COMMISSION OF THE EUROPEAN COMMUNITIES

Brussels, 6.2.2008
COM(2008) 54 final

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Multi-annual contracts for rail infrastructure quality

{SEC(2008) 131}
{SEC(2008) 132}
{SEC(2008) 133}

COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

Multi-annual contracts for rail infrastructure quality

1. GENERAL CONTEXT

1.1. The financing of rail infrastructure

The European Community's transport policy is concerned with developing and optimising transport infrastructure and ensuring its sound management in terms of quality, reliability, flexibility and customer orientation. This requires mobilising appropriate sources of financing. Six years after the adoption of the rail infrastructure package[1], there is still concern about the sustainable financing of existing rail infrastructure, the quality of infrastructure service and how to get infrastructure managers to perform better. This is one of the outcomes of extensive stakeholder consultations conducted between May 2006 and September 2007[2].

This Communication sets out the measures that Member States and infrastructure managers should take to combine financial equilibrium with an appropriate level of rail infrastructure services. The Commission recommends that these measures be applied consistently and fully in the European Union, but will consider whether to propose binding legislation to ensure that the rail services market in the European Union complies fully with Member States' responsibilities to develop rail infrastructure.

1.2. The strategic reference framework for rail infrastructure development

The provision of rail infrastructure is a key requirement for a competitive rail service market. Infrastructure development concerns two main players: the Member States, usually the national governments that own the infrastructure, and the managers of rail infrastructure. In accordance with their respective roles, as provided for in the rail legislation, they have to take decisions on the scope and nature of infrastructure development and the associated financial resources as part of a coherent approach.

The first prerequisite is a consistent strategic transport policy framework. The state should decide on the long-term infrastructure needs for all modes of transport within its transport policy in accordance with future user needs. This should generate the parameters necessary to decide on the best level of infrastructure quality and the extent of the rail network. This may involve pruning certain lines where no demand can reasonably be expected, or enhancing capacity to cope with growing demand[3].

---

1 Directives 2001/12/EC, 2001/13/EC and 2001/14/EC are collectively known as the 'infrastructure package'.

2 Consultations took the form of a stakeholder workshop in May 2006, two stakeholder consultations under studies the Commission launched in 2006 and 2007, and a public consultation which closed in September 2007.

3 For example, the Dutch government adopts its annual rail infrastructure management plan on the basis of a national ten year mobility plan covering all modes of transport.

1.3. The level of public intervention

EU Member States reported financial expenditure on maintenance[4] and on new railway infrastructure of €13.9 billion in 2006, not including funds from public-private partnerships (see Annexes 1 and 2). Adding on revenues from user charges, the cost of rail maintenance amounts to about €35 billion a year. Revenue from user charges only covers about 30 to 50%, with outliers at 10% and 100%.

The EU contribution is mainly focused on co-financing transport infrastructure under its TEN budget and parts of the cohesion and regional funds. This is for construction and rehabilitation of infrastructure on the trans-European rail network (TERN), and accounts for only a small part of the network.

Community legislation considers rail infrastructure charging at the cost of operating an additional train service as the rule, whereas it allows full cost recovery only as the exception and only on certain conditions[5]. In many cases, Member States play the dominant role in ensuring the financial stability of their rail infrastructure managers. The rail infrastructure managers have to cover a major share of maintenance expenditure from own revenues or from state transfers. This raises the question of the relationship between the state and infrastructure managers as far as such transfers are concerned.

2. STATE OF IMPLEMENTATION

2.1. The legal framework in the European Union

EU legislation requires setting incentives to reduce the cost of infrastructure provision and of consequent infrastructure charges. Costs have to be reduced with due regard to safety and maintaining and improving the quality of the infrastructure service. Whereas the Community has established detailed requirements for safety management and accident (data) reporting, there are no such obligations as yet at Community level for monitoring infrastructure service.

Member States may choose to meet this obligation by way of regulatory measures and/or contractual agreements, known as multi-annual contracts.[6] Such agreements are concluded for at least three years, i.e. longer than the traditional annual budgeting. Contract terms and the structure of payments have to be decided in advance for the entire contract duration.

Infrastructure managers in some European countries have gained valuable experience in using multi-annual contracts. The Commission thinks it would be useful if this approach were applied more widely on the basis of existing best practices. It has therefore invited Member States to continue setting their relationship with the infrastructure managers on a contractual basis for the funding of maintenance and modernisation of the railway infrastructure. This is also the appropriate framework for a performance-based system[7].

---

4 This term includes renewal and upgrading of rail infrastructure.

5 Directive 2001/14/EC, Articles 7 and 8

6 Directive 2001/14, Article 6, in particular paragraphs 2, 3 and 4

7 See Commission Communication COM (2006) 189 final of 3 May 2006 on the implementation of the 1st railway package, conclusions, page 10

2.2. Further legal requirements

Apart from the above rules, which refer directly to multi-annual contracts, the EU's rail directives set out other provisions which may be helpful in terms of implementation:

- Member States must take the measures necessary to develop their national railway infrastructure[8]. They may accord the infrastructure manager financing consistent with the tasks, size and financial requirements, in particular in order to cover new investment[9]. Infrastructure managers should set up a business plan to ensure financial equilibrium and to make sure the means are commensurate with the objectives[10].

- Member States are required to ensure that the infrastructure managers' expenditure and revenue are in balance over a reasonable period of time. This includes all activities, even if they do not relate directly to infrastructure maintenance.

Furthermore, specific provisions address the eligibility and transparency of financial transfers from the state, taking into account the requirement for management independence on the part of the infrastructure manager and the economic nature of its activities:

- Community law prohibits transferring public funds between infrastructure managers and railway undertakings.

- There is an obligation to keep and publish profit and loss accounts separately for infrastructure management.

- EU rail infrastructure managers are required to have a performance regime as part of their price system for infrastructure use.

- Finally, state aid rules have to be respected [11].

2.3. The current use of multi-annual contracts

The state of play regarding the use of multi-annual contracts varies considerably across Member States (see Annex 4). About half neither use nor plan to make use of them. Some Member States provide no finance for rail infrastructure maintenance in the first place, some are in the process of negotiating contracts for the first time, and some are preparing to extend them for a new multi-annual period. At the same time, an increasing number of Member States plan to introduce them, having put in place the requirements under the first railway package.

Infrastructure managers in Austria, Belgium, Bulgaria, Estonia, France, Ireland, Italy, Latvia, Romania and the United Kingdom have concluded multi-annual contracts with their states. Some states are renewing contracts, e.g. the UK, while others are preparing contracts for the

---

8 See Article 7 paragraph 1 of directive 91/440.

9 See Article 7.3 of Directive 91/440.

10 See Article 7.4 of Directive 91/440.

11 The Commission is considering whether specific guidelines on State aid to the rail sector would be required, covering among other things, transfers to railway infrastructure .

first time, such as Germany. In Austria, Bulgaria, Hungary, Ireland, the Netherlands, Slovakia and the UK, payments for infrastructure provision are already dependent on quality criteria.[12]

3. WIDELY CONTRASTING FORMS OF MAINTENANCE FINANCING

The competitiveness of the railway sector depends to an large degree on the availability and quality of the infrastructure. However, maintenance of infrastructure does not always get the attention and finance that railway operators expect in order to compete with other modes of transport.

Almost one third of infrastructure managers state that the finance available is not sufficient to maintain their network[13]. There are huge differences in expenditure on maintenance per track km in the various Member States[14], sometime up to 30 times. Infrastructure managers in certain Member States received no state transfers for infrastructure in 2003 to 2006, despite their significant networks. The Member States that joined the EU in 2004 spent €280 million on infrastructure development in that year, compared to over €13 billion in EU 15 (see Annex 1).

This discrepancy suggests that some networks may be building up maintenance backlogs, which the infrastructure manager is not able to finance.

By way of illustration, the figure below shows the development of equity and debts of the bigger European railway companies (both infrastructure managers and railway undertakings) from 1995 to 2004. While equity declined steadily, railways' debts multiplied. There are contributing factors other than infrastructure maintenance, such as lack of compensation for public service obligations, but the outcome as regards the lack of financial stability is the same.

2006 expenditure on maintenance per kilometre of track range from as little as €220 in Slovakia and €16 000 in Poland up to €160 000 in Germany and €360 000 in the United Kingdom[15]. This large discrepancy, over and above differences in cost levels, may imply that in some cases maintenance may not be sustainable, whereas in other cases **infrastructure managers may not have exploited cost reduction potentials in the same way all over Europe**.

The rail sector has succeeded in improving its safety performance, despite setting out from high initial levels. However, the same does not always apply to infrastructure quality. Where income does not suffice to maintain large, often oversized, networks, the infrastructure service quality declines. Without (common) performance indicators being defined and published, reduced infrastructure quality is not easily revealed. Only at the end of a long period, at a point where speed limits have to be lowered for safety reasons, does the true size of the problem become visible.

---

12 Source Community of European Railways and Infrastructure Managers, CER, 2006. Switzerland is renewing its multi-annual contract, in which payments depend on infrastructure quality.

13 A study entitled 'Guidelines for sustainable partnerships in railway maintenance' carried out by Ecorys in 2006 has revealed that 31% do not have an adequate budget. Those without an adequate budget have average annual deficits varying from 10% to 89% of total costs.

14 See table in Annex 2

15 See Annex 2 of Commission staff working document.

The case study presented in Annex 6 illustrates how, as a result of deficient infrastructure, transport service quality drops and customers opt for road instead of rail. This triggers a vicious circle, as infrastructure managers lose income that is no longer available for maintenance. Similar problems can be found where public service obligations in rail passenger transport are not duly compensated.

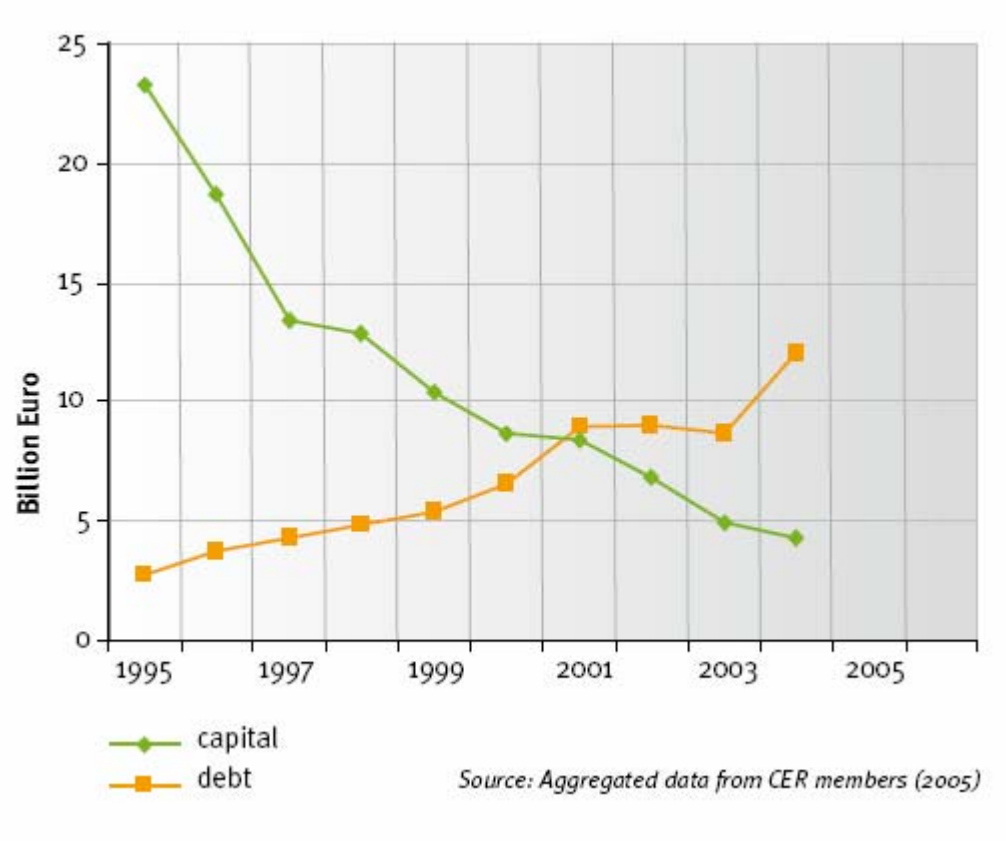

Figure: Capital and debt of railways in central and eastern European countries

4. THE ROLE OF MULTI-ANNUAL CONTRACTS

Multi-annual contracts represent a long-term financing arrangement for infrastructure maintenance. Annex 3 gives an overview of the main elements of a multi-annual contract and the potential advantages such an agreement can bring, if properly prepared and negotiated.

4.1. A long-term financing framework for maintenance

Preserving an existing network based on engineering criteria and fixed renewal intervals has been the dominant approach to rail maintenance for many years. What is needed, though, is for rail infrastructure to respond to future transport demand patterns and thus boost traffic and revenues from user charges. Multi-annual contracts should force both parties to take a long-term view and develop maintenance plans on the basis of the infrastructure manager's business plan and thus on future service demand. The stakeholder workshop concluded that multi-annual contracts also lead to more informed trade-offs between taxpayers' and users' interests, between maintenance and quality of the network, and between short-term maintenance and renewal.

4.2. Complementing the charging system

In a situation where most infrastructure managers are not able to recoup full maintenance costs from user charges, the transfers made through multi-annual contracts will supplement user charges to achieve the necessary financial stability. Thus, a multi-annual contract has to be consistent with the charging framework, which has to comply with the existing charging rules[16], without pre-empting the infrastructure manager's right to set the charges[17].

4.3. Enabling effective cost control

Long-term planning of rail maintenance and renewal can reduce unit costs, because maintenance equipment and staff will be better adapted to the type and volume of works envisaged, whereas there will be less need to change plans at short notice. This holds for both in-house works and outsourced maintenance.

Annual budget allocation requires funds to be spent before the end of a year, even if it is more cost-effective to postpone the works, and vice versa. In shifting from annual allocations to multi-annual ones, the infrastructure manager can make use of funds in a more flexible manner which is better adapted to business needs, rather than the rigid rules of public spending.

The table below sets out maintenance cost reduction potentials as quantified by infrastructure managers and transport ministries in the 2007 consultation exercise. Based on their replies, an absolute potential cost reduction of €580 million is estimated, just for those states that do not yet use multi-annual contracts, of which €370 million stems from maintenance works being scheduled more effectively (see impact assessment).

Multi-annual contract will reduce maintenance cost because of	*Expected cost reduction*	*Number of replies*
more efficient use of resources	2 – 5%	6
increased efficiency in outsourcing maintenance	5-10 %	3
more advanced personnel reduction policies	0,1- 3 %	3

Table: Maintenance cost savings. Source: EU rail infrastructure managers, PriceWaterhouseCoopers 2007

Under the pressure of 'use it or lose it', maintenance activities tend to peak towards the end of the year. The logic of public budgeting is such that budgets tend to be cut if they are not fully used in previous years. Massive maintenance works at this time also cause more delays and disrupt the service. Abandoning yearly planning in favour of multi-annual schemes thus reduces overall disruption as maintenance works can be planned such that traffic is disrupted

[16] According to Directive 2001/14/EC Article 4, Member States have to establish a charging framework and uphold the management independence of the infrastructure managers.

[17] As an example, see the England and Scotland case study in Annex 6 of the Commission staff working document

as little as possible. Once effective performance regimes have been introduced everywhere, this strategy will pay off even more, as the infrastructure manager will have to compensate users for any disruption he causes.

Where a multi-annual contract includes only certain parts of life cycle costs, e.g. either renewal or maintenance costs, this can create incentives for exceeding life cycle costs or can lead infrastructure managers to do too little maintenance, knowing that renewal costs can be recovered from the state at a later stage. Such deferred maintenance can lead to lower infrastructure quality.

4.4. Enabling benchmarking and regulatory supervision

Infrastructure managers should not ask for information, and in particular certain cost data on maintenance, to be treated as confidential. There is normally no competition for infrastructure services due to the infrastructure being a natural monopoly. The requirement to publish financial data accords with the public's right to be informed about the way public funds are used.

When performance targets can be set more effectively, then it is easier to gauge the relative positions of infrastructure managers. Consequently, cost effectiveness can be agreed not only by reference to the national infrastructure manager's cost data, but also with regard to his/her performance relative to other infrastructure managers. In parallel, regulatory bodies enforce the infrastructure managers' obligation to make available information on deteriorating infrastructure well before lower speed limits have their adverse effect on rail performance.

4.5. Improving performance and quality control

Multi-annual contracts facilitate the shift from input specifications – i.e. to compensate the infrastructure manager for a particular expenditure – to output specifications – i.e. performance-related payments. Quality indicators will have to comply with the SMART[18] principles.

There are two groups of quality criteria currently in use: indicators based on the quality of the train service, e.g. speed and safety, or on infrastructure provision. The first group quantifies delays resulting from lower speed limits, or accident data required under law for railway accident statistics. Indicators related to infrastructure provision can be maintenance costs per km track, or the percentage of lines under temporary speed restrictions. The infrastructure manager collects and calculates most of these data already to support his system of track access charges.

Increasingly frequent irregularities (e.g. broken rails, rail cracks) are early warning indicators that infrastructure quality is declining. Reducing the remaining lifetime for infrastructure assets can hint at unsustainable maintenance, i.e. the network being run down. Availability of track is another important performance indicator, with a distinction being made between planned and unplanned availability. When aggregating availability to a network basis, the

[18] SMART stands for Specific as regards the indicators' relation to objectives, Measurable as regards quantifiability, Achievable in a given market situation and resource availability, Relevant with a view to the business plan of the infrastructure manager, and Time-framed in terms of an agreed point in time when a criterion is measured and compared.

statistics for the different parts of the network should be weighted according to the importance of a line.

A basic prerequisite is for the infrastructure manager to monitor the condition of the fixed assets by means of an infrastructure register. Registers are already compulsory for the trans-European rail network[19]. They are designed to keep the infrastructure manager informed of the date of putting into service of an asset and its expected lifetime. It is thus an important factor in assessing the maintenance backlog.

The figure below shows delays in minutes caused by the UK infrastructure manager NetworkRail and its train operators. Since multi-annual contracts were introduced, delays attributable to infrastructure (see lowest curve) have been falling steadily.

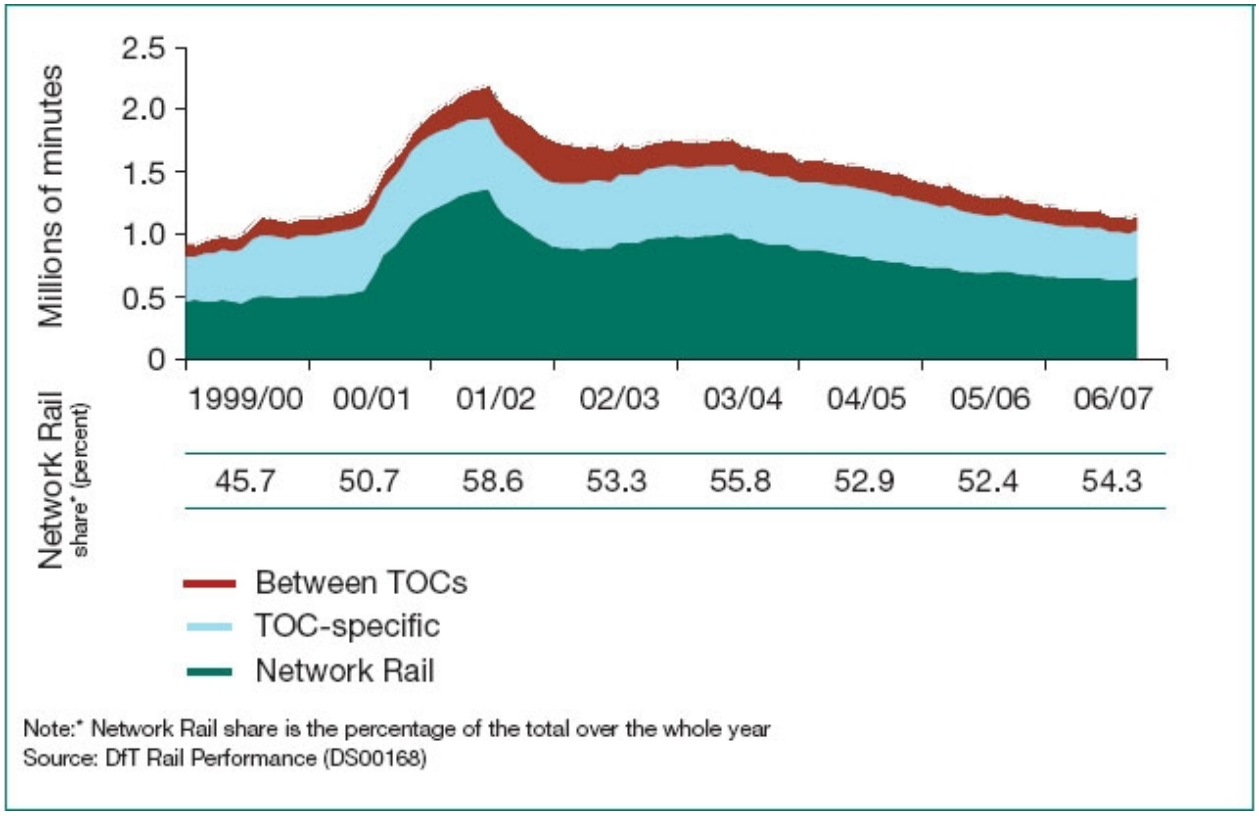

Figure: Breakdown of overall delay by responsible party

State, regulatory body and infrastructure users, particularly railway undertakings and shippers, can compare the performance of different infrastructure managers (benchmarking) and agree targets accordingly. This will give them better information on the quality of the infrastructure they can expect when they come to draw up their business plans. Users will also be able to assess and monitor maintenance in relation to the expected demand.[20]

---

19 Directive 2001/16/EC on the interoperability of the trans-European conventional rail system, Article 24, requires infrastructure registers for the conventional rail system to be published and updated annually. The norm leaves detailed features of the register to be stipulated in a Technical Specification on Interoperability. A similar provision was made in Directive 96/48EC on the interoperability of the trans-European high-speed rail system.

20 See Annex 5 of Commission staff working document for background information

4.6. Securing the effectiveness of the contractual agreements

To be credible, any contractual agreement needs to have sanctions to deal with non-compliance. Firstly, the contract has to lay down clear and transparent procedures on how to determine breach of a contractual obligation, such as under-financing or non-compliance with the agreed financing rules by the state, thereby affecting the infrastructure manager's ability to deliver. Vice versa, the infrastructure manager may not have complied with one or more of the agreed performance criteria. An independent body, rather than the state or the infrastructure manager, should lead this monitoring process. In practice, an independent, strong and competent regulatory body has proved to be best suited, provided it is not part of the contracting authority and has the requisite qualified staff, budget and access rights to data.

Sanctions can consist of penalties (fines), reduced output levels corresponding to reduced financial input, a replacement of managers or a reallocation of rail infrastructure to a different infrastructure manager. However, before sanctions are imposed, the two parties (and the regulatory body) should endeavour to reach an amicable settlement.

Sanctions should be progressive and appropriate to the infringement. At the beginning, the parties might find a consensus, where necessary with the mediation of a monitoring body. Where the infrastructure manager does not meet its contractual obligations, sanctions can be imposed by the state in its function as shareholder, e.g. replacements of managers. They can also take the form of penalties or a change in the franchise, with certain parts of the infrastructure being transferred to another infrastructure manager.

Where the state disregards part of its funding commitment, this will normally involve a relaxation in the quality requirements or a reduction in the size of the network. Again, the regulatory body should be involved in mediating and/or renegotiating the contract. The infrastructure manager should be able to assess the effect of different funding levels on the infrastructure quality. Having a model to use in the input-output relationship might be a useful way of adding transparency to this process.

5. PROMOTING BEST PRACTICE IN THE USE OF MULTI-ANNUAL CONTRACTS

In the light of the above, the need for further action is considered at three levels: Member States, infrastructure managers and regulatory bodies.

Best practice requires that Member States should **conclude multi-annual** contracts with their infrastructure managers, including the elements set out, and aiming at the advantages given in Annex 3. However, where no such contracts exist, Member States should at least provide for the **infrastructure manager to commit resources, including in-house provision or contracting, for periods of more than three years.**

Member States and their infrastructure managers have to **ensure that multi-annual contracts are consistent** with the national strategic transport plans and the infrastructure manager's business plan. The same holds true for infrastructure franchises and for any framework contracts between railway undertakings and infrastructure managers.

The state should **consult stakeholders** on any proposal for multi-annual contracts before letting a new contract or renegotiating existing provisions. It then negotiates the size and the quality of the network.

Member States should step up their efforts and reduce costs and charges for infrastructure provision and use. To this end, Member States should agree, monitor and enforce quantified cost reduction targets over periods of at least three years.

Infrastructure managers should **measure track condition** at least once a year on all their lines, and more frequently on their main lines.

Based on these measurements, infrastructure managers have to define and publish indicators making it possible to assess and predict infrastructure quality and performance on an annual basis for the duration of the multi-annual contract.

Discretionary intervention by the state in infrastructure management should be limited to cases provided for in the contract, while the infrastructure manager pursues the agreed objectives with a broad measure of **management independence**. Otherwise the agreement or contract needs renegotiating.

Infrastructure managers should report in the **network statement** when lines are not appropriately maintained and infrastructure quality is deemed to be in decline; otherwise infrastructure will be taken out of service. This information should be timely enough to enable it to act as an early warning system for users.

An **independent body** should be tasked with monitoring compliance with a multi-annual contract and with mediating between the parties to the multi-annual contract in the event of any dispute. This presupposes having the appropriate staff and expertise to carry out this type of assessment.

Finally multi-annual contracts can be a precursor for making better use of competitive tendering for infrastructure services. Since it will be difficult to put an entire national network out to tender at once, tendering might involve an increasing number of infrastructure managers, network statements, charging systems and access conditions. To minimise any possible negative effects, safeguard measures need to be taken to ensure simple and non-discriminatory access rules, ensuring respect of the rules on competition.

At this stage the Commission will consider including a number of the previous recommendations in its proposal for recasting the first rail package, planned for 2008.