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Fourth Railway Package:

Proposal for a Directive of the European Parliament and of the Council amending Directive 2012/34/EU of the European Parliament and of the Council of 21 November 2012 establishing a single European railway area, as regards the opening of the market for domestic passenger transport services by rail and the governance of the railway infrastructure

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 1370/2007 concerning the opening of the market for domestic passenger transport services by rail

- Progress report

I. INTRODUCTION

Under the Latvian Presidency, substantial progress was achieved on both the technical and the market pillar of the 4th Railway Package. The Presidency dedicated significant resources to the technical pillar, holding several informal trilogues, in which Parliament, Council and Commission could agree on compromise texts on most of the proposals of the Safety Directive, the Interoperability Directive and the ERA Regulation. Given the maturity of the discussions on the technical pillar between the co-legislators, the provisional conclusion of inter-institutional negotiations in substance is expected by the end of the Latvian Presidency continuing the established constructive spirit of cooperation and with an active support from the European Commission.

On the market pillar, the Presidency presented its first compromise proposals to the Land Transport Working Party on 7 January 2015, taking into account many of the concerns of the Member States expressed under the Italian Presidency during the second half of 2014. After the first round of article-by-article analysis at the working group meetings on 10 and 17 February 2015, an orientation debate was held at the Transport Council of 13 March 2015, where three main open issues identified during the working group meetings were discussed (definition of independence requirements in relation to essential functions, role of regulatory bodies, access to rolling stock). Following the orientation debate, on 9 April 2015, the Presidency presented revised compromise texts on both proposals based on the Ministers' policy guidance, which were discussed during the meetings on 21 and 30 April and 7 May 2015.

II. CONTENT OF THE PRESIDENCY COMPROMISE PROPOSALS

On the basis of the progress report of the Italian Presidency and the guidance of Ministers provided at the TTE Council in March 2015, the Latvian Presidency has addressed in the compromise proposals concerns expressed by Member States on the Governance Directive as follows:

a) Directive 2012/34/EU

- Defining a core of common rules on independence of infrastructure managers by means of reinstating the notion of 'essential functions' (covering infrastructure charging and capacity allocation), which should be subject to the strongest independence requirements.

- Revision of the definition of 'vertically integrated undertaking', referring to the notion of 'control' rather than ownership.
- Clarification that infrastructure managers that are owned or controlled by the same Ministry or other public body as a railway undertaking, but organised as two fully separate undertakings, can be considered as a separated structure.
- Removing restrictions on reversibility of governance models.
- Explicitly allowing Member States, where the infrastructure manager is not a separate legal entity and the essential functions have been entrusted to an independent charging and capacity allocation body before June 2015, to keep such arrangements in place.
- Clarification of the respective roles of Member States and infrastructure managers as regards financial and investment planning.
- Definition of specific rules to ensure impartiality as regards traffic management and maintenance planning.
- Limiting the applicability of provisions requiring organisational and decision-making independence of infrastructure managers, dedicated staff and premises of an infrastructure manager, appointment of staff and decisions on working conditions and career issues of personnel responsible for essential functions.
- Increasing flexibility of Member States in deciding on the identity of bodies responsible for appointment of staff taking decisions on the essential functions.
- Extending the possibilities for outsourcing of functions by allowing that all non-essential functions can be outsourced to different entities if they are not railway undertakings, while only specified development, renewal and maintenance works can be outsourced to railway undertakings, under the condition that the infrastructure manager would keep the decision-making and supervisory power over all functions.
- Introducing specific rules taking into account the particularities of public-private partnership projects, in particular by opening up the possibilities for the sharing of functions of an infrastructure manager.

- Simplification of the procedure for verification of compliance of independence of an infrastructure manager, which is limited to monitoring by the regulatory body; removal of the ex-ante control rights of the Commission.
- Streamlining the competences of the coordination committees and limiting the need to set up such committees to cases where this is requested.
- Deletion of the possibility to adopt implementing acts on the basis of the work of the network of infrastructure managers and streamlining competences of the network.

b) Regulation (EC) No 1370/2007

The objective of the Presidency compromises on the PSO proposal was to find a common understanding on the conditions of the introduction of the principle of competitive award of public service contracts (PSC) in rail, in particular as regards possible exemptions from this principle. The points of the compromise included:

- Reverting to the current definition of 'local competent authority' in the Regulation ('any competent authority whose geographical area of competence is not national') while introducing a safeguard disallowing the joint direct award of PSC to an internal operator in rail (not in other modes such as buses, trams, metros) by a group of local competent authorities.
- Removing the obligation to establish public transport plans. The authorities would only maintain an obligation to define specifications of public service obligations which have to comply with criteria of necessity and proportionality, cost-effectiveness as well as financial sustainability of the public transport policy.
- Allowing for bundling of profitable lines (cost covering) with unprofitable lines (not-cost covering) within the scope of one PSC to ensure cost-effective provision of public transport services by protecting against negative effects of 'cherry picking' by open access operators choosing to compete with PSO operations on profitable lines.

- Replacing the obligation of competent authorities to take measures to ensure non-discriminatory access to rail rolling stock for potential bidders by an obligation to assess whether potential bidders have non-discriminatory access to rolling stock for the purposes of the tender procedure to foster effective competition for PSC.
- Introducing new procedures or exemptions from the principle of mandatory competitive award, namely:
 - Codification of a simplified transparent and non-discriminatory award procedure in case there are not enough potential bidders.
 - Higher minimal threshold values for exempting small contracts from mandatory competitive tendering.
 - Exemption for physically and technically isolated rail systems.
 - Exemption of Ireland as a Member State located on an island with a rail link to only one other Member State (limited to 10 years).
 - Exemption in cases when national passenger rail traffic in the relevant Member State is less than 1% of the total European Union rail passenger market volume expressed in passenger kilometres ('market share-based exemption').
- Introducing a new external reciprocity clause protecting against the market entry of certain third country companies. This clause would allow a Member State to limit access to the tendering procedure for third country companies if the respective third country does not apply competitive tendering or discriminates against the Member State's companies in the tendering procedure.
- Extending the transitional period until 3 December 2022, date from which all PSC in rail should as a principle be awarded through competitive tendering. Rail contracts directly awarded until 3 December 2022 may continue until they expire but not later than 10 years after the entry into force of the new Regulation.

III. COMMENTS ON THE MAIN ISSUES

a) Directive 2012/34/EU

Member States generally welcomed the reintroduction of the notion of 'essential functions' and, while some maintained a reserved position, the approach of defining independence requirements more in relation to functions of infrastructure managers than in relation to organisational structures was widely supported. However, the new 'development' function was contested by some Member States, arguing that planning and investment decisions are taken at ministerial level.

On the definition of essential functions, a few Member States argued that the determination and collection of charges should not be considered as an essential function. The Commission cannot accept this request, as the collection of charges was added in the Recast Directive, and is therefore already part of the 'EU acquis'.

Several Member States also proposed to fine-tune the definition of 'public-private partnerships' which introduces flexibility on the 'fully-fledged' infrastructure manager principle.

While several Member States were generally in favour of defining a core of common rules applicable to separated and integrated structures, several other delegations expressed concerns that this approach might result in overregulation for separated structures. The revised compromise proposal presented in April addressed several of these concerns by limiting the application of provisions on independence of infrastructure managers for separated structures to core requirements that need to be met in order for an infrastructure manager to be considered as separated.

Member States having a structure where railway undertaking and infrastructure manager are under the control of the same ministry but organised as two fully separate entities, welcomed the clarification that such structures could be maintained and would be subject to the rules for separated structures. Member States with structures in which there is shareholding between a holding and a railway undertaking and infrastructure manager, but no effective control, were in favour of the revised definition of 'vertically integrated undertaking'; at the same time, several Member States indicated that additional work may be needed on the definition of 'vertically integrated undertaking' to ensure legal certainty.

One Member State proposed to safeguard existing intra-group loans (provided they were granted at market price/rate before the publication of Directive 2012/34/EU) if monitored by a regulatory body.

Member States generally supported the Presidency's proposals aiming at avoiding overregulation concerning the independence requirements to be met by infrastructure managers. At the same time, some delegations remain concerned about additional administrative burden resulting from rules on appointments of the management staff of the infrastructure manager and assessment of conflict of interest in case of transfer of staff responsible for essential functions; some Member States with separated structures were also concerned about the impact of new provisions on infrastructure managers' independence as regards the management independence of infrastructure managers from the State. On remuneration of management of infrastructure managers, some Member States were opposed to a provision that would require performance-based elements of remuneration to depend solely on the performance of the infrastructure manager.

Some Member States opposed the prohibition for members of management or supervisory boards of the infrastructure manager to be, at the same time, member of the management or supervisory boards of a railway undertaking, while others consider that this provision should apply regardless of the governance structure.

A number of Member States agreed that traffic management and maintenance planning could bear a potential for discrimination and should therefore be subject to more detailed analysis on possible specific safeguards, which, however, make involvement of railway undertakings in traffic management possible. A large majority of Member States welcomed the fact that traffic management is not listed in the definition of essential functions. Some Member States were of the opinion that non-discriminatory association of railway undertakings to traffic management could be ensured in different ways and this should be reflected in the text.

Member States also welcomed greater flexibility as regards the possibility for infrastructure managers to outsource and share functions, while some delegations requested that it should also be possible for infrastructure managers to outsource essential functions to entities that are independent from railway undertakings such as other infrastructure managers, and to outsource not only specific development, renewal and maintenance works, but also other non-essential functions to railway undertakings, for instance to reduce the cost of maintenance on low-traffic lines.

One Member State proposed to clarify that the rules on payment of dividends of the infrastructure manager to the ultimate owners do not prevent dividend payments to any private investors, if they are – solely or jointly with the State – the ultimate owners. The objective of such a proposal is to ensure that private and public investors are treated equally. Profits and losses (including dividends) should be distributed according to commercial law.

The provisions on financial transparency were generally supported by most Member States as being crucial in order to ensure a level playing field for all operators, even if some Member States expressed a need for more flexibility on specific aspects. All Member States supported the proposed elimination of the provisions entrusting the Commission with powers to supervise the independence of infrastructure managers. Most member States agreed that strong regulatory oversight is crucial for the functioning of the railway market. However, some found that the new powers entrusted to the regulatory body, such as the competence to decide on complaints against premature termination of office and career-related issues of management staff of the infrastructure manager responsible for essential functions would be too far-reaching and thus could not be supported. Some Member States also indicated that the substance of those provisions could already be covered by national labour law.

Most Member States welcomed the proposed amendments to the provisions on coordination committees, while others expressed remaining concerns about duplication of existing structures and excessive administrative burden resulting from reporting obligations. Some Member States raised serious concerns as to the creation of the coordination committees, while few considered it necessary to specify the needs of applicants related to the maintenance and development of the infrastructure capacity.

Introduction of an external reciprocity clause protecting against the market entry of certain third country companies was proposed. Most Member States were open to discuss such a clause, but some were reluctant to introduce such principle in the text and others underlined that the wording would have to be further examined to avoid unintended restriction of access to the railway market of undertakings established in a Member State and already operating in the EU market, but owned by third country investors. Two Member States were also supporting the inclusion of an internal reciprocity clause, together with the possibility for measures during the transition period in order to allow for a gradual opening of the national rail markets.

Moreover, several Member States were of the opinion that the provisions on market opening included in the Governance proposal had to be seen in close connection with the provisions of the PSO proposal and indicated that their further views on the Governance proposal would depend on the solutions found in the PSO proposal.

b) Regulation (EC) No 1370/2007

Delegations have welcomed maintaining the current definition of the local competent authority, the deletion of the obligation to establish public transport plans and the explicit permission to bundle profitable (cost-covering) and non-profitable (not cost-covering) lines. Many of them also welcomed the codification of a simplified transparent and non-discriminatory award procedure in case there are not enough potential bidders. A large majority of the Member States supported higher minimal threshold values for exempting small contracts from mandatory competitive tendering. Regarding an exemption from the principle of competitive award for physically and technically isolated rail systems from the main national network, several Member States asked for better definition of this exemption and questioned its added value.

Member States have supported in principle the extended definition of the exemption from mandatory competitive award in emergency cases.

A considerable number of Member States at this stage of discussions were, in principle, of the opinion that the possibility of direct award as a general rule should be maintained on subsidiarity grounds, keeping direct award and competitive tendering on an equal footing.

However, if the general principle of competitive award of PSC in rail had to be introduced, a majority of Member States would subject it to appropriate exemptions taking into account the specificities of the national markets.

Member States with a rail market share below or close to 1% of the whole EU market supported the Presidency compromise. A number of Member States as well as the European Commission expressed concerns about such an approach based on an arbitrary definition of the threshold of the market share and the potential discriminatory effects. However, the group of Member States with such small markets noted that this threshold approach was not arbitrary and that the other exemptions in the proposal also had such thresholds. The Commission explained the reasons behind the values of the *de minimis* thresholds.

Another possibility for an exemption, based on direct award linked to performance criteria, was presented by one Member State. This would provide the possibility of a direct award where the competent authority demonstrates that the rail PSC intended to be awarded in this manner would result in an improvement of efficiency and quality of services that is comparable or better to a contract awarded through a competitive procedure. The performance-based proposal also provided for the assessment to take into consideration socio-economic consequences, including continuity of services, network size and complexity, network integration and costs.

This exemption also requires the competent authorities to ensure that, based on their assessment, performance and efficiency targets are included in the PSC and are enforced either through deterrent fines or possible obligatory mandatory tendering for the next contractual period. While Member States have not had a chance to fully assess this proposal, many Member States welcomed it as a good basis for further detailed, technical discussion. Several Member States, however, expressed concerns about the aspects of the practical implementation of this proposal and indicated their wish to reflect also on other alternatives that could be proposed in the future.

Furthermore, many Member States with small rail markets stressed that such a performance-based proposal did not alleviate their concerns and that the market-size exemption remained necessary in addition to this new proposal.

Some Member States regretted the lack of compulsory social provisions in the framework of competitive award of PSC. Some delegations proposed to follow the approach adopted by the European Parliament that aims at strengthening the staff's social protection. One Member State opposed the inclusion of mandatory social provisions in a legal text.

Several more alternatives have also been presented during discussions, such as an exemption which specifies that PSC of lower value than 1% of the total EU market could be exempted. While certain delegations welcomed this *de minimis* approach, others pointed out that the threshold defined is too high. Another alternative envisages to exempt passenger services on urban, suburban or regional lines operated by an integrated railway undertaking that is outside the remit of the rail recast Directive.

Another alternative was put forward which introduces the possibility for competent authorities to limit the number of contracts granted to the same railway undertaking on the entire network with a view to enhance competition.

Another proposal related to the extended scope of the proposed exemptions from the principle of mandatory competitive award was also presented. These exemptions concern cross-border public services or public services that will be operated on infrastructure, which is supposed to be significantly modernized during the duration of the public service contract.

A majority of Member States welcomed that the obligation of the competent authority to ensure non-discriminatory access to the rolling stock is transformed into an obligation to assess whether measures to facilitate access to rolling stock would be necessary, thus allowing to avoid the unnecessary financial burden that would be created in case of an obligatory approach not taking into account the specificities of the different markets. Some delegations proposed to strengthen this provision, including by the introduction of a possibility for the competent authority to require a transfer of rolling stock used for the carrying-out of the public service to an incoming operator that would carry out the service under the new contract or the setting up of rolling stock leasing companies.

Regarding the external reciprocity clause, several delegations welcomed its introduction in the Presidency compromise. However, some Member States were concerned, as it could deter important foreign direct investment in the EU rail market. Several Member States requested the deletion of that clause. Member States generally suggested to continue working on the wording of this clause.

Several delegations did not want to determine their position on the transition period until the discussion on other issues, such as exemptions to competitive award, was closed. However, some delegations asked for a possibility to adapt the transitional period to allow for a progressive opening of the market in each Member State. Furthermore, some delegations stressed the importance to come up with a correct wording as regards the transitional arrangements to ensure legal certainty.

IV. SUGGESTIONS FOR FURTHER NEGOTIATION

According to a large majority of Member States, both proposals of the market pillar should be discussed together, as the main aspects 'governance of the railway infrastructure / opening of the market for domestic passenger transport services by rail' and 'the principle of competitive award (allowing some well-defined exceptions)' are not to be separated. Taking this into account and based on the results of discussions carried out, the Presidency has identified the following main remaining issues and possible approaches to find compromises on these issues:

a) Directive 2012/34/EU

Additional work on the definition of 'vertically integrated undertaking' and 'public private partnership' appears required to ensure legal certainty.

A crucial issue for several Member States, and one which requires further work, is the risk of overregulation as regards separate structures.

To address the remaining concerns of Member States on the rules on independence of infrastructure managers, it could be clarified that the 'independent bodies' referred to in Article 7a(2) may include infrastructure managers, as well as any other entity not controlled by a railway undertaking.

Moreover, it could be useful to envisage to give Member States flexibility in deciding which body should be responsible for handling complaints against premature termination of office and other career related issues of managers of the infrastructure manager. Also, the rules on mobility of staff in Article 7a(2) could usefully be streamlined in a way that ensures that an independent assessment, in particular regarding the essential functions, takes place, while leaving it to Member States to define which entity performs such an assessment.

As regards performance-based elements of remuneration of management of infrastructure managers, further discussion is necessary. It may be envisaged to amend the provisions with a view to allowing for rewarding infrastructure managers' staff for improvements of the overall performance of the railway system, while ensuring that bonuses do not depend on the performance of specific operators.

On traffic management and maintenance planning, it could be clarified that non-discriminatory association of railway undertakings to traffic management can be ensured either by means of granting access to all relevant information on a non-discriminatory basis or through access to traffic management centres, in cases where infrastructure managers grant access to these centres.

In view of addressing remaining concerns of delegations on outsourcing of functions, it may be envisaged to extend the possibility of outsourcing to essential functions, provided that these functions are performed by a body that is independent of any railway undertaking. The possibility of allowing the infrastructure manager to outsource non-essential functions to railway undertakings, in order to reduce maintenance costs on low-traffic lines, could also be assessed.

The rules on financial transparency are crucial to ensure a fair and equal level playing-field for all operators; the wording of this Article and the impact of any proposed changes to this Article would therefore need to be thoroughly assessed.

As regards concerns of some Member States about the scope of the monitoring powers entrusted to the regulatory bodies, it appears useful to clarify that the role of the regulatory body is confined to assessing the application of the national provisions within the framework of the tasks entrusted to them under the Directive, while the monitoring of the compliance of national rules with Union law remains the exclusive competence of the Commission.

In order to address Member States' concerns on coordination committees, it could be clarified that existing structures may perform the role of those committees and the provisions on reporting obligations could be further streamlined. In particular, it should be taken into account that parallel structures to already existing structures should be avoided.

The principle of the external reciprocity clause should be further examined, taking into account the concerns of certain delegations as regards limitation of access rights for operators already established in Member States but owned or controlled by third country investors.

The principle of the internal reciprocity clause could also be examined further.

b) Regulation (EC) No 1370/2007

Exemptions to the principle of competitive award of PSC in rail

All proposals presented during the discussions should be analysed further as well as possible new proposals. On the one hand, solutions addressing the concerns expressed by Member States, in particular that competitive award is not fit for small markets and complex networks, does not ensure long-term continuity of public rail transport services or can have serious negative socio-economic consequences, should be found in order to provide incentives to improve efficiency and performance of rail passenger services in the EU. On the other hand, the issues raised by Member States concerned by the lack of competition on railway markets induced by exemptions should also be considered.

The performance-based exemption, provided that it ensures stability of the passenger markets and continuity of service in the long run including in cases of small markets, avoids unnecessary administrative and management burden that could result in increased costs for services and also opens up to further criteria to be taken account of, such as complexity of networks and socio-economic consequences, could provide a good ground for further discussion, but new proposals could be considered as well.

Non-discriminatory access to rail rolling stock

Member States agree on the importance of non-discriminatory access to rail rolling stock. Given the fact that a majority of the Member States welcomed the Presidency proposal as balanced and budget neutral, it would appear that this principle could be acceptable in principle for Member States. However, further tools to facilitate access to rolling stock whose application would have no negative impact on the Member States' budgets could be considered in future discussions, including rolling stock leasing companies.

External reciprocity clause

This provision should be further discussed and account should be taken of the fact that it is only an optional provision.

Transitional arrangements

Transitional arrangements for non-rail modes should not be modified. For rail, there should be more flexibility as to the date of introduction of the principle of competitive award of PSC compared to the Commission proposal (as from 3 December 2019) and existing contracts should be able to continue until their expiry. Further reflection on calls for a gradual market opening at national level during the transitional period appears to be warranted.
