



**SEETO working group
railway and intermodality**

**Public Service Obligation Contracts
for Rail Passenger Transport**

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Belgrade, February 27th, 2009

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PSC for Passenger Rail
Belgrade, 27.02.2009

Who are we?

Presentation of KCW GmbH



- KCW is the leading source of strategic and management advice for public transport authorities (PTAs) and transport associations
- We are active in the European public services sector, our special field is public transport by road and rail
- Since 1998 we have been providing advice as an independent and interdisciplinary team of 30 experts in Berlin and Hamburg
- Our clients include local authorities, transport associations and ministries whom we assist in all the organisational, financial and legal aspects of their public tasks.
- We and our international network of experienced cooperation partners have excellent market knowledge and make full use both of national and international precedents and experience.

Who are we?

Presentation of KCW GmbH

Range of expertises of the KCW team:

- Holistic strategic and management advice for transport
- Public transport market organisation and its effects in D, CH, S, DK, GB, F, I, NL and PL (language skills for all countries are available within our team)
- Market development in Germany (close contact to the leading public transportation associations in Germany)
- Privatisation of companies (market development and potentials)
- Giving advice for public enterprises in case of reorganisation and aiming for competition
- Designing, preparing and conducting tender processes
- Market- and regulation strategies for rail transport
- Demand- and revenue modelling, marketing and yield management
- Infrastructure management and organisational forms of infrastructure issues
- Modelling and realisation of public private partnerships (PPP)

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PSC for Passenger Rail
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Belgrade, 27.02.2009

Public Service Contracts

Idea and Advantages (I)

Traditionally:

- Public transport services provided by state owned transport operators
- Public transport operators part of the public administration
- Problems: Inefficiency, lack of market orientation and innovation
- Intransparency between profitable and non commercial operations
- Budgetary problems may quickly cause interruption of operations

The new roles

- Organisation in 2 levels:
 - Authority side: definition of requested service level, public funding of non commercial services, choice of operator (the authority acts partly on behalf of the customers)
 - Operator side: Undertakings with market orientation and aim for profits
- Contractual Partnership of both parties within an Public Service Contract (PSC)

Public Service Contracts

Idea and Advantages (II)

Advantages

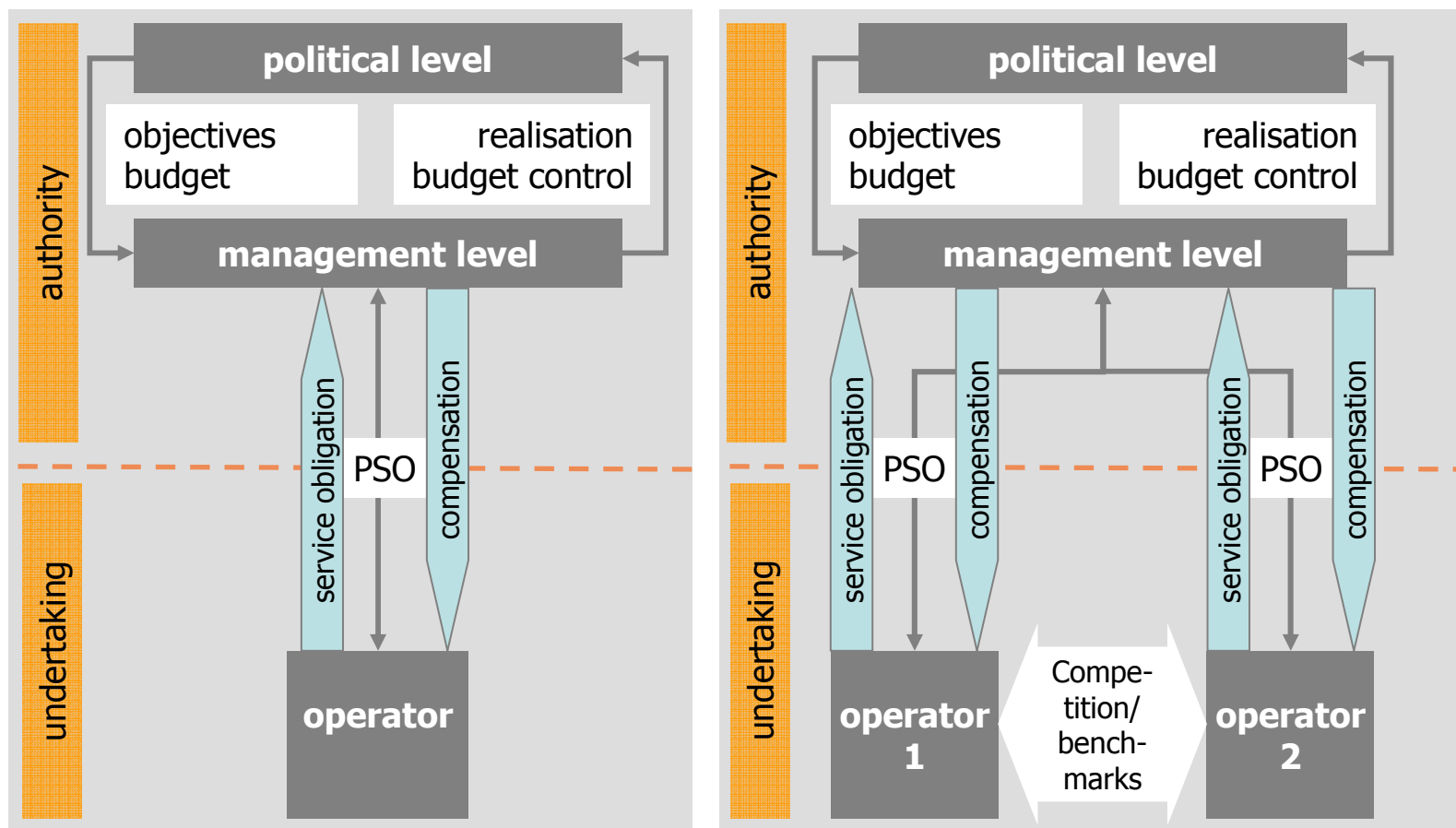
- Core aims of PSO-Contracts: Reducing costs and improving quality
- Budgetary control
- Improvement of efficiency and effectiveness
- Customer focus: main aspects are quality standards and the rolling stock fleet.
- Incentives for performance
- Long term perspectives for both sides
- Transparency
- Clarification of obligations and need for compensation
- Controlling of objectives and performance

EU-Law: Obligation to conclude PSC in case of any compensation or exclusive right (est. by Regulation 1370/2007).

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Public Service Contracts

Idea and Advantages (III)



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EC legal requirements (1)

The EC Regulation 1370/2007

EC legal framework: Reg. (EC) No. 1370/2007

- Scope: national and international operation of public passenger transport services by rail and other track-based modes and by road
- Lays down the conditions under which the competent authorities may compensate public service operators
- Exclusive rights and/or financial compensation must be granted in the framework of a public service contract (PSC)
- Content of Reg. 1370/2007:
 - Rules concerning the content of PSC and transparency (
 - Rules concerning the awarding procedure (art. 5)
- Regulation takes effect without further national legislation in the EU on 3 Dec 2009
- Rules on contract awarding (art. 5) binding from 3 Dec 2019 (transission)

EC legal requirements (2)

The EC Regulation 1370/2007

Mandatory content of PSCs

- Clear definition of the public service obligations with which the public service operator is to comply
- Establishment of the parameters on the basis of which the compensation payment is to be calculated and/or the nature and extent of the exclusive right granted, in an objective and transparent manner
- Rules to avoid overcompensation

Additional requirements for directly awarded PSCs

- Control of overcompensation: payments must not exceed the amount required to cover the net financial effect on costs incurred and revenues generated in discharging the public service obligations (including reasonable profit)
- Compensation must promote effective management and sufficiently high standard of transport
- Separation of accounts where operator also engages in activities other than compensated services

EC legal requirements (3)

The EC Regulation 1370/2007

Awarding of PSCs concerning transport by rail

- Principle of the regulation: competitive tendering procedure
- Art. 5 (6) Reg. 1370/2007 allows for direct award
 - unless prohibited by national law
 - duration of directly awarded contracts shall generally not exceed 10 years (extension up to 50% possible, see art. 4 (4))
 - Special transparency rules: mandatory publication of information enumerated in art. 7 (3) within one year after the award
- Any awarding procedure must be fair and observe the principles of transparency and non-discrimination

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Experiences with PSC

Concept of contracts in public passenger transport

What is the nature of a „typical contract“?

- Subject matter of PT contracts can be
 - transport services (design, operation, ...)
 - exclusivity
 - payments
 - infrastructure services (building, maintenance, operation, ...)

- Nature of the contract in PT
 - legally binding, enforceable, verifiable agreement or public service obligation by a competent authority
 - of two or more parties
 - defining service and adequate service/ payment in return

Experiences with PSC

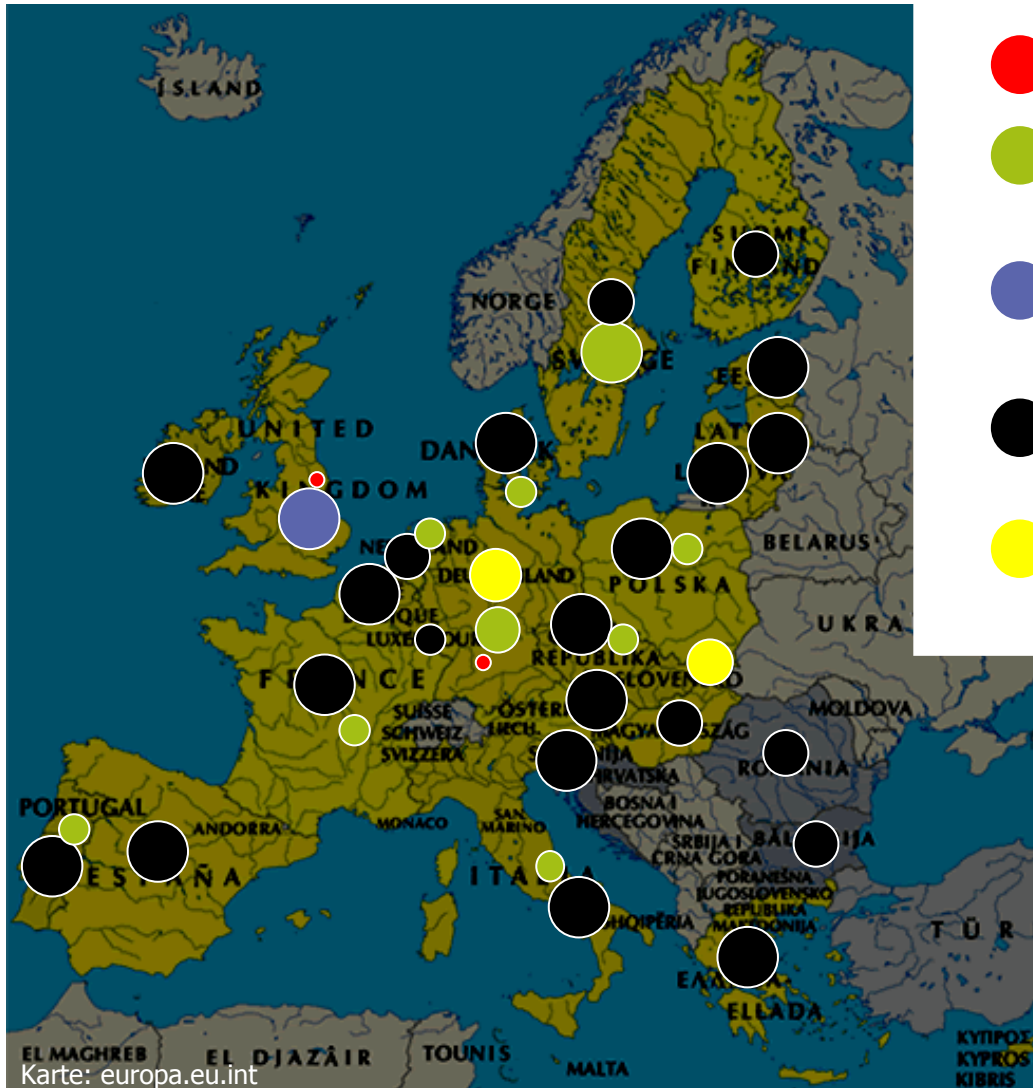
Experience in the EC

Different approaches in EU member states

- wide variation in types of contracts
- inhomogeneity of contracts and award procedures across Europe
- variation in legal appeal procedures
- Different ways of awarding contracts
 - Legal Monopoly
 - Direct awarding
 - Competitive Negotiations
 - Formal tendering procedures

Experiences with PSC

Liberalisation of Passenger Rail Services in the EC



- open access/ licensing
- competitive tendering (public procurement)
- national competitive procedures
- legal monopoly with contracts
- informal funding/ informal management

Experiences with PSC

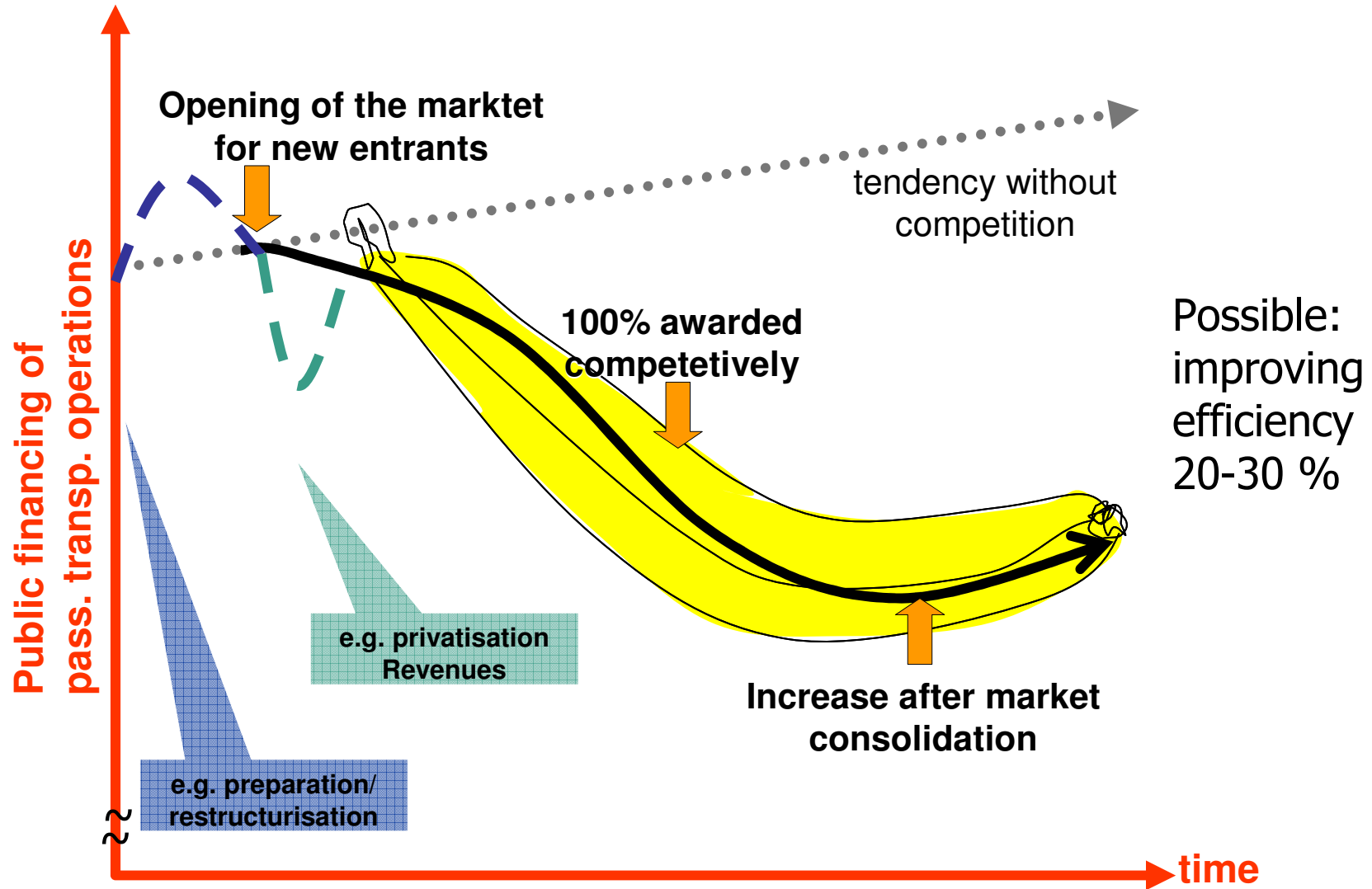
Liberalisation of Passenger Rail Services in the EC - Players

Company	Arriva	Deutsche Bahn	DSB	FirstGroup
<i>Activity region</i>	CZ, D, DK, E, H, I, NL, PL, P, S, SLO, UK	D, F, I, PL, S	D, DK, S	CAN, D, DK, S, UK, USA
<i>Turnover p.y. (2007/08)</i>	2,4 Mrd. €	6,5 Mrd. € (DB Regio)	?	7,8 Mrd. €
<i>Remarks</i>	strategy focuses on growth in operating areas	strategy focuses on major position in european market	some trials in D and GB	Intensive observation of markets but only selected bid activities

Company	Keolis	NedRailways	Transdev	Veolia
<i>Activity region</i>	D, DK, F, S, UK	D, DK, S, UK	AUS, CAN, D, E, F, I, NL, P, UK	Rail: AUS, CZ, D, F, NL, NZ, S, USA
<i>Turnover p.y.</i>	4,4 Mrd. €	?	1,4 Mrd. €	5,6 Mrd. €
<i>Remarks</i>	Rather consolidation than expansion	New strategy after takeover of Abellio		strategy focuses on growth in operating areas

Experiences with PSC

Development of Costs after Liberalisation: The „Banana-effect“



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Selected Aspects of PSC

The Market Vision (1)

Monopoly or Competitive Market?

- **Article 5 imposes competitive tendering as the rule**
- **According to 3rd railway package border crossing passenger rail services are liberalised from 2010 (open access)**
- **In respect to domestic passenger rail services member states are allowed to award directly, unless prohibited by national law**

- **How can the objectives be fulfilled best?**
- **PSC offers for both ways instruments for improvement**

Selected Aspects of PSC

The Market Vision (2)

Who's in charge?

- **Who designs and controls PSC?**
- **Regionalisation of responsibilities to regional bodies vs. national level**
- **Who knows best what kind of passenger services are needed?**
- **transfer of committed budgets from the treasury to regions or own financial sources?**
- **Know how needs to be allocated on each level**
- **Effectiveness and efficiency of administrative bodies**

Selected Aspects of PSC

The Market Vision (3)

Open access vs. exclusive rights?

- **Intermodal competitive conditions**
- **commercial vs. non commercial services**
 - **Sperate markets?**
 - **Distortion between segments?**
- **Perspectives for market driven services**
- **Calculability for non commercial services**

Selected Aspects of PSC

Transition from Monopoly to a competitive Market

Relevant aspects

- **A market needs to be generated**
 - **Which are (potential) players in the market?**
 - **How much time to they need, which amount of services can the cover?**
- **Perspectives for the incumbent**
 - **owner-perspective vs. view of the procurement authority**
 - **Separation, Privatisation?**
- **“Big Bang” versus step by step approach**
- **Crucial is access to rolling stock**

Selected Aspects of PSC

Contract volume, dimension of lots

Relevant aspects

- **Trade-offs between neighbouring authorities**
 - **Homogeneous contractual regime for the operator**
 - **Public cooperation contract between the authority bodies**
- **Criteria for lots**
 - **operational synergies (vehicle circulation, fleet structure)**
 - **Fitting to traffic stream**
 - **Fitting to competitiveness of players**
 - **Risk structure of the PSO**
 - **Homogenous economical constraints**
 - **operability of the incentive regime**
 - **risks of a nationwide contract**

Selected Aspects of PSC

Access to essential Ressources for Passenger Rail Services (1)

Purchase and ownership of rolling stock

- **Lifetime of vehicles is much longer than usual contract periods**
- **High investment for fleet renewal requires long time amortisation**
- **Traditionally: Purchase and ownership by transport undertaking**
- **impact of investment subsidies for fleet renewal**
- **Lack of fleet-interoperability creates distortion of the market: Vehicles as essential facilities**
- **Solutions:**
 - **Fleet strategy with focus on (future) competition**
 - **Public / private rolling stock pools**
 - **Transfer rules in contracts**

Selected Aspects of PSC

Access to essential Ressources for Passenger Rail Services (2)

Other “essential facilities” may also be crucial

- **Tariff system**
- **ticket distribution system**
- **Passenger information system**
- ...

Selected Aspects of PSC

Gross-Cost vs. Net-Cost Contract

Basic principles

- **Net-Cost Contract: Operator gets the ticket revenues and takes the risk of their development. Well applicable...**
 - ... for long term contracts
 - in case of calculability of crucial circumstances,
 - in public transport networks with sufficient internal travel,
 - with high revenues / low public aid payment level and
 - deduction of inter-operator transport integration
- **Gross-Cost Contract: Authority pays the operator for it's services, authority gets the ticket revenues. Well applicable...**
 - ... in case of significant risks for calculability,
 - even for short term contracts,
 - with low revenues / high public aid payment level,
 - presumably chances in request of services
 - if other incentives than revenues are implemented to ensure performance.
- **Incentive regimes can be set up based on both principles**

Selected Aspects of PSC

Incentives and Quality Management / Performance Regime

Relevant aspects

- **As the PSC is the instrument to ensure service quality, each PSC should contain incentives for good performance.**
- **The simple net cost contract principle is usually insufficient in respect to non commercial services**
- **Performance indicators**
 - **Orientation on passengers' demands and service expectations**
 - **Setting of targets instead of detailed service specifications**
 - **Direct: eg. reliability, punctuality - requires hard criteria and measurement systems for each indicator**
 - **Indirect: e.g. passengers' satisfaction measurement, passenger rights charta – freedom for operator, to choose methods**
- **Public transport authority needs instruments to check performance**
- **Failures of performance requirements cause penalties, in case of overrunning bonus is possible**
- **Penalties and rewards need to be calibrated to the operator's effort of avoidance / fulfilment**

Selected Aspects of PSC

Preparation of the Awarding of a PSC (I)

Necessary competences of the awarding body

- **Knowledge of passenger market demands (market potential, intermodal overview)**
- **Knowledge of the operators' view**
- **Precise definition of the service obligation: balanced design of cost efficiency and quality**
- **In case of competition: strict need to avoid discrimination and to ensure transparency to get bids from competitors**
- **Ability for contractual control from side of the authority**
- **Principal Agent-problem: both parties need similar level of knowledge and competence**

Essential requirement

- **Reliable public budget for a long term contract**

Selected Aspects of PSC

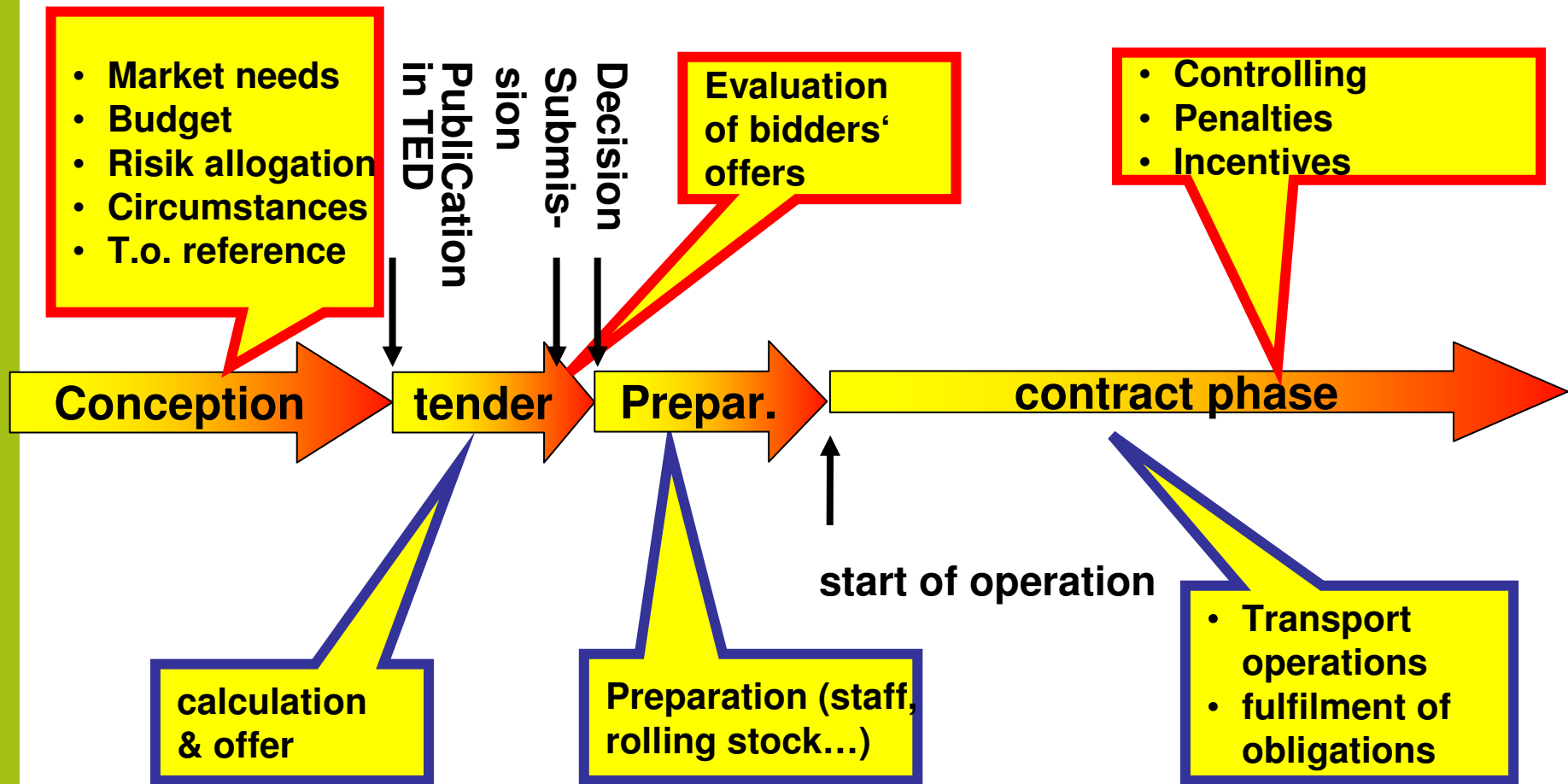
Preparation of the Awarding of a PSC (II)

Economically conception of the PSC

- **Combining services to lots (vs. nationwide contract)**
- **Requirements concerning rolling stock**
- **Risk allocation between authority and operator**
 - **Responsibility for Revenues**
 - **Infrastructure**
 - **Force majeure**
 - **Price adjustment clauses...**
- **Set-up time, duration, extension clauses, termination clauses**
- **Design of a proper incentive regime (rewards and penalties), contractual implementation and controlling procedures**
- **Design of quality management**

Selected Aspects of PSC

Time bar for a competitive awarded PSC (example)



~ 1 year (depends on experience)

Up to 1 year (depends on complexity)

~ 1-2 years (depends on way to obtain assets)

Up to 15 years (dep. on calculability)

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Benefit of PSC

Implementation of PSC

- **Usage of chances for improvements**
- **Moderate way, step by step learning lessons**
- **Point of view: it's a process that needs time but its time to start it**
- **Establishment of structures and competences**

Decision about competition

- **Participation of other players?**
- **Competition can be tested in a selected lot**
- **If yes: market organisation, regulation, probably regionalisation**

In case of any privatisation clear PSC is crucial

Recommendations

Concerning Circumstances

Budget

- **Calculability für both, operators and authority, concerning mid-term level of budget for PSC**

Rolling stock

- **Combining short time need for upgrade with mid-term possibilities by ensuring the chance of fair competition in future**

Infrastructure

- **Synchronised strategy for operational improvements (PSC) and infrastructure upgrades to ensure success at the passenger market**

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