Council of European Municipalities and Regions
European Section of United Cities and Local Governments

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CEMR reply to the consultation the Draft interpretative guidelines concerning Regulation (EC) No 1370/2007 on public passenger transport by rail and by road

The Council of European Municipalities and Regions (CEMR) is the broadest organisation of local and regional authorities in Europe. Its members are over 60 national associations of municipalities and regions from 40 European countries (www.ccre.org). CEMR is actively working on a number of issues of high interest to local and regional government, including local public services, public procurement and transport.

CEMR welcomes the opportunity to share its opinion on the draft interpretative guidelines concerning the implementation of Regulation (EC) No 1370/2007. The following contribution presents the views provided by CEMR members.

General remarks

CEMR welcomes the efforts to revise the guidelines to recast Public Service Obligations (PSO) Regulation and adjust to the current judgements of the ECJ. However, the non-paper of the draft interpretative guidelines does not clarify the interpretation of the legislation with regard to public transport but, on the contrary, causes practical problems, legal uncertainty and administrative burdens for the organization of public transport. The maintenance and development of public transport services in the post-Covid-19 period would require a stable and predictable regulatory environment. This is also essential for achieving the climate goals for the transport sector. The importance of public transport (PT) and the combination of the PT with new forms of mobility services have also recently been highlighted in the Urban Mobility Framework (UMF) published by the EC. It is even mentioned that these shared services should form part of PT in certain areas. Several statements made by European Commission in the non-paper of the new interpretative guidelines,

such as the **very narrow definition of a public service obligation under Point 2.2** for example, would be contrary to this objective of the UMF.

Therefore, CEMR and its members are deeply concerned that the non-paper on the interpretative guidelines – in particular Chapter 2.2.3 relating to the definition of public service obligations – **goes beyond the text of the Regulation and contains a restriction on the application area of the PSOs and their related public service contracting options**. The revised guidelines seem to contradict the concept of the Regulation by which public service obligations are indispensable to enable a higher quality of local transport services in the Member States. In our view, this basic decision must not be called into question or even be reversed by additional bureaucratic hurdles and additional obligations to provide evidence.

A central objective of the regulation is the control of state aid and the prevention of overcompensation[1]. This is ensured in particular by the instrument of public tendering. **Tendering procedures guarantee market prices and prevent overcompensation**. The Commissions revised guidelines would undermine this basic principle and try to introduce new formal and procedural requirements that precede the actual public tendering procedure and the decision on the award of public contracts.

The revision of the guidelines is also an **opportunity to align with recent EU strategies such as the European Green Deal and the Sustainable and Smart Mobility Strategy[2]**. However, there are several statements in this non-paper which hamper the development of sustainable and smart mobility in general and public transport , and therefore runs counter to the achievement of the objectives of the European Green Deal.

Specific remarks on the draft revised guidelines

On paragraph: 2.1.5 Article 1(2). Multimodal public service obligations

In the coming years, an increasing use of flexible forms of public passenger transport services is to be expected in order to ensure accessibility, especially in sparsely populated (peripheral or rural) areas and at off-peak times, in the sense of an adequate basic service and as part of an extended local public transport service. Therefore, it should be clarified in the guidelines that such forms of flexible on demand services can be part of a public service contract, as Regulation (EC) No 1370/2007 is, by no means, limited to line-bound transport services.

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[1] See CEMR general position on state aid rules, also quoted below.
[2] See CEMR key messages on Smart and Sustainable Mobility Strategy

On paragraph 2.2.3: Article 2 point (e) and Article 2a. "Definition of the nature and extent of public service obligations and of the scope of public service contracts"

- **General principles and definition of public service obligations**

This section contains detailed definitions of when a PSO can apply. We consider these to be excessively restrictive and potentially problematic in practice. As a result, the admissibility of granting public service contracts in accordance with the PSO Regulation would be reduced. We would furthermore like to stress that there is no attempt to circumvent the rules of competition, as the Commission insinuates, when applying the provisions of Regulation (EC) No 1370/2007, because these are the relevant rules of competition.

- **Consistency with objectives of Member State's public transport policy**

According to the draft, public service obligations must be consistent with the "*Member States' public transport policy documents*". However, this does not correspond with the wording of Article 2a of the Regulation, which speaks of policy documents "in the member states", not "of" the Member States. Here, as elsewhere in the revised guidelines, the level of the Member states and the level of the local competent authorities get mixed-up. It is our strong opinion that the need for public transport services can be assessed reliably only at a regional and local level, and stakeholder participation – in a meaningful way - can be organised only there.

The EC aims to embed rules in the guidelines which must be contained in the strategic papers of the Member States (e.g. the development of sustainable transport, also with demands for a quantitative assessment of the services offered on each line in particular). Furthermore, the Member States should also involve certain stakeholders in the formulation of these strategies according to Article 2a, para. 1 (last sentence) of the PSO Regulation "*The content and format of public transport policy documents and the procedures for consulting relevant stakeholders shall be determined in accordance with national law*".

Given that these previously mentioned rules contradict the text of the PSO Regulation, this is no longer a permissible interpretation and must therefore again be deleted in this detailed form. In respect of the subsidiarity principle, the Member States, local and regional authorities are permitted, particularly with regard to urban public transport, to decide themselves how and with which contents these strategies are prepared.

- **Existence of a real need for public service obligations**

In its non-paper on the guidelines, the EC proposes a completely new procedure for establishing the need for or the necessity of a public service obligation. However, given that the guidelines are legally non-binding in nature and only intended to aid interpretations of the Regulation, this procedure cannot be legally binding in nature and must permit alternatives. This new procedure leads to considerable legal uncertainty for the entire sector and should therefore definitely be diluted or again deleted.

Here the EC proposes the competent public authority should assess whether customer demand exists which cannot entirely or partially be satisfied by a market actor without a public service obligation. According to the EC, such a requirement would only exist if demand cannot be entirely satisfied by '*market forces*'.

As previously mentioned, these very strict rules contravene the principle of subsidiarity, particularly in the case of urban public transport. Competent local authorities are best able to estimate which measures need to be implemented in the course of such an assessment. A uniform EU-wide rule is not expedient in this case. It is evident that such demand exists. There would therefore be an unnecessary administrative burden were the competent public authorities required to undertake surveys in this regard. It should recalled and thus not ignored that public transport policies have a territorial and social integration function and that public transport services represent essential public services which must be accessible to every individual under the same terms. It is often challenging or impossible to provide these services on a profit-oriented basis even more in a pandemic or post pandemic situation in which local public transport have been and are still strongly affected by lock down measures and the development of teleworking..

What is extremely problematic is the statement that partial fulfilment by commercial operators would be sufficient. This would lead to a splitting of services and urban public transport system. This would culminate in cherry picking by private operators who would only operate lucrative routes. Public sector operators would therefore only continue to operate non-profitable lines, which would lead to a form of discrimination. The reference to the decision of the ECJ in the SNCM case (judgment T-454/13) is not appropriate in this context given that public transport, particularly in cities, is not comparable with passenger shipping services. In many other areas of Union Law, such as that relating to passenger rights, a clear differentiation is also made between the various modes of transport. In the case of PT in cities, it is essential to offer a range of services coordinated between the various transport providers (coordinated schedules in order to ensure good connections) so as to effectively take into account customer requirements along the entire route. This would not be possible in the case of several operators (particularly public sector and private sector operators) on various routes. It must also be permissible to consider several transport modes on a macroeconomic basis. An optimally integrated overall range of transport services as attractive alternatives to individual private transport is ensured should be considered. Besides the advantages from a passenger perspective, the transaction costs (contracting, monitoring, interfaces, etc.) of this model are also considerably lower than those in the case of splitting the services offered. The same applies in the case of the EC rule that operators should be asked by means of a consultation process for every route whether they wish to operate these routes (refer here to the subpoint "Analysis of the market failure" on page 9 of the Commission non-paper on the Interpretative Guidelines).

There is also a practical aspect to market consultation. In most urban areas, where public transport has been organized and financed by public authorities and/or public companies for decades or more, there are in fact no commercially oriented operators in the local market. Who exactly should be consulted and how? Open line-by-line negotiations are not possible in practice.

It is also unclear how to interpret "*market forces*". It is mentioned in this context that there is only a need for public service obligations if market forces alone are insufficient. From our point of view, this contradicts the previously mentioned formulation which seems to refer to a splitting of service offerings. It is important in the interests of offering services tailored to the needs of customers, on the one hand, and from a commercial perspective, on the other, that the entire range of public transport services offered in a city is considered and not simply individual lines when public authorities make their assessments. For this reason, the formulation "*even partly*"[3] must therefore be deleted. The interaction between public transport and new mobility services should also be taken into account. Rather than competing, these services complement each other. This is also a clear statement on the part of the EC in its recently published Urban Mobility Framework.

- ***Ex-ante* assessment of the demand for public transport services**

According to the draft guidelines, there must be a '*real need*' for the public service requirements. However, the notion of "real need" is narrowed to '*user demand*', which, in addition, is to be assessed and determined by customer surveys. This is far too narrow, insufficient and unsuitable to define the required level of public service obligations. The ex-ante assessment of the actual demand for public transport services prior to initiating the contracting of a PSO in this form is not legally prescribed in several Member States and could lead to extensive delays in the case of such contracting procedures. The involvement of all stakeholders – including affected residents, neighbours, etc. – during the early stages of such projects as proposed in the draft interpretative guidelines – could endanger the relevant project at the outset due to the discordant assessments it would be exposed to.

Furthermore, the Protocol 26 states that SGEIs should be organised "*as closely as possible to the needs of the users*", which implies the general interest of a community over time, and not the views expressed by a limited number of people at a given moment. Sustainable territorial development is dependent on integrated planning of land use, housing and transport. Many public transport projects, especially rail network extensions, are part of totally new development projects, where the residents and potential customers are not yet identifiable for consultation. The assessment of the needed level of public service must not complicate the planning and organisation of public transport and must not restrict the possibility to provide a level of service exceeding current demand. The level of service to be attained should be set by future-oriented local transport concepts (for which customer surveys may provide a basis but are only one of several possible aspects). In order to encourage people to switch to bus and rail for reasons of climate protection and for more liveable cities and rural areas, a level of service must be provided that offers a better and more extended local public transport than before to represent an attractive and viable alternative to less sustainable transport modes. In a strict

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[3] "*The Union courts have made it clear that before laying down specifications for public service obligations, the competent authority should assess whether there is a genuine need for the planned public transport services and to that end, whether there is a genuine demand from users that cannot be addressed, even partly, by market operators in the absence of public service obligations*" (non-paper, p. 8)

interpretation of the Commission's guidelines, this would not be admissible. Therefore, the guidelines need to be amended and clarified accordingly. In any case, the concept of a "real need" must include the creation of future user demand.

- **Analysis of the market failure**

The Commission's revised guidelines require a 'market failure' to be demonstrated in advance. In this regard, the Commission seems to demand some kind of "market investigation procedure". However, Regulation (EC) No 1370/2007 views regulated competition ("competition for the market") as the general rule, while completely unregulated competition is seen as an exception.

In our view, a 'market failure' within the meaning of the guidelines must be assumed in general and in all member states, because the overall revenues of public transport do not cover existing costs. In this context, an examination of the market failure 'for each route', as apparently required by the Commission, contradicts the explicit provisions of the Regulation. It would be diametrically opposed to the possibility of grouping cost-covering and non-cost-covering services as explicitly permitted and desired by the regulation. It would invite cherry picking and would require an inefficient use of public subsidies.

On the grounds of the subsidiarity principle, the Member States and local and regional authorities have to decide not only which aspects surveys should cover but also how they establish that the imposition of a public service obligation is necessary. The requirement to perform surveys with certain operators is also too far-reaching in this context. Here is also again the problem of which operators should be involved and if opinions can be considered as solid evidence. After all operators would not be bound in any way to their responses, and there would always remain a risk of market failure in practice. The time scale of providing efficient transport services does not enable a short-term reactionary approach to market failure, which would be the likely outcome of this requirement.

According to the EC, an analysis of market failure should also take into account comparable transport services which are provided by other forms of transport. It is however unclear which modes of transport are meant here. Public transport services by rail or road have been proven to be the most environmentally friendly form of mobility. As such, a comparison in this context is not expedient.

For the reasons mentioned above, we strictly reject a more elaborate market investigation procedure, especially with regard to individual routes or groups of routes in a given area.

- **Selection of the least harmful approach to functioning of the internal market**

This section defines a general rule as having less impact on the market than a public sector obligation in the form of a contract and should therefore be adopted. However, a general rule permits the public authority less flexibility in terms of changing circumstances then is the case with a bilateral contract. These general rules are also often extremely vaguely formulated and have a much more limited range of application. Such a ranking is also missing in the text of the Regulation. General rules can therefore not be generally regarded as equally suitable, milder means than the public service

contracts. These two cannot be equated, which is also in compliance with the Regulation (EC) No 1370/2007, which views the award of a public service contract as the default solution and regards the adoption of general rules only as an exception. There is a good reason why general rules have not been widely adopted over 15 years of PSO regulation. The compensation rules have been found extremely difficult to implement in practice without authorities being exposed to great uncertainty of legal and financial implications.

- **Possibility to group cost-covering services and non-cost covering services in the public service contract**

The Commission also applies very strict criteria here which go beyond those defined in the text of the Regulation. The competent public authorities need to be very precise with regard to this definition. Should the public authority make an error here, this could result in the entire compensation being considered to be unlawful aid and this would have to be repaid.

The Commission restricts the possibility to group cost-covering services and non-cost covering services by referring to the "real need of the public service" and by stating that the grouping must serve the goal of a "coherent transport system" and of "reaping the benefits of positive network effects" rather than "only limiting the amount of compensation". However, this differentiation appears theoretical and creates legal uncertainties for the formation of local transport networks.

With regard to the network effects, it is essential in terms of reducing the overall costs of public transport services and the continuity of these that the option of granting a public service contract is not restricted to non-profitable PT services. Since they are best able to assess this, the competent public authorities must have a certain degree of discretion here in order to decide which services are covered by a PSO and which are not. Network effects and other positive externalities, such as social inclusion, accessibility and environmental impact, are only fully realised with an integrated public transport offer. Fragmentation of the service would have a negative impact on urban regions. The Covid pandemic has also very dramatically demonstrated that profitability and thus continuity of commercial transport services is not a permanent status but a very fragile condition.

- **Invalidity of public service contracts in the event of infringement of the requirements**

Lastly, and not least problematic, the Commission holds the view that a breach of the above procedural requirements makes the award of a public service contract inadmissible and invalid and would require a complete recovery of all grants. This would lead to hardly controllable legal and economic risks for the award of public transport services, especially as there is no time limit. Public service contracts, even when awarded in a public tendering, could be called in question even after many years. This is particularly problematic, as, in addition, the Commission's comments indicate no restriction to a 'manifest error'. Rather, any violation of the procedural requirements seems to potentially and permanently call into question the awarded contracts.

We reject this view strongly as it would make it substantially more difficult or almost impossible to provide public transport services. In view of their far-reaching and detrimental consequences, the

Commission’s guidelines need to be reconsidered and amended. The assessment under State aid law must be limited to the question of overcompensation. There needs to be a broad discretion for the Member states. They must be able to exercise freely and without procedural restrictions, especially in view of climate policy objectives. Furthermore, we would like to point out that a public tendering does not interfere with the fundamental freedoms of the European Single Market, as the Commission apparently believes. Quite to the contrary, the award of a public service contract under Regulation (EC) No 1370/2007 serves precisely to organise a market competition in accordance with the European Single Market. Thus, a public tendering is not a restriction of the European Single Market or its freedoms, but rather the securing and enablement of these freedoms.

The decision of the General Court in the SNCM case, on which the Commission relies to justify its restrictive procedural requirements, related to state subsidies for ferry services in the Mediterranean Sea. However, the facts of the case and the reasons for the decision cannot be transferred to public passenger transport in general. In contrast to ferry connections, public transport competes strongly with other mobility alternatives, especially with motorized individual transport. If the Commission and the member states want to shift traffic to more sustainable transport modes, public transport services must be especially attractive.

Furthermore, the reference to the SNCM case is not convincing from a legal point of view, neither. Regulation (EC) No 1370/2007 precludes a recourse to criteria comparable to the judgment of the ECJ in case Altmark Trans. On the other hand, the compensation granted in maritime transport is based on Article 106 (2) TFEU, whereas that in public transport is also based on Articles 91 and 93 of the TFEU. The new interpretations in the draft guidelines would cause many legal uncertainties and make the tendering procedures even more vulnerable to legal actions. In order to ensure the award of public transport services and allow for a shift to more climate-friendly transport modes, the Commission’s guidelines need to be reconsidered and amended.

On paragraph: 2.4.6. Article 5 (4a). Conditions under which competent authorities may directly award a public service contract for rail in case of certain structural and geographic characteristics of the market and network and of performance improvements

In 2.4.6. of the draft guidelines the EC states that the provision on performance-related direct awards should be interpreted restrictively. We see this very critically: First of all, one can assume that the European legislator, who explicitly allows direct award under certain conditions, intended to have a corresponding scope of application, which should not be nullified by a restrictive interpretation. Recital 25 of the amending Regulation (EU) 2016/2338 clearly speaks in favour of a coexistence of equal rank between competitive award and performance-based direct award if the corresponding requirements are met.

Furthermore, the Commission seems to ignore the exact wording of the provision with regard to the individual direct award requirements: The provision only requires that the direct award is justified in the opinion of the competent authority ("in its opinion" or "where it considers") – which clearly speaks in favour of (i) focusing on or recognizing the subjective view /broad discretion of the authority and (ii) not overstretching the review of obligations for the competent authority in this area. This should be clarified accordingly, therefore the sentence “should be based on objective grounds” in the non-paper needs to be deleted.

In application of Article 5 (4a) the EC apparently requires a justification of the direct award by means of a comparison that in certain cases the improvement cannot be achieved by competitive tendering. Apart from the fact that such a comparison is unlikely to be feasible in practice, the EC also clearly departs from the wording of the provision here. A comparison to a hypothetical tender is not required by Article 5(4a). Subparagraph (a) merely requires that the direct award of the contract is justified in the opinion of the competent authority on the basis of the respective structural and geographic characteristics of the market and the network concerned. With regard to efficiency and quality considerations, subparagraph (b) is decisive, and here the "old contract" is the relevant benchmark (i.e., likewise not the results of a hypothetical tender). The parts „cannot be achieved by competitive tendering“ and „which the Regulation presumes to be achieved more effectively, in principle, by competitive tendering“ should therefore be deleted in the draft.

On paragraph 2.2.6. Article 4(7) and Article 5(2)(e). Conditions of subcontracting

Article 5(2)(e) Regulation (EU) No 1370/2007 requires the internal operator to provide ‘*a major part*’ of the public passenger transport service itself. As in the existing interpretative guidelines, the Commission continues to take the view that an internal operator must therefore provide at least two thirds of the transport service itself. It implies that a special justification is required for subcontracting more than 33%. However, this limit is set arbitrarily. The wording of Article 5(2)(e) states that an internal operator must provide ‘*the major part*’ of the passenger transport service itself. This can either be interpreted in relation to the transport service *as a whole* or – more narrowly – only in relation *to the parts of the service provided for* by other operators (i.e. subcontractors). In the first case, the execution of more than 50% of the transport service would already constitute the “bigger” (i.e. the major) part of the transport service and would thus be sufficient to meet the requirements of the Regulation. In the latter case, even less than 50% would be sufficient (for example, an internal operator performs 25 or 35% of the service itself, while a number of other operators (subcontractors) provide each between 5 and 10% of the service).

In no case, however, does the wording of the regulation support the Commission’s exceedingly narrow interpretation that the internal operator needs to provide “at least two thirds” of the transport service itself. The Commission’s interpretation would make sense if Article 5(2)(e) required internal operators to provide “by far the major part” of the service. However, this is not the case. Thus, the Commission’s comments restrict unduly the possibility of subcontracting and need to be amended.

We would also like to point out that recital 19 of the Regulation has a much more favourable view of subcontracting by stating that “subcontracting can contribute to more efficient public passenger transport and makes it possible for undertakings, other than the public service operator, which was granted the public service contract, to participate”.

In our view, subcontracting is indeed a good means of offering smaller companies a chance to become active on the market. It also enables the necessary flexibility in the short-term implementation of service extensions which are necessary to meet climate protection goals. Therefore, pursuant to recital 19, the Commission’s revised guidelines should make clear that the competent authorities, as laid out above, are assigned a much broader margin of appreciation to determine the modalities for subcontracting the case of services performed by an internal operator.

On state aid rules

CEMR is in favour of a regulatory state aid regime at EU and international level to limit arbitrary practices and artificial barriers to competition. The aim of the EU rules is rightly to ensure that fair competition is not unduly distorted by one organisation or business receiving public money to the detriment of its competitors.

Local and regional governments organise and provide essential services for their citizens and businesses, and they strive to deliver efficient and high-quality public services, which can be delivered in many different ways. The prevailing intention is not to circumvent competition rules, but – depending what procedure is adequate and appropriate – either launch a public procurement procedure and/or deliver via a public enterprise, rather than provide state aid (such as a grant or subsidy) directly to an organisation or a business active on the market.

Local and regional governments consider the state aid regime to be very complex, requiring knowledge of different pieces of EU legislation depending on the sector concerned, the purpose of the aid, and the financial amounts involved. This complexity can even stop valuable local projects from going ahead. The examination of whether state aid is involved requires in general external legal advice, and its costs are often disproportionate to the amount of money involved.

CEMR also deems that the European Commission should focus on large scale awards of aid – thus confirming the approach of the Commission, which concerns economic practices that really distort intra-EU trade. In its "Notion of Aid"[1] Communication and other decisions (subsidies for local culture/minority languages, local hospital and care centre refurbishment, sport centres and local infrastructure renewal), the Commission has taken the next logical step towards recognising that awards of financial support can be 'purely local' in nature, and thus not even constitute state aid at all. The Commission should continue to exempt an even wider range of local activities due to their 'purely local' nature.

However, the European Commission tends to unnecessarily limit local services by defining them as services of general economic interest, despite the fact that its role is restricted to rectifying 'manifest errors' in SGEI definitions adopted by the Member States[1]. Almost all cases of local SGEI do not have internal market relevance and their funding does not qualify as state aid.

CEMR therefore call on the European Commission for:

1. Simplification of the aid process itself: light-touch notification and reporting requirements focussing purely on larger awards of aid; rapid and transparent assessment and approval of aid, taking full account of the public benefits that the aid delivers.

2. Continue to develop new flexibilities for aid of a 'purely local' nature which delivers public-interest objectives.

3. A greater use of block exemptions and increased thresholds for de minimis provision that would be beneficial and help to achieve our request of simplification. These two steps

would allow to focus on the more distortive type of aids, and relieve public bodies from the need to notify several forms of aid.

4. A reversed burden of proof, which still lies with the public authorities: local public services should be exempted from the internal market and competition rules unless the Commission is able to prove that a local service has an impact on intra-EU trade.

5. EU state aid law should not be misused to regulate certain policy sectors which the EU does not succeed to regulate by dedicated legal instruments, e.g. the energy sector and housing, where the European Commission promotes a residual concept of access to social housing, focusing on disadvantaged citizens or socially less advantaged groups.

6. There is a real democratic deficit in the area of state aid law as the European Commission has the exclusive competence to set the applicable law and to control its application. In the longer term, all legislation in this area should be done by ordinary legislative procedure with the European Parliament and the Council. This requires a change of European primary law.

[cf. CEMR paper "The Future of Public Services in Europe"]

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