

Independent Regulators' Group – Rail

IRG–Rail

Position Paper on the new proposals concerning governance and the award of public service contracts with a strong focus on the role of the regulatory bodies

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IRG-Rail is the network of independent rail regulatory bodies from 26 European countries. The overall aim of IRG-Rail is to facilitate the creation of a single, competitive, efficient and sustainable internal railways market in Europe. IRG-Rail acts as a platform for cooperation, sharing of best practice on regulatory issues and promotion of a consistent application of the European regulatory framework.

This IRG-Rail paper is published on the responsibility of the IRG-Rail plenary. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the governments of its Member States.

I. Introduction

1. On 8 October 2015 the Council reached a general approach on the political pillar of the 4th railway package and adopted final proposals with regard to the outstanding issues in the areas of governance of rail infrastructure and the award of public service contracts. IRG-Rail fully supports the opening of the domestic rail passenger market and the objective of reducing the cost of services to consumers whilst maintaining high quality and performance standards.
2. IRG-Rail appreciates that a further step has been reached with the adoption by the Transport Ministers of this agreement on this final part of the Fourth Package. Nevertheless, this approach raises serious issues. IRG-Rail has grave concerns about the effect of weakening several key provisions in the Commission's initial proposal. In particular with regard to financial transparency and independence, the current proposal no longer matches the goals of the original Commission's text. The attempt to reach a compromise agreement should not mean conceding the principles of competition, transparency and non-discrimination: principles that are vital for the creation of a genuine European rail market.

II. IRG-Rail's position

3. IRG-Rail has already addressed a number of issues in detail in several previous position papers¹, endorsing some of the key concepts and requirements proposed by the European Commission in its initial proposals and by the European Parliament. These include:
 - appropriate requirements to ensure the independence of the infrastructure manager, with strong Chinese Walls and a high level of transparency, including financial transparency;
 - full opening of the market for domestic rail passenger services;
 - mandatory competitive tendering for rail public service contracts as a general rule; any exceptions from this general rule, which need to be limited, should at least be subject to clearly defined rules and criteria. in order not to undermine proper market opening.
4. IRG-Rail considers that appropriate regulatory instruments are key to preventing anti-competitive and discriminatory behaviour in the rail sector. Proper supervision and enforcement are only possible if regulatory bodies can rely on:

¹ <http://www.irg-rail.eu/public-documents/2015>

- Sufficient, clearly-defined competences and responsibilities to supervise and control the independence requirements and fair and non-discriminatory access to the market;
 - A legal basis for gathering the relevant information and data in order to be able to ensure the necessary regulatory supervision;
 - Enforcement powers and a legal basis for the application of remedies.
5. IRG-Rail anticipates major problems due to the absence of such provisions and rules in the current proposals. Additional provisions clarifying the role, competences and tasks of regulatory bodies, and providing sufficient instruments for supervision and enforcement are a precondition for delivering performance and efficiency of rail services for the users of the rail network. Regulatory bodies should have powers of intervention in order to verify all independence requirements, in particular those concerning the financial circuits. For the exemptions to competitive tendering, the text should also outline the tools an independent body or a regulator could use when the criteria laid down in the legislation are not followed by competent authorities.
6. IRG-Rail now urges all relevant parties to proceed with trilogue negotiations to ensure the establishment of a competitive rail market.

III. Main issues

7. IRG-Rail has identified some issues that substantiate the need for additional provisions concerning the role and task of the regulatory bodies.

Governance

8. INDEPENDENCE OF THE INFRASTRUCTURE MANAGER:
- Scope: The lack of independence of the infrastructure manager is a major barrier for reaching an open and competitive market. The functions for which the infrastructure manager is responsible must be carried out independently of any railway undertaking. IRG-Rail considers that limiting the scope to “*essential functions*” is a backward step, and is not the best way to achieve a transparent and non-discriminatory rail market. Under such circumstances, IRG-Rail maintains that regulatory bodies will not have the necessary tools to protect the interests of the market. Functions such as maintenance and traffic management should also be subject to regulatory oversight to prevent misuse of sensitive informations and discriminatory decision-making in the planning of maintenance work. IRG-Rail continues to endorse the original Commission proposal, which included clear scope of independence.
 - Independence requirements: IRG-Rail notes that the focus has been on essential functions and a core set of obligations for the independence of

the infrastructure manager for both vertically integrated and separated structures. However, it is regrettable that, as a result, a significant number of the independence requirements have been removed or substantially weakened for vertically integrated structures, in particular the present proposal does not extend the guarantees of independence to all infrastructure manager's activities which include development/investment activities and maintenance.

9. Further weakening of independence has been introduced. The prohibition of double mandates is now limited to very few cases. This increases the risk of partiality in decision making. Regulatory bodies will not be able to guard against conflicts of interest if double mandates are still allowed. For example, this means that it would be possible for a staff member to be involved in establishing charges for the infrastructure manager whilst working for a railway undertaking. There is also no longer an obligation to keep separate premises and it is not compulsory to keep separate information systems. Protecting information asymmetry will seriously complicate the regulatory bodies' task of controlling non-discrimination. In this respect IRG-Rail believes that access to sensitive information should be subject to regulatory oversight.
10. With fewer obligations to ensure the independence of the infrastructure manager, appropriate instruments for regulatory bodies to exercise supervision and apply remedies become even more important. In this context IRG-Rail has serious concerns that Article 7c (3) on cooperation agreements does not clearly allocate the regulatory supervision task to the regulatory bodies but only refers to an "*independent body determined by the Member State*". The introduction of this new body creates confusion, as regulatory supervision is the core responsibility of the regulatory body. Moreover, a clear mandate ensuring regulatory action is required. In IRG-Rail's opinion, "*may advise*" does not ensure that a solution can be enforced by the competent body, as it only offers an advisory role, rather than legally-binding decision-making powers.
11. FINANCIAL TRANSPARENCY: IRG-Rail continues to have strong reservations about the weakening of the rules on financial transparency, and the implicit facilitation of cross-subsidization. IRG-Rail has previously stated its support for a clear financial separation within vertically integrated structures. IRG-Rail still has concerns with regard to the wording in Article 7d which covers financial transparency. In Article 7d (a) it should be clarified that public money is fully covered as well as other revenues. With regard to the wording in Article 7d (c) it appears that loans between legal entities in a vertically integrated undertaking remain possible – a scenario contrary to financial transparency.
12. IRG-Rail also objects to the loophole that has been introduced with the deletion of "*ultimate*" before the "*owners*". This wording may allow cases in which public infrastructure funding (e.g. via taxpayers) is used for financing the holding. IRG-Rail's understanding is that this is not permitted under current

legislation. Such provision would be a serious backward step allowing public funds to be misused. The public funds are often designed to finance a type of the infrastructure manager's functions or a to subsidize a type of a traffic and should not therefore be misused in paying the dividends to the owner of the company.

13. IRG-Rail stresses the need to refer to "market" prices and "efficient" cost of production (currently a reference to "*cost of production plus a reasonable margin of profit*")². This is necessary for appropriate regulatory oversight in order to avoid excessive pricing or distortionary practices.
14. IRG-Rail considers that it is crucial to ensure separate financial circuits, and a provision (article 7d (de) that only requires *separate accounting and transparent financial circuits* is not sufficient. Accounting separation is already a requirement under the current legislation. Further financial transparency and no-cross subsidization can only be ensured through separate financial circuits. We believe that without this additional requirement the new proposed wording for Article 56 on the functions of the regulatory body is not fully adequate to ensure proper supervision of financial issues.
15. EXEMPTIONS: The latest proposal foresees a number of exemptions for dedicated infrastructure (regional low traffic networks, private infrastructure managers). Whereas some may be justified and already covered under existing legislation, for example, there is no explanation for the exclusion of PPP structures from the scope, taking into account the potential for discrimination – irrespective of funding arrangements. Any exemption should be strictly limited, justified, and subject to regulatory supervision.
16. ENSURING REGULATORY OVERSIGHT: IRG-Rail notes that the former Article 7e dealing with the supervision role of the regulatory bodies has been deleted. However, this article has been replaced by amendments to Article 7d and Article 56(12). The regulatory body is now responsible for controlling traffic management, maintenance planning and monitoring of compliance. This includes monitoring the financial flows referred to in Article 7d(a), loans referred to in Article 7d(c) and (cc), and debts referred to in Article 7d(dd).
17. IRG-Rail welcomes these extended powers of oversight but would reiterate that, instead of "monitoring powers", some additional powers and more detailed provisions should be in place allowing regulatory bodies to check accounting separation and financial circuits, ask for the necessary information from all parties (infrastructure managers, railway undertakings and service facilities) and, where necessary, apply remedies to enforce their decisions.

² Article 7d (d)

18. **BINATIONAL INFRASTRUCTURE** : We note the new provision regarding the regulation of bi-national infrastructure, which allows Member States to require regulatory bodies to coordinate their decisions, and align the impact of these decisions. The wording (in particular the meaning of binational infrastructure) and application of this provision is unclear, particularly with regard to enforcement, and implications for regulatory independence.
19. **TERMINOLOGY**: Clear and coherent terminology and definitions are necessary to ensure legal certainty and allow consistent application of legislation by regulatory bodies and stakeholders. IRG-Rail has identified some issues in this regard, such as the wording in the article on independence of the infrastructure manager. Article 7 (4) refers to “financial benefits from railway undertakings or bonuses *principally* related to the financial performance of *particular* railway undertakings” – it is unclear to whom this applies and allows broad interpretation and could lead to abuse. For legal certainty it is necessary to exclude all financial benefits. Furthermore, Article 7a(2) on independence of essential functions, foresees that “a railway undertaking shall not have a *decisive influence* on appointments and dismissals of persons in charge of essential functions”. For IRG-Rail, the meaning and impact of “decisive influence” is not clear. This term should be consistent with the existing EU Merger Regulation.

Public service contracts award

20. As indicated in earlier position papers, IRG-Rail fully supports mandatory competitive tendering as a general rule for the award of public service contracts, and regrets the addition of further provisions allowing direct award of such contracts. IRG-Rail stresses that derogations to competitive tendering and exemptions should be strictly limited to clearly defined and substantiated specific cases.
21. With this in mind, the extended timescales for implementation that have now been proposed, as well as the broadened exemptions, are a backward step. IRG-Rail regrets the further delays in the implementation of market opening, with the introduction of several lengthy transitional periods. In particular IRG-Rail is also worried about the new temporary derogation in exceptional circumstances in Art 5.3a, which appears very open-ended and open to abuse.
22. **APPROPRIATE SUPERVISION THROUGH REGULATORY BODIES**: As the current proposal concerning the awarding of public service contracts envisages a broad range of options for direct award at the discretion of competent authorities, appropriate supervision by an independent body is key in order to prevent protectionist behaviours. IRG-Rail has serious concerns about the removal of the regulatory oversight and validation of the competent authority decision's to make direct awards. In IRG-Rail's opinion, a competent, powerful, independent supervisory authority with appropriate resources needs to be involved in any direct award procedure. This body

would need appropriate instruments to guarantee transparency of the procedure and challenge any decisions.

23. **CORRECTIVE MECHANISM REQUIRED:** IRG-Rail notes that , under Article 5.4(a (ii), the competent authority has to demonstrate an *improvement in quality of services and/or cost-efficiency compared to the previously awarded public service contract* to be able to carry out a direct award. In our opinion, legislation should include a clearly defined mechanism allowing a party to challenge the decision of the competent authority awarding the public service contract and also requiring demonstration of improvement in cost efficiency . Relevant parties should be able to complain and appeal to an independent supervisory body, which should be able to initiate an ex-officio procedure to investigate the direct award. The current proposal requires the competent authority to substantiate its decision to carry out a direct award and inform the Commission. The powers of the Commission to require some remedy if necessary are far from clear.
24. **SANCTIONS:** Restricting the use of direct award by competent authorities, and setting adequate penalties for operators under direct award are necessary, in case the criteria for awarding a public service contract directly have not been complied with, or where a railway undertaking has failed to achieve the performance targets. Accordingly, an independent body should monitor compliance with the criteria laid down in legislation. Sanctions could take the form of a fine or an obligation to stop the direct award and require the contract to be awarded through competitive tendering.

Rolling Stock

25. Regularly bodies are responsible for market monitoring and identifying any barriers to entry. Limited or no “access to rolling stock” is a major area of concern for competitors entering the market and applying for public service contracts³. Original proposals provided measures to tackle these problems. However, the general approach no longer envisages any action in this area.
26. To move the debate forward, IRG-Rail has recently developed a questionnaire in order to better understand ownership, usage and availability of rolling stock in different countries, as well as problems and challenges. Its main findings are based on the answers from 17 IRG-Rail members.
27. **PROBLEMS CONCERNING ROLLING STOCK CONFIRMED:** IRG-Rail's evaluation widely confirms the rolling stock accessibility problems for railway undertakings which the European Commission had identified in its impact

³ See notably the impact assessment of the European Commission, <http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52013SC0012>

assessment two years ago. Issues relating to access to rolling stock are still valid in the majority of national passenger rail markets.

28. **IMPROVEMENTS** : While most IRG-Rail members confirmed a stagnating situation in their member states, some countries with a liberalized market reported the introduction of more competitive models in order to make rolling stock available to all railway undertakings, This has lead to an increase in competition and an improvement in prices and quality, for instance in the UK and Germany.
29. **NEED FOR ACTION**: In addition, based on an update of market information, IRG-Rail sees a need for an initiative facilitating the access to rolling stock at EU level – for example facilitation of financing of rolling stock by shifting financial responsibility (e.g. to tendering authorities) while leaving extensive flexibility for the way in which this is done. This could improve the situation in national rail markets as well as at EU level. Nevertheless it is important that any measure does not result in a barrier to competitive tendering of public service contracts.
30. IRG-Rail encourages further actions in due course to tackle the problems identified .

IV. Conclusion

31. As it stands, the Fourth Package falls short of its original objectives – the creation of a genuine European railway market, with improvements in efficiency, performance, and a rail sector that can compete with other modes. etc..
32. To secure the maximum benefit from the remaining provisions, IRG-Rail calls for appropriate regulatory instruments and powers to ensure appropriate supervision and enforcement in the area of governance and “award of public service contracts. The general approach represents only a transitional phase and further progress is needed to ensure a properly liberalized and competitive rail market. Ultimately, this will only be part of the journey towards a competitive, open EU rail market. IRG-Rail calls on member states, members of parliament, competent authorities, regulatory bodies and market participants to work together on a timely implementation of this package, to make sure that the gains in efficiency and performance are brought home to passengers, funders and investors, and to allow the future potential of rail to be seen An initiative addressing the problems which have been identified with regard to access to rolling stock should be part of the process.