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9TH EUROPEAN RAIL TRANSPORT REGULATION SUMMARY

**“DISCUSSING THE 4TH RAILWAY PACKAGE: WHICH ROLE FOR
MARKETS IN DOMESTIC RAIL PASSENGER TRANSPORT?”**

A SUMMARY OF THE PRESENTATIONS

Florence, 12th December 2014

**Editors: Matthias Finger,
Nadia Bert, David Kupfer**

Forum Summary Document

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The present document summarises the content of the presentations delivered during the [9th Florence Rail Forum](#), and the following paragraphs offer short summaries of each presentation, illustrating the main points made and matters treated. The thoughts and opinions reported by one do not necessarily reflect the views of the contributors, as they have been collected by the authors of this Summary.

To open the presentations, go to florence-school.eu, choose “transport” from the top menu bar and select “Forums” among the “activities”. Clicking on the title of the Forum will take you to the relevant page. Alternatively, by clicking on a presentation’s icon you may activate an internet link taking you to the full presentation, when available. Presentations are hosted on the FSR website by permission of the authors.



The poster for the 9th Florence Rail Forum features logos for the European University Institute, Robert Schuman Centre for Advanced Studies, and the Florence School of Regulation. The main title is "Discussing the 4th Railway Package: which role for markets in domestic rail passenger transport?" by Matthias Finger. It also mentions the location, Villa la Fonte San Domenico di Fiesole, and the date, 12.12.2014. The website www.florence-school.eu is at the bottom.

Introduction to the 9th Florence Rail Forum

Prof. Matthias Finger, Director of FSR-Transport and of the chair of Management of Network Industries (MIR), École Polytechnique Fédérale Lausanne (EPFL)

Opening the Forum Prof Finger introduced the topic of the day and gave a framework for the debate.

The aim of the day was to discuss the 4th Railway Package, especially the aspect of the opening of the domestic rail passenger markets. In the former Florence Rail Forums, two aspects of the Package have already been tackled, namely the technical pillar which addresses the issue of overcoming barriers to standardisation and interoperability ([6th Florence Rail Forum](#), 27th May 2013) and the financing component of the Package ([8th Florence Rail Forum](#), 28th April 2014).

The 4th Railway Package was proposed by the European Commission already last year, yet a consensus has not been reached. With regard to the role of markets in domestic rail passenger transport, two major issues have to be addressed:

- the **opening up of the commercial lines** has proceeded at a slow pace, and too many differences between the states still exist: the main challenge is to guarantee fair and open access to the network in those countries where vertically integrated railway undertakings operate.
- as far as the **provision of services under Public Service Obligations** is concerned, the 4th Railway Package amends Regulation 1370/2007. The Commission foresees a differentiation between smaller scale contracts (which may be directly awarded to an operator) and larger contracts (which will have to be opened for competitive tendering). To facilitate this, an important role will have to be played by the national regulatory authority, whose power would

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be strengthened.

The 4th Railway Package under negotiation: where do we stand?

Elisabetta Garofalo, Policy Officer at European Commission (DG MOVE B2)

The keynote speech given by Ms Garofalo at the beginning of the 9th Florence Rail Forum touched upon the most relevant questions related to the market pillar of the 4th Railway Package:

- Why do we have another Railway Package?
- What is the situation and where do we stand?
- Where would we like to be?
- How are the negotiations for the package going?

Why do we need another Railway Package?

In the past decades, the road to market opening in railways has been a bumpy one: small steps have been taken, and the 4th Railway Package may be the last big step to **achieve a better regulatory framework that enables fair competition.**

The best evidence for the fact that a new Railway Package is needed can be found in the **figures** concerning the modal share of rail: the picture is still fairly weak, as the modal share for passenger transport is around 6% and for freight the average is between 10% and 11%.

Another reason for the 4th Railway Package refers to the fact that, **technically**, there is a patchwork of different railway systems and not a truly European one. It is currently characterised by different structural models that go from vertically integrated structures to completely separated structures, state-owned or not. From the infrastructure's point of view, there is a serious problem of underinvestment and a significant number of bottlenecks as trains still have to stop at the borders.

Perhaps the most important obstacle to competition that has called for a 4th Railway Package was the fact that **domestic markets** are largely closed to competition, either legally or *de facto* because there is very little or no competition at all. In many countries incumbents are not doing well: some of them are heavily indebted and/or overstaffed because of inflexible regulation; some are inefficient because monopolies are inherently prone to inefficiency.

In this situation, it is urgent to act, and **the railway sector is indeed high on the European Commission's agenda** because it is the safest and most climate-friendly way to travel and at the same time part of a wider mobility strategy as it can be an engine for growth.

At the backbone of the European Commission's idea is to insert some competitive pressure as an incentive to increase efficiency, achieve cost reductions and encourage innovation, not only in terms of technical progress, but also in terms of more customer orientation and better business models. In spite of the fact that so far this was not always achieved, there is some evidence (also coming from other sectors such as telecommunications) where benefits for citizens (lower prices) and states (costs savings for public service contracts) have been realized the introduction of some competitive pressure.

What does the European Commission intend to do and what are the contents of the 4th Railway Package?

Leaving the technical pillar aside, as for the market opening aspect, two levels are addressed:

- **commercial lines**, namely those lines that can be opened to competition immediately, as they are profitable.
 - In many countries, competition on these lines has already started, yet the goal would be to remove the remaining barrier in those countries where competition is not opened yet with an **obligation to do so by 2019**.
 - A related challenge would be to try to put some order in the rules concerning **governance of infrastructure and infrastructure management**. The challenge would be to ensure that the infrastructure manager is impartial, especially in those member states where there are powerful integrated companies (where the infrastructure manager is part of a group that also involves service operation) and where access to the network has to be equally guaranteed to every operator. The impartiality of the network manager is a key element also in countries where companies are not vertically integrated, as without a level playing field for new entrants as regards access to infrastructure, competition cannot flourish.
 - Another aspect related to the level playing field regards the **guarantee of transparency in the financial flows** within the vertically integrated group to prevent the potential internal transfer of money from one branch to the other as to disadvantage new entrants. This would require better *ex-ante* rules as to avoid long and costly infringement proceedings.
- **public service contracts**, as genuine market opening in this sector would give the opportunity to operators to go beyond the border of their own member state and start to compete on a truly European scale. This is particularly important as services provided under PSO make up 2/3 of total traffic. Therefore, there cannot be market opening if this part of the market remains closed.

But many challenges exist both in the opening of commercial lines and in the opening of public service contracts:

- the issue of **cherry picking**: This is a serious concern for many member states as they fear that once different lines would be tendered (separately), operators would make good profits on certain lines whereas non-profitable lines will not even receive any bid and costs for the state to continue to operate those lines will increase. So far, cross-subsidisation has helped a lot in this sense as incumbents could transfer money internally and finance their operations on the unprofitable lines. Should this not be possible anymore, the Commission would like to propose to solve the problem in a way that would not lead to an excessive financial burden on the member states; by introducing the **possibility to bundle profitable and unprofitable lines** and tender them together within a well-defined geographical scope. By this means, member states will be able to get the services they need with the least costs.

Where does the legislative procedure stand?

As there is no big political dispute about the technical pillar, a final agreement is likely to be found soon here.

As regards the market pillar, the position of the European Parliament is known since the beginning of 2013, and it watered down the original Commission proposal as well as the work of the TRAN Committee (which was closer to the Commission proposal). As far as the Council is concerned, the real work started under the Italian Presidency (July 2014), with a significant number of meetings overcoming the initial scepticism and reluctance of the national delegations. The stumbling blocks and outstanding issues have been identified, and they are now outlined in the

Italian Presidency Progress Report submitted to the Council (3rd December 2014 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/trans/146022.pdf). The incoming Latvian Presidency already announced their intention to continue to work on these issues.

1. The main open issue is about how to deal with the **coexistence of different models** (vertically integrated and separated). The original Commission idea was to propose a “best solution” that was full separation, as this is still perceived as the most straightforward way to guarantee impartiality of the infrastructure manager and therefore competition. However political reality made this solution not possible. Member States want different structural models to coexist, on an equal footing and they want to be able to revert to vertical integration at any point in time. The Commission has opened to this and agreed on not focusing on the structural models but on effective rules. In the end, what is important is to meet the objective and not the way to reach it.
2. As regards PSOs and market opening, one of the big concerns of both large and small Member States is **cherry picking**. Thanks to the proposal of bundling profitable and non-profitable lines, the European Commission had thought that the problem would have been solved. However, resistance still remains and it is still unclear whether this is just a psychological fear or a well-grounded doubt on the feasibility of this.
3. Another stumbling block refers to the **principle of mandatory competitive tendering**, which lies behind the idea of opening public contract services. A few Member States are adamant that they want to retain direct award; the majority of Member States is willing to accept the principle of tendering but with exceptions. So the battle field would be on what the allowed exceptions and derogations from competitive tendering can be as to guarantee, on the one hand, that where no good bid comes the State can intervene, and, on the other hand, that contracts will no longer be guaranteed to incumbents!
4. **Transitional periods** are also an issue. The European Commission is ready to postpone the initial deadline of 2019 (or 2022) for the opening of the market, with the aim to reach their objective. In fact, the Commission understands that, before opening the market, incumbents must be fit for competition and introduction of a new corporate culture could take a while. But the aim would be to smoothly arrive there, maybe trying to open selected lines or certain parts of the services, as a big bang is not seen as positive. Furthermore, it is always interesting to hear the experience of countries that have already done this (Sweden and UK).
5. One last obstacle is the **availability of rolling stock**. Companies that want to enter the market have to procure rolling stock. However, use life of rolling stock usually exceeds the length of the contracts, so there is the risk of making an investment on rolling stock that can then become useless. The initial proposal of the Commission foresaw a leasing market run by the States (like in the UK), but Europe is very diverse and many Member States say that more flexibility is needed as this could not work. Another idea would be leasing from the Member States that buys the rolling stock but those are fearful not to have the money to buy and guarantee them. So, for the time being the idea would be to put together a set for a toolbox of options so that Member States could be free to choose in which way to open the market.

Officially the Commission will not present a new proposal, but there will be a new compromise proposal with a general agreement in 2015. Member States are afraid of competition from within the railway sector, but they should be afraid of outside competition: road and air transport are

eroding the rail market share, so it is urgent to act!

ITS

**9thth Florence Rail Forum: Discussing the
4th Railway Package: what role for
markets in domestic rail passenger
transport**

**Chris Nash
Research Professor
Institute for Transport Studies
University of Leeds**



**Discussing the 4th Railway
Package: which role for
markets in domestic rail
passenger transport?**

Chris Nash, Research Professor, Institute for
Transport Studies, University of Leeds

Prof Nash focussed his presentations on achievements and open issues with passenger market opening with specific reference to the British experience.

Prof Nash' opening remark underlined that there is always the need to adapt solutions to given circumstances with the aim to reach a stated objective and not with the focus on the means to reach this objective.

While his research focussed on the UK he noted that many other countries have gathered experiences with market opening as well. These were mainly in the form of competition for the market but increasingly also with competition in the market (as in the UK) is practiced, for instance, in Italy.

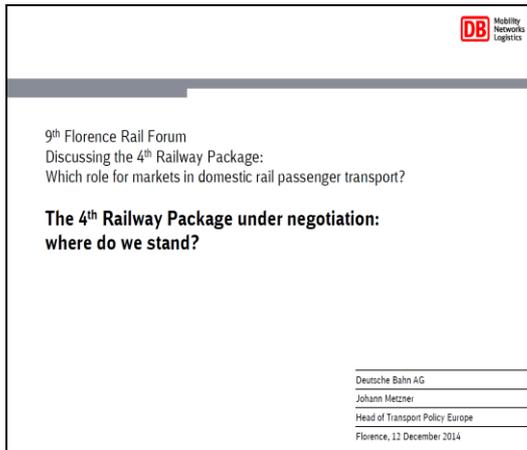
The British passenger market had been completely opened by 1997. The option that was chosen was complete tendering of all services whether they were profitable or not. Only a limited amount of commercial entry was allowed at the discretion of the regulator and on the basis of the rule that new entrants could not simply replace existing operators covering their traffic but had to generate new business. This was a good solution to the cherry-picking problem for Britain: through the bidding process the franchisee contributes to the infrastructure costs by paying substantial premiums to run a set of services.

Britain has probably the most experience with market opening, and it is the first country to apply complete vertical separation. On first sight it seems to have been a success: by 2012 there was a 67% growth in rail market share compared to 1997, and the overall performance improved significantly. This was however largely due to factors other than the reform of the railway system: the increase of rail passenger traffic in Britain was mainly due to the general economic growth, the decreasing rates of car ownership and the higher fuel prices. On the other hand, there is clear statistical evidence that vertical separation raises costs: there has been a strong increase in costs in terms of price per passenger kilometre, infrastructure cost and also train operating cost. Furthermore, costs for passengers have gone up as well.

The government had set up a rail working group to address the issue. The working group issued a report (Mc Nulty Report, 2011), and the main issue was identified: the misalignment of incentives between infrastructure manager and train operators. A coordination body was not enough to overcome this obstacle. Prof Nash recalled that several ways exist to deal with

misalignment of incentives, one of which would be going to back to a system of full vertical integration. In the UK another proposal was put forward that was consistent with the franchise approach: either the option for the operator to lease the part of infrastructure on which it is operating, or to create “deep alliances” between train operating company and the infrastructure manager in charge of the section as to share revenues and costs. This might however not necessarily be the right approach everywhere; in fact, this would be the most suitable option for situations where a single operator runs most of the traffic and where there is little to no freight traffic.

In conclusion Prof Nash recalled that the challenge for the UK rail system is to bring costs down. Also, it has to be remembered that the dilemma of incentives was at the heart of the problem. Because of the densely used network, a new form of cooperation between network management and train operators was sought. The approach that was adopted in the UK provided some evidence of benefits of improved services. However, this might not be the best solution everywhere.



The 4th Railway Package under negotiation: where do we stand?

Johann Metzner, Head of Transport Policy
Europe, Deutsche Bahn

Mr Metzner began his presentation by underlining that in order to understand the big picture of regulation of the European Railway sector one has to take account also of what has already been achieved so far. After over a decade of EU legislation aiming at achieving the Single European Transport Area, the railway sector has reached “a high plateau” of regulation. The focus should now lay on the full transposition and the symmetric implementation of the existing legislation.

Given this Mr Metzner turned to the question where in detail the focus should be in the upcoming years of railway regulation. An important element is still the technical pillar of the 4th Railway Package:

- In spite of its technical content, it is very political indeed, as it is very relevant for the competitiveness of the European railway sector. Different technical standards are market barriers for operators that provide services across borders or operate in different countries.
- Furthermore the European Railway Agency will have to have extensive competences in the future: it has to be able to take binding decision and should also act as an appeal body. It will become increasingly more important to facilitate coordination between the European level and the different national safety authorities.

Given this Mr Metzner stressed that the Latvian Council Presidency has to focus on closing the ongoing trilogue on the technical pillar as this was not accomplished during the Italian Presidency.

For the issue at hand, markets in domestic rail passenger transport, one has to look at two different kinds of markets and two corresponding pieces of legislation:

1. The market for PSO services and tendering (regulation 1370/2007): Mr Metzner stressed that DB was in favour tendering of PSO services as Germany has made very positive experiences with it; not only is the market share of new entrants growing each year, the introduction of competitive pressure also helped the incumbent DB to become more efficient. However it also has to be seen that market situations are very different throughout Europe and that a big bang market opening in 2019 can be a very difficult scenario for several Member States. It should be remembered that the possibility of tendering already exists everywhere; the question is whether it should be legally imposed. At present it was more a question of convincing the relevant actors of the usefulness and communicating the good experiences made, for instance in Germany.

2. Open access regulation: the relevant regulation here is 2012/44. Mr Metzner stressed his support for open access and pointed out that open competition should not be restricted in order to maintain the market equilibrium of the current operator. However the question has to be asked whether it is sufficient to legally open markets and not support the further development. He gave the example that in Germany an operator on an open access track has recently left the market – not because of insufficient legal framework conditions but because of the competition with the, recently liberalized, bus sector. Therefore the intermodal competition has to be addressed.

With regard to the ongoing process Mr Metzner noted that on the issue of vertical integration strict rules for stringent separation are already in place: all functions of the infrastructure manager that are market relevant have to be completely unbundled.

In his final remark Mr Metzner stressed again that the deciding question is addressing intermodal competition. In fact from the perspective of DB this could be addressed concretely:

- The “force majeure ruling” on passenger rights constitutes a disadvantage for rail operators that could be corrected very easily,
- Infrastructure investments need to be high on the agenda together with
- Investments in the innovation process.



The 4th Railway Package under negotiation: where do we stand?

Jacques Prost, IRG-Rail Chairman 2014

Mr Prost started his presentation by presenting IRG-Rail, the European Body for independent railway regulators, stressing that IRG-Rail is in favour of market opening of domestic passenger markets.

In his presentation he focussed on several elements of discussion concerning the 4th Railway Package pointing out IRG's view on the European Parliament's legislative amendments to the proposal.

First of all, Mr Prost underlined that several elements of the EP's amendments were very welcomed by IRG Rail. Among others, he mentioned the requirements introduced concerning open access and the need for transparency of the Cooperation Agreements (CAs): the CAs should be non-discriminatory, non-exclusive and subject to strong regulatory oversight.

However there are also major concerns with some other changes the EP introduced. It is important for IRG-rail that Infrastructure Managers can exercise their core functions in full independence. According to Mr Prost the current proposal fails to ensure this. With its amendments the EP has limited the essential functions of the Infrastructure Manager to capacity allocation and charging. It is problematic for IRG-rail that some of the strict rules proposed by the Commission, the so called "Chinese Walls", have been weakened by the Parliament's amendments. This concerns issues of funding, meaning the financial flows between infrastructure manager and operator, the issue of conflicts between supervisory board and management, and the sharing of information within shared systems of integrated operators.

Mr Prost recalled and stressed that the one of the goals of the 4th Railway Package was to allow for true non-discriminatory access. Achieving this needs strong regulators and strong regulation.

Turning to the PSO proposal Mr Prost expressed IRG-rail's support of mandatory tendering. It had to be underlined that competition is not an end in itself but a means to guarantee efficiency in the use of public funds. However IRG-rail is supportive of postponing competitive tendering from 2019 to 2023. On the issue of reciprocity (the possibility to exclude companies from countries with insufficiently open markets to operate in other markets) the proposed transition period is supported by IRG rail. However it should be clearly limited in its length.

At the end of his presentation Mr Prost called on Commission and Parliament to put forward legislation that creates clear rules. Legal clarity is essential and it must not be left to the court of Justice to finally clarify the rules.



Improving Access to the Italian railway network: The regulatory measures adopted by the Italian rail regulatory body

Roberto Piazza, Director – Access to Transport Infrastructures, Italian Regulatory Authority for Transport

Mr Piazza focused his presentation on the content of Regulatory decision n 70/2014 that was taken in November 2014 by the Italian Transport Regulatory Authority. This crucial regulatory decision provides the basis for the regulation of competition in the Italian railway market, which is particularly relevant for the open market competition in high speed train services in Italy.

Opening his presentation Mr Piazza outlined the newly established Italian Railway Authority, which has only recently become operational. The Italian Transport Regulatory Authority is a multimodal regulator for the access to transport infrastructure which includes railways, motorways airports and ports. It is accountable to the Parliament and governed by a board whose members are appointed by Parliament with a 7 year non-renewable mandate.

Turning to the content of Regulatory decision 70/2014 Mr Piazza first showed the consultation process that was carried out in preparation of the decision. Thematic questions were sent out and answered by almost all relevant stakeholders and provided evidence for the legislative basis which was then elaborated.

Contractual arrangements for the use of infrastructure

The first chapter addresses contractual arrangements for the use of infrastructure. The position provided that the Network Manager would have to make available crucial information in the network statement including details on: firstly, the maximum capacity which can be allocated, secondly, the currently allocated capacity and thirdly, the real amount of capacity allocated. The decision introduces several specifications of the framework agreements which deal with the strong competition for the scheduling of high speed train services in Italy.

Capacity Allocation

The decision includes the introduction of measures increasing the transparency of the capacity allocation process: Infrastructure Managers provide annual details of the capacity requested and the capacity allocated, with information on the incidence of harmonization and coordination processes. Another important element is the reduction of the flexibility margin from 15 to 10 minutes, which is used by the IM to allocate requested capacity within peak hours to competitors “in the market”. The decision also increases the transparency of the coordination process, which is the last, most crucial step of the capacity allocation process. Furthermore applicants are provided with the possibility to also informally complain about discriminatory behavior of the IM.

Access Charges

The decision foresees a significant reductions of access charges for empty runs of high speed trains. For access charges in general a new procedure is opened to define new principles and criteria for the calculation of access charges which will be applicable to the entire national railway network and will be finalised by September 2015.

The performance Regime

The principles of an improved performance regime are outlined in the decision. These are composed of detection of delays also in intermediary check-points and/or stations situated along the itineraries:

- Elimination of the tolerance threshold for delays;
- Increase of penalties per minute of delay, with possible differentiation according to operational peculiarities of market segments;
- Further increase of penalties per minute of delay above 60 and 120 minutes of total delay;
- Increased transparency of the overall process (through availability of traffic data on the web, detailed description of causes of delays, more transparent allocation of responsibilities for delays; dedicated dispute resolution system);
- Attribution of 120 minute delay to each cancelled train.

Concluding his presentation Mr Piazza summed up five clusters of regulatory issues that make up the decision:

- Access to the national railway network and programming of transport operations
- Management of network capacity
- Access to services for railway undertakings
- Persons with reduced mobility
- Access charges



Liberalisation of National Passenger Markets

Nicolas Fourrier, Head of railway strategy and regulation department, SNCF

At the 9th Florence Rail Forum, Mr Fourrier laid out the view of the main French operator on the issue of market opening in passenger transport.

SNCF supports market opening and sees it as an opportunity for itself as incumbent operator: the current company strategy at SNCF would not be compatible with not supporting competition also in the home market. In fact, SNCF could benefit itself from competitive pressure as this would allow conducting beneficial reforms, most importantly as regards agreements with the work force that are currently an element undermining the competitiveness of SNCF.

Mr Fourrier then turned to the conditions for market opening from SNCF perspective. First of all, these regard the legal framework, which should be based on common standards to become a condition for success. Secondly, measures must be taken to relieve the incumbents from the burdens of historic charges of the system such as historic debt and pension schemes. A level playing field is necessary, and this refers to both to new entrants and the incumbent. With regard to this, an analogy with the decline of the American car industry, which resulted from unsustainable competition with Asian manufacturers, was made. This decline was mainly due to the fact that the social burden of American car companies - that had to cover the social security of their workers - gave them a competitive disadvantage over their Asian counterparts - that had a younger work force and fewer obligations towards their employees.

Mr Fourrier then addressed the balance that would have to be kept between competitive lines and PSO. Commercial competition by open access is the best way to reduce costs and the burden on the tax payers. PSOs should be clearly limited and be applied only when the market cannot provide a satisfactory level of service. It has to be recalled that in a situation of a PSO contract the "customer" of the railway undertaking is not anymore the actual passenger but the contracting authority; It means that the operator is incentivised to satisfy the transport authority in the first place and not the actual passenger. In some cases this can lead to suboptimal results.

The biggest challenge in France is the change of social rules. Unlike in most other countries rules of employment in the railway sector had always been fixed by law in France. These laws will cease to be applicable as of July 2016 and have to be replaced with contracts negotiated between the unions and the employers. This will be a big issue because unions in France have no tradition of negotiating contracts and working towards win-win agreements. It will be a huge

burden for new entrants in particular in the freight sector if they would have to apply working time rules currently in place at SNCF. The social climate in France is difficult yet it is indispensable for SNCF to prepare for competition.

Concluding his presentation Mr Fourier gave a broader view on the current status of the railway sector. First and foremost, he stated that competition is desirable but does not by itself solve the issue of increasing the modal share of the railways. This has to be achieved first of all by addressing the financial equation: competition has to be incentivized by low track access charges. Infrastructure managers on the other hand should receive more subsidies. Moreover, the issue of technical harmonization has to be addressed, and the adoption of the technical pillar of the 4th Railway Package should be a top priority.



DISCUSSING THE 4TH REGULATORY PACKAGE

Session 2. Liberalization of National Passenger Markets
– which way forward for competitive lines and PSO?

Juan J. Montero
Professor UNED, Madrid

Discussing the 4th Railway Package: Liberalization of National Passenger Markets – which way forward for competitive lines and PSO?

Juan J. Montero, Professor, UNED Madrid

At the beginning of his presentations Mr Montero recalled the ultimate goal and the logic behind the regulatory measures that are currently discussed with the 4th Railway Package. Liberalisation is part of creating the Single European Railway Area that, by benefitting from economies of scale, would reduce overall costs in the rail sector. Competition is a tool to ensure that these cost savings are passed on to the customer.

Considering also what has been done in other network industries, the European Commission could look for a “regulatory toolkit”. While this has been successful in other network industries railways pose a series of particular challenges.

Infrastructure is a natural monopoly managed at national level, and the liberalisation of services is used as a tool to solve this problem. However competition in the market requires non-discrimination. Vertical separation is an effective tool to ensure this, but there is academic evidence that it also creates inefficiencies. Therefore is it necessary to accept these inefficiencies for the sake of fair competition? From a national perspective the answer to this question would clearly be a “no”, however from a European perspective one might come to the conclusion that the “inconveniences” of vertical separation are a necessary evil. The second challenge outlined by Mr Montero in his presentation concerns the problem that in railways operators cannot be charged with the full cost of using the infrastructure as the height of these costs would certainly undermine any competitive activity. As a consequence there will always be public money which naturally creates uncertainties. Whereas in other network industries the height of access charges is very predictable because it follows a clear rule, this is not the case for railways. This uncertainty in itself (and not just the height) is a big obstacle for the incumbent but, more importantly, for new entrants.

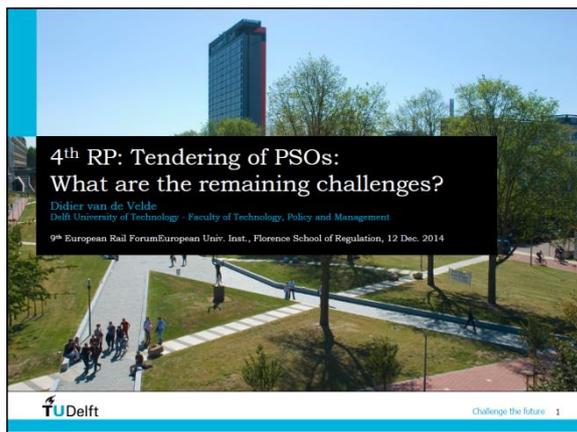
The railway industry as such has some objective limits to competition. The result of this problem in Europe is that a variety of different national models of liberalisation have emerged. Due to the lack of reciprocity there is currently a strategic notion among operators in the railway sector that the last to liberalise its own market will be the first in a competitive environment later on. New entrants need to be able to scale up in order to be more viable. For this they also need to be able to operate on different markets. Eventually losing a tender for a PSO Service will not be so bad if the possibility exists to win other tenders in different markets.

Also with the 4th Railway Package a significant portion of services will remain under PSO. Tendering can reduce the burden on public budgets. There are however barriers to entry to be

recalled: the duration of the contract, the size of the contracts and the availability of rolling stock.

It has also to be considered that the SERA would reduce risks for newcomers as they could spread their risk around several services in different countries. The importance of interoperability in this regard has to be noted. It is a requirement for cross border services and for cross border operators that have to be able to use the same rolling stocks in different markets. However in spite of the long term benefits interoperability creates short term costs, which creates a tension.

Concluding Mr Montero noted that uncertainty for railway undertakings has to be balanced with incentives to reform the removal of political obstacles and the possibility to expand to other geographical markets - also by means of consolidation.



Tendering of PSOs: what are the remaining challenges?

Didier van de Velde, Researcher, Delft University of Technology

Beginning his presentation Mr van de Velde summarized some of the evidence on rail tendering in Europe. Doing this, he pointed at the high costs of the British rail system, as shown by the 2011 McNulty report, pointing at the need for a better coordination between operators in infrastructure management to address this. He mentioned that it was unfortunate that similar assessment reports do not exist everywhere. He also referred to a German study which found evidence that tendering led to improvements in terms of more service, better quality and lower costs, despite problems connected to the incomplete separation of the operator DB. He also referred to Swedish research and to the EVES-Rail study.

Discussing the existing research, Mr van de Velde pointed out that very often the data used is weak, making the results emerging from these studies defective. Furthermore some studies tend to draw conclusions too easily, as improvements in the rail sector are too easily counted as a result of liberalisation when there are in fact several other factors that have to be taken into consideration, such as economic growth or demographic changes. Furthermore, he called for a more precise inclusion of structural factors such as the type of vertical separation followed, whether there is full separation or a holding model, the type of contract as there are gross cost contracts and net cost contracts, the type of competition, whether there is open access or competitive tendering.

Turning to the initial reasons for the tendering strategy Mr van de Velde mentioned that increasing efficiency of the rail system is often mentioned with the claim that overall efficiency gains of 20% would be achievable. However the experience in GB points in a different direction. Secondly more innovation is one of the key reasons mentioned. The market should provide incentives for more innovation which would result in better services for passengers. In fact, many cases show that many new developments are indeed taking place but they are imposed by the Transport Authority as input to the tendering. Many authorities also take on an important role in marketing and pricing. The strong role of the authority makes diminishes the scope for real entrepreneurial decisions taken by the operator, which leads to question whether the real aim of competitive tendering was about reshaping the power relationship between authority and private operator: tendering gives the Authority more possibility to make the operator "listen" to its ideas.

The next important question is whether the network should be split into several small contracts; the EP introduced an amendment that this shall depend on the size of the country. With regard to this Mr van de Velde pointed to a paradox: having several contracts in a network increases the need for central coordination, especially in countries with a densely used network. While this is

less the case when there is a lot of capacity and a less densely used network, too much capacity is an indicator for an inefficient network and that is not something that should be sought after. Note that there is also a relationship between the contract size and the possibility for innovations.

An alternative to full-scale tendering would be to tender only regional lines as is currently practiced in Germany and Sweden, and leave the main network to the free market. This would allow avoiding having to deal with the complexities of splitting and tendering the more complex services. But applying this solution would – paradoxically – give the authority reluctant to introduce full-scale tendering but wishing to regulate their main network less regulatory power than what would be the case with a non-tendered contract as regulation 1370/2007 fails to clearly lay out rules of the game when there is an open access situation.

Another alternative to the current approach would be to consider railways more as a part of the regional economy and focus on real estate development making use of the synergies between the railway system and real estate development in order to induce them to focus on customer needs.

In his final statement Mr van de Velde came back to the question how tendering should be organized and what the role of Transport Authorities should be. He considered that it has to be ensured that the Transport Authority has sufficient knowledge, which includes knowledge on tendering, contracting and monitoring. As experiences shows, this cannot be taken for granted. Having several Transport Authorities instead of a centralized one (as is the case in GB) may actually help as the different Authorities could learn from each other.

A balance in the distribution of responsibilities between railway operators and the Transport Authority has to be found to ensure that not all strategic and entrepreneurial decisions are taken by the authority instead of the private operator.

Finally, proper coordination between infrastructure management and train operations is needed to ensure that local Authorities take decisions that are in line with the aim of maximizing system-wide efficiency. This means that several elements need to be taken into consideration:

- The network effects: there has to be coordination of timetables, network wide schemes, seasonal passes etc.
- Incentives for efficiency of the infrastructure manager in the contracts: there is the danger of a bias for capital expenditure rather than optimizing costs and revenues by looking at system-wide efficiency over the infrastructure/train divide.
- It is important that the big picture of long-term development of the railway system is considered. In Japan operators take a 20 to 30 years approach, focusing on synergetic train services, retail and real-estate developments whereas in Britain, where there are many franchisees, the development goes more towards a “Ministry of railways”, where many strategic decisions are taken at the state level, paradoxically as a result of introducing competition.



4th Railway Package – Tendering of PSO: What are the remaining challenges?

Brigitte Ollier, Director European department,
UITP

The presentation of Ms Ollier at the 9th Florence Rail Forum was focused on urban, suburban and regional public transport, from UITP's perspective. The main characteristic of UITP is that it encompasses a wide range of members: not only operators of several means of transport are affiliated with UITP, but also the association has changed from a purely operators' association to an association covering the whole value chain of public transport including authorities, decision makers and industry.

One of the main reasons why UITP is interested in the 4th Railway Package refers to the fact that suburban and regional areas have to be better linked to the city centres, and rail in this context plays a crucial role. Ms Ollier presented some figures that show that 90% of all rail passengers travel on these kind of services, which are almost entirely covered by public service contracts. Currently, it can be estimated that almost 50% of these contracts are awarded directly, the other half is tendered. Also, these services are often coordinated with other public transport services, in terms of ticketing, information and fares.

Today there is a high diversity of situations and solutions in Europe, and this is the reason why the European legal framework should not prescribe the details: a legal framework is needed, but detailed prescription would never fit the situation. Among the elements on which regulation should focus, Ms Ollier mentioned:

- On the opening of the market, tendering is an important element for coping with the future challenges in suburban and wider metropolitan areas and it should be the rule. It should be complemented though by the (strictly limited) possibility for direct award. Effective opening of the passenger rail market should be done in a reasonable time frame, with feasible transition periods that are now already foreseen.
- Non discriminatory access to the infrastructure should be guaranteed, without much attention to be paid to the means to achieve this final goal (no need to focus on vertical separation as long as fair access is guaranteed).
- Regulation 1370/2007 is of utmost importance for conventional rail and all the other urban modes (buses, metro, light train), and agreement on it has been reached after long negotiation, because of the sensitivity of the topic. Furthermore, this regulation has been approved in 2007 and it entered into force in 2009, with a transition period of 10 years: doubts on the appropriateness of a revision now have been expressed, which recall the importance of legal certainty and regulatory stability, especially in a sector which such high investment volumes.

- UITP has always defended the specific legal framework for transport, which means that transport and public service contracts should not fall under the general state aid regime.
- Access to rolling stock is a crucial issue, and it has to be tackled bearing in mind that one solution does not fit all.

In conclusion, Ms Ollier recalled that the package approach of the 4th Railway Package has an added value and should be kept. Otherwise there is the concrete risk that a solution on the market pillar will not be found even though the elements included in this pillar are necessary to avoid asymmetries currently existing in the market.



4th Railway Package and Market opening – remaining Challenges

Irina Michalowitz, Director for European and
International Affairs, ÖBB

At the 9th Florence Rail Forum, Ms Michalowitz presented the view of ÖBB, an incumbent operator of a small European country. Before entering the discussion on technical details such as length of transition periods, systems for the provision of rolling stocks, etc., she clarified some principle points.

First and foremost, the issue of the level playing field has to be solved. From the perspective of ÖBB, the problem of the historical burden is very prominent.

In particular, Ms Michalowitz gave an overview of the current situation of the rail sector.

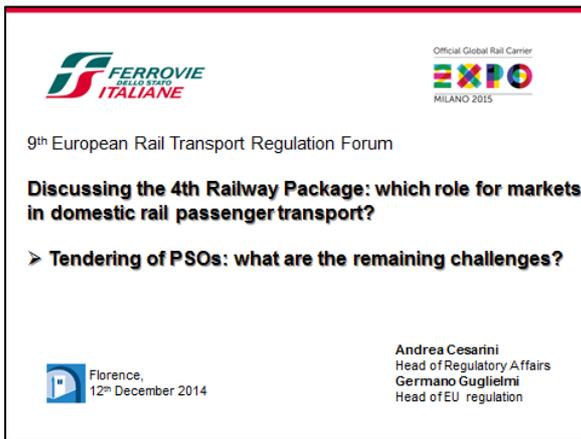
As for the freight sector, it was highlighted that in 2014 the European rail freight sector remains below pre-crisis level. After a moderate growth of the sector between 2000 and 2007, in 2008 a dramatic reduction started especially because of the impact of the economic crisis and the increase of prices of raw materials. In a framework that includes also other modes of transport, the cost development of rail freight in Austria is slightly disadvantageous compared to road transport. This is due to different factors, for instance, the possibility of the road sector to employ staff from Eastern Europe under their home countries' conditions. Another issue is the lack of interoperability that hinders quality and efficiency of cross-country traffic. This is a field of regulation where improvements are very much needed. Competitive disadvantage of the rail freight is the result of long waiting times at borders due to bureaucracy and technical issues that do not exist in the road sector. Thirdly, Ms Michalowitz pointed out that privatization in the rail freight sector is rarely successful.

On the passengers' side, new business models focused on specific target groups are emerging both in long distance (train vs. buses) and short distance (train vs. car sharing), where other service providers have less historic burdens than rail operators. This causes a competitive disadvantage for the rail passengers operators compared to low cost carriers and bus companies. Also the niche sector of high-speed rail faces competitive disadvantages vis-à-vis other transport modes as well as traditional train because of the high costs of the infrastructure and low level of investments.

Hence, from this picture it emerges that the 4th Railway Package does not address the real problem that the sector has and instead looks very much at the theoretical level, leaving aside the real problems of both the passengers and the freight sectors. One of the outstanding examples presented by Ms Michalowitz concerned labour costs arbitrage in the context of public tendering.

The question of legacy costs becomes prominent when speaking about opening the domestic passenger market. In Austria, ÖBB faces a structure where 2/3 of its staff are civil servants, among which 75% are older than 40. This makes the cost structure of staff unsustainable, making it impossible for ÖBB to compete on a level playing field with new entrants.

To conclude, Ms Michalowitz stressed that ÖBB is in favour of open competition; however competition itself cannot be the goal of the new legislation. Its goal should be the overall system efficiency, overall customers' satisfaction and better service quality.



Tendering of PSOs: what are the remaining challenges?

Germano Guglielmi, Head of Regulatory Affairs, Trenitalia

At the 9th Florence Rail Forum Mr Guglielmi presented the view of Ferrovie on the situation and possibilities for the creation of a European market for PSOs. According to Ferrovie, two outstanding issues have to be borne in mind:

- in Europe two systems coexist: competitive tendering of PSOs and direct award of PSO contracts;
- in terms of revenue resources, in Europe there is a wide range of combinations of compensation and railway fares that railway undertakings can take for the provision of the PSO service.

With regard to these differences, Ferrovie believes that no Single European Market for PSO could exist, unless compulsory competitive tendering enters into force everywhere. Only the “invisible hand of the market” (and the help of the regulator) can determine who should actually operate.

A stable regulatory framework is needed to answer the current main regulatory problems, which in Italy refer to the following areas:

- uncertainties in the resources available for the competent authorities (state or local level) given by the unstable national policies and budget constraints;
- weak regulation against cherry picking, which is temporarily solved through internal compensation;
- unclear definition of tendering procedures, especially regarding the length of the process;
- unstable framework with regard to fares and infrastructure charges;
- unclear conditions on the social aspect (hiring terms for the employees).

Finally, Mr Guglielmi recalled that a stable regulatory framework is not only needed for the creation of a PSO market, but also for every issue that relates to the evolution of the sector: for instance, the Italian government has recently announced that the Ferrovie group will be privatized. However, there is still lack of clarity on the terms of the privatization and on the possibility for this to happen in the near future.

FSR-Transport: Events 2015

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Date	Title
6 February 2015	FSR-Conference: Smart Cities, Smart Regulation?
23 February 2015	Executive Seminar: Aviation Safety
9 March 2015	3 rd Florence Intermodal Forum
20 April 2015	7 th Florence Air Forum
18 May 2015	10 th Florence Rail Forum
12 June 2015	4 th Annual Conference on the Regulation of Infrastructures

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