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Revision of Interpretative Guidelines concerning Regulation No 1370/2007

1. Introduction

The Community of European Railway and Infrastructure Companies (CER) would like to thank the Commission for this opportunity to share our thoughts in light of the upcoming revision of the "Communication from the Commission on interpretative guidelines concerning Regulation (EC) No 1370/2007 on public passenger transport services by rail and by road" (hereinafter "Guidelines"). Provisions of the Guidelines are of great importance for the railway sector as they ensure coherent application of the Regulation 1370/2007[1] (hereinafter "Regulation").

Overall, CER members find the Guidelines to be very helpful and clear. However, some points are either not reflected in the Guidelines yet, or require further clarification. In particular, CER members would like to stress that it is important that the Guidelines reflect subsequent changes to the Regulation as well as relevant existing case law of the CJEU. At the same time, it should be noted that Guidelines are of a non-binding nature, may not create new legal obligations, and shall be strictly limited to interpretation of the Regulation (without prejudice to any subsequent interpretation issued by the CJEU). In the following paragraphs it is outlined which clarifications in our view should be added to the updated text of the Guidelines.

2. Article 2a(2): compensation should always fully financially sustain provision of the public service

Article 2a(2) of the Regulation reads as follows "*The specifications of the public service obligations and the related compensation of the net financial effect of public service obligations shall: (a) achieve the objectives of the public transport policy in a cost-effective manner; and (b) financially sustain the provision of public passenger transport, in accordance with the requirements laid down in the public transport policy in the long term*".

We would like to refer to the statement that "*compensation… shall… financially sustain the provision of public passenger transport*". In regard to situations when competent authorities unilaterally impose public service obligations on operators, and therefore no negotiation of conditions of the public service contract takes place between an operator and a competent authority, it is unclear whether the quoted part of Article 2a(2) should be understood as meaning that the competent authority shall always provide the public service operator with sufficient amount of money to cover all the costs of provision of the respective public service. If this interpretation is correct, in case a public service contract, which was unilaterally imposed on an operator by a competent authority, does not provide for a sufficient compensation and such public service is performed by the operator at a loss, would it be possible to challenge such public service contract as not fulfilling the

[1] Regulation (EC) No 1370/2007 of the European Parliament and of the Council of 23 October 2007 on public passenger transport services by rail and by road https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A02007R1370-20171224

requirement of Article 2a(2) as the compensation does not "*financially sustain the provision of public passenger transport*"?

In our view, the Guidelines should clarify the provision of Article 2a(2), explaining that it should be understood as meaning that when a competent authority imposes a public service obligation on an operator, it shall always compensate the operator for the provision of such public service in full, and if it is not the case, such public service contract is not in line with the Regulation.

3. Article 4(8): 'information essential for the award of public service contracts' should be understood in a narrow way

In our view, the notions of '*information essential for the award of public service contracts*' and '*relevant information*' contained in Article 4(8) should be interpreted narrowly. Broad interpretation, i.e. the need to disclose various commercial figures, will create wrong incentives for potential bidders and will result in considerable weakening of the price competition. Moreover, broad interpretation of the notions '*information essential for the award of public service contracts*' and '*relevant information*' referred to in Article 4(8) would also not be in line with the principle of equal treatment of bidders embedded in the current European procurement law, as the current operator of the newly tendered contract would be exposed to a structural disadvantage when making the new offer.

In particular, we believe that, with regard to the disclosure of costs, the principle of legitimate protection of confidential business information should be understood as meaning that the competent authorities may disclose to interested parties only aggregated data and / or bandwidths, which are not divided per type of costs and do not provide any detailed elements of the costs. Besides, some types of information, due to its commercial sensitivity, cannot be disclosed to third parties at all. Hence, we would welcome if the updated text of the Guidelines further stressed the importance of protection of confidential business information and provided specific examples of data that are usually protected by confidentiality. We believe this should be, in particular, all prices, specific costs and calculation data of the current provider. Likewise, processed data (e.g. growth predictions), where the provider invested financially in order to gain a competitive edge should be protected.

4. Article 5(2)(e) and Article 4(7): further clarification in regard to the part of a contract that can be subcontracted is needed

According to the Regulation, subcontracting by an internal operator is permitted on the condition that '*the major part*' of the public passenger transport service is performed by the internal operator. The current text of the Guidelines in its point 2.2.9. on Article 5(2)(e) of the Regulation states that "*subcontracting more than one third of the public transport services would require a strong justification*", meaning that '*the major part*' is being interpreted as at least two thirds of the contract. We believe that this interpretation goes beyond the provision of the Regulation and is more restrictive, as 'the major part' does not necessarily mean 'not less than 66,66%'.

Besides, the text of the Regulation does not contain an obligation for the competent authority to provide a justification as to why it has decided to allow subcontracting for a certain share of the public service contract. Thus, the provision of point 2.2.9. of the Guidelines stating that the competent authority has a special duty to justify subcontracting of more than one third of the contract also establishes additional requirement that Regulation does not contain.

At the same time, the current text of the Guidelines does not contain any clarification on what should be understood under '*a major part*' of the contract referenced in Article 4(7) of the Regulation, which contains the general provision on subcontracting. In particular, it could be noted that in the German language version of the Regulation Article 4(7) uses the word '*bedeutend*' which is usually translated to English as 'significant'[2], and which does not necessarily mean "not less than 50%". In practice, which is also confirmed in national case law[3], certain competent authorities often set the part of the contract that cannot be subcontracted at 20-30% of the contract. We would welcome if the same interpretation is reflected in the updated text of the Guidelines, i.e. that '*a major part*' should not be interpreted as 'at least 50% of the contract', but should rather mean a considerable part of the contract, always to be determined by each competent authority. It could be noted that '*a major part*' of the contract may also be interpreted not from the quantitative perspective, but rather qualitatively, i.e. as a part that has essential and/or strategic importance for the whole contract. It is also important to note that such interpretation allows for more undertakings to actually provide services under the public service contract and, hence, supports competition. Promotion of subcontracting could possibly enhance the eligibility of smaller entities to participate in public services in case where the size, financial and/or technical potential of such entities would be insufficient for them to independently operate public service contract on their own.

In addition, we would also find beneficial if the Guidelines provided clarification that, in a case where a competent authority imposes on the operators an obligation to establish a separate subsidiary specially dedicated to the operation of a public service contract, if the respective public services are instead provided by the parent company on behalf of such dedicated subsidiary should not be considered as subcontracting, especially when it was the parent company(-ies) who submitted the offer during the competitive tender procedure.

5. Some concepts introduced by the Forth Railway Package in Articles 5(3a-4b) require further clarification

We would appreciate if the updated text of the Guidelines provided further clarifications to the direct award procedures introduced by Forth Railway Package in Articles 5(3a) - 5(4b). In doing so, the Guidelines should fully respect the political compromise contained in the wording of the provisions of the Regulation, without creating any additional requirements or restrictions that are not explicitly outlined in the legally binding text.

Article 5(3b) on direct award when there is only one interested operator

A clarification would be desirable as to when the intention of the competent authorities to start negotiations with only one interested operator (and the consequential conclusion of a contract with this bidder) could be subject to a review within the meaning of Article 5(7).

Article 5(7) states that "*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 …*". Article 5(7) speaks about 'decisions', while Article 5(3b) only refers to a decision to apply the procedure, i.e. to publish information notice on the award of public service contract. Therefore, in our opinion, the wording of Article 5(3b) suggests that only the initial decision to apply the negotiation procedure constitutes a 'decision' within the

[2] In contrast, in Article 5(2)(e) the German text refers to "überwiegenden Teil" – "predominant part".
[3] Court decisions supporting a 20-30%-threshold e.g. Vergabekammer Lüneburg, decision from 28.11.2016, VgK-43/2016; Vergabekammer Rheinland, decision from 19.9.2017, VK VOL 12/17. There are also some legal doctrine that supports this threshold, for example *Saxinger* in: Saxinger/Winnes, Recht des öffentlichen Personenverkehr, Art. 4 VII VO 1370 para 37; *Linke/Prieß* in Linke, VO (EG) 1370/2007, Art. 4 para 93; *Schmitz/Winkelhüsener* EuZW, 2011, 52 (56).

meaning of Article 5(7). If all criteria outlined in points (a)-(d) are fulfilled, subsequent steps such as negotiations with the one interested operator or the award of the contract to this operator, could not be subject to a review within the meaning of Article 5(7).

At the same time, we would also like to underline that this only applies to the situation outlined in the Article 5(3b), i.e. when the competent authority made public their intentions to award a public service contract and after a fixed period of not less than 60 days only one operator has expressed its interest. If, however, several operators expressed their interest in participating in the procedure to award the public service contract, it should be possible to review, within the meaning of Article 5(7), subsequent decisions of the competent authority such as to initiate the competitive tendering procedure and to award the contract to one of the bidders.

Articles 5(3a) on direct award in exceptional circumstances and Article 5(4a) on direct award justified by special characteristics

Article 5(4a), point (a) states that "*relevant structural and geographical characteristics of the market and network concerned*" justify the direct award of public service contract for public passenger transport services by rail. CER would welcome guidance on what kind of justification is expected to be provided by the competent authority. From the wording of the point (a), which starts with "*where it* [competent authority] *considers that the direct award is justified…*", it can be concluded that such justification is of a subjective nature. Consequently, it could also be concluded that a review within the meaning of Article 5(7) should not examine the objective existence of the respective characteristics, but rather only focus on whether the competent authority had the basis to assume that such characteristics justify the direct award. The opposite conclusion, i.e. that justification to be provided should be of an objective nature, would leave the words "*it considers that*" in point (a) without any meaning.

The same logic is applicable to the first indent of Article 5(3a), which requires that "*the competent authority considers that the direct award is justified by exceptional circumstances"*. Just like in the case of Article 5(4a), point (a), the wording of the Regulation points to the fact that justification in this case has a subjective nature, and the subsequent review would therefore need to focus on the question whether the considerations of the competent authority did not contain an error from an *ex ante* perspective.

Besides, there is a discrepancy between the texts of Article 5(4a) letter (a) and recital 25 of the Regulation 2016/2338. The text of the letter (a) of Article 5(4a) reads as follows: "*the competent authority may decide to award public service contracts for public passenger transport services by rail directly: (a) where it considers that the direct award is justified by the relevant structural and geographical characteristics of the market and network concerned, and in particular size, demand characteristics, network complexity, technical and geographical isolation and the services covered by the contract, and (b)…*". At the same time, the recital 25 to Regulation 2016/2338 states that where "*certain conditions related to the nature and structure of the railway market or the railway network are fulfilled, competent authorities should be entitled to award public service contracts for public passenger transport services by rail directly…*".

While the recital refers to "*railway market or the railway network*", implying that it would suffice if only one of them has certain 'structural and geographical characteristics', letter (a) of Article 5(4a) refers to "*market and network*", indicating that both market and the network should have such relevant characteristics. Therefore, we would suggest that the Guidelines clarify whether two elements listed in letter (a) of Article 5(4a) – market and network – should each have certain 'structural and geographical characteristics', or it is sufficient that only one of them does.

Furthermore, letter (a) of Article 5(4a) also has an additional reference to "*the services covered by the contract*". It is, however, unclear which characteristics should the service covered by the contract fulfil in this case. We would find it helpful if updated text of the Guidelines clarified how the services covered by the contract should be analysed in the framework of letter (a) of Article 5(4a).

In addition, Article 5(4a) states that when "*competent authority decides to award a public service contract directly, it shall lay down measurable, transparent and verifiable performance requirements*", which shall be included in the contract, and "*shall in particular cover punctuality of services, frequency of train operations, quality of rolling stock and transport capacity for passengers*". In our view, the structure of Article 5 indicates that this requirement only applies when the contract is directly awarded on the basis of Article 5(4a), but not on the basis of remaining paragraphs (i.e., paragraphs 3a, 4, 4b, 5 and 6). It would be appreciated if the updated text of the Guidelines highlighted that the quoted obligation to establish performance requirements is limited to the cases of direct award of the contract on the basis of Article 5(4a).

6. Article 5a(3): more clarity in regard to the costs for maintenance of the rolling stock to be included in the tender documents

Article 5a(3) introduced by the Fourth Railway Package states that if the rolling stock is made available to a new public transport operator, the competent authority shall include in the tender documents any available information about the cost of maintenance of the rolling stock and about its physical condition. We would appreciate if the updated text of the Guidelines clearly states that the maintenance costs of the rolling stock do not have to be made available by the competent authority if, according to the intended compensation model, it is the competent authority, and not the new operator / potential bidder, who bears the maintenance costs of the rolling stock. Furthermore, with regard to the costs for the maintenance of the rolling stock to be included in the tender documents, the question arises whether this cost information should be provided merely as an indication, or whether potential bidders must include these costs as default values in their own bid calculation without any further changes. It also could be noted that the actual condition of the rolling stock may change within the period between the issue of tender documentation and the moment when the winning bidder actually takes the rolling stock in possession.

7. Remarks on the current wording of the Guidelines

Point 2.2.2. and 2.2.3. of the Guidelines on general rules

Overall, further clarification of the scope of application, as well as on the characteristics and establishment process of general rules would be appreciated.

Furthermore, Article 3(2) of the Regulation says that "*…the competent authority shall compensate the public service 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*". It would be helpful to have more guidance on whether and to what extent services related to the maximum tariffs introduced by the competent authority, for example ancillary services, may be included in the general rule and, therefore, be covered by the compensation.

Besides, while Article 3(2) of the Regulation says that "*…the competent authority shall compensate the public service operators for the net financial effect, positive or negative, on costs incurred and revenues generated*". However, in practice it occurs that when competent authority imposes maximum tariff obligations on public service operators in

accordance with the national law, only a part of incurred costs are being compensated, in accordance with the budget allocated for this purpose. Therefore, we would find it very helpful if the updated text of the Guidelines stresses that Article 3(2) should be interpreted as meaning that if competent authority imposes maximum tariff obligations on public service operators in accordance with the national law, the competent authority is obliged to compensate *in full* the public service operators for the net financial effect, positive or negative, on costs incurred and revenues generated, and in case of lack of sufficient funds the competent authority may not impose such maximum tariffs on the public service operator.

Point 2.4.2. of the Guidelines on absence of overcompensation in the case of direct award

Point 2.4.2. of the Guidelines in particular reads as follows: "*The Annex to that Regulation establishes an ex post check to ensure that the compensatory payments are not higher than the actual net cost for the provision of the public service over the lifetime of the contract. Additionally, the Commission considers that regular checks are in principle needed during the lifetime of the contract in order to detect and avoid at an early stage clear overcompensation situations from developing. This is the case, in particular, for long-term contracts.*"

In contrast with the quoted wording of the Guidelines, the Regulation and its Annex do not expressly require any ex-post return controls. At the same time, return controls from an *ex ante* perspective can take efficiency incentives into account much better than controls from the *ex post* perspective. Therefore, CER believes that the competent authorities should remain free to establish the specific design of the checks that would ensure that the public service compensation is in full compliance with the provisions of the Regulation.

In particular, a competent authority might perform rigorous *ex ante* checks, and should not be obliged to perform additional *ex post* checks, as the text of the Regulation does not impose any mandatory *ex post* checks. It should therefore also be sufficient and fully compliant with the Regulation if a competent authority decides to only perform *ex ante* checks. Therefore, we would suggest that the text of the point 2.4.2. of the Guidelines is adjusted to remove this additional requirement to perform *ex post* checks, which goes beyond what is stipulated by the Regulation.

Besides, the quoted wording of point 2.4.2. of the Guidelines contradict the provisions of the Regulation and its Annex on the reasonable profit. If the reasonable profit is to be determined over the entire term (as the current Guidelines correctly points out in point 2.4.3, paragraph 6), then the question of overcompensation can and must only be answered taking into account the entire contract term.

Point 2.4.3. of the Guidelines on the notion of 'reasonable profit'

Point 6 of the Annex to the Regulation states that '*reasonable profit*' should be understood as "*a rate of return on capital that is normal for the sector in a given Member State*". The current text of point 2.4.3. of the Guidelines clarifies that the level of reasonable profit should be calculated based on the existing market remuneration for a given service, or, in its absence, on the profit margin required by a "*typical well run undertaking*", at the same time taking into account the level of risk involved in each public service contract.

CER members support the need to provide an adequate remuneration to the invested capital and would welcome further clarifications on how a suitable return on capital should be calculated. A clearer methodology for calculation of the reasonable profit (including the use of internationally recognised indicators and best practices), as well as public service

compensation in general[4], outlined in the Guidelines would ensure a uniform understanding across the EU. Such methodology should ensure that capital investments that are made by the public service operators are adequately remunerated.

Apart from that, in our view the reference to "*a typical well run undertaking active in the same sector*" made in the current text of point 2.4.3. of the Guidelines is inadequate and goes beyond the stipulations of the Regulation. While the Regulation takes full account of the Altmark judgment[5], point 6 of the Annex deliberately makes a reference to "*a rate of return on capital that is normal for the sector in a given Member State*", and not to the "*costs of a typical undertaking, well run and adequately provided with means*" as stated in the fourth Altmark judgement criterion[6]. Even though the legislator decided not to limit the reference point for calculation of the reasonable profit only to '*well run undertakings*', point 2.4.3. of the Guidelines nonetheless re-introduces the reference to the fourth Altmark judgement criterion. In order to be able to calculate a adequate amount of the reasonable profit for the sector, the calculation should take into account the data of *all* undertakings, and not only the well run ones, which also seems to be the intention and the reasoning of the legislator. Therefore, we would suggest that the reference to "*a typical well run undertaking active in the same sector*" is removed from the updated text of point 2.4.3. of the Guidelines.

In addition, we would like to stress that the same logic applies to the point 2 of the Annex to the Regulation that sets the rules applicable to compensation connected with public service contracts awarded directly. Point 2 refers to "*the costs and revenue of the public service operator*", unlike the fourth Altmark judgement criteria, which refers to "*the costs which a typical undertaking, well run and adequately provided with means … would have incurred"*. Just like in regard to the calculation of the reasonable profit, the legislator made a clear decision to deviate from the 4th criteria of the Altmark judgement when setting the rules of calculation of the compensation. This precise wording of the binding legal text should be fully respected, and could be further underlined in the updated text of the Guidelines.

Point 2.4.4. of the Guidelines on cross-subsidisation

The last paragraph of point 2.4.4. of the Guidelines reads as follows: "*Each public service contract should contain specific rules on compensation and should give rise to specific accounting entries. In other words, if the same undertaking has entered into several public service contracts, the accounts of the transport undertakings should specify which public compensation corresponds to which public service contract. At the written request of the Commission, these accounts must be made available in accordance with Article 6(2) of Regulation (EC) No 1370/2007.*" We would like to stress that the quoted paragraph of the Guidelines goes beyond the wording of point 5 of the Annex to the Regulation, and therefore should either be amended accordingly or deleted.

Point 5 of the Annex only requires accounting separation for the entirety of *all* services subject to public transport service obligations provided by the operator vis-à-vis other -

[4] Including, for example, the "*assessment of the situation where the public service obligation is met with a situation which would have existed if the obligation had not been met*" and the extent of "*any other revenue generated while fulfilling the public service obligation(s) in question*" mentioned in point 2 of the Annex to the Regulation.

[5] See recitals 33 and 36 of the Regulation; as well as point 4 "The Altmark Judgment" of Explanatory Memorandum to Revised proposal for a Regulation of the European Parliament and of the Council on public passenger transport services by rail and by road /* COM/2005/0319 final - COD 2000/0212 */ https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=COM%3A2005%3A0319%3AFIN

[6] Judgement of the Court, case C-280/00, Altmark [2003], § 93 "*where the undertaking … is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means…*"

commercial - activities.[7] In particular, based on the wording of the point 5 of the Annex, in practice an additional smaller public service contracts may be integrated in the accounting separation initially set up for an existing, larger public service contract.

The above-quoted wording of point 2.4.4. of the Guidelines, according to which railway undertakings should have separate accounting for each public service contract, goes beyond what is stated in the Annex to the Regulation. A corresponding obligation to have a separate accounting for each public service contract cannot be found in any other provision of the Regulation either. Incorrectness of interpretation provided in point 2.4.4. of the Guidelines has also been indicated by the European Court of Justice. Namely, §131 of the judgement in the case C-482/14 *Commission v. Germany*[8] states that "*the Commission's interpretation that undertakings are required in their annual accounts to identify separately, contract by contract, public funds received in respect of their public service activities cannot be inferred … from Article 6(1) of Regulation No 1370/2007 read in conjunction with point 5 of the annex to that regulation"*.

Point 2.5.2. of the Guidelines on publication obligations

Article 7(2) states 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"* certain information on the envisaged contract is published in the OJEU. It would be helpful if further clarification is added to the Guidelines on (i) how exactly the one year period has to be calculated and (ii) what is the consequence for the procurement process / tender if the one year period is not complied with.

In particular, in our view supplementing the previously made publication with additional information or corrections should not result in restarting of the one year period calculation. The following wording of Article 7(2) can lead to different interpretations: "*rectification shall be without prejudice to the launching date of the direct award or of the invitation to tender*". We understand this provision in a way that a rectification does not affect the calculation of the one year term, i.e. the calculation of one year term shall not be restarted after a rectification has been made. However, it is also possible to interpret the wording of this sentence in the opposite way. Therefore, further guidance in regard to the wording of Article 7(2) appears useful.

About CER
The Community of European Railway and Infrastructure Companies (CER) brings together railway undertakings, their national associations as well as infrastructure managers and vehicle leasing companies. The membership is made up of long-established bodies, new entrants and both private and public enterprises, representing 71% of the rail network length, 76% of the rail freight business and about 92% of rail passenger operations in EU, EFTA and EU accession countries. CER represents the interests of its members towards EU policy makers and transport stakeholders, advocating rail as the backbone of a competitive and sustainable transport system in Europe. For more information, visit www.cer.be or follow @CER_railways on Twitter.

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[7] "*In order to increase transparency and avoid cross-subsidies, where a public service operator not only operates compensated services subject to public transport service obligations, but also engages in other activities, the accounts of the said public services must be separated*"
[8] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A62014CJ0482