terminate (Article 1(3)) and “transport services” which those authorities are authorised to ensure through “public service contracts” (Article 1(4)), stating that those authorities may “however, ... maintain or impose the public service obligations referred to in Article 2” (Article 1(5))’.⁹¹ It came to the conclusion that the common compensation procedures laid down in Articles 10 to 13 of Regulation 1191/69 are only applicable to imposed PSO and not to the financial relations between the parties within such a price contract because the contracting undertaking was free to participate in the tender and was not obliged to operate its services in an unprofitable manner.⁹² The General Court further held that Article 17(2) of Regulation 1191/69 provides for a favourable derogation from the obligation of prior notification contained in Article 108(3) TFEU and must therefore be interpreted narrowly so that the derogation may only apply to aid which is necessary for the performance of transport services *per se* and not to sponge unsound financial management.⁹³ Consequently, Article 17(2) does not apply to these relations which are therefore not exempted from the procedure of prior notification.⁹⁴ In the case of public financing of deficits not specific to transport, the general rules of Article 107(2) and (3) TFEU apply.⁹⁵

Another interesting case occurred in Germany. The Commission qualified a German aid granted to bus operators per passenger in *Wittenberg* as state aid since it did not fulfil the third *Altmark* criterion. The sum given per passenger did not avoid the risk of an overcompensation as it depends on the success (i.e. the number of transported passengers) and no connection exists between the costs which occur during the service and the actual allowance granted. Due to this risk of overcompensation the aid was also not compatible with Regulation 1107/70. Nevertheless, the aid was declared to be compatible with EU Law on the ground of Article 107 (3) (c) TFEU.⁹⁶ It is to be noted that this decision of the Commission, relying on Article 107(3) TFEU whereas Article 93 TFEU constitutes a *lex specialis* in the Treaty, differs from its general decisional practice.⁹⁷

⁹⁰ Case T-157/01 [2004] ECR II-917, noted L. Hancher (2004) EStAL 455-460.

⁹¹ Para 77.

⁹² Paras 77 and 80.

⁹³ Paras 85 and 86.

⁹⁴ Paras 77, 78, 79 and 85.

⁹⁵ Para 86.

⁹⁶ N 604/2005- Public bus transport services in *Wittenberg* [2006] OJ C 207.

⁹⁷ See N207/2009 Financing of the transport services in district of *Wittenberg*, C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and *Danske Statsbaner*, C(2010) 975 final, para 300.

4. Assessment

This chapter provides for an assessment of the current state of play in regulatory and contractual practices against Regulation 1370/2007. Each important item of Regulation 1370/2007 is analysed, discussed and, if necessary, interpreted. Where relevant, existing studies are referred to. On this basis, for each important section of Regulation 1370/2007, examples of best practice in implementing Regulation 1370/2007 will be given in a box, account being taken of the stakeholder's opinions.

4.1 Introduction

Regulation 1370/2007 is of direct application and does not require transposition measures in the EU Member States. Therefore, it is necessary to make a case by case analysis of compliance.

In particular, Regulation's provisions are directly applicable to all contracts, except some transitional arrangements regarding the award procedure and regarding the duration of contracts entered into before the entry into force of the Regulation.

4.2 Scope of the application of Regulation 1370/2007

Regulation 1370/2007 may be declared applicable to inland waterways and national sea waters (Article 1(2)).

A few EU Member States have made use of this possibility. Public transport of passengers by inland waterways and national sea waters, although not subject to Regulation 1370/2007, must comply with the general Treaty rules. Regulation 1370/2007 does not create a parallel system to the general Treaty rules but implements them. Therefore, for the sake of legal certainty, Member States may wish to consider making public transport by inland transport and national sea waters subject to Regulation 1370/2007.

Harmonised legislation on public transport (IT)

Legislative Decree n. 422/1997 established that regional and local public transport services include sea, lagoon, rail and road, lake, river and air mobility systems which are operated in a periodic or recurring fashion with pre-established routes, timetables, frequencies and tariff, within a territory which can be regional or infra-regional.

4.3 PSO

4.3.1 Definition

'Public service obligation' is taken to mean '*a requirement defined or determined by a competent authority in order to ensure public passenger transport services in the general interest that an operator, if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions without reward*' (Article 2(e), emphasis added).⁹⁸

'Public passenger transport' is defined as '*passenger transport services of general economic interest provided to the public on a non-discriminatory and continuous basis*' (Article 2(a), emphasis added).

For the sake of subsidiarity, Member States have considerable discretion to define what they regard as SGEI.⁹⁹ Hence, the definition of such services by a Member State can be questioned by the Commission only in the event of manifest error.¹⁰⁰

According to some studies, there are three levels of responsibility in the definition of public transport:¹⁰¹

- policy aims, such as environmental objectives, modal shift, target groups, intermodality, etc. (strategic level);
- service design, such as fares, timetables, routes, vehicles, etc. (tactical level);
- operations, such as selling activities, information, vehicle maintenance, production, etc. (operational level).

⁹⁸ The Commission has attempted to describe in its proposal of 2000 some criteria that Member States have to take into account in determining PSO. Those criteria aimed at defining at the European level what constitutes 'adequate transport services' which may justify the adoption by Member State of public service requirements. Such definition at EU level has been abandoned on the basis of the subsidiarity principle. See COM(2000) 7 final.

⁹⁹ Case T-442/03, para 195.

¹⁰⁰ Ibid., referring to Opinion of Advocate General Léger in Case C-309/99 *Wouters and Others* [2002] ECR I-1577, I-1583, para 162.

¹⁰¹ Ibid. 30.

The table below shows synthetically the different levels of responsibility in defining public transport.

Level	General description	Decision	
Strategic Long term	<i>What do we want to achieve?</i>	General Goals <ul style="list-style-type: none"> • Transport policy • Market share • Profitability / Public transport budget General description of the services <ul style="list-style-type: none"> • Area • Target groups • Intermodality 	
Tactical Medium term	<i>Which services can help to achieve these aims?</i>	Detailed service characteristics <ul style="list-style-type: none"> • Fares • Personnel skills • Image & additional services • Vehicles • Routes • Timetable 	
Operational Short term	<i>How to produce these services?</i>	Sales <ul style="list-style-type: none"> • Selling activities • Information to the public • ... 	Production <ul style="list-style-type: none"> • Infrastructure mngt • Vehicle rostering & maint. • Pers. rostering & mngt

Source: study on 'Contracting in urban public transport', p. 33.

The **policy objectives** can only be determined by the competent authority, as the guardian of the public interest in a territory. Article 2(c) on the definition of PSO also clearly refers to requirements defined or determined by a competent authority. Service operation is the responsibility of the operator, which might be either the competent authority itself, an internal operator at local level or a third party operator. Different approaches in planning and designing concretely public services (tactical level) were observed, although this level must be based upon the policy aims defined by the authority and the local circumstances.¹⁰² Policy aims are sometimes defined by law and, although not much information was made available, extrapolation of information suggests that they are also sometimes defined in the tender documents (section 2.1.2) However, it appeared that, sometimes, they were not set out in legislation but only in the contract. In the latter case, attention should be paid to possible 'capture phenomenon' whereby policy decisions would actually be adopted by economic operators. Such phenomenon would not be in line with the definition of a public service obligation under Regulation 1370/2007 and would be unacceptable with regard to the principle of transparency and non-discrimination.

¹⁰² NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the Commission, 67.

Policy aims defined by law

The Portuguese National Regulation for the Road Transportation of Passengers, approved by the Decree law n 37 272 of 31 December 1948, Articles 1 and 72 state that PSO relating to transportation are considered as a service awarded to a company in order to satisfy the transportation needs which are characterised by their concentration and regularity, always bearing in mind the coordination of intermodal transportation.

Article 1 of the French law n° 82-1153 of 30 December 1982 on the orientation of domestic transport (LOTI) stipulates that: *'[T]he domestic transport system must satisfy the needs of the transport users in the most advantageous economic, social and environmental conditions for the community. It contributes to the unity and the national solidarity, to the defence of the country, to the social and economic development, to the balanced land planning and sustainable development of the territory as well as the expansion to international exchanges, notably Europeans.*

These needs are satisfied in the respect of the objectives of limitation or reduction of risks, accidents, nuisances, notably noise and gas pollution by the implementation of measures allowing the effectiveness of the right of all users, including persons with reduced mobility, in moving and the freedom to choose the means (...)' (free translation).

As for **tactical decisions** either the authority specifies to a large extent the consistency of the services ('constructive design') or it limits itself to defining the service standards that the operator will have to fulfil leaving the operator more freedom in the design of services ('functional design'). We have observed a large number of possibilities in adopting tactical decisions (from constructive to functional design, with various intermediates). We have also seen that the time when the tactical decisions are taken also varies (in the tender documents, in the PSC, after the contract has entered into). The way and moment PSO are defined appear not to be neutral as regards the efficiency and quality of public transport:

As emphasised by EPTO and UITP, freedom of entrepreneurship allows attributing the task of designing services to the stakeholder which is better placed from an operational point of view to take such decisions. In the words of EPTO, efficient and effective public services are best provided where there is recognition of the different skills and resources that each party involved in the process can bring to the delivery of services. Practices consisting of tendering out public transport services whereby the tenderers should propose a bid ready to be implemented, and any other practices relying on functional design of the services, give some leeway to the operator. This would permit taking into account the experience of undertakings which are active in diverse markets, to develop more customer-oriented strategies, to manage risk where the operator is also given revenue risks, etc., whereas the operator would generally be less inclined to investigate customers' needs and to innovate when the tactical decisions are adopted by the competent authority.

That being said, too imprecise a definition by the competent authority may lead to uncertainties in a competitive tender whereby potential bidders could be discouraged, which would benefit the incumbent having a better knowledge of the situation, and hence the outcomes of competition would be rather low.¹⁰³

The question remains how to reconcile these approaches with the requirement set out in Article 4(1) of Regulation 1370/2007, according to which PSC or general rules shall clearly define the PSO with which the public transport operator is to comply, and the geographical areas concerned. This requirement is of particular importance in monitoring the required link between the public service and the compensation granted to cover the discharge of these services.

We have seen in section 2.2.2 that it is not always possible in the current PSC to see that link because of too imprecise a definition of PSO in the PSC. This would not fulfil the requirement of Article 4(1). However, we have also seen cases in which the operator bore a substantial responsibility in the design of the service, but such design is made part of the contract. This is the case where it is required from the bidders to submit an offer ready to use or where, after the conclusion of the contract, the operator must establish a transport plan to be approved by the authority.

Functional definition of PSO but precise scope for compensation and exclusive rights (NL rail services)

Within the PSC, the Ministry of Transport in NL imposes on NS, the national railway incumbent, the adoption of a transport plan. The Authority provides guidelines on the way and procedures to establish such transport plan. There is a requirement to consult the consumer organisations, the infrastructure manager and the local authorities. It is also required that the transport plan contains the report of consultation, a description of the way NS intends to execute the basic PSO defined in the contract and transport trends as well as indicators of quantity and quality of the PSO services. These indicators are submitted for the approval of the Minister. The exact timetable is established by NS and then sent to the Minister.

4.3.2 Reward for carrying out PSO

As shown above, the definition of PSO contained in Regulation 1370/2007 refers to a reward without which the operator would not assume the services. Article 3(1) of Regulation 1370/2007 provides that when a competent authority decides to grant the operator of its choice an exclusive right and/or

¹⁰³ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 50, available at: <<http://mpira.ub.uni-muenchen.de/2253>>

compensation, of whatever nature, in return for the discharge of PSO, it shall do so within the framework of PSC.

The rewards generally conferred on the public transport operator relate indeed to compensation and/or exclusive rights, which trigger the application of Regulation 1370/2007.

The concept of compensation is largely dealt with in the Regulation and will be evaluated below. As to the concept of 'exclusive rights', Regulation 1370/2007 gives the following definition: '*right entitling a public transport operator to operate certain public passenger transport services on a particular route or network or in a particular area, to the exclusion of any other such operator*' (Article 2(f)) (emphasis added). This definition appears to relate to both the service and the route or network.

Under Article 106 TFEU, an 'exclusive right' is a right granted by a state measure to an undertaking to engage in an economic activity on an exclusive basis. In other words, 'exclusive right' means that, for each economic activity in a given territory, there is a single beneficiary.¹⁰⁴ It is also possible for 'exclusive rights' to be granted in parallel to different undertakings, provided that they operate in different territories¹⁰⁵ or *different services*. In this case each operator is a 'monopolist' within its reserved territory and service. However, when the activity is reserved to more than one competing undertaking, the state is not said to have granted 'exclusive rights' but 'special rights'. Indeed, the Court used in the past¹⁰⁶ the expression 'exclusive' to refer to rights granted to three undertakings for the fulfilment of the same activity in the same territory; nevertheless it was further settled that the qualification to be given in such cases should be 'special rights'.¹⁰⁷

The concept of 'special rights' and its relationship with 'exclusive rights' remains controversial since 1991 when the ECJ condemned the Commission for its failure to differentiate between these two categories.¹⁰⁸ The Commission further refined the definition of 'special rights' as those rights to engage in a certain economic activity in a given territory granted by a state measure only to a limited number of undertakings.¹⁰⁹

The reference to certain services suggests that there should be a possibility of providing other services than the ones under PSO on the same route/network.

In DE, there is a discussion on whether the licence granted to an operator for the carrying out of public transport services amounts to the grant of exclusive rights as such licence provides a protection as

¹⁰⁴ Case C-203/96 *Dusseldorp* [1998] ECR I 4075, para 58.

¹⁰⁵ Case 30/87 *Bodson* [1998] ECR 2479.

¹⁰⁶ Case C-209/98 *Sydhavnens* [2000] ECR I 3743, paras 53 and 54.

¹⁰⁷ J. Faull and A. Nikpay, *The EC Law of competition*, Second Edition, Chapter 6, footnote 36.

¹⁰⁸ Case C202/88 *Terminal equipment for telecommunications* [1991] ECR I 1223, paragraphs 45 to 47.

¹⁰⁹ The definition of special rights is currently contained in Art 1(6) of Commission Directive (EC) 2002/77, OJ L249/21.

long as the transport needs can be served by means of the already existing licence. The question arises because, in DE, public transport is based upon the principle of market initiative (see section 2.2.1). As a consequence, the protection conferred by the licence is contingent upon the operator's offer and is not settled for a certain period of time. However, it remains that the operator benefiting from such licence would not be subject to competition as long as there are enough transport services. This provides him an advantage in comparison with the operators which have not been awarded any licence but are willing to provide public transport services. Therefore, it is submitted that the German licence would amount to the grant of 'exclusive rights', subject to Regulation 1370/2007.

It emerges from the Member States studied that the concept of 'exclusive rights' invites various interpretations. For instance, in the contract between the county of Rhein-Neckar-Kreis and PalatinaBus GmbH, the concept should be understood as rather relating to the contract services, so that other operators may potentially provide other services in parallel. Whereas, in the contract model used by the Province of Gelderland, the exclusivity appears to be territorial as to cover the concession's area. In this case, other services in the territory provided by other companies would not be possible. This last type of exclusivity is said to impede the ability of other service providers to enter the market, to the detriment of consumers (see section 3.3.3). In this respect, the Law on passenger transport of 2000 in NL provides for the possibility of establishing public transport to and from another concession area if the competent authority for that other area agrees.¹¹⁰ Also, in ES, exclusivity relates to the territory and it would not be possible to have multiple PSO providers operating the same route. In that EU Member State, competent authorities create new bodies to meet the needs of new geographical areas, such as metropolitan areas.¹¹¹ This type of exclusivity might, however, in the case of railway services be considered as contrary to Directive 2007/58, except in certain conditions (see section 4.10).

Exclusive rights allowing other services on (DE Rhein-Neckar-Kreis)

In Rhein-Neckar-Kreis, the operator is granted an exclusive right for the contract services. The Landkreis commits not to order parallel services from other operators nor will he support applications for parallel licences from other operators. However, the operator would not be protected against competitors providing services which are only parallel in part and which serve a different transport function in comparison with the routes that it operates.

One concept, although not expressly stated in Regulation 1370/2007, relates to the **transfer of risks** to the public transport operator which may act as an incentive for the provision of (efficient) public transport services. Since this reward relates to 'payments', this point is analysed under the section on compensation. Although not expressly stated in Regulation 1370/2007, this type of reward

¹¹⁰ Article 25 (2) of the Law on passenger transport of 6 July 2000.

¹¹¹ UITP, 'Organisation and major players of short-distance public transport; New developments in the European Union', 2010, 73.

corresponds to the current practices and is linked to the type of contract to be awarded which in legal terms relates to concessions (whereby revenue risks are transferred to the operator) and other PSC.

4.4 PSC and general rules

'Public service contract' is taken to mean *'one or more legally binding acts confirming the agreement between a competent authority and a public transport operator to entrust to that public transport operator the management and operation of public passenger transport services subject to public service obligations'* (Article 2,i)). Regulation 1370/2007 not only relates to 'contracts' or 'concessions' in the general meaning of a meeting of two wills but, depending on the law of the Member State, the PSC *'may also consist of a decision adopted by the competent authority, taking the form of an individual legislative or regulatory act, or containing conditions under which the competent authority itself provides the services or entrusts the provision of such services to an internal operator'*.

When a competent authority decides to grant the operator of its choice an exclusive right and/or compensation in return for the discharge of PSO, it shall do so in PSC, or by derogation, in general rules if these aim at establishing maximum tariffs (Article 3). Such derogation, if adopted, should apply without discrimination to all public passenger transport services of the same type in a given geographical area (Article 2(l)). According to Recital 5, such general rules are to apply to all operators. General rules may present some advantages, such as a harmonised approach towards tariffs for the whole country/region, better interconnections between the networks, etc.

Joint tariffs decided by the Verkehrsverbund in DE

In Germany, a *Verkehrsverbund* is an association bringing together local authorities competent for close-range public transport services. Its objective is usually to develop and maintain public passenger transport within a certain area.

In order to fulfil this objective a *Verkehrsverbund* incorporates joint activities such as matched schedules, joint tariff systems or joint marketing campaigns. A joint tariff means for instance that within the area of the *Verkehrsverbund*, there is a single price system applicable. As a consequence, passengers only need a single ticket for the services of different operators whilst travelling within the area of the *Verkehrsverbund*.

Contract as an incentive to provide efficient services?

Regarding the broad definition of the concept of PSC under Regulation 1370/2007, various current practices could be considered as fitting in with the Regulation's requirements (e.g. licences granted in DE, etc.).

The practice of concluding PSC appears to be widespread. However, it was also emphasised that a proper contract does not always exist or, when it does exist, is considered as not binding on the parties by lack of enforcement.

It is sometimes considered that PSC are unfair. As to the fairness of the contract, either it is awarded after a competitive tender and the transport undertaking has the choice not to enter into a relationship which it considers unfair, or the PSC are directly awarded and the public transport operator has little choice as to accepting or refusing the contract. In the latter case, Regulation 1370/2007 does provide for some safeguards.

According to the study on 'Contracting in urban public transport', a contract has an incentivising power specially for publicly owned operators when service supply and financial compensation are exclusively organised through the contract, since the effect of the contract may be in this case similar to what would have been the case when contracting with a fully independent operator.¹¹²

And indeed, many stakeholders, not only publicly owned undertakings, highlighted the fact that a contract has been a reward which made them consider providing public transport services. EPTO further considers that it is more suitable to have a contract than an individual legislative or regulatory act (as provided for in Article 2(i), first indent of Regulation 1370/2007).

<i>Contracts as the meeting of two wills as for instance between SNCB/NMBS and the Belgian State</i>

Scope

Current PSC cover either a particular route, a bundle of routes, networks or, according to the study on 'Contracting in urban public transport', sub-networks.

Regulation 1370/2007 does not provide guidance as to the services which may be comprised in the PSC for the purpose of carrying out PSO or not. Article 2(f) defining the concept of 'exclusive right' refers indirectly to the possibility of contracting public passenger transport services for a particular route or a network. There is no specific legal restriction on the possible scope of PSC which is to be determined by the competent authority. This has been confirmed by the Commission in its Decision on PSC between the Danish Transport Ministry and Danske Statsbaner. In this Decision, the Commission stated that the legislation in force does not preclude the possibility of entrusting public services covering a bundle of lines to establish a coherent transport system, notably with a view to

¹¹² See NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the Commission, 14.

guaranteeing the continuity of transports.¹¹³ The Commission further held that such entrustment is irrespective of the profitability of each of the individual lines in question as well as of the existence of comparable transport services on the said lines.¹¹⁴

In addition, Regulation 1370/2007 expressly provides for the possibility of having PSC for international passengers transport services (Article 1(2)), which would suggest that the PSC are not to be restricted to the territory of the competent authority. That being said, such international PSC, if required by a competent authority, should be required in such a way as not to impede the powers of the competent authority abroad.

Cross-border PSO of railway services (BE)

The management contract between the Belgian State and SNCB provides that SNCB must ensure, in agreement with the foreign authorities, public transport services to and from the first stations located beyond the border. These stations cover Aachen in DE, Lille in FR, Luxembourg, Troisviergers and Rodang in LU and Maastricht and Roosendaal in NL.

It is to be noted that the choice of contracting out for a particular route or a network is not neutral. This choice depends on the **needs** and the **risk level** accepted by the contracting parties.¹¹⁵ The study on 'Contracting in urban public transport' makes recommendations on the choice of contract size.¹¹⁶

Network contracts

- *Provide substantial optimising opportunities to the operator and therefore potentially increase efficiency levels*
- *Provide integrated public transport services delivered by one operator to passengers*
- *Enable net cost contracts*
- *Account for a great operational complexity*
- *Might be more difficult to monitor*
- *Increase the need to select long-term contracts*
- *Produce market entry barriers for small and medium sized companies*

Route contracts

- *Provide fewer optimising opportunities*
- *In case of dependency on the performance of other operators net cost contracts are not recommended*

¹¹³ C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and Danske Statsbaner, C(2010) 975 final, para 263.

¹¹⁴ Ibid.

¹¹⁵ NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the Commission, 83.

¹¹⁶ Ibid.

- *Integration of public transport services needs to be realised through other organisations (authority or related body)*
 - *Low market or no market entry barriers exist for small and medium sized operators*
- Sub-network contracts provide a compromise between network contracts and route contracts if required'.*

Hence, the determination of the scope of the PSC shall depend on the policy objectives pursued and the local specific features.

Basic features of the PSC

Article 4 of Regulation 1370/2007 provides for a mandatory content of PSC and the general rules. As highlighted in chapter 2, PSC contain various content throughout the Member States for which information has been made available. It would appear from the description of the basic features of PSC and general rules provided by the competent authorities that some mandatory content of PSC as provided in Article 4 of Regulation 1370/2007 does not necessarily reflect the current practice.

- Article 4(1)(a) imposes a **clear definition** of the PSO with which the public transport operator is to comply, and the **geographical** areas concerned.

This aspect has been largely addressed in section 4.3. It can be recalled that the objective is mainly to allow an unequivocal identification of the PSO so that it would be possible to monitor the compliance with the rules on compensation and cross-subsidisation. This provision is also important to determine the scope of possible exclusive rights granted.

However, as seen above, the definition of PSO in current PSC provide more or less leeway to public transport operators in designing public services. It is unclear from Article 4(1)(a) to what extent the PSO are to be defined in the PSC.

Regarding the objective pursued by this provision, it is of importance that the PSC or general rules indeed contain such clear definition or at least a reference to such clear definition, so that there might be no doubt as to the obligations which warrant a reward. It can be here underlined that, in Member States where PSO are defined in a licence or licence to provide public transport services and compensation decided in the remit of a subsequent contract, the link between the PSO services and the compensation must however be possible to identify.

Regarding the geographical area concerned, as emphasised above, Regulation 1370/2007 does not preclude the competent authority from entrusting public services covering a bundle of lines/network to establish a coherent transport system, notably with a view to guaranteeing

the continuity of transport.¹¹⁷ The Commission further held that such entrustment is irrespective of the profitability of each of the individual lines in question or of the existence of comparable transport services on the said lines.¹¹⁸ The Commission considered that the competent authority did not make any manifest error by including one or several profitable lines, to the extent these lines make part of a coherent transport system.¹¹⁹

Regarding the scope of Regulation 1370/2007 which may comprise international services, the geographic area is not necessarily limited to the area of the competent authority either. This has also been confirmed by the Commission.¹²⁰

- Article 4(1)(b) imposes the establishment **in advance**, in an **objective** and **transparent** manner, (i) the **parameters** on the basis of which the compensation payment, if any, is to be calculated, and (ii) the **nature and extent** of any exclusive rights granted, in a way that prevents overcompensation.

For directly awarded contracts, the parameters shall be determined in such a way that no compensation payment exceeds the amount required to cover the **net financial effect** on costs incurred and revenues generated in carrying out the PSO, taking a reasonable profit into account.

In general, the competent authorities already incorporate the financial arrangements in their contracts. However, on the basis of our analysis and the answers received from competent authorities, it would appear that current PSC do not always describe the parameters on the basis of which compensation is paid. Similarly, the nature and extent of exclusive rights are not always specified.

<p><i>Parameters for compensation contained in the PSC in LT (awarded after a competitive tender)</i></p>
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¹¹⁷ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, C(2010) 975 final, para 263.

¹¹⁸ Ibid.

¹¹⁹ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, C(2010) 975 final, para 266.

¹²⁰ Ibid., para 265. The Commission also referred to Regulation (EC) No 1008/2008 of the European Parliament and of the Council of 24 September 2008 on common rules for the operation of air services in the Community (Recast) [2008] L293/3.

On the basis of the contract between the City of Kaunas and Kauno autobusai, the calculation of the compensation for the discharge of PSO is made in accordance with the Rules on Compensation,¹²¹, the reference to which is expressly provided for in the Contract.

The compensation for discharge of PSO (K LTL) is calculated according to the following formula:

$$K = \left[\left((R - R(n)) \times M + M(0) \right) \times S \right] \times \frac{100+r}{100} - (P + A)$$

Where:

R – planned number of trips on routes per month (unit);

$R(n)$ – cancelled (undelivered) number of trips on routes per month (unit);

M – length of the routes (km);

$M(0)$ – length of the run (necessary to start and finish the route) (km);

S – net cost of 1 km on routes (i.e. expenses incurred as a result of passenger transport by the operator divided by the run on those routes) (LTL/km);

r – profitability, established according to the terms of the Contract, which would allow the operator to accumulate resources for renovation of buses;

P – revenue collected from passengers per month for passenger transport on routes (LTL);

A – compensation which operator is entitled to receive from the city due to the privileges granted for the passengers under the law (LTL).

r (profitability) is determined according to the following formula:

$$r = \left[(PK_{KMi} + S) \times 100 \right] - 100$$

Where:

i – year;

PK_{KMi} – the price in LTL of 1 bus km on routes; the price is being determined for the first contracting year (i.e. 2005), which later is subject to yearly indexation, according to the terms of the Contract.

¹²¹ Rules on Compensation of Losses Incurred by Passenger Road Transport Carriers, which have Resulted from Provision of Passenger Transport Services to the Public, approved by the Resolution No 3-154 of 13 March 2003 of the Minister of Transport of the Republic of Lithuania (hereinafter, "Rules on Compensation"); the Rules on Compensation are drafted taking into account the requirements of Regulation 1191/69 (as amended). These rules have been repealed by the Rules on Calculation of Compensation of Losses Resulting from Provision of Public Passenger Transport Service Obligations, approved by Resolution No 3-457 of 20 July 2010 of the Minister of Transport of the Republic of Lithuania (hereinafter, "New Rules on Compensation"); the New Rules on Compensation are drafted taking into account the requirements of Regulation 1370/2007.

- Article 4(1)(c) stipulates that the PSC or general rules must contain arrangements for the **allocation of costs** connected with the provision of services.
 - This provision requires determining the costs which are admissible for compensation. This provision should be thought of as a tool for competent authorities to monitor the evolution of costs for carrying out PSO and overcompensation. Hence, this tool provides valuable information on the market, and its evolution as well as compliance with Regulation 1370/2007 and the general Treaty rules.

List of costs in the PSC between Région Provence Alpes Côtes d'Azur and SNCF

The contract enumerates the costs which are taken into account to determine the amount of compensation. These costs cover the support, driving, the maintenance of rolling stock, exchange of material between activities, costs EEX, lump sum for services, capital costs of fixed installations, maintenance costs of fixed installations, fees (relating to intermodality, energy, interpenetration, TER management, studies, structure fees, remuneration of SNCF).

- This provision also appears to require determining the costs which are attributable to the services provided under PSO where the operator also engages in other activities. This would then allow monitoring the absence of cross-subsidisation.

In general, current contract practices do not include the description of such cost-allocation arrangements in the PSC. In some cases, competent authorities consider that cost-allocation rules are the responsibility of the operator and not of the competent authorities so that there is no need for such arrangements.

The text of Article 4(1)(c) imposes the adoption of cost-allocation arrangements in the PSC, irrespective of the way they are awarded, or the general rules. As regards PSC awarded after a competitive tender, Article 4(1)(c) leaves the parties to PSC free to determine such arrangements. For directly awarded PSC or general rules, the annex imposes that accounts must be allocated so as to 'at least' attribute variable costs, some portion of fixed costs and assets. This would not appear to refer to any particular allocation method but is consistent with several commonly used methods, as discussed below.

- The second sentence of Article 4(1)(c) provides that the costs allocated to the services provided under PSO 'may include in particular the costs of staff, energy,

infrastructure charges, maintenance and repair of public transport vehicles, rolling stock and installations necessary for operating the passenger transport services, fixed costs and a suitable return on capital (emphasis added). In referring to a suitable return on capital, it is unclear whether 'capital' refers to financial capital or physical capital. If it is referring to physical capital, such as rolling stock, it could mean depreciation.

This sentence does not appear to provide a maximum level of costs which might be attributable to the services provided under PSO and is written as an open ended list. Hence, little specific guidance is being provided as to the suitable method of cost allocation (fixed formula for apportionment, real usage of assets, etc.). To the extent that the allocation method has implications for cross-subsidisation (see discussion below), it may be desirable to have further clarity on what costs can reasonably be included.

- Article 4(2) provides that PSC and general rules shall determine the arrangements for the allocation of revenue from the sale of tickets, which may be kept by the public transport operator, repaid to the competent authority or shared between the two.

Revenue allocation arrangement in the PSC between Brussels Capital Region and STIB/MIVB

In the PSC between Brussels Capital Region and STIB/MIVB, the revenues remain with STIB/MIVB. The contract further provides that these revenues must be spent by way of priority on costs and the improvement of the operator's financial situation.

This provision may also relate to the risk transferred to the operator and would then also determine the type of contract awarded (contract service in the sense of the Public Procurement Directives or concessions).

Pursuant to the Public Procurement Directives, service concessions are contracts '*of the same type as a public service contract except for the fact that the consideration for the provision of services consists either solely in the right to exploit the service or in this right together with payment*' (emphasis added).¹²²

The Court of Justice of the European Union provides for a test to determine whether a service contract constitutes a concession. The test consists of verifying whether the service provider's

¹²² Article 1(4) Directive 2004/18 and Article 1(3) b) Directive 2004/17.

consideration is 'the right to exploit for payment its own service'.¹²³ According to the Advocate General Pergola in *BFI Holding*, 'exploitation' entails that the provider 'assumes the economic risk arising from the provision and management of the services' (emphasis added).¹²⁴ The ECJ has for instance recognised the existence of a service concession where the service provider's remuneration came from **payments made by users** of public transport service.¹²⁵ Indeed, such remuneration method means that the provider takes the risk of operating the services in question.¹²⁶ The analysis shall be made on a case-by-case basis.

The Commission issued in 2000 an interpretative communication on concessions under Community law which might give further guidance in identifying a service concession.¹²⁷ Since the Treaty does not provide any definition, the Commission, referring to the case law of the ECJ, stated that 'there is a concession when the operator bears the risk involved in operating the service in question (establishing and exploiting the system), obtaining a significant part of revenue from the user, particularly by charging fees in any form. [...] service concessions are [...] characterised by a transfer of the responsibility of exploitation' (emphasis added).

- Article 4(3) relates to the limitation of the duration of PSC. It can here be said that the current contracts appear to contain a clause on the duration of contracts, which, in general, is in line with Regulation 1370/2007.

Article 4(4) provides for possible extension, limited to 50% and only if necessary regarding asset depreciation for significant assets. Similar extension can be agreed if justified by costs deriving from the particular geographical situation. However, it is observed that where PSC provide for an extension of their duration, they often go beyond the conditions set out in Article 4(4).

Regulation 1370/2007 also provides for transitional periods during which current contracts can stay in force under certain conditions. This point is analysed in the procedural aspects (see 4.9).

¹²³ Case C-324/98 *Telaustria v Telekom Austria AG* [2000] ECR I-10745.

¹²⁴ Ibid. See Opinion AG Pergola in Case C-360/96, *Gemeente Arnhem v BFI Holding* [1998] ECR I-6821, para 26.

¹²⁵ Case C-410/04, *ANAV* [2006] ECR I-3303, para 16. For comments on this case, see Case Comment, Public service concession may be awarded to wholly-owned company, [2006] 187 EU Focus, 16-17; A. Brown, Case Comment, Legality of a national law allowing public authorities to award services contracts directly to their subsidiaries: a note on C-410/04 *ANAV v Comune di Bari*, [2006] Public Procurement Law Review. See also Case C-458/03 *Parking Brixen*, [2005] ECR I-0000, para 40.

¹²⁶ Please note that the ECJ has recently considered in a particular case that the quality of the risk (significant risk or limited) was not relevant in determining the concession nature of a contract (Case C-206/08, *Wasser- und Abwasserzweckverband Gotha und Landkresgemeinden (WAZV Gotha) v Euawasser Aufbereitungs- und Entsorgungsgesellschaft mbH* [2010] para 80). This case was strongly criticised by T. Kotsonis, Case Comment, The role of risk in defining a services concession contract: *Wasser- und Abwasserzweckverband Gotha und Landkresgemeinden (WAZV Gotha) v Euawasser Aufbereitungs- und Entsorgungsgesellschaft mbH (C-206/08) (WAZV)* [2010] 1 Public Procurement Law Review, 4-12.

¹²⁷ [2000] OJ C-121/02.

- Article 4(5) of Regulation 1370/2007 allows competent authorities to require the selected public transport operator to grant staff previously taken on to provide services the rights to which they would have been entitled if there had been a transfer within the meaning of Directive 2001/23.¹²⁸ In this respect, it would appear that such provision is not often used by the competent authorities consulted (e.g. in FR contracts contain social clauses on the transfer of personnel) nor in the contracts analysed. In IT, pursuant to regional regulations, the employees of the incumbent automatically become the employees of the new entrant which would replace the old operator for public transport. The employees would benefit from the same terms and conditions as the new entrant than with their previous employer.¹²⁹ In the case of IT, according to the economic literature, it is doubtful that a prospective entrant would be able to submit a competitive bid compared with the incumbent where a large part of the costs (i.e. labour costs) and productivity are exactly the same as that of the incumbent.¹³⁰ The situation has been denounced by the Italian NCA. In consequence, competitive tendering process, without social clauses, were launched in Rome, showing that competitive tendering tends to be more effective when less constraints are imposed on the participants.¹³¹ Where competitive tendering exists, as in NL, the law provides for a transition between two concessions which also relate to the personnel.¹³² With the possible development of competitive tendering, recourse to such a clause might be more and more observed as to preserve social rights.
- Article 4(6) of Regulation 1370/2007 provides that quality standards are to be enshrined in the contract but also in the tender document. This provision makes clear that PSC can be awarded also on the basis of quality criteria (and not pure economical criteria).¹³³ In addition, given the rationale behind this provision, it is thought that current practices according to which quality criteria are established during the execution of the contract by the operator subject to the approval of the authority are nevertheless compliant with the Regulation.

¹²⁸ Council Directive 2001/23/EC of 12 March 2001 on the approximation of the laws of the Member States relating to the safeguarding of employees' rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses [2001] OJ L82/16-20.

¹²⁹ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 50, available at: <<http://mpira.ub.uni-muenchen.de/2253>>

¹³⁰ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 50, available at: <<http://mpira.ub.uni-muenchen.de/2253>>

¹³¹ Ibid.

¹³² Article 37 of the Law on passenger transport of 6 July 2000.

¹³³ See Case C-513/99, *Concordia Bus Finland*.

Evaluation and certification of the quality in the PSC between the Brussels Capital Region and STIB/MIVB

The contract describes the objectives in terms of quality as being the preservation of the *acquis* of the previous period, the increase of the standards where possible, the implementation of new initiatives as regards the information to the client, the improvement of the perception of the quality, the study of the certification of exchanges encompassing the stations of SNCB and the offering of increased safety.

STIB must continue its efforts to obtain the ISO 9001 certification.

In addition, to encourage STIB in its efforts to achieve these objectives, four types of incentives are provided for a total amount of 3,25 Mio €.- a bonus-malus according to the results of the certification of the basis quality by an independent organisation pursuant to the criteria and procedures at least as strict as CEN 13816

- a bonus to encourage new initiatives of quality
- a bonus-malus to reward improvements in the perception of the client
- a bonus to reward the good perception of innovative elements (such as new lines, renovation of stations, etc.)

The certification of the basis quality must relate to the following criteria:

- reception and the selling of tickets
- information
- punctuality and regularity
- comfort
- cleanness
- accessibility and availability of equipment.

- Article 4(7) relates to subcontracting. Recital 19 of Regulation 1370/2007 provides that subcontracting can contribute to more efficient public passenger transport and makes it possible for undertakings, other than the public transport operator which was granted the PSC, to participate.

This provision provides that the tender documents and PSC must indicate whether and, if so, to what extent, recourse shall be made to subcontractors. This provision states that if recourse is made to a subcontractor, then the operator entrusted with the *administration* and *performance* of public passenger transport services in accordance with this Regulation shall be required to perform a '**major part**' of the public passenger transport services itself. In the

French version, it is not referred to as a 'major part', but as an 'important part' (*'une partie importante'*).

Such a requirement for the operator to **perform** the major part of the services itself does not apply where the PSC cover at the same time *design, construction* and *operation* of public passenger transport services, in which case even full subcontracting of just the operational aspects may occur. Some stakeholders emphasised the fact that it is not entirely clear why, in the event the operator is in charge of the ministry and performance of the public service, it has to perform a 'major' part of the services itself, and why, in the event of PSC covering the design, construction and operation of the public service, such requirement does not exist any longer.

In addition, some stakeholders emphasised that it is unclear how this provision relates to Article 5(2)(e) concerning internal operators. On the basis of Article 5(2)(e), internal operators may subcontract but are then required to perform the 'major part' of the public passenger transport services itself (as in the French version *'la majeure partie'*).

One could consider as a hypothesis that the distinction made in Article 4(7) between contracts in which the operators have only the responsibility of the administration and performance of the service and contracts in which they also bear the tasks of design, construction and operation of the service appears to refer to the operational categories identified in the study 'Contracting in urban public transport', functional and constructive service design. In contracts where the competent authorities only provide for a functional service design, the operator has a larger responsibility for the design of the services than where the competent authorities proceed to a constructive service design. The first category, functional service design, would allow operators to fully subcontract the operation of the services, possibly because the operators in such a case would at least design the services. In the second category, constructive service design would require the operator to perform itself a major part of the services otherwise the operator would only be a façade and would not accomplish any task at all under the contract. This could be understood as a rule aiming to prevent operators, because of their particular position, reserving markets for themselves while not providing services themselves. Further, one may set as a hypothesis that internal operators are actually in the same situation as operators for which the competent authorities have constructively designed the services.¹³⁴

It can be submitted that the European legislator has actually set out a single subcontracting rule whereby the principle is that the contracting operator may not subcontract all the tasks

¹³⁴ This might reflect standard practice in areas such as light rail (trams), where a contract (e.g. *DBFO-Design, Build, Finance and Operate*) is assigned to a lead supplier, which is often a construction company that needs the operational competence of an operator that it subcontracts with.

which are under its responsibility. When the contracting operator is responsible for both the design and the performance of the services, it must itself design the services and may subcontract the performance of the services it has designed in full. In this case, an operator may have particular expertise in designing services but may not have the capacity to operate day-to-day services. On the other hand, when the contracting operation is only responsible for the performance of a service already designed by the competent authority, it has to perform the major part of the contract.

The current practices examined in chapter 2 appear to make limited recourse to subcontractors (if so, often about 20%, apart from an internal operator which has a legal obligation to subcontract 50% of its bus services to private operators).

Contractual limitation of the services which can be subcontracted in the PSC between the Hungarian State and Tisza Volán

The contract between the Hungarian State and Tisza Volán was amended on 2 December 2009. According to the amendment brought, the public service operator may involve subcontractors in the performance of contract services up to 30% of the annual scheduled performance.¹³⁵

4.5 Award

In the event a competent authority chooses to entrust PSC to a third party, it must select the public transport operator in accordance with EU law on public contracts and concessions, as established by Articles 49 and 56 TFEU and the general principles of transparency and non-discrimination.¹³⁶

Regulation 1370/2007 establishes in Article 5 a number of specific provisions with regard to the award of PSC.

From a policy point of view, the establishment of a specific award procedure has an influence on the achievement of the internal market which has as the objective the removal of barriers for improving overall economic welfare and growth.¹³⁷ Several stakeholders have stated that competition through a regulated award procedure provides the best mechanism to secure high quality, efficient and effective public transport services.

¹³⁵ Section 2 of Amendment to Tisza Volán PSC.

¹³⁶ Recital 20 of Regulation 1370/2007. See case C-231/03 *Coname* [2005] ECR I-7287, paras 17 and 18.

¹³⁷ S. Arrowsmith, *The Law of Public and Utilities Procurement* (Sweet & Maxwell, London, 2005), 121.

Applicable rules

The award of PSC is governed by Article 5 of Regulation 1370/2007.

Article 5(1) of Regulation 1370/2007 provides that:

'Public service contracts shall be awarded in accordance with the rules laid down in this Regulation. However, service contracts or public service contracts as defined in Directives 2004/17/EC or 2004/18/EC for public passenger transport services by bus or tram shall be awarded in accordance with the procedures provided for under those Directives where such contracts do not take the form of service concessions contracts as defined in those Directives. Where contracts are to be awarded in accordance with Directives 2004/17/EC or 2004/18/EC, the provisions of paragraphs 2 to 6 of this Article shall not apply' (emphasis added)

This provision gives room for interpretation.

It is clear from the second sentence of Article 5(1) that PSC for passenger transport by bus or tram are to be awarded according to the Public Procurement Directives, unless they are service concessions, in which case Regulation 1370/2007 applies. As some authors have stated, it would appear that the PSC for all other means of transport would have to be awarded according to the rules contained in the Regulation.¹³⁸ However, as stated by the same authors, the last sentence of Article 5(1) does not mention bus and tram but refers to 'contracts' which '*are to be awarded in accordance with Directives 2004/17/EC or 2004/18/EC*' to exclude the application of the award procedure provided in the Regulation.¹³⁹ The wording of Article 5(1) is thus ambiguous.

To shed some light on the interpretation to be given, this provision should be read in conjunction with Recital 20 of Regulation 1370/2007 which provides that '*[I]n particular, the provisions of this Regulation are to be without prejudice to the obligations applicable to public authorities by virtue of the directives on the award of public contracts, where public service contracts fall within their scope*' (emphasis added).

It would then appear that the award of PSC is subject to the general Public Procurement rules where applicable. In other words, it would be only in the event that PSC do not fall within the scope of the Public Procurement Directives that the award provisions of the Regulation would be applicable (e.g. concessions, permissions, licences, legislative or regulatory act, etc.).

Article 5(1) of the Regulation results in the award of PSC being regulated by a complex system. PSC take various forms (service contract, service concession, licence, permissions, etc.). If the PSC are

¹³⁸ G. Skovgaard Olykke, 'Legislative Comment, Regulation 1370/2007 on public passenger transport services' [2008] Public Procurement Law Review, 86.

¹³⁹ Ibid.

service contracts (in general, so-called "gross-cost contracts"), the Public Procurement Directives apply. In the other cases (in general, so-called "net-cost contracts"), Regulation 1370/2007 applies. Regulation 1370/2007, furthermore, contains a number of exceptions.

As a consequence, Article 5(1) and Article 5 (6) of the Regulation, thus, appear to create the following categories of PSC:

- PSC for public passenger services by bus or tram that do not take the form of service concessions as defined in Directives 2004/17/EC and 2007/18/EC¹⁴⁰ are to be awarded in accordance with these Directives, i.e. on the basis of an open procedure,¹⁴¹ a restricted procedure¹⁴² or a negotiated procedure with or without publication.
- PSC for public passenger services other than those by bus or tram, such as railway or metro, that do not take the form of service concessions as defined in Directives 2004/17/EC and 2004/18/EC are also to be awarded in accordance with these Directives, i.e. on the basis of an open procedure,¹⁴³ a restricted procedure¹⁴⁴ or a negotiated procedure with or without publication.¹⁴⁵
- PSC for public passenger services by bus or tram that do take the form of service concessions as defined in Directives 2004/17/EC and 2004/18/EC or do not fall in the scope of these Directives are to be awarded in accordance with the provisions of the Regulation, i.e. on the basis of a competitive tendering procedure.
- PSC for public passenger services by rail that do take the form of service concessions as defined in Directives 2004/17/EC and 2004/18/EC or do not fall in the scope of these Directives can be awarded directly.
- PSC for public passenger services other than by rail, bus or tram that do take the form of service concessions as defined in Directives 2004/17/EC and 2004/18/EC or do not fall in the scope of these Directives are to be awarded in accordance with the provisions of the Regulation, i.e. on the basis of a competitive tendering procedure.

¹⁴⁰ According to Article 1.3(b) of Directive 2004/17/EC and Article 1.4 of Directive 2004/18/EC a service concession is 'a contract of the same type as a service contract except for the fact that the consideration for the service consists either solely in the right to exploit the service or in that right together with payment'.

¹⁴¹ An open procedure is a procedure 'whereby any interested economic operator may submit a tender' (art. 1, 11 (a) of Directive 2004/18, art. 1, 9 (a) of Directive 2004/17).

¹⁴² A restricted procedure is a procedure 'whereby any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender' (art. 1, (11), b) of Directive 2004/18; art. 1, 9, (b) of Directive 2004/17).

¹⁴³ An open procedure is a procedure 'whereby any interested economic operator may submit a tender' (art. 1, 11 (a) of Directive 2004/18, art. 1, 9 (a) of Directive 2004/17).

¹⁴⁴ A restricted procedure is a procedure 'whereby any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender' (art. 1, (11), b) of Directive 2004/18; art. 1, 9, (b) of Directive 2004/17).

¹⁴⁵ Article 5(1) in fine of the Regulation states: 'Where contracts are to be awarded in accordance with Directives 2004/17/EC or 2004/18/EC, the provisions of paragraph 2 to 6 of this Article shall not apply'. This general rule is stated in Recital 20 of the Regulation as follows: 'In particular, the provisions of this Regulation are to be without prejudice to the obligations applicable to public authorities by virtue of the directives on the award of public contracts, where public service contracts fall within their scope' (Recital 20).

Article 5(1) creates an additional ambiguity. This provision explicitly refers to service contracts or public service contracts as defined in Directive 2004/17/EC or 2004/18/EC and, in even more general terms, to contracts that are to be awarded in accordance with these Directives. It is, however, unclear how Directive 2004/18/EC would apply to PSC for public passenger services.¹⁴⁶

According to Article 1(2) the Regulation applies to the national and international operation of public passenger transport services by rail and other track-based methods by inland waterways and by road. These contracts would appear to be contracts that can only fall under the scope of Directive 2004/17 and not, subsidiary, under the scope of Directive 2004/18. Article 5(1) of Directive 2004/17 states that the Directive applies to '*activities relating to the provision or operation of networks providing a service to the public in the field of transport by railway, automated systems, tramway, trolley bus, bus or cable*'. These services are the same services that are covered by the Regulation. It is correct that the Directive relates these services to the provision or operation of a network. A network shall, however, be considered to exist '*where the service is provided under operating conditions laid down by the competent authority of a Member State, such as conditions on the routes to be served, the capacity to be made available or the frequency of the service*'. This definition of network is larger than what can be understood from an operational point of view, as described in chapter 2. Given the broad scope of this definition it is difficult to conceive how PSC for public passenger services to which the Regulation applies would not fall under the scope of Directive 2004/17 and, therefore, under the (subsidiary) scope of Directive 2004/18. Indeed, Regulation 1370/2007 defines PSO as '*a requirement defined or determined by a competent authority in order to ensure public passenger transport services in the general interest (...)*' (emphasis added). This provision has, in itself, meant that PSC will always be provided under operating conditions laid down by the competent authority of the Member State (even if sometimes the competent authority proceeds to a functional definition of the services), i.e. in a context that is defined, under Directive 2004/17, as a network.

The complex formulation of Article 5 (1) of Regulation 1370/2007 and, more specifically, the fact that the award of PSC will either be subject to Regulation 1370/2007 or to the Public Procurement Directives has been raised by some stakeholders as a difficulty. Stakeholders have submitted that there is need for clarification and legal certainty.

The principle of a competitive tendering procedure

The aim of Regulation 1370/2007 is to establish a legal framework for compensation and/or exclusive rights for public service contracts and not the (further) opening of the market.¹⁴⁷ The Regulation thus constitutes a framework for competition between companies bidding to obtain public service contracts.

¹⁴⁶ According to Article 1.3(b) of Directive 2004/17/EC and Article 1.4 of Directive 2004/18/EC a service concession is 'a contract of the same type as a service contract except for the fact that the consideration for the service consists either solely in the right to exploit the service or in that right together with payment'.

¹⁴⁷ See 'Funding public transport services: in need of standard regulation tools?' Oxera, Agenda, June 2008: <http://www.oxera.com/cmsDocuments/Agenda_June08/Funding%20public%20transport%20services.pdf>

A study has highlighted as one of the benefits of competitive tendering that it can lead to more attractive services at lower costs.¹⁴⁸ This study further underlined that in a sample contracts examined, '*competitive processes have been able to select more efficient firms than negotiated procedures*'.¹⁴⁹ In that study, though, only efficiency has been studied and not the impact of the tender procedure on policy objectives such as the quality of the services. In the economic literature, it is often recognised that competitive tendering can lead to more efficient public transport services. However, the design of the competitive tendering procedure is important in lending weight to this statement¹⁵⁰ (e.g. fair and non-discriminatory tender specifications, appropriate incentives, etc.).

The fundamental principle of competitive tendering is, as far as the award of PSC under Regulation 1370/2007 is concerned, enshrined in Article 5(3) and Recital 20 of Regulation 1370/2007.

Article 5(3) of Regulation 1370/2007 states that any competent authority which has recourse to a third party other than an internal operator shall award public service contracts on the basis of a competitive tendering procedure. The procedure adopted for competitive tendering shall be open to all operators, shall be fair and shall observe the principles of transparency and non-discrimination.

These principles are implemented, in the Regulation, throughout a number of fairly general provisions. These provisions are not fundamentally different from the provisions under the Public Procurement Directives. Indeed, according to these (Article 28 of Directive 2004/18 and Article 40 of Directive 2004/17), a tendering procedure is either open,¹⁵¹ restricted¹⁵² or a negotiated procedure.¹⁵³ In the event the Public Procurement Directives apply, different, detailed steps and modalities are to be complied with. As shown in annex I, these steps and modalities constitute a translation of the transparency and non-discrimination principles. It is, therefore, submitted that, although they tend to be less detailed, the steps and modalities which shall be followed under Regulation 1370/2007 are *de facto* comparable to the ones described in the Public Procurement Directives.

Article 5(3) of the Regulation states that PSC can be awarded on the basis of a negotiated procedure if the requirements of PSC appear to be specific or complex: '*Following the submission of a tender*

¹⁴⁸ ICLEI, Better Public Transport for Europe through Competitive Tendering, A Good Practice Guide, August 2003.

¹⁴⁹ A. Boitani, M. Nicolini and C. Scarpa, Do Competition and Ownership Matter? Evidence from Local Public Transport in Europe, Nota di Lavoro, Fondazione Eni Enrico Mattei, September, 2010.

¹⁵⁰ A. Boitani and C. Cambini, To Bid or Not to Bid, This is the Question: The Italian Experience in Competitive Tendering for Local Bus Services, Munich Personal, RePEc Archive, July 2006, 52, available at: <<http://mpira.ub.uni-muenchen.de/2253>>.

¹⁵¹ An open procedure is a procedure 'whereby any interested economic operator may submit a tender' (art. 1, 11 (a) of Directive 2004/18, art. 1, 9 (a) of Directive 2004/17).

¹⁵² A restricted procedure is a procedure 'whereby any economic operator may request to participate and whereby only those economic operators invited by the contracting authority may submit a tender' (art. 1, (11), b) of Directive 2004/18; art. 1, 9, b) of Directive 2004/17).

¹⁵³ A negotiated procedure is a procedure 'whereby the contracting authorities consult the economic operators of their choice and negotiated the terms of contract with one or more of these' (art. 1 (9), d) of Directive 2004/18; art. 1 (9), c) of Directive 2004/17).

and any pre-selection, the procedure may involve negotiations in accordance with those principles in order to determine how best to meet specific or complex requirements'.

The Regulation does not specify which requirements are to be considered 'specific or complex'. It is submitted that the requirements of PSC will mostly be considered to be specific and/or complex and, therefore, that most PSC will be awarded on the basis of a negotiated procedure. This seems logical because contracting entities that award a contract that falls under the scope of Directive 2004/17, which applies to contracts falling under the scope of the Regulation (see above), have a free choice between open, restricted or negotiated procedures. Contracting entities that award a concession will also let the contract on the basis of a negotiated procedure. If Regulation 1370/2007 would limit the recourse to negotiated procedures, this would have as an effect that the regime for the award of PSC that take the form of a service concession would be more severe than the regime under Directive 2004/17 or the regime under the general principles of transparency and non-discrimination.

The negotiated procedure on the basis of which PSC are awarded is a procedure *with* a call for competition. Article 7 (2) of the Regulation implies that each competent authority shall take the necessary measures to ensure that, at least one year before the launch of the invitation to tender procedure or one year before the direct award, the name and the address of the competent authority, the type of award envisaged and the services and areas potentially covered by the award are published in the Official Journal of the European Union.

Negotiated award procedure after call for competition in FR ('délégation de service public')

In France, the Law n° 93-122 of 29 January 1993 on the prevention against corruption and on the transparency of the economic life and of the public procedures (so-called 'Loi Sapin') contains provisions on the delegation of public service. Pursuant to Article 38 of the Loi Sapin, a '*délégation de service public*' is a contract whereby a public entity confers the management of a public service of which it is responsible on a public or private delegate, the remuneration of which is substantially linked to the results of the use of the service. The delegation of public service is subject to publication, allowing the presentation of several competing bids. The public entity establishes a list of the candidates which are allowed to submit an offer after verification of their professional and financial guarantees and of their ability to ensure the continuity of public service and equality between the users of the public service. The public entity must provide to the candidates a document defining the quantitative and qualitative characteristics of the performance as well as, if applicable, the tariff conditions of the service. The submitted offers are then freely negotiated by the public entity responsible for the delegating entity which chooses on that basis the delegatee.

Competitive tendering in SE

In SE, contracts are tendered out. In general, the Public Procurement rules would apply apart from concessions to long-distance railway services, but in all cases competitive tendering processes are in place. The transport authority determines a number of transport and social policy goals which then serve as a planning framework for its own transport department. By doing this, the authority states its 'public service aims'. Through its transport department, the authority then organises the contracting out of the services planned. Competitive tendering procedures are used.¹⁵⁴

Application of the Public Procurement rules for the award of PSC in ES

According to the Law (Ley) 16/1987 of 30 July regulating terrestrial transport, the attribution of PSC concerning the public transportation of passengers must comply with the national Spanish laws on public procurement (Article 69).

Internal operators

Public services at a local level may be provided by the **competent authority itself**, which can also decide to award a public service contract **directly** to an **internal operator** over which it exercises similar **control** as over its own department, that is to say on which it has a dominant influence (Article 5(2)). Article 2(j) defines an internal operator as '*a legally distinct entity over which a competent local authority, or in the case of a group of authorities at least one competent local authority exercises control similar to that exercised over its own departments*'.

The concept seems, at first glance, to have been developed on the basis of the case law of the ECJ on 'in-house' operators. According to this case law the ECJ considers that a contract or a concession is not subject to competitive tendering if two conditions are met: the contracting entity exercises control comparable to that exercised over its own services (first condition) and if the company carries out the essential part of its activities with the controlling authority (second condition).¹⁵⁵ However, Regulation 1370/2007 provides for specific conditions:

- The ECJ has stated, on several occasions, that the mere fact that private capital participates in the company prevents the first condition from being met.¹⁵⁶ Regulation 1370/2007 provides for a less strict test than the test the ECJ has developed, with regard to in-house operators, in its *Teckal* case law. According to Article 5(2)(a) of the Regulation, it stipulates that '100%

¹⁵⁴ See NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the European Commission, 20.

¹⁵⁵ See, with regard to service contracts, C-107/98, *Teckal* [1999] ECR I-1821, para 50 and, with regard to concessions, C-410/04, *ANAV* [2006] ECR I-3303

¹⁵⁶ Case C-26/03, *Stadt Halle and RPL Lochau* [2005] ECR I-1, para 49.

*ownership by the competent public authority, in particular in the case of public-private partnerships, is not a mandatory requirement for establishing control within the meaning of this paragraph, provided that there is a dominant public influence and that control can be established on the basis of other criteria*¹⁵⁷.

The wording of this provision does not require 100% ownership by the competent public authority, which allows for private investment and in particular public-private partnerships.¹⁵⁷

- Article 5(2)(b) provides for the administrative principle of '**geographic specificity**' whereby the internal operator agrees not to apply for other public tenders outside the territory of the local competent authority on which it depends.¹⁵⁸

Some uncertainties concerning the concept of internal operators have been raised by the stakeholders.

As regards the geographic specificity, the question arises as to whether it also applies to subsidiaries of internal operators. In this respect, Article 5(2)(b) clearly states that the geographic specificity also applies to any entity over which the internal operator exerts even a minimal influence. This provision appears thus to encompass subsidiaries of the internal operator.

It was also wondered whether the principle of geographic specificity was applicable to all the activities of an internal operator or whether such operator could for instance provide consulting services outside the territory of the competent authority. In this respect, the wording of Article 5(2)(b) appears to limit the thrust of the principle to the performance of public passenger transport services.

Another question concerns the scope of the 'geographic specificity': does the principle relate to geographic and/or institutional confinement? In this respect, guidance can be found in the preamble of Regulation 1370/2007 and in particular Recital 18 which provides that '*[t]he authority controlling the internal operator should also be allowed to prohibit this operator from taking part in competitive tenders organised within its territory*'. Hence, it would appear that Regulation 1370/2007 does not prohibit *per se* internal operators active in a part of the territory of the controlling authority from participating in tenders organised by this authority, but the Regulation prohibits such internal operator that has been awarded PSC directly, from participating in tender procedures outside the territory of the competent authority.

¹⁵⁷ See also Annex I on the drawbacks of the ECJ case law on the control issue when considering the in-house exemption.

¹⁵⁸ L. Gard, 'Le droit européen de transports une référence pour le service public en environnement de concurrence', in J-V. Louis et S. Rodriguez, *Services d'intérêt économique général et Union Européenne* (Bruylant, Bruxelles 2006), 417.

A further point of clarification has been highlighted above as regards the possibility of internal operators subcontracting.

Internal operator in the Brussels Capital Region (BE)

STIB/MIVB is the internal operator of the Brussels Capital Region. It is owned 100% by the Region and operates public transport services exclusively in its territory.

STIB/MIVB expressed its will to expand its activities outside the territory of the Brussels Capital Region, but only for consulting services or services not related to the operation of public transport.

The question arose whether internal operators may exist where there are several layers of competent authorities, such as in Germany (*'Bezirksregierung'* which awards a licence to perform public transport services and *'Aufgabenträger'* which is in charge of public close-range passenger transport). In this respect, it has to be stressed that the internal operator does not have to fulfil the requirements regarding all the competent authorities but at least with regard to one competent local authority. Indeed, Article 5(2)(b) refers to any competent local authority *'whether or not it is an individual authority or a group of authorities'* and provides that the control is to be exercised by the local competent authority or, in the case of group of authorities, at least one competent local authority.

Some stakeholders have also highlighted the negative effects of Article 5(2) on competition because of the increased risk of market foreclosure.

Direct award

If recourse is made to a third party to organise the public service, possible derogation from the principle of competitive tendering may apply whereby the competent authority may decide to award directly PCS in three situations (Article 5(3) of Regulation 1370/2007):

- below determined ceilings (Article 5(4)). This can be seen as a *de minimis* rule particularly defined in the case of small and medium undertakings;
- for an emergency situation, in the event of disruption of services or risk of such a situation (Article 5(5));
- transport by heavy rail, i.e. not for other track-based modes such as metro or tramways (Article 5(6)).

Such direct award must however be transparent as to allow interested parties to indicate their interests in providing the required public transport service. Article 7(2) of Regulation 1370/2007 imposes the obligation to publish the recourse to a direct award at least one year in advance.¹⁵⁹

Direct award of PSC to the publicly owned Railway Undertaking after publication in CZ

In CZ, the Ministry of Transport has directly awarded PSC to the publicly owned Railway Undertaking, *České dráhy, a.s.* Pursuant to Section 146 of the Act on public orders, the Ministry of Transport published information on the award in line with the Public Procurement rules.

The current practices often align with one of these circumstances. It has however to be noted that there is a **risk** that, in EU Member States where competitive tendering was the applicable principle, the competent authorities would directly award PSC (see the contribution of NL/Gelderland and of IT/Federmobilità as well as the contribution the German NCA, the *Bundeskartellamt*).

According to some stakeholders, this might be considered as a step backwards in the promotion of the internal market and in the efficient provision of services.¹⁶⁰

It is to be emphasised that if some stakeholders have highlighted the risk of a growing recourse to direct award of PSC, Article 5 is written in such a way as to reduce such risk. Indeed, the competent authorities may not be prevented from launching competitive tendering. In this respect, some current legislation may need to be revised so as not to prevent competent authorities from launching competitive tendering. In addition, EU Member States are able to prohibit direct award either to internal operators, to small contracts or to heavy rail, by national law. This is already the case for instance in SE and in most of the areas in UK where competitive tendering is compulsory.

In addition, Article 5(7) of the Regulation imposes on Member States to ensure that direct award decisions can be reviewed effectively and rapidly, at the request of any interested person. Furthermore, Article 7(4) allows any interested party to require from the competent authority the communication of the reasons of a direct award. The decision to award PSC directly is, therefore, to be adequately motivated. In lack of adequate motivation, national courts (administrative or civil) might question the decision that has been taken.

Articles 5(4), (5) and (6) are exceptions to the general principle of a competitive tender. Hence, they are of strict interpretation and the one who intends to invoke them shall have to prove that the

¹⁵⁹ In the Case C-231/03 *Coname* [2005] ECR I-7287, paras 17 and 18, the ECJ considered that direct awards of concessions were not *per se* contrary to the Treaty principles if they are transparent and non-discriminatory.

¹⁶⁰ See the contributions of some stakeholders, the position of the Commission on the benefits of competition, etc.

conditions for their fulfilment are met. Some stakeholders have also highlighted the negative effects of Article 5(6) on competition because of the increased risk of market foreclosure.

A number of ongoing contracts have been directly awarded outside the scope of the exceptions provided for in the Regulation. These contracts are to be brought in line with the Regulation, gradually, during the transitional period.

Eventually, it should be noted that the direct award of contracts is, under the Public Procurement Directives, also possible through a negotiated procedure without publication of a contract notice, in one of the following situations (relevant for public transport):

- 1) For all types of contracts:
 - a) When, following an open or restricted procedure, no tenders have been submitted.
 - b) When the contract can only be awarded to a specific economic operator due to technical or artistic reasons.
 - c) When unforeseeable events resulted in extreme urgency and therefore the time limits of the open or restricted procedure, or the negotiated procedure with publication of the contract notice, cannot be respected.
- 2) For public services contract:

When the contract is awarded to the successful candidate in a design contest.
- 3) For works and service contracts:
 - a) For additional services which were not included in the initial contract and have become necessary due to unforeseen circumstances, and this up to 50% of the amount of the original contract.
 - b) For new services consisting in the repetition of similar works or services entrusted to the initial economic operator for a maximum period of three years.

We are unaware of reasons why these additional exceptions are not applicable to PSC that are awarded on the basis of the Regulation. However, general publication obligations are applicable to all PSC, even if adopted on the basis of the public procurement rules.

Transitional period

During the transitional period, ending on 3 December 2019, the award of public service contracts by rail and by road will have to comply gradually with the award procedure referred to in Article 5 (Article 8(2)).

There may be some discussion as to the applicable rules before the adoption of Regulation 1370/2007. It would appear that contracts which fall within the scope of the Public Procurement

Directives were to comply with these Directives, even before the adoption of Regulation 1370/2007. Similarly, as will be examined below, PSC which do not fall within the scope of the Public Procurement Directives were to comply with the general principles of transparency and non-discrimination, even before the adoption of Regulation 1370/2007.

In addition, the transitional rules only apply as regards the award procedure as stated in Article 5 of Regulation 1370/2007 and not as regards the other provisions of Regulation 1370/2007, such as, for instance, the mandatory content of PSC or the compensation rules. The only exception relates to the duration where contracts have been awarded prior to the entry into force of Regulation 1370/2007 (Article 8(3)) (see section 4.9).

This has resulted in the provisions of Regulation 1370/2007 other than Article 5 being applicable as of 3 December 2009. This has been confirmed by the Commission in its decision on PSC between the Danish Transport Ministry and Danske Statsbaner applying Regulation 1370/2007.¹⁶¹ In that decision dated 24 February 2010, the Commission considered that the examination of the compatibility of compensation granted on the basis of PSC entered into prior to the entry into force of Regulation 1370/2007 was subject to that Regulation since it was the applicable legislation at the time of the examination. Such application of Regulation 1370/2007 is justified by the Commission as follows:

- Regulation 1370/2007 provides itself the modalities of its entry into force and of its application *ratione temporis*.
- There is no indication in Regulation 1370/2007 that it would not apply to PSC concluded before its entry into force. On the contrary, Article 8(3) provides for specific transitional rules as regards the award procedure applicable to PSC awarded before the entry into force of Regulation 1370/2007.
- Regulation 1370/2007 contains a specific state aid regime vis-à-vis the Commission's communication on illegal aids.¹⁶²
- The ECJ also held that a new rule applies immediately to future effects of a situation that arose under the old rule.¹⁶³
- The ECJ has considered that EU rules of material law must be interpreted as covering situations that arose before their entry into force only to the extent their terms, finality and economy intend to give such effect, which is the case in Regulation 1370/2007.
- In the same case judged by the ECJ, the ECJ considered that when an aid has been notified and the rules change before the Commission took a decision, the new rules apply.¹⁶⁴

¹⁶¹ C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and Danske Statsbaner, C(2010) 975 final.

¹⁶² [2002] OJ C 119/22.

¹⁶³ The Commission refers to the Case C-334/07 P *Freiststaat Sachsen*, para 43.

¹⁶⁴ *Ibid.*, para 53.

Modification of ongoing contracts to comply with Regulation 1370/2007 in HU

In HU, it would appear that competent authorities renegotiated the PSC of two Railway Undertakings at the end of 2009 and concluded new PSC with these undertakings based on the rules of Regulation 1370/2007.

As to road transport, many PSC concluded with bus companies ("Volánbusz" companies - internal operators) providing public passenger transport services were reviewed and amended in 2008 and in 2009. The objective of the amendments brought in 2008 was the avoidance of overcompensation. The amendments made in 2009 addressed the subcontractors' involvement and the examination of further necessary changes because of Regulation 1370/2007.

Similarly, PSC with two private bus companies (G-Busline and Weekendbus Zrt.) were also reviewed and amended at the end of 2009 to address subcontractors' involvement and other necessary modifications.¹⁶⁵

4.6 Overcompensation

Regulation 1370/2007 prohibits overcompensation, be it in the remit of general rules, directly awarded PSC or PSC awarded after a competitive tender (Articles 6 and 4).

Public service compensation paid in accordance with the Regulation shall be compatible with the internal market and exempt from the prior notification requirement laid down in Article 108(3) TFEU (Article 9(1) Regulation 1370/2007).

The *Altmark* case¹⁶⁶

With its revised proposal for a Regulation of 2005, the Commission was seeking '*to reconcile the various positions adopted by revising its proposal in the light of in particular the latest developments in case law (Altmark judgment) and its recent White Paper on services of general interest*'.¹⁶⁷

The *Altmark* case of the Court of Justice provides the rule according to which compensation for PSO is **not a state aid**, in the absence of an economic advantage for the beneficiary, if certain conditions are fulfilled.¹⁶⁸

¹⁶⁵

<http://www.koziranytu.hu/hirek/nyilvanosak_a_helykozi_szemelyszallitasi_kozszolgaltatasi_szerzodesek/100>

¹⁶⁶ Case C-280/00 *Altmark* [2003] ECR I-7747.

¹⁶⁷ Revised proposal for a Regulation of the European Parliament and of the Council on public passenger transport services by rail and by road, COM(2005) 319 final, 4.

¹⁶⁸ Case C-280/00 *Altmark* [2003] ECR I-7747.

- (1) the PSO must be clearly defined;
- (2) the parameters used to calculate the compensation must be established in advance in an objective and transparent manner;
- (3) the compensation cannot exceed what is necessary to cover the costs incurred in the discharge of PSO, taking into account the relevant receipts and a reasonable profit;
- (4) the fourth condition contains in reality two possibilities:¹⁶⁹
 - (i) if the State organises a competitive tender, it has to select the undertaking that is capable of providing the PSO at *the least cost* to the Community. In that case, overcompensation is assumed not to exist;¹⁷⁰
 - (ii) if the undertaking in charge of PSO is not chosen pursuant to a competitive tender, the compensation must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately equipped, would have incurred, taking into account the relevant receipts and a reasonable profit ('efficiency criterion').¹⁷¹

The case was brought specifically in the transport sector, but the conditions that were set out in Regulation 1191/69, now repealed by Regulation 1370/2007, were not, in the event, applicable.

These conditions can be analysed as a synthesis of the debate regarding the appropriate approach towards state aid control of compensation for the discharge of SGEI, opposing, on the one hand, the defendants of a 'state aid' approach and, on the other hand, the ones advocating a 'compensation' approach. Following the 'compensation approach', an undertaking does not benefit from any advantage where it receives an appropriate remuneration for the services provided or the costs of providing those services.¹⁷² This approach implies that state funding of services of general interest amounts to state aid within the meaning of Article 107(1) TFEU only if and to the extent that the economic advantage which it provides exceeds such an appropriate remuneration or such additional costs. Under the 'state aid' approach, state funding granted to an undertaking for the performance of general interest obligations constitutes state aid within the meaning of Article 107(1) TFEU which may however be justified if the conditions of the derogation are fulfilled and, in particular, if the funding complies with the principle of proportionality.¹⁷³ This approach raised procedural issues as every compensation scheme is subject to prior notification and to a standstill obligation in waiting for the Commission's approval. The compensation approach was also criticised for stripping derogations such as Article 106(2) or 93 TFEU of its substance and was considered as providing no incentive for undertakings to keep costs low.

¹⁶⁹ See A. Sinnaeve, 'State Financing of Public Services: The Court's Dilemma in the Altmark Case' (2003) 3 EStAL, 351, 357.

¹⁷⁰ *ibid.*

¹⁷¹ See A. Bartosch, 'Clarification or Confusion? How to Reconcile the ECJ's Rulings in Altmark and Chronopost' (2003) 3 EStAL 375, 384 and A. Sinnaeve, 'State Financing of Public Services: The Court's Dilemma in the Altmark Case' (2003) 3 EStAL, 351, 358.

¹⁷² Advocate General Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769, para 95. See for instance Case C-53/00 *Ferring* [2001] ECR I-9067.

¹⁷³ Advocate General Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769, para 94. See for instance Case T-106/95 *FFSA* [1997] ECR II-229, Case T-46/97 *SIC* [2000] ECR II-2125.

Advocate General Jacobs proposed a compromise, a third approach, being the *quid pro quo* approach, according to which the link between the public financing granted and PSO determines the application of the state aid approach or the compensation approach.¹⁷⁴

Finally, the Court of Justice retained some combination of these approaches in the *Altmark* ruling and formulated an 'efficiency criterion' where PSC were not awarded after a competitive tendering process whereby the costs which cannot be exceeded by the compensation are the ones that a typical undertaking, well run and adequately equipped, would have incurred. Where a competitive tender process led to the award of the contract, there will be a favourable presumption of absence of overcompensation. In such a case, it would be considered that in principle the public funding of a SGEI reflects market price.¹⁷⁵ However, as some scholars state, '*where the contract is to be awarded by reference to the most economically advantageous offer, the market price might be totally different to the price the contracting authority wishes to pay for the procurement of the relevant services*'.¹⁷⁶ The synthesis made by the *Altmark* ruling was sometimes analysed as creating a rule of justification in a rule of substance.

The result of the *Altmark* test implying the existence of state aid or not led the Commission in its decisional practice to apply a **two-stage examination** of compensation schemes in SGEI after the issuing of *Altmark*. This two-stage examination consists of determining whether a compensation constituted a state aid following the four *Altmark* criteria and, if so, whether this compensation could nevertheless be declared compatible with the Treaty.

To clarify its decisional practice, the Commission adopted a Decision on the application of Article 106(2) TFEU (ex 86(2) EC) to state aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest.¹⁷⁷ The Decision was adopted to clarify the application of Article 106(2) TFEU to compensation for some public services that would not fulfil the four cumulative *Altmark* conditions and which constitutes state aid under Article 107(1) TFEU. The compensation which fulfils the conditions set out in the Commission's Decision is compatible with the internal market and is exempt from the obligation of prior notification. The conditions to be fulfilled are the following:

- (1) entrustment: the act of entrustment with a SGEI shall specify the nature and duration of the PSO, the undertaking and territory concerned, the nature of exclusive or special rights, the

¹⁷⁴ See Advocate General Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769.

¹⁷⁵ M. T. Karagyigit 'Under the triangle rules of competition, state aid and public procurement: public undertakings entrusted with the operation of services of general economic interest' (2009) ECLR, 542, 561.

¹⁷⁶ C. Bovis, 'Financing services of general interest, public procurement and state aids: the delineation between market forces and protection in the European Common Market' (2005) *Journal of Business Law*, 1, 22.

¹⁷⁷ Commission Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, [2005] OJ L 312/67.

parameters for calculating, controlling and reviewing the compensation, and the arrangements for avoiding and repaying any overcompensation;

(2) compensation: the compensation shall not exceed what is necessary to cover the costs incurred in carrying out the PSO, taking into account the relevant receipts and a reasonable profit.

Under the Commission's Decision, 'reasonable profit' means a rate of return on own capital that takes account of the risk, or absence of risk, incurred by the undertaking by virtue of the intervention by the Member State, particularly if the latter grants exclusive or special rights. This rate shall not normally exceed the average rate for the sector concerned in recent years. In determining a reasonable profit, the Member States may introduce incentive criteria relating, in particular, to the quality of service provided and gains in productive efficiency. The costs shall comprise all the costs incurred in the operation of the SGEI as calculated on the basis of generally accepted cost accounting principles.

Further, following the Decision, the control of overcompensation occurs *ex post*, meaning that Member States shall require the undertaking concerned to repay any overcompensation paid.

However, this Decision does not apply in the field of land transport.

As regards land transport, the Commission also applied such **two-stage** approach by examining whether the compensation amounts to state aid under the *Altmark* judgment and, if so, whether it may nevertheless be declared compatible with the internal market under Regulations 1191/69 and 1107/70 (which are now repealed by Regulation 1370/2007).¹⁷⁸ The Commission adopted this approach whereas the Court of Justice stated that '*the provisions of primary law concerning State aid and the common transport policy would be applicable to the subsidies at issue (...) only in so far as, (...), those subsidies did not come under the provisions of Regulation No 1191/69 (...)*', which amounts to a "reversed two-stage approach" whereby it is first examined whether the measure comes under the Regulation and if not, then primary European law applies.¹⁷⁹

Prior to the entry into force of Regulation 1370/2007, the Commission's approach resulted in the conclusion that a compensation scheme cannot comply with the old Regulations if it is not cleared under the *Altmark* ruling. However, the old Regulations in the field of land transport were also based on Article 109 TFEU which allows the Council to exempt categories of aid from the procedure of prior notification. Hence, one could query whether such a conclusion would not result in a blurring of the distinction between determining the existence of state aid and the assessment of the compatibility of

¹⁷⁸ See, for instance, C 16/07 (ex NN 55/06) - *Official support for Postbus in the Lienz district*, [2007] OJ C 162 and C 47/07 (ex NN 22/05) – *Public service contract between Deutsche Bahn Regio and the Länder of Berlin and Brandenburg*, [2008] OJ C 35.

¹⁷⁹ Case C-280/00 *Altmark* [2003] ECR I-7747, para 105.

aid with the internal market, and consequently restricting the exempted categories.¹⁸⁰ This might have been felt necessary as the Regulations dated from the 1970s and no longer reflected the economic situation of transport.

Therefore, Regulation 1370/2007 intends to clarify the state aid regime applicable to compensation in land transport. The *Altmark* conditions, and the Commission's Decision on the application of Article 106(2) TFEU, have inspired the European legislator in the redaction of Article 4 and the Annex to Regulation 1370/2007.

With these provisions, public service compensation for the operation of public passenger transport services or for complying with tariff obligations established through general rules is compatible with the internal market and may be granted without necessitating a prior notification to the Commission under the Treaty rules on state aid (Article 9(1)). Hence, based on Article 109(3) TFEU, Regulation 1370/2007 exempts some cases of compensation from prior notification on the basis of conditions which are comparable to the conditions used to determine the existence of state aid pursuant to the *Altmark* case.

Since the entry into force of Regulation 1370/2007, the Commission appears to continue applying a two-stage approach towards compensation granted for the discharge of PSO in public transport.¹⁸¹ Such two-stage approach, which from a practical point of view may appear unnecessary since the application of the test of the Regulation is sufficient for exemption from prior notification, appears in line with Article 93 TFEU according to which State aid could however be justified.¹⁸² This approach remains advisable, because of the burden of proof upon Member States that invoke an exemption and the strict interpretation to be given to such exemption whereas the existence of state aid has to be shown by the Commission. Indeed, the General Court in the *Combus* case stated that Regulation 1191/69, now repealed by Regulation 1370/2007, provides for a favourable derogation from the obligation of prior notification contained in Article 108(3) TFEU and must therefore be interpreted narrowly.¹⁸³ It is to be seen whether the ECJ will validate this approach or restate its statement as in the *Altmark* case according to which '*the provisions of primary law concerning State aid and the common transport policy would be applicable to the subsidies at issue (...) only in so far as, (...), those subsidies did not come under the provisions of Regulation No 1191/69 (...)*'.¹⁸⁴

Regarding the inspiration taken in the *Altmark* case to set out the conditions to fulfil in order to benefit from the exemption of prior notification, the examination of Regulation 1370/2007 would on some

¹⁸⁰ Paragraphs 103 to 105 of the *Altmark* judgment clearly states that either the measure is to be analysed under the former Regulations or under the *Altmark* judgment.

¹⁸¹ C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and Danske Statsbaner, C(2010) 975 final.

¹⁸² Advocate General Jacobs in Case C-126/01 *GEMO* [2003] ECR I-13769, para 116.

¹⁸³ Case T-157/01 *Combus* [2004] ECR II-917, paras 85 and 86, noted L. Hancher (2004) EstAL 455-460.

¹⁸⁴ Case C-280/00 *Altmark* [2003] ECR I-7747, para 105.

points (e.g. clear definition of PSO and setting out of the parameters for compensation beforehand) be comparable to the examination made to identify the existence of state aid under the *Altmark* case.¹⁸⁵

Regarding the conditions contained in Regulation 1370/2007 and which are formulated differently from the *Altmark* case, this two-stage approach must not lead one to interpret the conditions set out in Regulation 1370/2007 as under the *Altmark* case, otherwise it would be restrictive of Regulation 1370/2007 which aims to exempt the categories of compensation fulfilling the conditions of the Regulation, but potentially not the ones of the *Altmark* ruling. Furthermore, neither should this approach lead competent authorities to circumvent the application of the provisions of Regulation 1370/2007 (on the award procedure, on the mandatory content, etc.) because they would consider that the compensation they have granted complies with the *Altmark* criteria.

The prohibition of overcompensation

As reviewed above, compensation which fulfils the *Altmark* criteria is not state aid and compensation which is state aid may nevertheless be exempt if paid in accordance with Regulation 1370/2007.

The prohibition of overcompensation applies to general rules, PSC awarded directly and after a competitive tender.

General rules and PSC awarded directly also have to comply with the Annex to Regulation 1370/2007 (calculation of the net financial effect and separation of accounts).

In the case of PSC awarded after a competitive tender, apart from the general compliance with Regulation 1370/2007, there is no specific requirement formulated to avoid overcompensation. As examined above, the fourth *Altmark* criterion does not apply to contracts awarded after a competitive tender because there is a presumption of absence of overcompensation. We have seen, however, that such presumption could be rebutted. The question is whether the same reasoning as to determine the existence of aid is applicable in applying the test of Regulation 1370/2007 exempting from prior notification. In this respect, it is worth noting that various competent authorities considered that the mere fact that PSC have been awarded after a competitive tendering process excludes overcompensation.

In the case of directly awarded PSC or general rules, the parameters are to be set out in a way that prevents compensation exceeding the amount required to cover the net financial effect on costs incurred and revenues generated in carrying out the PSO, taking into account related revenue and a reasonable profit. *'The effects shall be assessed by comparing the situation where the public service*

¹⁸⁵ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, C(2010) 975 final, paras 317 and 318.

obligation is met with the situation which would have existed if the obligation had not been met.¹⁸⁶ The annex allows taking into account the recipient's own costs as a benchmark of what could exceed the correct compensation. From an economic point of view, such benchmark with the recipient's own costs is not capable of incentivising the public transport operator to perform services efficiently.

Determination of costs admissible for compensation in DE

The Landkreis (county) Bergstraße in the federal country of Hessen reported that when contracts are to be awarded directly, compensation will only be accepted if it is not above market price. The market price is evaluated by means of a comparison of the compensation per km with neighbouring line bundles. These neighbouring line bundles have been granted under competitive conditions and have comparable requirements for the service.

Under the *Altmark* ruling, to determine whether there is state aid or not, the relevant costs taken into consideration are not the recipient's own costs but the costs which a typical undertaking, well run and adequately equipped, would have incurred, taking into account the relevant receipts and a reasonable profit. This is considered to incentivise the public transport operator to provide services in an efficient way.

Regulation 1370/2007 pursues efficiency by requiring that the compensation reflects a 'desire for efficiency and quality of service' (Recital 27) and by requiring that the method of compensation promotes the maintenance or development of effective management and the provision of passenger transport services of a sufficiently high standard (Annex, para 7). Such incentive for efficiency would not suffice to fulfil the fourth *Altmark* criterion. Indeed, as stated by the Commission, '*having an incentive to be efficient with regard to the compensation scheme does not mean that the absolute level of the [recipient's] costs [...] can be shown to be those of an efficient undertaking*'.¹⁸⁷

Possible incentives

The rule of compensation is directly linked to **incentives** provided under PSC. Recital 27 of Regulation 1370/2007 states that '*[w]here a competent authority plans to award a public service contract without putting it out to competitive tender, it should also respect detailed rules ensuring that the amount of compensation is appropriate and reflecting a desire for efficiency and quality of service*'. As seen above, incentives are considered as an important tool to introduce an **efficient market** for the discharge of PSO which are of quality.

¹⁸⁶ Annex.

¹⁸⁷ N582/2008 - Ireland, *Health Insurance intergenerational solidarity relief*, para 72.

As some studies explain, incentives may stem from the **risk** transferred to the operator.¹⁸⁸ These incentives may take various forms: transfer of production risks, transfer of both cost and revenue risks, passengers' rights, incentives related to performance and risk related to operational complexity related to the complexity of a network, of a new vehicle, subsidy caps, etc.

Despite the importance of incentives for the organisation of public transport, the rule of compensation as stated in Regulation 1370/2007 leaves room for interpretation and hence for some uncertainties as regards possible incentives linked to financial payments, at least in the realm of directly awarded PSC.

- In the event of PSC directly awarded, Regulation 1370/2007 indicates in Recital 27 that the amount of compensation should reflect a '**desire for efficiency and quality of service**'. This appears to be mirrored in the Annex, at point 7, whereby the method of compensation must promote the maintenance or development of effective management by the public service operator, which can be the subject of an objective assessment, and the provision of passenger transport services of a sufficiently high standard.

One could query what standard of efficiency is compatible with a public transport operator receiving a directly awarded contract: either it is sufficient that the contract provides incentives to the operator to become more efficient over the life of the contract or the contract should only be awarded when the operator is deemed efficient against some benchmark. The second interpretation would in some cases run contrary to the possibility offered to competent authorities in Article 5(2) to award directly a contract to an internal operator, which a recital cannot do in comparison with the operational part of a Regulation. This could be clarified by the Commission.

- In the event of directly awarded PSC, overcompensation is defined by reference to the **net financial effect**. However, for PSC awarded after a competitive tender, Regulation 1370/2007 does not provide any definition of overcompensation or the way to identify it. Some guidance can be found in the recitals.

Recital 33 refers to the *Altmark* case which sets out the four conditions whereby compensation of PSO does not amount to state aid in the sense of Article 107(1) TFEU. Recital 34 describes the conditions which are to be fulfilled for compensation to be compatible with Article 93 TFEU on the coordination of and the discharge of some PSO in transport: (1) compensation must be granted to ensure the provision of services which are services of general interest within the meaning of the Treaty; (2) in order to avoid unjustified distortions of competition, it may not exceed what is necessary to cover the net costs incurred through carrying out the PSO, taking into account the revenue generated thereby and a reasonable

¹⁸⁸ See NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the Commission.

profit. Recital 35 concludes that the compensation granted on the basis of the Regulation is exempted from the prior notification requirement of Article 108(3) TFEU.

Hence, overcompensation appears to refer in both cases (directly awarded PSC/General rules or PSC awarded after a competitive tendering) to the **net financial effect** of providing PSO. However, where a competitive tender occurred there would be a favourable **presumption of absence of overcompensation** whereas for directly awarded contracts, the financial effect shall be calculated on the basis of the own costs of the operator but as if it were in a commercial situation. Although PSC awarded after a competitive tendering process appear to benefit from a favourable presumption of absence of overcompensation, such presumption is rebuttable, in the absence of an explicit provision in this respect. Hence, a competent authority might have to justify compensation granted to an operator chosen after a competitive tender by showing that the net financial effect has not been exceeded.

- It is unclear whether the test for overcompensation applies **ex ante** or **ex post** as a regularisation rule (when the actual costs and actual revenues are known).

The application of an *ex post* test may render to a certain extent immaterial the possible incentives based on transfer of risks (e.g. gross cost contract and net cost contract) as well as some incentive schemes consisting for instance of bonuses/mark ups, since these incentives would have to be regularised on the basis of the actual costs and revenues. In addition, there may be a downside risk, depending on the terms of the contract. If the undertaking is found to have been overpaid, it must repay, while if it has not been overpaid (or indeed has been underpaid) it does not get any extra. Depending on the structure of the contract, this might incentivise inflating costs to ensure adequate payment. Such *ex post* test would also impact on the reasonable profit. A regularisation, whereby the public transport operator would have to repay the exceeding amount of compensation, would reduce risk but it would also reduce expected returns since only the 'positive' side of the distribution of expected returns is removed. Thus the risk to the operator of making losses on the contract is increased. Even an efficient operator would lose out if profits fell below the 'reasonable' level. Hence, it would appear that an *ex post* test for overcompensation would provide less inducement for efficiencies than would an *ex ante* test.

The Commission's Decision on the application of Article 106(2) TFEU to state aid in the form of public service compensation expressly provides for an *ex post* test.

It also appears that in the framework of the application of Regulation 1370/2007, the Commission considers that possible overcompensation can only be avoided with the

establishment of a mechanism of restitution.¹⁸⁹ Such mechanism has to be structural to allow the automatic adjustment of the compensation.¹⁹⁰

Some current contract practices appear to proceed to a regularisation of the compensation granted, some other contract practices, which aim at transferring some risks to the operators as an incentive to deliver efficient services, appear to calculate the compensation *ex ante*, without any *ex post* regularisation on the basis of the actual cost incurred. These practices could be put into question.

- If the test of overcompensation is to be made *ex post*, another potential uncertainty is the **time period** over which overcompensation is to be assessed. In the Commission's Decision on the application of Article 106(2) TFEU to state aid in the form of public service compensation, the assessment of overcompensation is to be made annually. In the case of a short period of assessment, the question arises of how to treat one-off costs and short-term fluctuations. The shorter the period to be controlled, the smaller the incentive to provide efficient services. If the test for overcompensation is to apply *ex post*, the Commission could usefully indicate the period of assessment.

In the framework of the application of Regulation 1370/2007, the Commission considered that corrections to the compensation due to a variation of the parameters must be applied annually.¹⁹¹

- There might be some doubts regarding what is meant by **reasonable profit**. The annex relating to directly awarded PSC and general rules provides that 'reasonable profit' is '*taken to mean a rate of return on capital that is normal for the sector in a given Member State and taking into account the risk or absence of risk incurred by the public service operator by virtue of public authority intervention*' (e.g. gross cost contract, net cost contract, other risks, regulatory risk, etc.). According to the economic literature, this definition implies that competent authorities shall have to calculate the weighted average cost of capital (WACC) of the operator, meaning the competent authorities shall have to collect detailed information on the operator.¹⁹²

Some guidance might be found in the Commission Decision on the application of Article

¹⁸⁹ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, paras 332 and 352.

¹⁹⁰ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, para 345. Therefore, the Commission considered that a dividend policy to the benefit of the representatives of the competent authority cannot be considered as such a structural mechanism, even if it actually leads to the same result.

¹⁹¹ C 41/08 (ex NN 35/08), *Public service contracts between the Danish Transport Ministry and Danske Statsbaner*, para 332.

¹⁹² Oxera, 'Funding public transport services: in need of standard regulation tools?', June 2008, 2.

106(2) TFEU, which is not applicable to state aid in the form of public service compensation in land transport (Article 2(2)) but is nevertheless instructive.¹⁹³ In this Decision, the Commission states that the rate of return on capital shall not normally exceed the average rate for the sector concerned in recent years. The Commission also allows the EU Member States to introduce incentive criteria relating, in particular, to the quality of service provided and gains in productive efficiency.

This concept was verified by the Commission in its decision regarding PSC between the Danish Transport Ministry and Danske Statsbaner.¹⁹⁴ In that decision, the Commission recognised that the reasonable profit could vary so as to integrate incentives for costs reduction and for the volume of passengers transported.¹⁹⁵ Such variations were considered as being in line with paragraph 7 of the Annex to Regulation 1370/2007.¹⁹⁶ As to these variations, the Commission appeared to allow a longer time period to be taken into consideration than for corrections of compensation.¹⁹⁷

In the same Decision, when determining the reasonable profit, the Commission took into account the risk transferred to the public transport operator since the contractual payments were fixed in advance and could not be increased in the event of a negative difference to the provisions showing a degradation of the public transport operator's performance caused for instance by a derive of costs or a reduction of revenues.¹⁹⁸

Compensation provided for pursuant to a contract awarded after a competitive tender in DE

The German county of Rhein-Neckar-Kreis has recently awarded a PSC to PalatinaBus GmbH. Under this contract, the amount for compensation is determined *ex ante* by the bidder in its offer. The estimate of the bidder covers the vehicle costs, the labour costs, the energy costs and other costs and reduced with an estimate of all income generated on the bundle of lines making the scope of the PSC. This amount is paid in monthly instalments and in part at the end of the year. If it would appear that the paid amount was too high or too low compared with the compensation the operator was in fact entitled to (e.g. due to a variation in the

¹⁹³ Decision of 28 November 2005 on the application of Article 86(2) of the EC Treaty to State aid in the form of public service compensation granted to certain undertakings entrusted with the operation of services of general economic interest, [2005] OJ L312/67, para 5.4.

¹⁹⁴ C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and Danske Statsbaner, C(2010) 975 final, paras 352 and seq.

¹⁹⁵ It is to be noted in the Decision, N207/2009 - *Financing of the transport services in district of Wittenberg*, which was examined before the entry into force of Regulation 1370/2007, the Commission considered that incentives such a lump sum for per passenger can make part of a reasonable profit.

¹⁹⁶ C 41/08 (ex NN 35/08), Public service contracts between the Danish Transport Ministry and Danske Statsbaner, C(2010) 975 final., para 355.

¹⁹⁷ Ibid., para 354.

¹⁹⁸ Ibid. para 362.

number of KM effectively run), PalatinaBus GmbH will have to reimburse the excess or will be entitled to be paid for the undercompensated services provided.

On the basis of our analysis of Regulation 1370/2007 and of the data available to us, we could not identify examples of best practice on compensating for PSO in the framework of a directly awarded contract. For the costs to be taken into consideration, see above.

4.7 Undercompensation

Many stakeholders emphasised the absence of an obligation made to competent authorities under Regulation 1370/2007 fully to compensate the public transport operator as being a problem.

Some stakeholders have highlighted that the possibility of undercompensation '*might be used by an Authority to discourage bids from commercial enterprises enabling it to make a direct award*'. In this case, undercompensation would constitute a way to circumvent the principle of competitive tendering.

Undercompensation is also held to imply poor quality of service, if not disruption, in some countries.¹⁹⁹

Regulation 1370/2007 clearly states the prohibition of overcompensation. As regards undercompensation, although there is no express prohibition of undercompensation stated in Regulation 1370/2007, it might be considered that the Regulation is not entirely silent and neutral in this respect.

Regarding PSC awarded after a competitive tendering, there is no provision in Regulation 1370/2007 imposing or suggesting an obligation of compensation of PSO. This might be justified by the fact that Regulation 1370/2007 imposes the contractualisation of PSO, and hence the adherence of both parties - the competent authority and the operator - to the possible financial arrangements. This solution appears to have been suggested in the *Combus* judgment, based on Regulation 1191/69 and according to which the common procedures of compensation were not applicable to contracts. Yet, undercompensation of PSO provided under PSC awarded after a competitive tendering may be found contrary to the Public Procurement rules or the general Treaty rules (see section 3.4.2b)).

Regarding general rules and PSC awarded directly, the justification of contractual freedom would appear less convincing, since the public transport operator has not had the choice to provide the PSO, which, by definition, are services that, if the operator were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions without reward.

¹⁹⁹ See J. Pucher and R. Buehler, 'Transport Policy in Post-Communist Europe', available at: <<http://policy.rutgers.edu/faculty/pucher/PDF%20of%20chapter.pdf>>.

Regarding the general rules, Article 3(2) states that '(...), the competent authority shall compensate the public transport operators for the net financial effect, positive or negative, on costs incurred and revenues generated in complying with the tariff obligations established through general rules in a way that prevents overcompensation' (emphasis added). Hence it would appear that the Regulation obliges competent authorities which lay down general rules to compensate the public transport operators.

Regarding both the general rules and PSC directly awarded, paragraph 3 of the Annex reads as follows:

'Compliance with the public service obligation may have an impact on possible transport activities of an operator beyond the public service obligation(s) in question. In order to avoid overcompensation or lack of compensation, quantifiable financial effects on the operator's networks concerned shall therefore be taken into account when calculating the net financial effect' (emphasis added).

This paragraph shows the initial premise of Regulation 1370/2007 that PSO would not be performed or would not be performed under the same conditions without reward.

In addition, Regulation 1370/2007 should be read in conjunction with Article 14 TFEU, which reads:

'Without prejudice to Article 4 of the Treaty on European Union or to Articles 93, 106 and 107 of this Treaty, and given the place occupied by services of general economic interest in the shared values of the Union as well as their role in promoting social and territorial cohesion, the Union and the Member States, each within their respective powers and within the scope of application of the Treaties, shall take care that such services operate on the basis of principles and conditions, particularly economic and financial conditions, which enable them to fulfil their missions. The European Parliament and the Council, acting by means of regulations in accordance with the ordinary legislative procedure, shall establish these principles and set these conditions without prejudice to the competence of Member States, in compliance with the Treaties, to provide, to commission and to fund such services' (emphasis added).

Hence, it would appear that undercompensation is not allowed under Regulation 1370/2007. Therefore efficiency incentives consisting for instance of subsidy caps could be considered as running contrary to Regulation 1370/2007. These incentives could be revised in a way consistent with the principles set out above (see section 4.6).

It is to be noted that, in some EU Member States, there is a legal obligation to give a fair remuneration for the discharge of PSO (e.g. the LOTI in FR). ²⁰⁰
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²⁰⁰ Loi n°82-1153 du 30 décembre 1982 d'orientation des transports intérieurs, Article 6.

4.8 Cross-subsidisation

Article 1(5) of Regulation 1191/69 provided for the separation of accounts where an operator engages not only in public transport services but also in other activities. Regulation 1370/2007 only provides for a specific rule to avoid cross-subsidisation in the event of general rules imposed or when PSC have been awarded **directly** and the public transport operator not only operates compensated services subject to PSO but also engages in other activities (Annex para 5). This specific rule stipulates that:

- the operating accounts corresponding to each of these activities must be separate and the proportion of the corresponding assets and the fixed costs must be allocated in accordance with the accounting and tax rules in force;
- all variable costs, an appropriate contribution to the fixed costs and a reasonable profit connected with any other activity of the public transport operator may under no circumstances be charged to the public service in question;
- the costs of the public service must be balanced by operating revenue and payments from public authorities, without any possibility of transfer of revenue to another sector of the public transport operator's activity.

In the railway sector, Article 9(4) of Directive 91/440 contains a provision on accounting separately for public passenger services that are publicly subsidised and the prohibition of transfers from this account to other activities. Hence, the obligation of accounting separation as contained in the annex of Regulation 1370/2007 has already been partially executed.

In general, Commission Directive 2006/111 on financial transparency imposes the separation of accounts for different activities.²⁰¹ This Directive shall in general apply in cases where Regulation 1370/2007 applies (application to undertakings which enjoy exclusive or special rights and/or have been entrusted with the discharge of SGEI against compensation). However, this Directive excludes from its scope '*undertakings which have been entrusted with the operation of services of general economic interest pursuant to Article [106](2) of the Treaty if the compensation they receive, in any form whatsoever, was fixed for an appropriate period following an open, transparent and non-discriminating procedure*' (Article 5(2)(c)).

Since Regulation 1370/2007 does not define the concept of cross-subsidisation and only provides a rule in a particular event (for directly awarded PSC/General rules whereas cross-subsidisation might also be prohibited in the realm of PSC awarded after a competitive tendering and between compensated services and others), it is worth briefly describing the phenomenon of cross-

²⁰¹ Commission Directive 2006/111/EC of 16 November 2006 on the transparency of financial relations between Member States and public undertakings as well as on financial transparency within certain undertakings, [2006] OJ L318/17-25 (hereinafter, 'Directive 2006/111').

subsidisation in the context of services of general economic interest (SGEI).²⁰² In the words of the Commission, '*[c]ross-subsidisation means that an undertaking bears or allocates all or part of the costs of its activity in one geographical or product market to its activity in another geographical or product market.*'²⁰³ As regards SGEI, cross-subsidisation may basically occur in three different ways:

- (i) between services which are reserved/provided under PSO/subsidised to one undertaking (hereinafter, the 'reserved services'), generally the incumbent in network industries;
- (ii) from competitive activities to the reserved services/under PSO/subsidised services;
- (iii) from the reserved services/under PSO/subsidised services to competitive activities.²⁰⁴

There are different methods provided by economists to identify the existence of cross-subsidy, each of them having its drawbacks and specific outcome. These methods look at the cost allocation:

- Fully Allocated Cost (FAC) method which involves all costs (fixed, variable and common) being allocated to particular outputs.
- Long Run Average Incremental Cost (LRAIC) method which would consider those costs that can be avoided in the long run if the provision of the PSO ceases. It would include all fixed costs of the PSO, and may include some common costs if these would be avoided in the long run were the PSO no longer produced.
- Average variable costs only include those costs that vary with output (i.e. no fixed or common costs).

In principle, cross-subsidisation would be minimised if all costs, including fixed and common costs, were allocated between PSO and non-PSO activities. However, there may still be scope for cross-subsidisation depending on the way that common costs are allocated (e.g. on the basis of revenue or share of assets, etc.).

Once cross-subsidisation has been identified, it does **not necessarily follow** that there is a **breach** of the Treaty provisions. It is not *per se* illegal to cross-subsidise. The concept of cross-subsidisation only means that the costs of providing one particular service are not covered by the price charged for it but by the price charged for another service. The fact that the costs of one particular service are borne by the consumers of another service may be found illegal under European law and in particular under Articles 101 (prohibition of illegal agreements), 102 (prohibition of abuses of dominant position) and 107 (prohibition of illegal state aid) TFEU **only if** the conditions of application of these Articles are fulfilled.

²⁰² For an in-depth analysis of the phenomenon of cross-subsidisation regarding EC Competition law, including the state aid rules, see L. Hancher and J.-L. Buendia Sierra, 'Cross-Subsidization and EC Law' (1998) CML.Rev 901-45 and G. B. Abbamonte, 'Cross-Subsidisation and Community Competition Rules: Efficient Pricing Versus Equity' European Law Review (1998) E.L. Rev. 414-433.

²⁰³ Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services [1998] OJ C39/2.

²⁰⁴ L. Hancher and J.-L. Buendia Sierra, 'Cross-Subsidization and EC Law' (1998) CMLR 901, 905.

The Commission already stated that the two first examples of cross-subsidisation (between reserved services and from competitive activities to reserved services) are not such as to fulfil those conditions;²⁰⁵ in the first case, because there is no competition and, in the second, because it generally does not reinforce the dominant firm but actually disadvantages it. Indeed, in this second case, such cross-subsidy is likely to enhance quality of service, should the operator be willing (or obliged by contract) to behave in such a way.²⁰⁶ In these cases, competition is thus unlikely to be restricted.²⁰⁷

Regarding the first example (between reserved services), cross-subsidisation, as a means to finance public services, was even legitimised and considered as necessary by the ECJ in the *Corbeau* judgment.²⁰⁸ Similarly, cross-subsidisation was recognised by the General Court as necessary to preserve the stability of the health insurance market in the *BUPA* judgment.²⁰⁹ This case law recognised that public service providers should be protected from cherry-pickers grabbing the benefits of profitable services. Directive 2007/58/EC concerning the opening up of international passenger transport services, including cabotage, legally expresses the possibility of restricting competition in order to ensure that such a cross-subsidisation maintains the 'economic equilibrium' of PSC.²¹⁰

Regarding the second example (from commercial services to reserved services), cross-subsidisation is normally not considered as contrary to EU law. However, this type of cross-subsidisation by dominant companies could in some circumstances qualify as illegal predatory pricing, if the conditions of Article 102 TFEU are fulfilled (see section 3.4.2). As highlighted by some public transport operators, it could also prevent an efficient pure-play firm from being able to win a tender, if other firms are building a cross-subsidy into their bids. It might also simply constitute a breach of the terms of the PSC.

Regarding the third example (from reserved services to commercial services), cross-subsidisation shall amount to an illegal state aid where exclusive right or compensation by the competent authorities has been granted.²¹¹ It might also constitute an abuse of dominant position, unless there is no dominance and no evidence that the cross-subsidy stems from abusive practices.²¹²

²⁰⁵ See for instance, Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services, [1998] OJ C 39/2.

²⁰⁶ It is though to be noted that such cross-subsidisation may be detrimental to other types of services which are also promoted under EU law, such as rail freight services.

²⁰⁷ Faull & Nipkay, *The EC Law of Competition* (2nd edn Oxford University Press, New York 2007) 394.

²⁰⁸ Case C-320/91 *Criminal proceedings against Corbeau* [1993] ECR I-2533. See also E. Szyszczak, *The Regulation of the State in Competitive Markets in the EU* (Hart Publishing, Oxford 2007) 249.

²⁰⁹ Case T-289/03 *British United Provident Association Ltd (BUPA) and Others v Commission of the European Communities* (CFI 12 February 2008). For a comment on the case, see A. Biondi, 'BUPA v Commission: Annotation' (2008) 2 *EstAL*, 401.

²¹⁰ Directive of the European Parliament and of the Council of 23 October 2007 amending Council Directive 91/440/EEC on the development of the Community's railways and Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure, [2007] OJ L 315/44–50.

²¹¹ Joined cases C-83/01 P, C-93/01 P and C-94/01 P, *Chronopost* [2003] ECR I-6993.

²¹² Case T-157/99, *UPS v. Commission* [2002] ECR II-1965, para 61.

On the basis of these principles, contrary to some opinion given in some contributions received, there is no guarantee that competitive tendering would as such avoid illegal cross-subsidisation.

Therefore, account separation and cost allocation rules are a general recommendation for PSC awarded to operators active in both PSO and commercial services.

This would require a **clarification** by the Commission with a view to avoiding distortions of competition and the use of public money for commercial activities.

4.9 Procedural aspects

Duration

Article 4(3) further provides that the duration of PSC shall be limited:

- to 10 years for coach and bus services; and
- to 15 years for rail, unless the PSC has been directly awarded in case of which the duration may not exceed 10 years, and other track-based modes.

Where the PSC relate to several modes of transport, the maximum duration of the contract shall be determined by the representation of modes in the value of the services. If rail services or other track-based modes represent more than 50% of the value of the services, the maximum duration of the contract shall be 15 years.

The maximum duration of the PSC may be extended by 50% if such an extension has been rendered necessary by the conditions of asset depreciation or in the outermost regions (Article 4(4)).

In any case, if justified by the amortisation of capital in relation to exceptional infrastructure, rolling stock or vehicular investment and if the PSC are awarded in a fair competitive tendering procedure, PSC may have a longer duration (Article 4(4)).

However, contracts awarded before 26 July 2000 on the basis of a fair competitive tendering procedure may continue until they **expire**. The same shall apply to other contracts awarded prior to 26 July 2000 and contracts awarded on the basis of a competitive tender after 26 July 2000 but before 3 December 2009, with a limitation of 30 years. Other contracts awarded before the entry into force of Regulation 1370/2007 may continue until they expire if they are of a limited duration, as anticipated in Article 4. The same applies for any PSC where their termination would entail undue legal or economic consequences, upon the approval of the Commission.

In general, it appeared from the contributions received that current practices are already in line with the maximum duration of PSC.

However, current PSC in some EU Member States have been secured at their maximum possible duration. This is the case in France which has, by law, fixed the duration of current PSC for the Region of Ile de France until 31 December 2024 for road transport services, 31 December 2029 for tramway services and 2039 for metro services and other guided means of transport (such as suburban trains).²¹³

It would appear that this transitory period raises some interpretation issues. On 13 January 2010, a written question was raised by Nathalie Griesbeck (ALDE) and Marielle De Sarnez (ALDE) to the Commission concerning the French draft law on the 'Greater Paris' and its compatibility with the provisions of Regulation 1370/2007 and more specifically whether the *'Commission believes that it is possible to give the SNCF and the RATP exclusive contracts to run transport by bus, tram and underground until 31 December 2024, 2029 and 2039 respectively, despite the fact that the taxpayer would at the same time be bearing the financial risks taken on by these public enterprises outside the Greater Paris area?'*²¹⁴

M. Kallas responded, on behalf of the Commission, that the Commission was aware of the draft law but considering the fact that it was still under review by the French government, the Commission did not need to verify, at this stage, if it was compatible with EU legislation.²¹⁵ However, the Commission emphasised that the PSC existing on 3 December 2009 and awarded without a competitive tendering procedure before 26 July 2000 may continue until they expire but for no longer than 30 years, meaning, according to the Commission, at the latest on 25 July 2030.²¹⁶

RATP emphasises that the contracts have been secured not only for RATP but also for other public service operators. It also recalled that the French law has been adopted in the context of the improvement of public funds and the reduction of the debt. In addition, the project 'Grand Paris' is an infrastructure project not covered by Regulation 1370/2007. Regarding Article 8(3), RATP considers that, in the absence of an express identification of the starting point of the 30 years period, that provision can only govern situations as they are after the entry into force of Regulation 1370/2007 with a view to ensuring legal certainty and legitimate expectations. Hence, the starting point for the period of 30 years is the entry into force of Regulation 1370/2007. Finally, RATP refers to the interpretation of Article 8(3) first given by the Commission in 2008 in its invitation to submit comments pursuant to Article 108(2) TFEU concerning the reform of the method by which RATP finances its pension

²¹³ Ordonnance n°59-151 du 7 janvier 1959 relative à l'organisation des transports de voyageurs en Ile de France, modifiée par la loi n°2009-1503 du 8 décembre 2009, Article 5.

²¹⁴ See Parliamentary question of MEP N. Griesbeck and M. De Sarnez, 13 January 2010, E-6628/09 <<http://www.europarl.europa.eu/sides/getDoc.do?type=WQ&reference=E-2009-6628&language=EN>>.

²¹⁵ See Parliamentary response of MEP M. Kallas, 4 March 2010, E-6628/09 <

<http://www.europarl.europa.eu/sides/getAllAnswers.do?reference=E-2009-6628&language=EN>>.

²¹⁶ Ibid.

scheme.²¹⁷ In this invitation, the Commission states that '*The future PSO Regulation provides for an opening-up of the public transport market which is staggered over time. Article 8(3) of the Regulation allows public transport companies in Île-de-France to maintain their exclusive rights for a period of 30 years after the entry into force of the Regulation*' (emphasis added). The Commission further states that '*the effective opening up of public transport in the Parisian region, which will be able to intervene as late as 30 years after the entry into force of the new PSO Regulation*' (our translation - emphasis added).²¹⁸

The Commission is however of the opinion that its appreciation in an opening decision in a state aid case is always provisional so that it cannot raise any legitimate expectation vis-à-vis its first analysis. *In casu*, this provisional appreciation of the Commission has not been confirmed in the final decision of July 2009 which was issued well before the conclusion of the new contract between the Region and RATP.

One could have also understood Article 8(3) as meaning that PSC directly awarded before 26 July 2000 or awarded after a competitive tender as from 26 July 2000 and before 3 December 2009 may continue until they expire but, if their length exceeds 30 years, in any case not longer than 30 years after their award. Under such interpretation, it would have not been possible to intervene *a posteriori* in the contract to extend its length which would have been limited to 26 July 2030 at the latest. One could also wonder whether such extension of contracts by law effectively guarantees the competent authority's freedom of choice of the operator provided for in Regulation 1370/2007.²¹⁹

If the duration of a contract must be set out to conform to Article 4(3) (10 years maximum for coach and bus services and 15 years for rail services or other track-based modes), the concrete choice is to be adopted on the basis of a trade-off between the need to ensure competition and the need to ensure long-term investment. Indeed, many stakeholders highlighted the need for a long-term framework enabling planning. Every particular situation should be evaluated in this respect.

Review mechanism

Article 5(7) of Regulation 1370/2007 reads as follows:

'Member States shall take the necessary measures to ensure that decisions taken in accordance with paragraphs 2 to 6 may be reviewed effectively and rapidly, at the request of any person having or having had an interest in obtaining a particular contract and who has been or risks being harmed by an alleged infringement, on the grounds that such decisions have infringed Community law or national rules implementing that law.

Where bodies responsible for review procedures are not judicial in character, written reasons for their decisions shall always be given. Furthermore, in such a case, provision must be made so that any alleged illegal measure taken by the review body or any alleged defect in

²¹⁷ State aid C 42/07 (ex N 428/06) — Reform of the method by which RATP (the Paris public transport operator) finances its pension scheme, Invitation to submit comments pursuant to Article 88(2) of the EC Treaty.

²¹⁸ Ibid, para 152.

²¹⁹ See Article 5 in combination with Recital 9.

the exercise of the powers conferred on it may be the subject of judicial review or review by another body which is a court or tribunal within the meaning of Article 234 of the Treaty and independent of both the contracting authority and the review body.' (emphasis added)

Where Public Procurement Directives apply to the award of PSC, the Remedies Directives relating to Directive 2004/18 and Directive 2004/17 provide for various remedies.²²⁰ Three main types of remedies can be summarised as follows:²²¹

- Member States adopt the necessary measures to ensure that procurement decisions may be reviewed effectively and, in particular, as rapidly as possible.
- Member States adopt the necessary measures to ensure that specific forms of relief are made available (e.g. interim measures, setting aside of unlawful decisions, and damages).
- Member States adopt the necessary forum and procedure such as effective enforcement of the review decisions.

Under the Public Procurement Directives, it is worth noting that a contract may not be concluded following the decision to award before the expiry of a certain period of time (10 or 15 calendar days – standstill period) with effect from the day following the date on which the contract award decision is sent to the tenderers and candidates concerned.

Hence, the review mechanism provided for in the Remedies Directives relating to the Public Procurement Directives is more descriptive and more complete. The standstill period also constitutes a strong tool for an effective recourse because, on the one hand, it encourages the authority to scrupulously respect the Public Procurement rules and, on the other hand, if the award procedure were to be illegal, there is still a real chance for a new procedure or a new decision and not only for possible damages.

Recital 21 of Regulation 1370/2007 also suggests that:

'an effective review procedure is needed and should be comparable, where appropriate, to the relevant procedures set out in Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts and Council Directive 82/13/EEC of 25 February 1992 coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunication sectors'.

Public procurement review mechanism in ES

²²⁰ Council Directive 89/665/EEC of 21 December 1989 on the coordination of the laws, regulations and administrative provisions relating to the application of review procedures to the award of public supply and public works contracts, [1989] OJ L395/3 and Council Directive 92/13/EEC of 25 February 1992 coordinating the laws, regulations and administrative provisions relating to the application of Community rules on the procurement procedures of entities operating in the water, energy, transport and telecommunications sectors [1992] OJ L 76/14.

²²¹ S. Arrowsmith, *The Law of Public and Utilities Procurement* (Sweet & Maxwell, London, 2005), 1388 et seq.

In ES, the Law 30/2007 of 30 October regarding PSC (revised by the Law 34/2010 of 5 August) establishes the appeal procedures against award procedures in the transport, energy and water sectors.

On the basis of that Law, the decision of an award is notified to the interested parties. All the persons affected by the award decision can appeal against it. The competent entity to decide against the appeal in first instance is the person in charge of the administrative organ of the public entity awarding the contract (Article 37(4)). The deadline to proceed with the appeal is 10 working days counted after the official notification of the appealed decision (Article 37(6)). The exercise of the right to appeal freezes the entire proceeding until a final decision has been issued by the competent organ. This means that the award decision or the evaluation of the proposals will not be effective until the decision regarding the grounds for the appeal. The first instance administrative decision can only be challenged according to the general administrative procedure, as established by the Law 29/1998 of 13 July regulating the administrative procedure.

It would appear from the answers received that it is not entirely clear that the obligation to ensure an effective and rapid review procedure applies to all types of PSC irrespective of the way they were awarded. However, even if no specific measure has been adopted in these EU Member States, it is possible that the general administrative or civil law would apply as to catch the award procedures. There might be a need to raise awareness of this provision of Regulation 1370/2007 so as to guarantee effective and rapid review procedures.

Some current review procedures were put into question by some stakeholders, indicating their doubts as to the effectiveness of these procedures. This is the case where the contract constitutes a concession not subject to the Public Procurement rules. Again, there might be a need to raise awareness on this provision of Regulation 1370/2007 as to guarantee effective and rapid review procedures.

In any case, it might be useful for EU Member States to rely on the Public Procurement rules to guarantee effective and rapid review procedures.

Transparency

Transparency is a key principle for competitive markets and to guarantee the absence of illegal state aid. When PSC are directly awarded, compliance with the Treaty is ensured by transparency.²²²

Article 7(2) of Regulation 1370/2007 reads:

²²² Case C-231/03 *Coname* [2005] ECR I-7287.

'Each competent authority shall take the necessary measures to ensure that, at least one year before the launch of the invitation to tender procedure or one year before the direct award, the following information at least is published in the Official Journal of the European Union:

(a) the name and address of the competent authority;

(b) the type of award envisaged;

(c) the services and areas potentially covered by the award.

Competent authorities may decide not to publish this information where a public service contract concerns an annual provision of less than 50 000 kilometres of public passenger transport services.

Should this information change after its publication, the competent authority shall publish a rectification accordingly as soon as possible. This rectification shall be without prejudice to the launching date of the direct award or of the invitation to tender.

This paragraph shall not apply to Article 5(5)'. (emphasis added)

Article 7(2) of Regulation 1370/2007 imposes the publication, **one year before** the invitation to tender or before the direct award of the basic information relating to the prospective contract. This obligation does not apply to small contracts nor to contracts concluded under urgent circumstances. Should the situation change in the meanwhile, rectification can be brought to the announcement, without impacting the prospective date for the launch of the award procedure or the direct award.

This provision would allow potential operators to express their interest in the prospective contract and possibly trigger a change in the award procedure.

Prior information notices

The Bayerische Eisenbahngesellschaft mbH (BEG), competent authority for organising local public railway services has published in the Official Journal of 18 August 2010 a prior information notice to announce that it will proceed to an open call for tenders for the route Nuremberg-Ingolstadt-Munich (2010/S 159-245972).

The Syndicat Intercommunal des Transports Publics (SITP) de Cannes published on 10 July 2010 a prior information notice announcing the future award of a delegation of public service for the exploitation of the urban transport network within the perimeter of Transports Urbains (PTU) des villes de Cannes. The procedure will be based on an open call for tender with a negotiated procedure pursuant to the Code general des collectivités territoriales (2010/S 132-203249).

The Ministry of Transport in AT published on 12 December 2009 a prior information notice on the basis of Article 7(2) of Regulation 1370/2007 for the direct award of a contract for railway services pursuant to Article 5(6) of the regulation (2009/S 240-343648).

Some stakeholders fear that changes during the year before the launch of the procedure or the direct award may raise legal doubts about the validity of a decision adopted afterwards. The provision clearly states that modifications are possible, subject to a rectification notice, and without prejudice to the

scheduled date. Hence, on the basis of this provision, there is no specific circumstance to be met in order to be able to bring changes to such notifications.

Some stakeholders seem also not to list in the transparency requirements this particular obligation. Hence, there might be a need to raise awareness of this provision.

On the basis of Article 7(3), the competent authority has to publish the following information when PSC have been awarded directly for railway services on the basis of Article 5(6) within one year of granting the award:

- Name of the contracting entity, its ownership and, if appropriate, the name of the party or the parties exercising legal control.
- Duration of the PSC.
- Description of the passenger transport services to be performed.
- Description of the parameters of the financial compensation.
- Quality targets, such as punctuality and reliability and rewards and penalties applicable.
- Conditions relating to essential assets.

4.10 Economic equilibrium and levy

Directive 2007/58 of the European Parliament and of the Council amending Council Directive 91/440/EEC on the development of the Community's railways and Directive 2001/14/EC on the allocation of railway infrastructure capacity and the levying of charges for the use of railway infrastructure (hereinafter, 'Directive 2007/58'), was adopted on 23 October 2007, on the same date as Regulation 1370/2007.²²³ This piece of legislation is part of the so-called third railway package.

The main objective of the Directive is to promote rail transport services in order to provide consumers alternatives to air transportation, especially to low-cost airlines, in a more environmentally friendly fashion.²²⁴ Therefore, the Directive opens up to competition the international rail passenger services as from 1 January 2010. Cabotage is included as long as it is ancillary to the international service.²²⁵ However, the access rights to international routes may be postponed until 1 January 2012 in Member States where international passenger services constitute more than a half of the passenger turnover of railway undertakings.²²⁶ The Directive had to be brought into force in national law before 4 June 2009.²²⁷

Relation to Regulation 1370/2007

²²³ [2007] OJ L315/44.

²²⁴ Recital 5.

²²⁵ Article 1(8), new Article 10(3)(a) of Directive 91/440/EEC and Article 1(3), new Article 3 fifth indent of Directive 91/440/EEC and Recital 8.

²²⁶ Article 1(8), new Article 10(3)(a) of Directive 91/440/EEC. This provision should allow Luxembourg to prepare the CFL to the opening up of the market.

²²⁷ Article 3(1).

The new Article 3(b) of Directive 91/440 reads as follows:

'Member States may limit the right of access defined in paragraph 3a on services between a place of departure and a destination which are covered by one or more public service contracts conforming to the Community legislation in force. Such limitation may not have the effect of restricting the right to pick up passengers at any station located on the route of an international service and to set them down at another, including stations located in the same Member State, except where the exercise of this right would compromise the economic equilibrium of a public service contract'.

This provision may raise questions as to the possible conferral of exclusive rights under PSC within the scope of Regulation 1370/2007 and the prohibition to restrict the right of Railway Undertakings to pick up passengers at any station located on the route of an international service and to drop them off at another, including stations located in the same Member State.

Indeed, section 4.3 analysed the concept of 'exclusive rights' used in Regulation 1370/2007. It was concluded that the concept used in the Regulation appears to relate to the concept used in Article 106 TFEU as interpreted by the ECJ, and does not create a new concept. Depending on the breadth of the interpretation, the conferral of 'exclusive rights' would exclude the other operators from providing a similar service (passenger transport service) in the same territory. Such conferral of exclusive rights to a Railway Undertaking may be considered as contrary to the access rights from which Railway Undertakings benefit under Directive 2007/58 and in particular their right of cabotage relating to an international railway transport service. However, Article 10(3)(c) of Directive 91/440 as modified by Directive 2007/58 provides for a specific exception to cabotage where the exclusive rights have been granted under a concession contract awarded before 4 December 2007 on the basis of a fair competitive tendering procedure and in accordance with the relevant principles of European law. This exception can last for the original duration of the contract without exceeding 15 years.

Hence, exclusive rights conferred to a Railway Undertaking for the provision of PSO should take such right to cabotage of other Railway Undertakings into account. Concession contracts awarded in NL before 4 December 2007 may continue to refer to a wide interpretation of 'exclusive rights' as to encompass a territory.

For an example of exclusive rights which would not run contrary to this Directive, see section 4.3.2.

The Commission could clarify the interplay of both pieces of legislation.

Restrictions on the right of access

Directive 2007/58 provides Member States with the possibility of limiting (including denying) access rights (Article 1 (8) inserting Article 10(3)(b) in Directive 91/440/EEC). Limitations may be decided *'...where the exercise of this right would compromise the economic equilibrium of a public service*

contract (emphasis added). New Article 10(3)(b) of Directive 91/440 further states that: '[w]hether the economic equilibrium would be compromised shall be determined by the relevant regulatory body or bodies referred to in Article 30 of Directive 2001/14/EC on the basis of an objective economic analysis and based on pre-determined criteria (...)'.²²⁸

Recital 12 of the Directive gives examples of the predetermined criteria which can be taken into account to determine whether the PSC economic equilibrium would be compromised: the impact on the profitability of any services which are included in PSC, including consequential impacts on the net cost to the competent public authority that awarded the contract, passenger demand, ticket pricing, ticketing arrangements, location and number of stops on both sides of the border and timing and frequency of the proposed new service.

Recital 12 further explains that if a contract were to be compromised, it can be decided to authorise, modify or even deny the right of access for international passenger services sought and/or impose a levy.

It appeared that the determination beforehand of the criteria on the basis of which the RB shall assess whether the economic equilibrium of PSC would be compromised by an international service is either the responsibility of the RB or the legislator. It is true that the Directive merely states that the assessment of the RB shall be made on the basis of pre-determined criteria, without specifying who is responsible for defining these criteria. However, the Commission appears to favour an interpretation according to which these criteria are to be set out by the RB and not the legislator. The Commission could usefully clarify its position.

Subject to the Commission's clarification of the entity responsible for determining these criteria, the following examples of best practice have been identified.

Criteria to assess the threat to the economic equilibrium of PSC defined by law in PL

The criteria on the basis of which the analysis is carried out, as to whether the planned international service compromises the economic equilibrium of services provided on the basis of public services contracts, are defined in the Regulation of the Minister of Infrastructure of 30 December 2009 on the access to the infrastructure by railway undertakings having their principal place of business in another Member State of the European Union or in a Member State of the European Free Trade Association (EFTA) (Journal of Laws of 2010, No. 2, Item 7).

On the basis of the Polish Regulation, the RB, when assessing whether an international service would

²²⁸ Article 1(8), new Article 10(3)(b) of Directive 91/440/EEC and Recital 12. The reference to the economic equilibrium of a public service contract stems from the *Corbeau* judgment, Case C-320/91 *Corbeau* [1993] ECR I-2533. See also Case C-393/92 *Gemeente Almelo and others v Energiebedrijf Ijsselmij* [1994] ECR I-1477.

compromise the economic equilibrium of services provided on the basis of PSC, takes the following criteria into account: the days and times that the trains stop at railway stations, the frequency that the trains run in a given time period as well as the number of connections, the number of seats offered in first class and second class as well as the categorisation of particular types of cars and types of trains, the categories of the trains, the commercial speed of the train, the tariffs offered, the anticipated proceeds earned from the transport of passengers on the train routes, the profitability of the provision of public services, the amount of compensation borne by the organisation which entered into the contract for providing public services on a given train route, and the number of station stops within the territory of the Republic of Poland and beyond its borders.

Criteria to assess the threat to the economic equilibrium of PSC defined by RB in UK

In the UK, it is the RB, the Office of Rail Regulation (ORR), which has set out criteria.²²⁹ To consider whether the economic equilibrium of PSC has been compromised, there needs to be a material impact on those PSC (moving outside the expected range). This takes account of the expected range of movement in the value of PSC over time, and also recognises the intention of the Directive to encourage competition in the market for international passenger. According to ORR, the impact must be significant enough to impede any competition. The evaluation of ORR will be based on the following criteria:

- profitability of incumbent franchised passenger operator or concession operator;
- likely scope for competitive responses by franchised passenger operator or concession operator;
- to the extent relevant, likely impact on the future value of the PSC when next retendered;
- impact on the long-term profitability of the most profitable routes covered by the PSC;
- specific new costs likely to arise within the operation of the PSC; and
- likely impact on performance costs of the PSC as a result of the new international passenger service.

Levy to finance PSO

Directive 2007/58, without prejudice to the possibility of restricting access rights as a means to preserve PSO, permits Member States to '*authorise the authority responsible for rail passenger transport to impose a levy on railway undertakings providing passenger services*' for domestic routes which are in its jurisdiction.²³⁰

The levy should be imposed on all railway undertakings operating domestic or international services.

²²⁹ ORR guidance on the assessment of new international passenger services, text available at: <http://www.rail-reg.gov.uk/upload/pdf/399.pdf>.

²³⁰ Article 1(8), new Article 10(3)(f) of Directive 91/440/EEC.

The levy shall be designed to compensate the excess costs for carrying out public services, pursuant to Regulation 1370/2007. Such levy consists of a compensation mechanism for PSO not paid by the competent authority, but paid by the sector through a mutualisation of the costs. Its imposition must comply with the principles of fairness, transparency, non-discrimination and proportionality and shall not endanger the economic viability of the rail passenger transport service in question.²³¹

The question is whether such levy could be classed as state aid and be subject to the *Altmark* criteria and to the rule of compensation under Regulation 1370/2007 or not. For a measure to constitute state aid under Article 107 TFEU, four cumulative conditions are to be fulfilled: (1) there must be an intervention by the state or through state resources; (2) that intervention must confer an advantage on the recipient and the advantage must be selective (not general); (3) the intervention must be liable to affect trade between Member States and (4) it must distort or threaten to distort competition.

Regarding the first condition, the fact that the compensation would be paid through a levy imposed on the Railway Undertakings might raise questions about the nature of the state intervention. Indeed, the jurisprudence of the ECJ applies a cumulative test for the first condition so that it requires not only that there is an intervention by the state but that intervention must also be through state resources.²³² One could wonder whether a levy would fulfil this cumulative test. However, the levy could be classed as a particular tax imposed upon the Railway Undertakings, making it public money. It can also be stated that if a levy is being charged, such funding of PSO would occur via the state or under its supervision, so that it would be considered as fulfilling the first condition for having state aid.²³³

Hence, it is highly likely that the same examination as under the *Altmark* ruling and the Regulation would be necessary for the compatibility of the levy with the internal market.

4.11 Passengers' rights

Regulation 1371/2007²³⁴ has been adopted in addition to the CIV Uniform Rules under the COTIF, in order to guarantee an extended scope for passengers' rights.²³⁵ Indeed, Regulation 1371/2007 also applies to domestic railway services (subject to the possible exception as described below) whereas CIV only applies to international traffic.

Regulation 1371/2007 is of direct application in EU Member States to all rail journeys and services throughout the EU provided by one or more licensed Railway Undertaking (Article 2(1)). However,

²³¹ *ibid.*

²³² Joined Cases C-72/91 & C-73/91, *Sloman Neptun*, Case C-189/91 *Petra Kirsammer Hack* □ 1993 □ ECR I-6185, para 17, Joined Cases C-52/97, C-53/97 and C-54/97 *Viscido* □ 1998 □ ECR I-2629.

²³³ In this respect, see the *Poor Farmer Case* which applied an alternative test because the state acted as an intermediary.

²³⁴ Regulation (EC) No 1371/2007 of the European Parliament and of the Council of 23 October 2007 on rail passengers' rights and obligations.

²³⁵ See Recital 6 of Regulation 1371/2007.

domestic rail services may be excluded for three periods of a maximum five years (Article 2(4)). Urban, suburban and regional rail passenger services may also be excluded (Article 2(5) and Recital 26). A further exemption may be granted for particular services or journeys because a significant part of the services is operated outside the EU (Article 2(6)).

Since the rail passenger is the weaker party to the transport contract, according to Recital 3 of Regulation 1371/2007, obligations towards him pursuant to the Regulation may not be limited or waived (Article 6(1)). Only a more favourable system is accepted (Article 6(2)).

Member States designate a body or bodies responsible for the enforcement of Regulation 1371/2007 (Article 30). Penalties are also to be set out by Member States to sanction infringements of the Regulation (Article 32).

According to the study on 'Contracting in urban public transport', '*passenger rights are non-direct incentives, enabling the authority to implement an incentive scheme without bearing the costs of its management and control (e.g. financial compensation in case of not meeting punctuality requirements)*'.²³⁶ This type of incentive proved to raise customer satisfaction sharply while costs are usually lower than expected.²³⁷

In this regard, chapter IV of Regulation 1371/2007 deals with delays, cancellations and missed connections. It provides for the reimbursement of the full cost of the ticket or re-routing of the passenger in the event of a delay of at least 60 minutes. If the ticket has not been reimbursed, the passenger has the right to request compensation without losing his right of transport. The compensation amounts to 25% of the price of the ticket (or half of the price if it is a return) in the event of a delay of 60 to 119 minutes and 50% of the price of the ticket (or half the price if it is a return) when the delay exceeds 119 minutes. The passengers have a right for assistance as soon as a train is subject to 60 minutes of delay. These provisions apply whatever causes the delay or the cancellation.

Thus, as identified in the study on 'Contracting in urban public transport' and in conformity with the objective described in Recital 13, the Regulation puts in place a compensation system that can be seen as an incentive for operators to provide the best efficient and quality services.

Since financial incentive schemes may raise state aid issues, passengers' rights may constitute an alternative incentive scheme for better public service. Therefore, when applying for the possible exemptions granted under Regulation 1371/2007, it might be recommended to EU Member States that they consider their application in the larger remit of public transport policy. In addition, such passengers' rights could also be set out for other land transport means than railways, through PSC.

²³⁶ Study on 'Contracting in urban public transport', 75.

²³⁷ Ibid.

No exemption granted to Regulation 1371/2007 on rail passengers' rights and obligations in DK, IT, NL, SL

Additional passengers rights imposed on the Railway Undertaking in BE

In BE, an exemption to Article 8 and Annex II of Regulation 1371/2007 has been granted for all types of services (domestic, urban, suburban, etc.). The other provisions are of direct application in the Member States. However, the PSC between the Belgian Federal State and SNCB/NMBS provides for an additional compensation for passengers having sustained regular or systematic delays. The compensation amounts to 25% of the ticket price per delay for a minimum of 20 occurrences of more than 15 minutes over a period of six months and to 50% of the ticket price per delay for a minimum of 10 occurrences of more than 30 minutes over a period of six months. It is however to be noted that punctuality remains unsatisfactory according to consumers in BE.

4.12 Conclusions

Despite its direct application (except for the award procedure), the sample of current contracts analysed poorly implement Regulation 1370/2007.

Amongst the contracts analysed (see annex III), only one integrates the mandatory content of Article 4 and, at the same time, provides for a compensation mechanism based on the actual costs incurred (PSC between Kaunas City and UAB Kauno autobusai in LT).

Also, in a single Member State, there are contracts which do (largely) integrate the principles contained in Regulation 1370/2007 and some others which do not (e.g. there is no contract in LT for railway services whereas the present study analysed PSC at local level which are compliant with the Regulation) or not sufficiently. Contrary to a relatively widespread belief amongst competent authorities and public operators, the fact that PSC have been awarded after a competitive tendering process does not necessarily imply a higher level of compliance with Regulation 1370/2007 (e.g. contracts in NL outside railway services). Indeed, it is observed that some directly awarded contracts integrate to a larger extent the principles contained in Regulation 1370/2007 (e.g. PSC in HU, PSC with STIB/MIVB and the Brussels-Capital Region in BE) than some contracts awarded after a competitive tendering (e.g. PSC for the rail services between Gothenburg – Narvik and Stockholm or PSC between the Ústi Region in CZ and Veolia).

Another point worth making is that contracts which were entered into after the entry into force of Regulation 1370/2007 or amended after its publication appear to (largely) comply with the Regulation (e.g. PSC between Kaunas City and UAB Kauno autobusai in LT and PSC between the Hungarian

State and Tisza Volán).

It would appear that there is no specific feature of a competent authority or Member States identifying compliant or non-compliant behaviour.

Finally, as largely shown in the assessment, although a practice can be considered as compliant with the Regulation, such practice may nevertheless be considered as improvable in terms of guaranteeing public transport of quality at the best price for the Community.

5. Recommendations

As analysed in chapter 4, Regulation 1370/2007 raises many questions of interpretation, as there is no case law on it yet and little decisions providing for such interpretation. Besides these questions, it also appeared that the content of the very complex Regulation 1370/2007 is not always known and/or understood.

The present chapter shall make two main recommendations:

- The adoption of an EU action aiming to clarify the way the Commission intends to interpret Regulation 1370/2007 with a view to increasing legal certainty and achieving more harmonisation (5.1).
- The exchanging of best practice and the raising of awareness among the competent authorities and the national/regional/local legislators with a view to fully complying with Regulation 1370/2007 (5.2).

Both recommendations shall be based on the results of the evaluation made under chapter 4 and shall aim to strive to the fulfilment of an integrated, economically and legally suitable market regulation for the provision of public passengers' transport services capable of providing 'value for money'.

5.1 EU action

5.1.1 The choice of the instrument

One of the objectives of the present study is to identify the difficulties in implementing Regulation 1370/2007 and to suggest possible solutions therefor. As highlighted in chapter 4, Regulation 1370/2007 raises several interpretation questions. Hence, many stakeholders called for clarification by the Commission.

Since stability in legislative reform is necessary in general but also in the public transport sector to allow competent authorities to organise public services and operators to develop their commercial strategies, it is not the objective of the present study to propose legislative amendments to Regulation 1370/2007. Such proposal for new legislation could not rely on experience of the implementation of Regulation 1370/2007 justifying its modification. Such proposal may possibly be made after the end of the transitional period, after 3 December 2014, in accordance with Article 11 of Regulation 1370/2007. In addition, regarding the long process which led to the adoption of Regulation 1370/2007 due to the political sensitivity of questions relating to public services, such proposal, even if it were adopted, would not be able to address the questions which exist at present. Therefore, the way of legislative reform is ignored in this study.

There is then a need to determine which instruments of 'soft law' the Commission can use to achieve its policy goals through the encouragement of a correct and efficient implementation of Regulation 1370/2007.

Soft law can be defined as the '*rules of conduct that are laid down in instruments which have not been attributed legally binding force as such, but nevertheless may have certain (indirect) legal effects, and that are aimed at and may produce practical effects*' (emphasis added).²³⁸

Article 17(1) TFEU gives the Commission a general power to promote matters dealt with in the Treaty, either where it expressly provided so or where the Commission believes that it is necessary to do so, provided that the measures taken are in the general interest of the Union. A neat checklist of legislative and non-legislative measures that the Commission intended to take in order to achieve the single market is to be found in its 2000 Review of the Internal Market Strategy.²³⁹ It is clear that the Commission disposes of a broad range of policy instruments to spread its policy goals.

Among the soft law measures available, not all are adequate for the purpose of clarifying how the Commission would monitor the implementation of Regulation 1370/2007 in the EU Member States. Three main categories have been classified by the literature:²⁴⁰

- Preparatory and informative instruments are instruments geared to lead to legislation (such as e.g. Green Papers, White Papers, informative communications, etc.).²⁴¹ Since the objective here is not new legislation, this instrument would not be of any use at the stage considered in the present study. Such instruments might be envisaged at a later stage when, after the transitional period of 10 years provided in Article 11 of Regulation 1370/2007, the Commission will have to present a report on the implementation of the Regulation.
- Steering instruments (both formal and non-formal) aim to establish or give further effect to EU objectives and policies (e.g. opinions and recommendations, for the formal instruments and declarations, resolutions, etc. for the informal ones).²⁴² Recommendations and opinions constitute the principal way in which a policy can be developed within the European Union. The aim is usually to lay down new rules, which are not necessarily linked to existing legislation or Treaty provisions and cannot be said to be inherent in the existing legal framework. Therefore, this type of soft law instrument does not appear to be adequate for the purpose of clarification of the existing legislation.
- Interpretative and decisional instruments are instruments profiled to give guidance for the interpretation of existing EU law. The interpretative instruments are used to indicate how EU law should be applied in the view of the Commission. These types of instruments in general rely on the existing case law. The decisional instruments are often used where the

²³⁸ L. Senden, 'Soft law and its implication for institutional balance in the EC', *Utrecht Law Review*, 79, 81.

²³⁹ COM (2000), 257, final.

²⁴⁰ L Senden, 79, 81.

²⁴¹ *Ibid.*

²⁴² *Ibid.*

Commission has implementing or discretionary powers as it is the case in competition law and in state aid control. They may consist in notices, communications and guidelines.²⁴³

Regarding the nature of Regulation 1370/2007, which mainly deals with state aid control and is on the edge of competition law issues, the Commission may wish to underline how it will act in the event of breach of the Regulation. Therefore, it would appear that the most adequate soft law instrument to clarify Regulation 1370/2007 is a decision.

Hence it is recommended to the Commission to adopt a mixed instrument which would be both interpretative and decisive (similar to the notices issued by DG COMP to explain the way competition regulation shall be monitored).

Such soft law measure, although not having legally binding effect, engages the Commission which has to comply with what it states in its instruments. In addition, the principle of equality also leads this instrument to be applied without the possibility of deviating from it depending on the stakeholders or a particular situation. Hence this instrument is able to achieve legal certainty.

5.1.2 The adoption of Guidelines on the implementation of Regulation 1370/2007

The Commission could as a general recommendation advise competent authorities/legislators to apply the Public Procurement rules as transposed in their national law to the award of PSC even under Regulation 1370/2007. This might however only consist of a recommendation and is not compulsory under the Regulation. However, as shall be discussed in section 5.2, such application is in the interest of the competent authorities.

The Commission's Guidelines will aim at explaining some concepts used in the complex Regulation 1370/2007 as well as the way it considers that the particular competition issues may be dealt with. Therefore, a close cooperation with DG COMP is recommended in the setting out of the principles contained in the Commission's Guidelines.

The Guidelines could follow the structure of the Regulation to facilitate its use by the readers.

²⁴³ Ibid., 82.

Scope (Article 1)

This study has not emphasised difficulties regarding the scope of Regulation 1370/2007 as described in Article 1. There is hence no specific recommendation of clarification in this respect.

Definitions (Article 2)

This study has highlighted some difficulties with the concepts used in Regulation 1370/2007, but these difficulties are rather linked to the substance of Regulation 1370/2007 and not the definitions contained in Article 2 as such.

PSC and general rules (Article 3)

Similar to the definitions contained in Article 2, this provision setting out the principle of contractualisation, and, by way of derogation, the adoption of general rules to establish maximum tariffs does not raise problems of understanding.

Regarding the question raised on undercompensation, the Commission could confirm that where general rules establishing maximum tariffs are adopted, the public authority is obliged to compensate for such obligations which the undertakings had no choice in assuming and which have an impact on their cost structure.

Mandatory content of PSC and general rules (Article 4)

Definition of PSO

The definition of PSO raises two types of question: (1) what can be considered as PSO (2) how far should the PSO be detailed to allow the appropriate control of compliance with Regulation 1370/2007 (and in particular the rule of overcompensation and cross-subsidisation).

(1) On the question of what constitutes PSO, the jurisprudence of the Court of Justice relating to the definition of SGEI could be recalled and its application to define PSO under Regulation 1370/2007 could be confirmed. As examined above, according to that jurisprudence, Member States have a wide discretion to define what they regard as SGEI and the definition of such services by a Member State can be questioned by the Commission only in the event of manifest error. The Commission could also refer to its decisional practice and highlight that, in principle, a Member State does not commit any manifest error when it defines PSO in a way that establishes a coherent transport system with a view to ensuring the continuity of public transport services. This might thus cover specific routes or networks and, within such networks, it might also include profitable routes.

As regards the geographic area concerned, the Commission could also confirm that the PSC may cover other territories than those of the competent authority. In such a case, the Commission could encourage the necessary discussions between the authorities concerned.

(2) On the question of how far the PSO should be detailed to allow appropriate control, the Commission could give some guidance (impact on the control of compensation, cross-subsidy and exclusive rights). Such guidance could take into account the request of public transport operators to have some autonomy in the design of the services as to enhance the quality of their services.

Parameters for compensation and nature and extent of exclusive rights

- As shown in chapter 4, Regulation 1370/2007 does not define the concept of overcompensation under PSC awarded after a competitive tendering. On the basis of the interpretation given in Recital 34 of Article 93 TFEU, it would also appear that overcompensation relates to compensation which exceeds the net costs incurred in carrying out PSO. Therefore, the Commission could indeed clarify the applicable definition of overcompensation also with regard to PSC awarded after a public tendering and explain to what extent the level of compensation, as generated from the competitive tender, should be further subject to control and adaptation or not. Such clarification is even more important since under the *Altmark* criteria which verify the existence of state aid, these contracts benefit from a favourable presumption that they cannot entail overcompensation. However, as shown in the discussion above, this presumption can be rebutted if the price of the contract does not reflect the market price because the tendering process would have relied on the most economically advantageous offer. It would be useful for the Commission to either confirm the same approach as under the *Altmark* criteria for the application of Regulation 1370/2007 or to clarify the possible differences.
- As regards general rules and directly awarded PSC, the parameters for compensation should be established in a way that no compensation payment may exceed the amount required to cover the net financial effect of costs incurred and revenues generated in carrying out the PSO. The parameters are to be set out following the guidance set out in the Annex. Recital 27 also provides that the amount of compensation should be appropriate and should reflect a desire for efficiency and quality of service. The Commission could clarify the interpretation of the 'desire for efficiency': either it is sufficient that the contract provides incentives to the operator to become more efficient over the life of the contract or the contract should only be awarded when the operator is deemed efficient against some benchmark. With a view to allowing competent authorities to have recourse to their internal operator, it might be advisable to favour the first interpretation, as being the one according to which the compensation should

incentivise the public transport operator to reduce its costs.

- The nature and extent of exclusive rights is important information, and in particular regarding the access rights from which the Railway Undertakings benefit with the opening up of international railway services. As examined in chapter 4, it would appear necessary for the competent authority awarding PSC to a Railway Undertaking according exclusive rights in return for carrying out PSO to define those exclusive rights in a way that Directive 2007/58, and in, particular, the right of cabotage, is complied with. As stated in the explanation of the concept of 'exclusive rights' above, this might only lead to actually giving special rights. This might also lead the competent authority to defining the service in a way that other services would be conceived on the same line (e.g. instead of submitting a route or a network to PSO, describing the PSO as relating to a particular service, such as during off-peak hours, etc.). The Commission could explain its views on the interpretation of 'exclusive rights'. Such interpretation would look at the possibility of distinguishing between commercial and PSO services, even if they both relate to the transport of passengers and to the same route, as a way of reconciling the possibility offered under Regulation 1370/2007 and the right provided for under Directive 2007/58.

Costs and revenue allocation

The PSC must contain the arrangements for the allocation of costs and revenues connected with the provision of PSO services. This rule is essential to monitor compensation and - where the public transport operator also engages in commercial activities - possible cross-subsidisation.

As explained in section 4.4, the parties are free to determine cost-allocation arrangements whereas the Annex is applicable for directly awarded PSC and general rules. The recommendation on that particular point will be made below.

Duration of the contracts

The current study has not emphasised particular issues regarding the interpretation of this provision. The interpretation problem related to the duration of the contracts rather relates to the transitional period.

Possible application of Directive 2001/23

The current study has not highlighted particular interpretation problems linked to that provision.

Quality standard

Again, the current study has not highlighted particular interpretation problems linked to that provision.

Subcontracting

The Commission's Guidelines could usefully clarify the subcontracting rule contained in Regulation 1370/2007. A possible interpretation of Article 4(7) could be the following:

The distinction made in Article 4(7) between contracts in which the operators have only the responsibility of the ministry and performance of the service, and in which they also bear the tasks of design, construction and operation of the service, refers to the operational categories of functional and constructive service design, widely spread in public transport jargon. Regarding the control exercised by the competent authorities on the internal operator, PSC awarded to internal operators could be considered as pertaining to the category of constructive service design. In contracts where the competent authority only provides for a functional service design, the operator has a greater responsibility as to the design of the services than where the competent authority proceeds to a constructive service design.

The first category (functional service design) would allow operators to fully subcontract whereas the second (constructive service design) would require operators to perform a major part of the services themselves.

Award of PSC (Article 5)

As shown, there are some uncertainties as to the applicable rules to award procedures. However, Article 5(1) read in combination with Recital 20 would suggest that the award provisions of Regulation 1370/2007 would apply without prejudice to the Public Procurement Directives. The Commission could clarify the applicable rules to the award of PSC.

Internal operator

As emphasised in chapter 4, the concept of internal operator has, at first glance, been developed on the basis of the case law of the ECJ on in-house operators. However, Regulation 1370/2007 provides for a less strict test than the one developed by the ECJ for in-house operators, in its *Teckal* case law. Article 5(2)(a) of the Regulation stipulates that '*100% ownership by the competent public authority, in particular in the case of public-private partnerships, is not a mandatory requirement for establishing*

control within the meaning of this paragraph, provided that there is a dominant public influence and that control can be established on the basis of other criteria'.

Therefore, a case-by-case analysis shall be required. However, to enhance legal certainty, the Commission could usefully provide its interpretation of the provision. The Commission could give examples of companies which, despite private participation, are internal operators.

The concept of internal operator also raises questions as to the interpretation of the territorial confinement with which the operator has to comply with. The Commission could confirm the principle of geographic specificity, which also applies to subsidiaries of the internal operator. The Commission could also recall that such principle is limited to the performance of public passenger transport activity and does not extend to possible ancillary activities, such as consulting. The Commission could also clarify the extent of the geographic confinement, by possibly limiting this condition to the European Union. These elements of interpretation would align with economic reality and necessity.

Competitive tendering

Regarding the competitive tendering procedure as set out in Article 5(3) of Regulation 1370/2007, the extent to which it is possible for the competent authority to negotiate with the tenderers has been questioned. As indicated in the introduction to this section, it would be advisable for EU Member States to rely on Public Procurement rules even for concessions. However, this is a choice to be made by the EU Member States. Therefore, this point is discussed in the following recommendation addressed to the EU Member States.

Public service compensation (Article 6 and Annex)

- As examined in section 4.6, a first question relates to the procedure for examining the compensation. Indeed, the Commission follows a two-stage analysis of a compensation arrangement according to which it first examines whether the compensation is state aid under the *Altmark* criteria and, if so, whether it could nevertheless be exempted from prior notification and considered as compatible with the internal market under Regulation 1370/2007. From a practical point of view, it would appear unnecessary to proceed to such a two-stage review since there is no need to notify a compensation which would comply with Regulation 1370/2007. This approach is however in line with Article 93 TFEU and leaves the distribution of the burden of proof intact.

The Commission could either confirm this approach towards the examination of compensation granted for the discharge of PSO or refer to the *Altmark* ruling according to which *'the provisions of primary law concerning State aid and the common transport policy would be*

*applicable to the subsidies at issue (...) only in so far as, (...), those subsidies did not come under the provisions of Regulation No 1191/69 (...).*²⁴⁴ A confirmation of the two stage approach requires two particular points of caution. First, this approach must not lead the Commission or national courts to interpret the conditions set out in Regulation 1370/2007 as would be the case under the *Altmark* conditions, otherwise it would be restrictive of Regulation 1370/2007 which aims to exempt the categories of compensation fulfilling the conditions of the Regulation, but not the ones set out in the *Altmark* ruling. Second, this approach must not lead competent authorities to circumvent the application of the provisions of Regulation 1370/2007 (on the award procedure, on the mandatory content, etc.) because the compensation they have granted is not state aid following the *Altmark* judgment.

- Another question relates to the room for manoeuvre left by Regulation 1370/2007, and in particular the rule on overcompensation, in setting out incentive schemes for the public transport operator to provide efficient services of quality, in particular in the remit of general rules or of a directly awarded PSC.
 - The question was whether the test of overcompensation applies *ex post*, as in the Commission's Decision on the application of Article 106(2), or *ex ante*. In this respect, an *ex ante* test appears to allow more incentives to provide efficient services, whereas an *ex post* test might on the contrary encourage inflated costs to the extent that the operator's own costs are used in the assessment of what is necessary. In addition, an *ex post* test would raise consequential uncertainties, such as the time period used to verify the conformity of the compensation with the Annex. Following its decision on PSC between the Danish Transport Ministry and Danske Statbaner, the Commission would certainly confirm the *ex post* test of overcompensation and require that Member States establish restitution mechanisms. In that decision, the time period to be taken into consideration was one year. The Commission could clarify whether such period is the only possible period for regularisation or whether longer periods could also be used. By choosing a period longer than the one year period provided for in its Decision on the application of Article 106(2) TFEU, the Commission could leave more incentivising power to the compensation rule.
 - The Commission could clarify the definition of reasonable profit for instance by building upon its Decision on the application of Article 106(2) TFEU and on its Decision on PSC between the Danish Transport Ministry and Danske Statbaner. According to these decisions, the introduction of incentive criteria relating, in particular, to the quality of the service provided and gains in productive efficiency, is possible. In this manner reasonable profit, which is allowed to the public transport

²⁴⁴ Case C-280/00 *Altmark* [2003] ECR I-7747, para 105.

operator without it being considered as having received overcompensation, may constitute a variable element in the compensation of PSO linked to the performance of the operator. Such reasonable profit, calculated on the basis of what is normal in the sector, could be varied in line with performance (e.g. good performance might entitle the operator to receive the highest possible profit allowed in the PSC, which has still to be reasonable, and poor performance might not entitle the operator to any profit for the year in question). Such reasonable profit will, according to the definition contained in Regulation 1370/2007, take the risk transferred to the public transport operator into account. The Commission could in that manner confirm that point 7 of the Annex to Regulation 1370/2007 on the insertion in the compensation method of incentive for effective management and quality services can be integrated in the concept of reasonable profit.

Cross-subsidisation

As seen above, the Annex to Regulation 1370/2007 provides some guidance on how to avoid cross-subsidies. The Commission could clarify its approach towards cross-subsidies.

- The Commission could describe the methods it would use to detect cross-subsidy (Fully Allocated Cost, Long Run Average Incremental Cost, etc.).
- The Commission could recall as a general principle that PSO cannot finance commercial services as, under the Regulation, these PSO would be accorded compensation and/or exclusive rights. The principle is applicable to all types of PSC, irrespective of the way they have been awarded and to the general rules.
- The Commission could describe the cases in which cross-subsidies between commercial services and PSO could be objectionable, by referring to the relevant case law and its Communication on the application of Article 102 TFEU to abusive exclusionary conduct by dominant undertakings.²⁴⁵ The Commission could also describe the cases in which it would consider that cross-subsidies from commercial services and PSO would not be objectionable and would help deliver more efficient PSO services.

Undercompensation

As emphasised in chapter 4, there is some uncertainty as to whether competent authorities are obliged not to undercompensate or at least to compensate the provision of PSO under Regulation 1370/2007. The assessment of current practices against the Regulation concluded that there is not a rule prohibiting the competent authority from undercompensating as regards PSC awarded after a

²⁴⁵ Communication from the Commission - Guidance on the Commission's enforcement priorities in applying Article 82 of the EC Treaty to abusive exclusionary conduct by dominant undertakings [2009] OJ C 45/7.

competitive tendering procedure, whereas it would appear to be an explicit obligation to compensate the discharge of PSO imposed through general rules and an implicit prohibition to undercompensate PSO discharged pursuant to general rules or PSC directly awarded.

The guidelines issued by the Commission could clarify this point. The Commission could recall the definition of PSO which clearly refers to a reward without which the service would not be assumed or would not be assumed to the same extent.

The Commission could also recall the principle of contractual freedom which is of application between a competent authority and an operator in a competitive environment.

Regarding directly awarded PSC, it would appear difficult for the Commission to impose the compensation for PSO where financial compensation is not always requested. Indeed, the conferral of exclusive rights may be a sufficient reward for the discharge of PSO in certain circumstances. However, it would be advisable on the basis of the definition of PSO to indeed confirm that the provision of PSO implies by definition some kind of reward, which is to be determined case by case. Where compensation is chosen as the appropriate reward to provide PSO, because of the lack of cost recovery of a service, the compensation should be appropriate as to allow the public transport operator to provide its services. This principle would apply without prejudice to the 'desire for efficiency and quality of service' the compensation should reflect.

Publication (Article 7)

Although there were some questions raised with regard to this provision, these questions appear to be answered by the wording of the provision itself. A particular stakeholder suggested that the Commission could issue a standard form for the publication in the Official Journal of the European Union. Beyond this suggestion, there is no specific recommendation in this respect.

Transition (Article 8)

According to Article 8(2), during a transitional period ending on 3 December 2019, EU Member States shall take measures to gradually comply with Article 5 of Regulation 1370/2007. Although there might be some questions as to how gradually the measures are to be taken, it is thought that the provision is clear. Therefore, there is no specific recommendation in this respect.

As regards Article 8(3), contracts awarded before 26 July 2000 on the basis of a fair competitive tendering procedure may continue until they expire. The same shall apply to other contracts awarded prior to 26 July 2000 and contracts awarded on the basis of a competitive tender after 26 July 2000 but before 3 December 2009, with a limitation of 30 years. Other contracts awarded before the entry

into force of Regulation 1370/2007 may continue until they expire if they are of a limited duration as provided in Article 4. The same applies for any PSC where their termination would entail undue legal or economic consequences, upon the approval of the Commission.

It appeared that this provision raised interpretation problems. It was not always understood that the transitional period only refers to the award procedure and not other provisions of the Regulation such as the ones relating to the mandatory content of PSC or compensation of PSO.

The interpretation problems also related to the starting point of the transition and appeared in our assessment to also be caused by the Commission itself, which on one occasion stated that the starting point for the 30 years period is the entry into force of Regulation 1370/2007 and later that this starting point is 26 July 2000. Our analysis suggested also a third possible interpretation linked to the date when the contract was effectively awarded. Therefore, the Commission could usefully give its interpretation of that provision, taking into account the possible legitimate expectations it had already created.

Compatibility with the Treaty (Article 9)

The question of the compensation granted on the basis of the Regulation is dealt with above.

5.1.3 The monitoring by the Commission of the implementation of Regulation 1370/2007

Some stakeholders have advocated the regular monitoring of the implementation of Regulation 1370/2007 on a yearly basis. As highlighted by this study, such monitoring can raise awareness and lead to progressively determine best practice on the basis of the experience acquired in the implementation of Regulation 1370/2007.

With a view to having a better knowledge of the way competent authorities award PSC when the Regulation is of application by contrast to the Public Procurement Directives, there is a need for a close monitoring by the Commission.

Regarding the very large amount of PSC in force and the very different practices, such monitoring would prove to be difficult. Therefore, the Commission could use standardised tools of monitoring, such as pre-established forms. The Commission could investigate developments in the legislation and in the PSC on a yearly basis. The contributions would be centralised in every Member State by the Ministry of Transport. The Commission could publish the information gathered. It could then make in-depth investigations randomly and possibly following complaints.

5.2 National/Regional/local action

As already highlighted, this study does not aim to replace general guidebooks such as provided in the study 'Contracting in urban public transport' but to highlight best practice from a legal point of view in the implementation of Regulation 1370/2007 with the objective of obtaining 'value for money'. Therefore, it is not here repeated that competent authorities should, before envisaging procurement of public transport services, determine their strategic objectives, analyse the existing market or situation and take account of the specific features that their territory present. The present section aims to give, besides the identified best practice, general recommendations on the implementation of Regulation 1370/2007.

5.2.1 Raising legal certainty and stability

Legal certainty and stability has been highlighted by some stakeholders as an important objective as to allow them to develop strategies (both for competent authorities and operators). Therefore it can be recommended to the EU Member States to rely as much as possible on a single legal system.

First, as regards inland waterways and national sea waters which would be subject to PSO and, in return, to exclusive rights and/or compensation, chapter 4 concluded that the general Treaty rules are of application. Hence, the principles of transparency and non-discrimination are to apply to potential PSC concluded in this area.²⁴⁶ As we have also seen in chapter 4, Regulation 1370/2007 constitutes a legislative recognition of the general treaty rules as applicable to public transport. In other words, the application of Regulation 1370/2007 helps to comply with the general EU rules. Hence, Regulation 1370/2007 can be seen as a 'safe harbour' for PSC in public transport. Since Regulation 1370/2007 expressly states that its scope can be extended to inland waterways and national sea waters, it is recommended to Member States to effectively declare their application to these means of transport, when relevant, unless other specific reasons would prevent them from doing so.

Second, regarding the award procedure of concessions, chapter 4 showed that Regulation 1370/2007 indeed addresses the issue of whether competitive tenders should exist or not. However, the Regulation does not deal with the modalities of the procedures but only provides that the procedure should be in line with the general principles of transparency and non-discrimination. In addition, some PSC (the ones falling under the scope of the Public Procurement Directives) are subject to the particular rules set out in the Public Procurement Directives. Regulation 1370/2007 can lead to the application of various different procedures, thwarting *de facto* the required legal certainty as to the applicable procedure. While it was shown that the Public Procurement Directives 'implement' the general principles of transparency and non-discrimination, they might give useful guidance on the way award procedures (be they direct or based on competition) should be followed. In addition, as

²⁴⁶ Case C-231/03 *Coname* [2005] ECR I-7287, paras 17 and 18.

highlighted in section 3.4.2, if some behaviour could indeed be caught by the competition rules, it would often be more interesting for competent authorities to act upstream and avoid competition problems, which is rendered possible by the Public Procurement rules. Therefore, it is recommended to extend the national rules transposing the Public Procurement Directives to the award procedures of the PSC which are concessions (or net cost contracts). It is similarly recommended to apply the same review procedures as for public procurement following the transposition in national law of the Remedies Directives. This type of review would, thanks to the modalities anticipated, provide for an effective and adequate review procedure as required under Regulation 1370/2007.

It is worth noting that the Commission is currently envisaging adopting a legislative initiative on service concession which would probably give useful guidance in this respect.²⁴⁷

5.2.2 Securing the provision of public transport

Predatory bidding

As seen above, with the opening up of the public transport market, it would appear to be a risk that some operators will bid at very low prices with a view to winning a contract but will not fulfil their obligations under the contract.

Some remedies available in the commercial environment, such as penalties or termination, seem not to be the best remedies in the realm of SGEI, where continuity is one of the key requirements. Remedies such as the step-in of the competent authority in the contract to provide itself the public services or the recourse to an operator of 'last resort' could be applied, provided the competent authority is itself able to provide such services or to find an operator in the short term. Hence, it would appear that *ex post* remedies to predatory bids entail some risks to the continuity of public service.

In this respect, as analysed in section 3.4.2b), Public Procurement rules specifically deal with abnormally low bids. These rules only provide that the authority may reject the tender. Therefore, it might be recommended to the competent authorities to draw special attention to possible abnormally low bids regarding the potential harm caused to the continuity of public services. When assessing whether tenders are abnormally low, competent authorities might find inspiration in methods that are also used to determine whether there is overcompensation. As suggested by some authors, the methods could be a combination of a reconstruction of the projected costs and revenues underlying the bids in the specific tender and a bottom-line approach, using historical data as comparative data.²⁴⁸

²⁴⁷ See the consultation launched on the website of DG MARKT:
<http://ec.europa.eu/internal_market/consultations/2010/concessions_en.htm>.

²⁴⁸ G. Alexandersson, S. Hulten, 'Predatory bidding in competitive tenders: a Swedish case study' [2006] European Journal of Law & Economics, 75 et seq.

Competent authorities might also reduce the risk of receiving abnormally low bids by imposing upon operators the provision of surety bonds. Surety bonds have the advantage of imposing on the tenderer some element of rigour in setting up its bid since a lack of rigour would be sanctioned by the keeping of the bond. However, these surety bonds have to be proportionate to the size and the importance of the contract as not to deter smaller operators from participating in tender procedures.

Compensation

As highlighted under chapter 4, undercompensation may have a negative impact on the provision of PSO. As highlighted in the study on 'Contracting in urban public transport', too much risk can have a negative effect on the outcome of contracting, especially when using competitive awarding. Undercompensation can constitute, as emphasised by some stakeholders, a high entry barrier.

Therefore, as advocated in the study on 'Contracting in urban public transport', there is a need to adequately allocate risk between the competent authorities and the operator, not only the risk linked to the absence of cost recovery due to undercompensation but all the possible other risks linked to public transport.²⁴⁹

Obstruction to the public service

In some EU Member States it might be considered that the provision of PSO might be compromised by the competition from operators other than the public transport operators. This might be the case where transport services have been opened up to competition, as is the case for railways following Directive 2007/58. In that situation, a decision relating to a possible restriction of competition because of the potential obstruction of the public services has to rely on pre-determined objective criteria determining whether the economic equilibrium of PSC may be compromised. If EU Member States want to make application of such possibility, the criteria must be defined in advance.

5.2.3 Providing appropriate incentives to operators

Definition of PSO

Current contractual practices range from functional to constructive service design by the competent authority. As highlighted in the study on 'Contracting in urban public transport', both approaches have their advantages and drawbacks. The adequate approach is to be determined on a case-by-case basis, depending on several factors, such as the holder of the know-how, the degree of maturity of the market, necessity for free enterprise, etc. Whatever the approach chosen by the competent authority, Regulation 1370/2007 requires that the PSC clearly define PSO, notably as to allow the monitoring of

²⁴⁹ 64 et seq.

compensation granted.

Passengers' rights

Regulation 1371/2007 on rail passengers' rights puts in place a compensation system that can be seen as an incentive for operators to provide efficient and good quality services.²⁵⁰ It also allows for several exemptions. However, passengers' rights constitute '*non-direct incentives, enabling the authority to implement an incentive scheme without bearing the costs of its management and control (e.g. financial compensation in case of not meeting punctuality requirements)*'.²⁵¹ This type of incentive has been demonstrated to raise customer satisfaction sharply while costs are usually lower than expected.²⁵²

Since financial incentive schemes may raise state aid issues, competent authorities should consider whether passengers' right could not achieve the result of providing better public services. Therefore, when applying for the possible exemptions granted under Regulation 1371/2007, it might be recommended to EU Member States to consider their application in the larger remit of public transport policy. In addition, such passengers' rights could also be set out for other land transport means than railways, through PSC.

Transfer of risk

As examined in chapter 4, transfer of risks may act as an incentive for the efficient provision of public services. Gross costs contracts put pressure on the costs whereas net cost contracts also encourage the operator to attract as many users as possible (for the definitions of those types of contracts, see section 2.2.2). In SE, where gross contracts are the most widespread type of contract in local transport, there is currently a discussion to modify business models and rely more on net cost contracts.²⁵³ However, if risk may act as an incentive, too much risk may also act as a deterrent for the provision of PSO, in particular in competitive tendering. In London, since net cost contracts had not delivered the expected result, the authority has reverted back to gross cost contracts. Too much risk transferred to the operator can lead at best to higher prices²⁵⁴ and at worst to barriers to entry.²⁵⁵ In the latter case, if it would appear from the possible motivations given for recourse to direct award that the transfer of risk constitutes a covert way to circumvent the application of Regulation 1370/2007, such decision might be challenged first at national level but also at European level.

In addition, the transfer of risk can arguably impact the calculation of the reasonable profit from which

²⁵⁰ See Recital 13 of Regulation 1371/2007.

²⁵¹ Study on 'Contracting in urban public transport', 75.

²⁵² Ibid.

²⁵³ Swedish transport doubling project. See

<http://www.busandcoach.travel/download/best_practices/en/doubling_the_share_sweden_1.pdf>.

²⁵⁴ Study on 'Contracting in urban public transport', 109.

²⁵⁵ As highlighted by some stakeholders.

the public transport operator can benefit. Indeed, as stated above, the calculation of the reasonable profit would require the calculation of the weighted average cost of capital (WACC) which is determined on the basis of the risk borne by the public transport operator. The higher the risk, the higher the reasonable profit could be.

Regarding risk as a means of payment, if an *ex post* test for compensation is to be retained, Regulation 1370/2007 would instruct competent authorities to employ specific caution when compensating for PSO so that these typical categories of PSC might be limited in their incentive power where public co-financing is required as not to exceed the net financial effect of carrying out PSO.

PSC

As highlighted by many stakeholders, the mere fact that a contract governs the relationship between the competent authorities and the operator brings about incentives for efficient services. From an economic point of view, incentive to provide efficient services would depend on the structure and content of the contract. It can however be said that the legally binding character of PSC between the parties constitute a condition *sine qua non* for the provision of public services, as required in Regulation 1370/2007.

The added value of a contract is even more important for public undertakings. Through contracts, the public undertaking acquires generally a greater autonomy in relation to the authority and service supply and the way financial compensation is organised. The process of contracting out the service leads to a necessary definition of the requirements and framing of the relationships between the contractor and the authority. This may have for the authority a similar effect to what would have been the case when contracting with a fully independent operator.²⁵⁶ In addition, contracts indeed allow taking account of specific features which general rules do not.

Regulation 1370/2007 imposes the adoption of PSC where a competent authority intends to entrust an operator with PSO in exchange for exclusive rights and/or compensation, whereas general rules constitute an exception to the principle of contractualisation. However, general rules might be necessary to guarantee specific tariffs for certain categories of passenger throughout a territory which may cover more than the territory of a particular competent authority.

Hence, the drafting of a contract constitutes an important step in the procurement of public services. In this respect again, the Public Procurement rules may give some guidance on the points which are to be thought of. Guidebooks such as the study on 'Contracting in urban public transport' also provide guidance on the steps to follow for drafting PSC. In any case, the contract should contain the mandatory content referred to in Article 4 of Regulation 1370/2007.

²⁵⁶ See NEA, Study on 'Contracting in urban public transport' [2008], commissioned by the Commission, 14.

5.2.4 Avoidance of overcompensation and cross-subsidisation

As shown in chapter 4, all PSC should avoid overcompensation and, in certain cases, cross-subsidisation. For both objectives, separation of accounts between services provided under PSO and other activities constitutes a minimum measure as to provide transparency and hence a necessary tool for identifying possible wrong behaviours. This is already an obligation imposed by Directive 2006/111 and which would have been transposed in all Member States.

To avoid overcompensation, the parameters for compensation are to be defined beforehand, in the contract.

To set the standard for cross-subsidisation and to monitor possible occurrences, the cost-allocation method ought also to be determined in the contract. This is even so when risks have been transferred to the operator or the contract awarded after a public tendering. When the contract is directly awarded, the cost-allocation method should allocate to the commercial activities at least variable costs, some portion of fixed costs and assets. However, as seen in chapter 4, cross-subsidisation from commercial services to PSO services may in certain circumstances amount to an abuse where the operator is dominant. That would mean that if commercial services are to bear their own costs, it might in some circumstances be unacceptable that commercial services also bear the costs of services provided under PSO. Therefore, competent authorities would be well advised to indeed favour a clear method for cost allocation.

5.2.5 Securing competition

As highlighted above, Regulation 1370/2007 applies over and above EU competition rules. The application of those rules is not the object of the current study. However, as shown in section 3.4, their application may influence the provision of efficient services and is intimately linked to Regulation 1370/2007.

Competition policy aims to ensure transport markets operate efficiently. This is especially important when newly competitive markets are emerging as a result of liberalisation policies.

Where markets are opened up to competition, competition law enforcement is necessary to protect the provision of public services and passengers from increasing price or lowering quality. Council Regulation (EC) N° 1/2003 is designed to ensure more effective enforcement of the EU competition rules in the interest of consumers and businesses, while easing the administrative burden of firms doing business in Europe. Via decentralised application of the competition rules and by strengthening *a posteriori* control, the Regulation aims at lightening the Commission's workload and increases the part played by NCA and national courts (NC) in implementing competition law while guaranteeing its

uniform application.

Under a decentralised application of EU Law all these entities have to directly apply Articles 101 and 102 TFEU. The direct effect of the legal exception system established by the Regulation is to increase the responsibility of undertakings since, given that they are no longer subject to a prior-notification requirement, they will have to ensure in good faith that agreements do not affect free competition and do not infringe the EU rules in this area. However, in order to avoid any abuse, the NCA in Europe - including the Commission - and the NC shall themselves assume greater responsibility in ensuring that the rules on competition are complied with, while coordinating their respective activities. To that end, efforts are required to encourage an exchange of information between the various institutions.

This should involve constant communication by the Commission and the Member States' competition authorities of all *de facto* or *de jure* information, including confidential information, which might help identify violations of the rules on competition. To this end, Regulation 1/2003 provides for mutual assistance to take place between the Commission and the NCA.

Decentralised application by NCA

Together with the Commission, the NCA form the European Competition Network (ECN) which shall monitor the application of the competition rules. The principles of the close cooperation between the Commission and the NCA in the context of the ECN are laid down in Articles 11 to 14 of Regulation 1/2003, and they are further developed in the Commission Notice on cooperation within the Network of Competition Authorities.²⁵⁷ The close cooperation between the Commission and the NCA essentially concerns the allocation of cases and the exchange of information in the ECN.²⁵⁸ *Sensu Latu* it also concerns the rules applying to the parallel application of EU and national competition law, as well as the consecutive application of EU Competition law by the Commission and the NCA.

Decentralised application by NC

The NC may be called upon to apply Articles 101 and 102 TFEU in litigation between undertakings. The cooperation between the NC and the Commission in this context is provided by Article 15 of Regulation 1/2003 and further developed in the Commission Notice on the cooperation between the Commission and the Courts of the EU Member States.²⁵⁹ The cooperation between the Commission and the NC is reciprocal: on the one hand, the Commission serves as *amicus curiae* (transmission of information or opinion), on the other hand the NC facilitate the Commission's role to enforce competition law (transmission of national judgments and documents).

²⁵⁷ [2004] OJ C101/43, paras 5-15.

²⁵⁸ Reg 1/2003, Art 11 and 12 and Commission Notice on cooperation within the Network of Competition Authorities (see above), paras 16-19 and 26.

²⁵⁹ [2004] OJ C101/54.

Added value of effective decentralisation of enforcement of EU competition law

The decentralised enforcement policy ensures that EU competition law²⁶⁰ is applied more effectively between the Commission, the NCA and NC,²⁶¹ maintaining **consistent** application of the law within the internal market.

In fact, in an enlarged European Union, NCA and NC need to cooperate actively in the enforcement of EU competition law once it is clear from other areas of competition law that the Commission alone cannot ensure effective enforcement of the law.²⁶²

Therefore, cooperation mechanisms implemented by Regulation 1/2003 are the backbone of the ECN and they can bring numerous advantages in the application of competition law and policies in the EU. By assuring that the NCA of the Member States shall inform the Commission of new cases at an early stage (and *vice versa*), the management of the case could be more effective and individual cases could be reallocated to other authorities better placed to deal with them. To improve competition law enforcement, a decentralised approach can:

- eliminate all unnecessary notifications, to the Commission and to national authorities;
- facilitate handling of cases at national level wherever practical, including applying Article 101(3) TFEU;
- coordinate the actions of national authorities and minimise differences between national and Community antitrust laws;
- ensure that NC efficiently and fully protect rights given by Community antitrust law and to try to ensure that the conclusions arrived at are the same everywhere;
- enable the law to be enforced more effectively against the most serious practices;
- avoid forum shopping;
- avoid multiple procedures.

A harmonised application of EU competition law by the NCA and the Commission allows the companies the possibility of better self-assessing their business activities' compliance with competition law.

By increasing the effectiveness of competition law enforcement, the decentralised model tends to produce quicker decisions which allow market players to proceed with their proposed business plan (e.g. merger, acquisition, joint venture).

²⁶⁰ particularly Articles 101 and 102 TFEU.

²⁶¹ In particular NCAs which applied national competition law almost exclusively.

²⁶² For the positive effects of decentralised enforcement please see Case C-198/01 *Conorzio Industrie Fiammiferi* (CIF) [2003] ECR I - 8055.

Finally, the decentralisation should allow the inclusion of regional market specific knowledge in the decision of competition issues, once that NCA are in principle better prepared to decide over cases that are directly connected with their national market specificities.

It might be interesting in EU Member States where transport markets have been opened up to competition for NCA to determine their priorities as regards the enforcement of competition rules in public transport. These priorities are to be determined on the basis of the specific circumstances prevailing in their territory of competence and would probably relate to a certain extent to the competition issues highlighted in section 3.3.

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Annexes

- I. **The award procedure under Regulation 1370/2007 and under the Public Procurement Directives**

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III. Table summarising contractual practices

IV. Questionnaire to competent authorities

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