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Guidelines for a shift to rail: for establishing predictable and stable environment

In the light of the market development and Green Deal objectives and Sustainable and Smart Mobility Strategy, the international rail services enjoy new momentum that should lead to increased modal shift to rail as a sustainable mode of transport. Such change only happens if railway companies have predictable, stable and safe business environment to launch and operate new services. EU Member States play more active role in defining services in passenger rail compared to other modes of public transport. Establishing a business environment and precise objectives by the Member States should always lead to more commercially viable services as a main objective than to establishing PSO-driven 'market'. PSO should be used as last resort, only in transparent and non-discriminatory manner and in the least harmful manner for the proper functioning of the internal market. Even in the case of PSO, this approach and principle has to be secured.

The principle of organising public transport services in the interest of the users, in line with Article 1 of Protocol 26 annexed to the TFEU (p. 8 of the revised Guidelines), is sometimes explained as a justification for procurement of PSO. We would like to highlight that organisation of public transport services also applies for open access services, and only if it is proven that commercial services are not viable option, can PSO then be procured. Clarifying the relation between open access services and services of general economic interest is essential. As open access services are not defined and do not have regulation, it may seem that PSO is the default approach. The Guidelines should provide the basis for better understanding open access as a default regime of operations.

While being aware that the interpretative Guidelines cannot change or amend existing legislation, we would like to highlight the role of the competent authorities (Member States) in setting criteria for the open access operations, assessment of market failure and identifying reasons for such market failure and how possible barriers can be reduced or eliminated. We have been experiencing that current absence or few open access services were identified as market failure and it serves as a justification for PSO. This is worrying especially in the context of international services as the first international open access services have already emerged or are about to start in the near future. It can lead to closing the international market for competition before it even starts and losing the potential of growing rail vis-à-vis other less sustainable modes of public transport.

In order to meet the Green Deal objectives, we have to support level playing field between the transport modes. While in aviation or bus market the conditions for operations are set, meaning that long distance services are then prepared and deployed by the operators as their own business case.

There are of course also other differences between the transport modes, however the Member States have different approach to rail than to aviation and other competing modes. In case of rail, the Member States have active, almost business, approach which is currently one of the main obstacles in achieving modal shift as the space for business cases in rail is currently rather limited. In short, in aviation an operator needs 30 days to start new service, in rail we need at least almost two years even with acquired rolling stock.

We believe in an active role of Member States in creating environment for attractive services – both current and new. We also highly appreciate that Member States are now discussing their role more actively, also for example currently in the International Passenger Rail Platform. However, we believe that the main role is to secure an environment where business cases are defined by the operators while meeting requirements set by the Member States in a transportation plan or by general measures. We believe that the objective and the position of the Member State should be highlighted and clarified in the Guidelines.

In our feedback, we mainly focus on defining conditions as to whether service can be operated in open access or if it needs PSO procurement as well as focus on their application regarding international services too.

We would like to suggest to further elaborate on the following topics:

1. Importance of the legal framework of SGEI for the PSO Regulation, expanding on the SNCM ruling

Public passenger transport is, by definition (Article 2 point (a)), a Service of General Economic Interest (SGEI). Although the Commission rightfully acknowledges the SGEI-status in the paper, we would welcome further an analysis of the fundamental characteristics of SGEIs, most notably as described by the Court of Justice in the highly relevant “Altmark Criteria”.

We observe that many competent authorities seem to be unaware that this legal framework is also applicable to the procurement of Public Service Obligations (passenger transport services are currently included in PSOs without an ex-ante examination to assess whether the desired services could be delivered by the market without a PSO). We would welcome if the Commission would emphasize more prominently that the entire legal framework of the PSO Regulation must be understood as an addition to the legal framework of SGEIs.

We suggest that the Commission refers explicitly to the cumulative conditions of the Altmark Criteria and the SNCM ruling in the text of the Guidelines.

We believe that understanding of the legal framework of SGEIs and the Altmark Criteria is crucial for understanding of the PSO Regulation, in example to understand the limitation of PSOs to services that assumingly won't be delivered by the market without compensation, which is implied with article 2 point (e). We observe that some Member States fail to acknowledge this condition for PSOs, which underlines the added value for clarification via these Interpretative Guidelines.

We would like to suggest the Commission to explicitly conclude in paragraph 2.2.3:

“Following the legal framework for SGEIs, most notably defined by the Court of Justice in the Altmark Criteria, and article 2 points (a) and (e) of the Regulation, only public transport services that assumingly could not be delivered by market parties without compensation, are eligible to be included in a public service obligation. This should apply without prejudice to the option of grouping cost-covering and non-cost-covering services in one PSO as described in article 2a (1), under the conditions that such grouping is necessary and proportional.”

We furthermore suggest a minor clarification to the first sentence of the paragraph “Analysis of the market failure” (p. 9):

“Before making any decision to procure a PSO, Member States must assess whether the identified demand for public transport services cannot be met by operators on open access in the absence of a public service obligation.”

The possibility of exceptions to the obligation to provide a quantitative ex-ante assessment of the services to be provided for the entire period under consideration, as described in 2.2.3, has the potential to cause several issues that continue to be unaddressed.

The fact that it is not required to assess transport services ex ante in general, but also providing the option to do so during the term of the contract does inevitably lead to serious issues. What happens if the examination during the term of the contract shows that there is no need? In such case, staff, trains, and paths have already been organised/paid for. How does a reversal take place? Would claims for compensation from competitors, who could have provided the service profitably in open access, be possible and rightful? Has there ever been any example of such a procedure?

Due to the risk of massive negative consequences for competition and mobility offers, we believe that there should be no exceptions to the quantitative ex-ante assessment.

The present draft is regrettably not sufficient. The ex-ante evaluation of the needs in an assessment must be further specified. Minimum standards for this assessment must be defined. These must be evident to third parties and the evaluation criteria and results must be comprehensible and verifiable. The highest level of transparency must be ensured in such an assessment. The standards must be published, as must the data and facts upon which the assessment is based; access to third parties must also be granted. All potentially interested operators must be given the equal opportunity to comment on the assessment process based on the fully published documents. These comments must also be considered by the competent authority and taken into account when deciding on the necessity of a PSO obligation. Furthermore, it must be possible for interested third parties to review this decision in the appeals process. Only in this way can the rule of law be ensured for this essential step. Discretionary decisions by the authorities must be ruled out.

2. Definition of the scope

We observe that there are PSOs that define the scope by just defining a geographical route or network, but not specify the exact services or frequencies.

We suggest adding to the guidance relating to the scope definition that the PSO should explicitly define the train services that belong to the scope of the PSO, meaning that the route, stops and frequencies need to be specified.

We also ask for more guidance as to whether the scope can be flexible in terms of frequencies, in example by defining a bandwidth of frequencies, or that the defined minimum frequencies are also the maximum frequencies, at least regarding the scope of the PSO. Such set of information is also requested when assessing the Economic Equilibrium Test. Proportionality should be required in case of PSO too.

3. PSO and commercial services in parallel

Another lack of clarity that we would like to highlight is more guidance on whether it is possible to operate comparable PSO and commercial services parallel to each other, regardless whether by the same operator or by two different operators or even different, similarly sustainable means of transport. In that case, the existence of the commercial service would suggest the absence of the required market failure.¹

We suggest the Commission to acknowledge and elaborate in the Guidelines that a situation with PSO and commercial services in parallel can lead to market distortion and under what conditions such PSOs have to be justified.

4. More guidance on Open Access and alternatives to PSOs

Some Member States want to procure PSOs even for train services that could be delivered on commercial basis, as they believe that PSOs are the only way to secure the public interest. There seems to be a fear that if publicly important cost-covering services would be left to the market in an open access regime, there would be no guarantee at all that the operators will continue to offer these services and will not suddenly cease operations. In reality the opposite is true: open access services grow the market, increase demand and continually add new additional frequencies.

We observe the persistent incorrect perception among some competent authorities that only PSOs can be regulated whereas Open Access ('OA') is just out-of-control market forces.

We currently face a Catch XXII. situation where Member States want to preferably have lines in PSO and therefore not aiming for commercially viable services and even blocking new OA by establishing new PSO. Because new OA then cannot easily start (as there is already PSO service and thus an Economic Equilibrium Test is necessary), it seems that there is a market failure - and PSO has to be procured.

¹ This is relevant as some Member States are planning to procure a PSO for the "basic offer" and a low commercial services on top of that, but for such situation, we question the legitimacy of the PSO and see potential issues with the evenly paid and the Economic Equilibrium Test.

From the regulatory perspective, a SERA with commercially viable services should be the objective. However, it seems that competent authorities have adopted a narrative that only PSOs can secure mission of services of general economic interest. It leads to an absurd situation where PSO – and ultimately loss-making services are preferred over commercially viable services, because Member States fear they cannot impose and enforce requirements. We believe that the Guidelines would be a useful tool to explain the possibilities Member States have in an open access regime.

We believe that Member States have tools (through capacity allocation, general mechanisms) to request a certain type of service. There have not been cases of cherry-picking, which is often used as political spin for justifying a PSO-driven approach instead. We would like to highlight that open access operations are not operated on a completely laissez-faire basis and cooperation of the Ministry, IM and operator is essential.

We see it as a shortcoming of the PSO Regulation that it gives limited guidance on how competent authorities can secure the public interest regarding cost-covering services in the absence of a PSO. We would like to expand on general measures and how to apply them. Therefore, we would like more precision regarding the subsequent actions and highlight that PSO can be procured only if it is not possible to operate commercially while the obstacles against doing so (e.g., high fixed costs, e.g., for rolling stock and track access fees) are also being minimised.

For example, on p. 9 we would like to suggest the following clarification: “As the market for the services at hand has now been liberalised, Member States must assess the level of open access services provided or are about to be provided and only if needed, enact general measures or, in case services operated on a commercial basis were proven not possible, award a public service contract.”

- The Commission could significantly contribute to the success of the 4th railway package by simply further expanding on the concept of “general rules” and providing more guidance on how competent authorities can use them to secure the public interest, without having to award a PSO.

We believe such guidance is necessary and would increase the support for market liberalisation and the objective of the EU 4th Railway Package.

5. Direct awards before the 24 December 2023 deadline

As rightfully addressed in section 2.2.5 of the draft Guidelines, closer monitoring and treatment is required in cases when a new public service contract be awarded directly to an incumbent operator in the proximity of the cut-off date of the 24 December 2023 deadline for direct awards and advertising requirements. A circumvention of the regulations of (EC) No 1370/2007 on the phasing-out of unconditional direct awards must be prevented.

The current trend is for as many direct awards as possible to be made shortly before the end of the deadline, without it being clear when the service will actually start. In our view, it should also be made clear in the conditions of direct awards that the service must start close to the time of the award, while meeting the criteria for awarding a PSO as set in the Altmark conditions and the SNCM ruling.

6. The legitimacy of “hybrid services”

We are very concerned about the application of “hybrid services” or “PSO-Open Access combinations”. For development of the international services it would be essential that such hybrid services are in reality available in transparent and non-discriminatory manner equally to all operators, state incumbents as well as the newcomers, as so far this has been very questionable. We are especially worried when the same international train service is being operated on the territory of one Member State as PSO, and “on a commercial basis” in another Member State.

First of all, these services were awarded on the basis on historical set up /historic-political relations and collaborations and therefore are in reality not equally open to all operators. It must be ensured that such procedure is equally available to all operators in transparent and non-discriminatory manner, taking in account time constraints, access to rolling stock, service facilities or capacity. The requirements would have to be even more detailed in case of such services. There would have be also even more precise financial requirements to avoid cross-financing.

First of all, it must be analysed whether a PSO is necessary, also what are the barriers for commercially viable services and whether all other possibilities of less harmful approaches to the functioning of the internal market were exhausted. If it is assessed by a Member State only regarding the part of the service up until border, then it does not reflect the scope of the service. In case of PSO in a hybrid service, then it has to be tendered to ensure fair opportunity to all operators. Especially directly awarding the PSO part of potential hybrid services directly would lead to distortion of the market.

Hybrid services essentially prevent the deployment of commercially viable services. First, the barriers that block deploying services on commercial basis should be identified and if possible reduced. If the service is preferred by the Member States and identified and described in the transportation plan, they should first attract commercially viable services by less harmful and exclusionary means, for instance by lowering track access charges on certain routes or for certain types of traffic (such as night train services).

6.1. Legitimacy to virtually split up a service at a border

While we understand the legal de-jure possibility of hybrids, we also believe that existing legislation obliges us to consider a “train service” always for the full route and not virtually split up an international train service on the administrative borders of Member States – as the single European rail market has been established. The rules of the Union’s rail market are applicable to the entire market, regardless of the territory of a Member State or its competent authority/ies. We believe that an international train service can only be a PSO for the full route or should otherwise be operated exclusively on a commercial basis.

In the Explanatory Memorandum to Directive of the EP and the Council amending Council Directive 91/440/EEC on the development of the Community Guidelines when international passenger service was defined it states that “[...] two Member States or two local authorities straddling a border, may

together define and award a PSC for the provision of an international service or a cross-border regional services”, International PSO should be awarded as one contract, the service should be assessed accordingly. We also find support for this claim in the SERA Directive, in the definition of “international passenger service” in article 3 point (3). An international passenger service by definition crosses at least one border.

In the interpretation in which train services could be split up at the border, we are no longer speaking of an “international service”, but two “domestic services” stuck together at the border. This is not compliant with the Union’s achievement to establish a single European rail market; instead, it is a Europe consisting of just national “island” markets and it means going back in time and in addition worsening the level playing field for passenger rail.

We strongly encourage the Commission to set strict requirements for international services in the least harmful manner. The Member States have to declare that they will exhaust all possibilities. These should be also described in the Guidelines to declare hybrid services only as a very last resort rather than the misguided philosophy that they are a key solution to grow-cross border rail.

We also want to bring to the attention of the Commission that an international train service that is part of a PSO would still be a Service of General Economic Interest and that the Altmark Criteria must apply. In order to assess whether there is a real demand for the proposed international train service and whether there is a market failure, there is no doubt that the full international route should be considered. It would not make sense to assess market demand to just an administrative border between two Member States. We also like to stress that the sections of train services on both sides of the border can usually not exist without each other, as in most cases the train cannot turn around at the border – not to mention that there would not be enough demand for such a train service. The service that the passengers are consuming is a cross-border train service from their origin to their destination.

6.2. Note on distortion of Level Playing Field

Secondly, we would like to bring to the Commission’s attention that a train service that suddenly transforms from a PSO to a commercial train service on an administrative border is by definition distorting the Level Playing Field on the so-called commercial part of the route. Passenger will not alight the train at the border and consider competing offers – most borders are nowadays crossed at full speed without stopping. But even when a train would stop at the border, passengers would still have a preference to stay onboard of the same train over changing to a competitor’s train and buying a new ticket – even if that train service was fully identical. The “hybrid service” would therefore also have an advantage on the “commercial” part, because of the PSO-part.

It is even more distorting for the single market when passengers can travel for a discount fare or free ride on the PSO-part, in example if passengers have a “student card” or a seasonal ticket, as it is common in many Member States. In that case, the hybrid service can charge a higher fare than competing services on the commercial part of the route, and still be cheaper for the overall cross-border route than the competitor’s train as that competitor would have to charge a higher price on the part where the hybrid service receives compensation via the PSO. This is not only distorting

competition, but will also prevent other operators to start international open access services as there is no level playing field or fair competition due to the incumbent's national PSO.

Although cross-financing is forbidden, it is very difficult to exclude and "track" in international hybrid PSO services. The Commission should therefore expand in the Guidelines further less harmful approaches to promote international passenger traffic by Member States.

6.3. Lack of transparency

In addition to hybrid PSO/Open Access services being unfair, as explained before, we have observed that some operators seem to be getting a market advantage by starting a "cooperation", usually on historical experience, and strategically hiring each other and allocating costs in different Member States. Whereas cooperation between the operators is legitimate, these cooperation exclude the deployment of other competitive services.

We observed a situation where one incumbent operator had a new international night train added to its existing directly awarded national PSO, with the argument that it was unprofitable to operate in that Member State. A more in-depth study of the case showed that the train service was mainly unprofitable because the incumbent had to pay high fees to another incumbent. As soon as the train crossed the border into another Member State, the roles were reversed, and the other incumbent hired and paid the first incumbent. The two incumbents were circulating money, whereby the part of the route in one Member State was artificially loss-making to legitimate compensation via a PSO, while the reality was that the train service would not loss-making if it were not artificially split up at the border but considered for the full cross-border route.

Furthermore, on exactly the same route in exactly the same Member State, the same incumbent operates an identical cross-border long distance service in terms of speed, quality, product, train type and track access fees but with a different final destination in a different country, yet that cross-border service is entirely commercially viable from start until finish.

Such abuse schemes are hard to detect as there is just a requirement of transparency on the PSO-part, which allows the operators to obscure financial flows by allocating them to the commercial part of the route and argue they are "company secrets" and "commercial information".

We advise the Commission to be very cautious regarding so-called cooperation between two market players that jointly operate an international train service and take advantage of each other's PSOs instead of operating the full route independently on a commercial basis, as was intended with the Third Railway Package in 2007.

6.4. Any legitimate hybrid service?

We believe that the Commission's perspective on hybrid services was based on situations where a clearly distinguishable PSO-service would be connected to a commercial service. In example a regional PSO-operator that operates a touristic train once per day that continues to a touristic destination outside its PSO-network. In that case it means two separate train services that are

operationally connected rather than hybrid. Such connections seem legitimate when it is possible to objectively and transparently distinguish the PSO-part and commercial part outside the normal network. This is a very different situation than what we see as hybrid services, where one single train service is artificially split at an administrative border into a PSO-part and a commercial part.

- Most “hybrid services” are incompatible with the principle of an international train service in one single European rail market, that they by definition distort the level playing field, lack transparency and promote PSO in cases where commercially viable services can be deployed. We therefore strongly suggest that the Commission reconsiders its position.
- Instead, the Single European rail market should be promoted and international train services should be considered for the full route, regardless the territory of the Member State.
- In case one of the concerned Member State concludes that the proposed international train service is not eligible for a PSO on its territory, the full route should be operated on a commercial basis. This is also consistent with article 1 (2), second paragraph, that states that the consent of all Member States is required before a Member State is allowed to add an international train service to a PSO.

The last paragraph of 2.1.3 could be interpreted as if the Commission would encourage Member States to administratively treat international passenger services as domestic services stuck together at the border, despite our belief that this is not the Commission’s intention and not in line with the establishment of the European rail market and the fundamental characteristic of an international passenger service as a cross-border economic activity. We therefore suggest changing the last paragraph of 2.1.3 by removing the last part: If a competent authority does not give its agreement to the proposed international public service, the entire passenger transport service shall be provided on a commercial basis.

7. Access to rolling stock

Article 5a is one of the core provisions of the draft. It must be ensured that equal access to rolling stock is guaranteed for all operators or bidders. In case of PSO, it is imperative that a route must be specified that secures that operators of transport services do not have a better position in a competitive procedure because they already have the rolling stock. It is particularly troubling when a state-owned incumbent that effectively enjoys exclusive access to a specific type of rolling stock or to new rolling stock (which can be perceived as quality criteria by some Member States) - stock that has been financed either directly by the taxpayer or by means of a PSO - is aware of its market power and is then potentially able to withhold such vehicles unless there is a PSO for a specific type of service. This can be akin to 'ransom' and would undermine a potentially commercially viable service. Only yesterday, at an online night train event, an representative of incumbent ÖBB said: "From 2024, new regulations for fire protection will apply in Italy. Then de facto only we will be able to travel there with our new night trains."² Does this mean ÖBB can essentially

² <https://www.berliner-zeitung.de/mensch-metropole/nach-london-oslo-madrid-so-koennte-das-berliner-nachtzugnetz-wachsen-li.210676>

'demand' a PSO for cross-border night train services to and from Italy in the future - otherwise its rolling stock will be used elsewhere?

The availability of rolling stock must therefore not be a criterion for awarding a contract and enough time for all operators to possibly acquire a rolling stock have to be ensured. It must also not be the criterion for having PSO in the first place. The competent authorities must ensure that third-party operators also have the same opportunities in the award procedure, either by observing appropriate lead times in the award procedures that also allow for the procurement of new rolling stock or by ensuring access to the rolling stock of the existing operator.

8. International services: tender & Direct award

We believe that vast majority of international lines can be operated on open-access basis. If PSO is justified, the awarding procedure currently in a huge majority of cases favours the state-owned incumbent operator. If there are to be cross-border PSO, they must be awarded only competitively to ensure fair competition. Such tendering procedure must start 4 years before the start of operations to secure that newcomers have a chance to offer. Any discretion on the part of the competent authorities must be ruled out.

We welcome the clarification in paragraph 2.4.8 that article 5(6) may not be used to circumvent the phasing out of the unconditional direct awards. We suggest that the Commission might also add the reasoning why article 5(6) was not directly abolished in 2017, which was in our perspective to prevent that the already ongoing award procedures would have to change to another procedure. In our opinion, it would not be desirable to start new award procedures based on article 5(6) after the new legal framework of the EU 4th Railway Package came into force in 2017.

We observe that some Member States interpretate article 5(6) in a way that they can unconditionally direct award and therefore not fulfil the general requirements for PSOs.

We would therefore suggest the Commission to elaborate that "Any direct award based on article 5(6) is not fully unconditional, as it would still need to comply with the general legal framework for PSOs, such as the identification of a real demand, the existence of market failure and the condition of proportionality and doing the least harm to the functioning of the market."

In case of transitional arrangements, in the Guidelines the restrictive approach regarding of the Article 8(3)(d) and Art 4, the Guidelines do not emphasise enough that the term of contracts directly awarded in 2023 cannot be extended. This principle must be maintained.

However, the possibility of extending a contract by up to 50% of its term must be critically questioned. It is questionable whether it would not make more sense for the operator to have to hand over to a successor operator any operating equipment it has acquired that it can no longer use outside of this service contract. Competition would be more possible in such cases: the operator of a PSC has the option of using resources elsewhere or handing them over to the downstream operator. In this way, the power of disposal over these resources does not lead to any advantages in the award process and there is equality of opportunity between the bidders.

We would also like to ask for the Commission's clarification on the position in the final paragraph on 2.2.5 (page 12 of the Draft Guidelines) that direct awards before December 2023 cannot exceed ten

years. In view of some of the Member States it means they can use the interim exception adding 50 % to 15 years, and effectively close the country for competition until 2039. We believe it contradicts the objective of the Regulation.

9. Proportionality

We agree with the Commission's analysis on the principle of proportionality in relation to the geographical scope in paragraph 2.2.3, but we suggest to further elaborate on this as we observe that some Member States have PSOs covering (almost) an entire country or creative "gerrymandering" to prevent new commercial services.

We suggest adding that train services might be bundled into a package of coherent train services, but that such package should not be bigger than necessary and in the least harmful manner for the internal market. We also suggest to explicitly state that this means that it is not allowed to design one PSO for an entire country or a considerable part of the market.

Currently there is often a difference between a service and PSC, they do not correspond. Such situation makes it difficult to assess current services whether they are justified. Moreover, in some Member States it is even unclear what parts of the network are open-access and what parts are PSO. We also suggest elaborating that if just certain trips of a generally cost-covering train service are non-cost-covering, the appropriate way in the light of the Principle of Proportionality would be to procure just the missing non-cost-covering trips via a PSO instead of the whole train service. If the volume of the missing services is below the threshold of article 5(4), it could be even a direct award to the operator that is running the generally cost-covering train service on a commercial basis.

