ABSTRACT
This paper aims at presenting the draft EU regulation on public services requirements (current legal framework, reasons for updating it, main content of the new regulation) and analysing the consequences on local public transport, providing examples of various types of organisations.

Prior to present the new proposal and to analyse the consequences on authorities and operators, the paper will first describe the current legal framework ruling public transport in Europe with a specific focus on financial compensations and granting of exclusive rights for operators. The paper will then describe how several legal disputes have been raised in the public transport sector and led to a strong expectation for a new regulation.

The EU Commission released in July 2005 its third proposal for a “regulation on action by Member States concerning public service requirements and the award of public service contracts in passenger transport by rail, road and inland waterway”.

EMTA, association of European Metropolitan Transport Authorities bringing together 32 authorities responsible for public transport, has analysed possible consequences of this regulation on the awarding of public service contracts in Europe with a focus on its member cities.

The level of change expected by this draft regulation depends mainly on the institutional framework and on the status of operating companies. However, rules applying for the award of public service contracts can have substantial impacts on all public transport authorities.

Impacts of the draft regulation can be evaluated through three items: the organisational impacts, the consistence of public transport networks and the provision of services.

A political agreement has been reached on this text in June 2006 by the Transport Council. The Council should then adopt a common position and publish the updated text for transmission to the European Parliament in Autumn 2006 for the second reading. Despite a high probability of being adopted, the final content of the regulation is not determined yet. This paper is based on the 2005 Commission proposal and the text adopted by the Transport Council following the political agreement reached in June 2006.
1 BACKGROUND

1.1 Current regulation in place

Everywhere in Europe, public transport operating costs are not fully covered by fare revenues so as to ensure an equal access to all, a geographical coverage of the services not only driven by the commercial profitability and to take into account the positive external effects on collective wealth in terms of congestion, noise and pollution. In other words, urban public transport is a service of general interest for which public authorities set up specific rules in terms of exclusive rights to operate or financial compensations.

Article 73 of EC Treaty deals specifically with the transport sector stating that “aids shall be compatible with the Treaty if they represent reimbursement for the discharge of certain obligations inherent to the concept of a public service”. This article is considered as a *lex specialis*, in regard with Article 86 that states “Undertakings entrusted with the operation of services of general economic interest (…) shall be subject to the rules contained in this Treaty, in particular to the rules on competition, insofar as the application of such rules does not obstruct the performance, in law or in fact, of the particular tasks assigned to them. The development of trade must not be affected to such an extent as would be contrary to the interests of the Community.”

The conditions required to comply with this article are listed in a regulation adopted in 1969\(^1\) that describes three types of obligations:

- The obligation to operate
- The obligation to carry
- The fare obligation

This regulation lays down detailed rules for calculating the compensations levels to apply in order to avoid the State aid notification and authorisation procedures described in EC Treaty\(^2\).

This text has been amended in 1991\(^3\) with the distinction of local public transport and the concept of public service contracts as the normal but not mandatory tool for public transport service provision.

The minimal content of contracts is described in detail in this regulation but there is no provision regarding the possible ways to award these contracts.

1.2 A long legislative process

1.2.1 The need for a new regulation

This regulatory framework was relevant as long as public transport players were exclusively national operators and therefore financial compensation or granting of exclusive rights could not be seen as affecting trade among Member States. Public transport services were mainly provided by local public monopolies and a very small part of the market was open to competition.

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\(^1\) EEC 1191/69
\(^2\) Article 88(3)
\(^3\) Regulation EEC 1893/91
This situation has changed with the development of pan-European operators and the increase of international competition in the opened markets. Some of these operators started to bring complaints before national jurisdictions, then to the EU Commission and lastly to the European Court of Justice with the central question: ‘are financial compensations or exclusive rights granted to an operator to be considered as State aid within the meaning of EC Treaty’.

1.2.2 July 2000: Initial proposal by EU Commission

In 2000, almost nine operators had their activities in more than one Member State and service provision was limited to home-country operators in only four Member States. In this context, the Commission proposed in July 2000 a regulation\(^1\) aiming at defining a common framework for the European public transport market in terms of contract awarding if financial compensations and/or granting of exclusive rights were at stake.

The initial proposal was based on the results of ISOTOPE\(^2\) project showing that the production costs were higher in closed markets than in markets with controlled competition. In fully deregulated markets, the costs were even lower but quality of service was also one level below. These results encouraged the Commission to propose a regulation almost exclusively based on controlled competition, with a triple aim:

- Ensure legal certainty
- Ensure market access to all operators
- Reduce the level of subsidies required for funding public transport operations

In some situations however, it would have been possible to award directly public transport contracts, for rail based services with considerations of safety of investment costs, for integrated services or for small contracts.

1.2.3 October 2001: first reading by EU Parliament

This text passed the first reading in EU Parliament in 2001, with more than 100 amendments.

The main modification brought to the text consisted in allowing direct award of public transport contracts to internal or in-house operators, in other words, the right for transport authorities to decide to provide the service themselves on an exclusive basis. This possibility left to transport authorities comes alongside with necessary restrictions for the operator in terms of geographical coverage. An operator cannot provide services in a protected market and compete in other opened markets.

Another important amendment proposed by the Parliament but not accepted by the Commission concerns the hierarchy of applicable legislation for contract awarding. The Parliament proposed to grant provisions of this regulation priority on public procurement directives\(^3\), which would have set a

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\(^1\) COM(2000) 7 final  
\(^2\) Improved Structure and Organisation for urban Transport Operation in Europe  
\(^3\) Directives 92/50/EEC and 93/38/EEC, replaced by Directives 2004/17/EC and 2004/18/EC
common legal framework for public transport. The Commission’s refusal is based on the interpretation of WTO procurement agreement.

1.2.4 February 2002: Updated proposal by EU Commission

Following the first reading, the Commission published in February 2002 an updated proposal\(^1\) based on the same principles, with a similar structure, taking into account the ability for transport authorities to choose to provide services by themselves, modifying the maximal duration of contracts and the situations in which direct award is possible. With regard to safety or advantage of the incumbent, direct award would have been possible in some cases for rail based modes but not for bus or coach services, even if integrated with underground services for example.

1.2.5 2003: Waiting for Council agreement and Altmark judgement

As the co-decision procedures requires, the updated text was transmitted to the Council for the first reading but the various positions of Member States on this proposal were too contradictory and the Council suspended its work, also waiting for the expected judgement in the Altmark Case\(^2\) in which the European Court of Justice had to clarify in a specific situation whether granting of public transport licence to an undertaking without a tendering procedure was compatible with Community rules on State aid.

The judgement described four conditions according to which compensation relating to a public service is not classified as State aid. These conditions also known as “The four Altmark Criteria”:

1. The recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined;

2. The parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner

3. The compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations

4. Where the undertaking is not chosen pursuant to a public procurement procedure, the level of compensation needed must be determined on the basis of an analysis of the costs that would have a typical undertaking, well run and adequately provided taking into account the relevant receipts and a reasonable profit for discharging the obligations.

The conclusions of this judgement led to the adoption by the Commission of the so-called “Monti Package” in July 2005, that apply to services of general interest but which excludes transport from its scope. In fact, this judgement contributed to the debate but its conclusions are barely applicable to public transport, in particular the fourth one.

\(^1\) COM(2002) 107 Final
\(^2\) Judgement of 24 July 2003 in Case C-280-00

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1.2.6 **July 2005: Commission’s third proposal**

In July 2005, the Commission proposed a new text\(^1\) acknowledging the conclusions of the Altmark judgement and of the debate on services of general interest.

The text is sensibly shorter than the previous versions and also more simple. References to contract awarding without tendering but taking into account quality criteria have been suppressed. Conditions according to which direct award is possible have been also simplified. The list of criteria to observe when comparing bids has been suppressed.

In this proposal direct award is possible for long distance and regional rail services, i.e. all services which are not catering the transport needs of an urban centre or a conurbation.

The text is based on the principle of subsidiarity: Transport Authorities can choose to operate public transport services by themselves or through an invitation to tender. The Commission provided however a very restrictive definition of the internal operator, stating that the authority should exert total control on it, excluding in particular the participation of private stakeholders or raising problems for transport authorities made up of several public bodies.

1.2.7 **June 2006: Political agreement reached by the Council**

The Council reached for the first time a political agreement on this text in June 2006. This agreement brings substantial modifications to the Commission’s proposal, among others:

- The possibility granted to Member States to include inland waterways services;
- The extension of possible direct award to all heavy rail services, due to the difficulty to define clearly in practice the scope of regional rail services;
- A higher threshold under which direct award is possible to medium-sized companies, compared to the threshold under which direct award is possible in general;
- Measures obliging authorities to provide information on their decision to award contracts directly.

1.2.8 **Next steps**

The text as agreed will be adopted as a common position of the Council and will be transmitted to the European Parliament with a view of a second reading. If the text is adopted without any amendment, the regulation will be published in the Official Journal during the first semester of 2007 and will enter into force three years later in 2010 with a transition period running until 2022.

If the Parliament wishes to amend the text, a third reading will take place if these amendments are not accepted by the Council. This conciliation procedure is not very long (6 months at most) but can lead to the abandon of the text if no compromise is reached. However, as this regulation seems to be unanimously expected this last situation will probably not occur.

\(^1\) COM(2005) 319

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2 CONTENT OF THE PROPOSED REGULATION

The draft regulation proposed by the Commission consists in:

- an explanatory memorandum that describes the context, the purpose and the content of the regulation
- a list of thirty “whereas”, supporting the following text
- twelve articles and an annex describing the rules applicable in the case of direct award of contracts

An in-depth analysis of the text is required to understand all the implications on public transport organisation, funding, and service provision. However, the main expected impacts can be understood bearing in mind the content of the main important principles.

2.1 Generalisation of contracts

The proposed regulation goes one step further than the regulation 1893/91 insofar as it generalises the use of contracts (Article 1) when an authority grants an exclusive right or a compensation for the discharge of public service obligations. In the only case where only a tariff compensation for certain types of travellers is granted to any company who wishes to operate, a contract is not mandatory and these compensations can be done under so-called “general rules”.

2.2 Content and duration of contracts

The purpose of the contracts is to clarify the roles and responsibilities of the different players (transport authority/operating companies). The regulation defines mandatory content of contracts (Article 3), directly inspired by the conclusions of Altmark judgement. The contracts have to define clearly the public service obligations, the parameters on which the payments are calculated, paying attention to avoid overcompensation of net costs incurred, the allocation of costs and the share of revenues.

To ensure an effective competition or at least a regular clarification of roles and responsibilities, the duration of contracts is limited to 10 years for coach and bus services, 15 years for rail based services and 15 years for multimodal contracts if rail services account for more than half of the value of the contract (Article 4). This duration can be extended by 50% if the operator provides significant assets in relation with the service provision described in the contract.

For transport service contracts combined with exceptional infrastructure or rolling stock investment and if the contract is awarded in a fair competitive tendering procedure, the duration of the contracts can even be longer but in this case, the authority will have to justify this choice to the Commission.

Duration of directly awarded contracts for rail services are limited to 10 years.
2.3 Award of public service contracts (Article 5)

2.3.1 General rule: choice between in-house production or tendering

In accordance with the principle of subsidiarity, transport authorities can choose to tender out public transport services or to provide these services themselves, i.e. through an internal operator, also called in-house operator.

The definition of the internal operator is rather restrictive in the Commission’s proposal insofar as “internal operator” means a legally distinct entity over which the competent authority exercises complete control similar to that exercised over its own departments. Criteria proposed to determine the effectiveness of this control can be the degree of representation on administrative, management or supervisory bodies, ownership, effective influence and control over strategic decisions.

Moreover, the internal operator and any entity over which the latter exerts even a minimal influence must perform all their public passenger transport activity within the territory of the competent authority and do not take part in competitive tenders organised outside the territory of the competent authority.

The Council however took into account the possible participation of the private sector for in-house operators. It proposed a less restrictive definition allowing a public ownership below 100% provided that public control is effective. Taking also into account the diversity of organisation of transport authorities, the internal operator can be owned by a local authority, stakeholder of a transport authority at a greater geographical level.

In order to avoid cutting lines because of administrative boundaries, the Council also proposed to allow outgoing lines run by an internal operator in the neighbouring of its territory.

2.3.2 Other situations for which direct award is possible

According to the last known version of the text, direct award is also possible:

- If the value of services is below €1 million per annum or if the contract concerns an annual provision of less than 300,000 kilometres. If contracts are granted to a small and medium sized company, these thresholds are raised to €1.7 million and 500,000 kilometres.
- In case of disruption of service or risk of such a situation. In this case, direct award can also consist in the extension of the current contract. This kind of award is however limited to 2 years.
- For heavy rail services, i.e. long distance, suburban rail, urban rail but not for metro or tram services.

2.3.3 Specific rules applicable in the case of direct award (Annex)

All compensation, connected with a contract awarded directly must also conform to the provisions laid down in the annex of the draft regulation. The annex proposes a method of cost calculation which requires to take into account the situation which would have existed if the public service obligation had been operated under market conditions. Moreover, the calculation of financial effects must take into account the impact of compliance with the
public service obligation on demand on transport services. These provisions are directly linked to the Altmark criteria.

2.4 Transitional period (Article 8)

In order to invite to a progressive implementation of the regulation, it will enter into force 3 years after its publication and will have a 12-year transitional period during which on-going contracts will still have a legal basement under certain conditions described below:

<table>
<thead>
<tr>
<th>Contracts awarded before July 2000</th>
<th>Contracts awarded after July 2000 and before entry into force of the regulation</th>
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<tbody>
<tr>
<td>Contracts awarded on the basis of a fair competitive tendering procedure</td>
<td>May continue until they expire</td>
</tr>
<tr>
<td>Contracts awarded with another procedure</td>
<td>May continue until they expire if duration is less than 30 years</td>
</tr>
</tbody>
</table>

During the second part of the transitional period however, transport authorities may exclude from participation in competitive bids operators whose less than half of the value of their contracts are granted in accordance with the regulation.

2.5 Publicity, monitoring and justification of choices (Article 7)

Every competent authority has to publish once a year a detailed report on public service obligations for which it is responsible listing the exclusive rights and the compensation granted to the operators.

At least one year prior to an invitation to tender, transport authorities have to publish basic information regarding the bid in the Official Journal of the European Union.

In order to increase transparency, transport authorities have to be able to justify on request their choice to award directly services. In the case of direct award of rail services, information on the contract and its parameters has to be published at within one year after having granting it.

Authorities will have to provide a progress report just after the half of the transition period on the implementation of the regulation. The Commission will then analyse this report and propose if necessary appropriate correcting measures.

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3 POTENTIAL IMPACTS OF THE REGULATION

3.1 Organisation of public transport

3.1.1 Share of roles and responsibilities

The need to face up to the issues related to the widespread use of the car, urban sprawl, town congestion and pollution has led a number of cities to set up specific structures for organising public transport, particularly over the last 20 years. Despite this common trend, the range of devolved competencies, the various organisational models and relations with operators nevertheless demonstrate the wide variety of local and national cultures in the management of urban mobility.

Public transport is organised at three levels corresponding to three time horizons:

- Strategic level, with a horizon of five years or more, determines the transport and mobility policy and investment to be made.
- Tactical level, with a 1-2 year horizon, sets up the tools required to achieve the strategic objectives by determining for example fare policy, quality of service, rolling stock and the level of transport supply.
- Operational level, with a horizon of less than one year, relates to the provision of transport services, sale of tickets, quality control and public transport promotion.

If the situation is rather clear for the first and the last item – operators are always in charge of the operational level and organising authorities are responsible for the strategic level - at tactical level, role distribution varies significantly depending on the town and is highly dependent on the regulatory framework and the competencies of organising authorities.

The use of contracts has become a very common practice in western Europe in particular. In new Member States, this trend will be reinforced by the entry into force of the text and will lead to the setting up of transport authorities where this kind of structure is not in place yet.

3.1.2 Regulatory framework of public transport in Europe

In Europe, three main approaches govern the regulation of public transport:

- Deregulated systems, such as the buses in Great Britain (excluding London) or intercity buses in Sweden. The initiative then comes from the operators, except for non-profitable services that organising authorities may decide to set up and subsidise.
- Regulated systems where the initiative reverts to the operators, such as in Germany in respect of the so-called “commercial” services. The organising authorities issue operating licences which consist in exclusive rights for a limited period of time. They thus play a co-ordinating role insofar as they ensure that new routes do not compete with routes already in service.
- Regulated systems where the initiative reverts to the organising authority, such as in Scandinavia or France. The networks are planned in terms of areas served and level of service at local authority level. Their operation is entrusted to one private operator (Lyon), several private operators...
(Stockholm) or even private and public operators (Helsinki). The organising authority can also operate those services itself under local government control as in Brussels.

3.1.3 Issues at stake with the new regulation

The proposed regulation seems to leave enough space for a wide range of models regarding kind of organisations or sharing of roles and responsibilities. In particular, the last version of the text mentions: “Passenger transport markets which are deregulated and in which there are no exclusive rights should be allowed to maintain their characteristics and way of functioning insofar as these are compatible with Treaty requirements”.

The text stresses raises some questions, in particular in the case of in-house operation.

- What will be the future relations between a transport authority and the corresponding in-house operator?

The draft regulation mentions the possibility to consider a contract as an individual regulatory act or a document containing conditions under which the competent authority provides itself transport services.

Currently, London Underground is part of Transport for London, 100% owned by Greater London Authority (GLA). Transport for London is also the body in charge of tendering out bus services and of contracting with selected companies. The contract (or equivalent) between London Underground and TfL or GLA have to be enough detailed to comply with the regulation but shall leave enough room for flexibility, in order to avoid too much bureaucracy within a single organisation.

With the same concern, the current contract between the Ministry of Brussels Capital region and the operator STIB allows a large initiative to the latter. STIB is actually responsible for the tactical level to a large extent: advising the region for mobility policy, involvement in updating transport plans, investments aiming at encourageing intermodality... A strict interpretation of the provisions laid down in the annex (calculations of the net cost incurred by public service obligations clearly defined) could lead to share differently the respective roles and transfer some tactical level responsibilities to the authority.

- Which involvement of private stakeholders is compatible with the regulation?

The very last version of the text leaves the room to the participation of private actors in internal operators, despite a large number of Court Cases having a very strict definition of the in-house concept: in the Case Stadt Halle1, the Court considered a minor participation of a private shareholder incompatible with the notion of internal operator.

A new orientation of the text towards the position of the Court can be an impediment to the French model of SEM (Sociétés d’Economie Mixte). The question of possible involvement of private sector can also be an issue for the model used in Genoa (Italy) where Transdev took a 41% share in the former

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1 Judgement of 11 January 2005 in Case C-26/03

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public operator AMT and also its management, following an invitation to tender.

3.2 Impacts on networks and operators

Beyond the organisational impacts, the regulation could also have consequences on the operators in place and the consistence of networks.

3.2.1 Rail services

The possibility granted to transport authorities to allow direct award for rail services (metros and tram excepted) seems to remain the current situation unchanged for the rail sector. It is however important to notice that this possibility has to be compatible with the national law. As a consequence, in the Netherlands, where the national regulation impose competitive tendering for rail services, the local authorities will not have the ability to award directly rail services contracts.

On the other hand, when the national level decides for the rail operator, which is the case in France or in Finland, transport authorities will not have the possibility to tender out these services if they wish to.

For rail services, that represent a large part of passenger*kilometres (more than 50% in Paris, Berlin and Rome), the new regulation doesn’t bring new possibilities and a higher autonomy to transport authorities. Moreover, the market opening for international rail services, including cabotage could increase technical (capacity of tracks) and financial (needs for subsidies) constraints on rail services.

3.2.2 Integrated networks

The initial versions of the regulation left the possibility to authorities to award directly public service contracts to companies operating integrated networks.

This provision has been removed in the first reading by EU Parliament and the impact on the regulation on integrated networks is a major question for the biggest European cities.

The question arises in particular for Paris where RATP operates a multimodal network made of metro, tram, bus and heavy rail system but is state owned and therefore cannot be considered as internal operator of STIF, the transport authority bringing together only local governments.

The transformation of RATP into an in-house operator could be a possibility to keep the same organisation but would imply, with respect to the principle of reciprocity, the split of numerous RATP activities outside Paris region, in France and abroad.

If RATP wishes to continue its international development, the corollary will be the introduction of competition in Paris area. On the one hand, tendering out the whole network would imply a huge change in the provision of public transport (provided that other operators could be in position to win the bid), but would ensure the integration of the network. On the other hand, a progressive opening to competition during the transition period, starting with a group of bus lines for instance, would be better in terms of learning curve but would require a higher co-ordination role for STIF.
3.2.3 Small operators

The ability given to transport authorities to award directly contracts to small and medium enterprises when their annual value is estimated less than €1.7 million seems to secure (better than in the previous versions of the text) the provision of bus services in Germany, where the market is made of a very large number of small players: about 1,000 private-sector bus operators provide short distance bus services.

3.2.4 Border effects

The first versions of the draft regulation didn’t take into account the possible difference between administrative boundaries and mobility areas. This would have been a problem for internal operators to be strictly contained within the perimeter of competency of the corresponding authority, raising issues at borders.

The most illustrative example would have been in Belgium where each of the three regions (Flanders, Wallonie and Brussels) has an internal bus operator (De Lijn, TEC, STIB). The consequence of a strict containment of the in-house operator would have lead to three totally independent bus networks!

The new text grants the possibility to an internal operator to have any outgoing lines or other ancillary elements of its activities in the territory of the neighbouring competent local authorities.

3.3 Impacts on service provision

The expected benefits of the regulation on service provision lie mainly in the cost effectiveness of operators and in quality of service.

3.3.1 No unique model of contract awarding

The figures provided in the introduction of the regulation tend to describe controlled competition as the best way to combine cost effectiveness, quality of service and use of public transport. The implementation of this regulation can lead to a larger number of situations where this model is used.

However, benefits in terms of costs have to be assessed in a long-term perspective as opening of former public monopoly markets can in a first stage increase pressure on costs and later see the presence of a private monopoly, taking all the market and technical expertise out of public control.

On the other hand, the experience of market opening seems to be very successful in cities like Stockholm where public subsidies fell from 70% of operating costs in 1990 to 50% in 2002 with an increase of quality levels and patronage.

3.3.2 Incentives for operators

The contracts generally contain provisions related to quality expectations and delivery. These provisions describe incentive schemes for operators in order to improve quality, which can be directly related to patronage (for instance if the operator gets all extra revenues from fares above a certain level) but also to any item related to quality of service.

To be really effective, the incentives have to be rather high. In the case of contracts granted through an invitation to tender, this possibility seems to be
compatible with the regulation. However, for contracts awarded directly, the provisions laid down in the annex impose a strict compensation of the public service obligations plus a reasonable profit.

Beyond the practical difficulty to define the financial effect of these obligations, this exact compensation could be an impediment to conclude highly incentive contracts, depending on the interpretation on ‘the reasonable profit’. A too strict interpretation could bias the comparison between competitive tendering and direct award on quality delivery.
4 CONCLUSION

This new regulation, expected for a very long time will deeply change the provision of public transport, even if in a large number of metropolitan areas, the institutional organisation will probably remain the same.

The generalisation of contracting and a common framework for their content will certainly clarify the roles and responsibilities of operators and authorities, even if this evolution has started before the first discussions on this text.

Contrary to the explicit objectives of the initial versions of the text, this regulation does not necessary lead to the opening of public transport market in every network. However this option is still largely promoted and the direct award to an internal operator has to comply with a set of conditions that could be more difficult to implement in practice than competitive tendering.

The actual impacts on quality provision, cost effectiveness and users’ perception will have to be properly assessed with regard to the options chosen by competent authorities. The review after the first half of the transitional period will provide some answers.
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Draft proposals released by EU commission:


Positions of national or international organisations:
• UITP (Union Internationale des Transports Publics):
• CEMR (Council of European Municipalities and Regions):
  http://www.ccre.org/prises_de_positions_detail_en.htm?ID=57
• EMTA (European Metropolitan Transport Authorities):
  www.emta.com/article.php3?id_article=270