The fourth railway package: the next stop on the journey to liberalization

Transportation Alert

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By:

The fourth railway package has been adopted in two stages: a technical pillar, recasting the interoperability and safety directives and amending the regulation establishing a European Railway Agency, adopted on May 11, 2016, and a market pillar, amending the Public Service Obligation Regulation (PSO Regulation), the Directive establishing a Single European Railway Area (SERA Directive) and repealing the Regulation on accounts normalization, adopted on December 14, 2016.

The package will achieve the liberalization process that was initiated in the 2000s, but as the following will highlight, it will still take time until a truly competitive sector is achieved. The railway sector has specific characteristics that make applying market conditions in this sector complex and atypical.

In the meantime, technical barriers should be progressively lifted with the new interoperability and safety directives, as well as with the new regulation that establishes the agency.

The technical pillar

The new interoperability and safety directives have to be transposed by member states in their domestic legislation in theory by June 16, 2019.
The most significant development under the technical pillar lies with the increase of the agency's powers. The agency may now adopt decisions to issue single safety certificates and authorization to introduce railway vehicles onto the market, or for the approval of ERTMS elements. It must establish and manage an information and communication system, and act as a one-stop shop for applicants for type authorizations, vehicle authorizations and single safety certificates. The one-stop shop system should also provide a common information-exchange platform that provides the agency and national safety authorities with information on applications and related decisions and on approvals of ERTMS elements by the agency. Finally, the system must also act as an early-warning system to identify the needs for coordination between the agency and national safety authorities.

The new safety directive aims to clarify the distribution of roles among stakeholders. It now also contains the common safety indicators (CSI) in an annex, instead of referring to the methodology to establish them. A major novelty in the directive relates to the progressive phasing out of national safety rules. Member states may still adopt national safety rules; however, only under exceptional circumstances where no EU rule exists, or as an urgent preventive measure, for instance, after an accident.

The interoperability directive has, in turn, been recast.

The market pillar

Open access

Under the fourth railway package, open access in the domestic passenger market will be allowed from December 14, 2020. The new directive provides for the following potential limitation to open access:

- As for international services, restrictions to open access for domestic services could be imposed when access rights would (possibly) compromise the economic equilibrium of public service contracts.
- Regarding high-speed passenger services (international or national), such limitations could only be decided by the regulatory body if the service (effectively) compromises the economic equilibrium of a public service contract.
- Further limitation is possible when exclusive rights on the proposed route have been granted under a public service contract awarded before June 16, 2015 or when an additional right or license to operate commercial passenger services has been awarded by December 25, 2018 on the basis of a fair competitive tendering procedure and on condition that the operator does not receive any compensation to operate the services.
- Another limitation can be imposed by the member state for international services from/to a third country that has a different track gauge from the main railway network in the EU and if distortions of competition arise.

In an attempt to foster multimodality, member states may establish a requirement for railway entities operating domestic passenger services to participate in a common information and integrated ticketing scheme for the supply of tickets, through tickets and reservations. Alternatively, member states may decide to grant competent authorities the power to establish such a scheme.

Governance structure of infrastructure managers

A subject which is almost as sensitive as the opening of the market is the governance structure of infrastructure managers. The fourth railway package does not impose full institutional unbundling of Railway Undertakings (RU) and Infrastructure Managers (IM). Special and reinforced independence requirements will continue to be required for essential functions only (ie decision making on train path allocation and on infrastructure charging).

Member states must ensure that the IMs have organizational and decision-making independence concerning essential functions. To do so, they are still allowed to decide that essential functions will be carried out by a charging body and by an allocation body independent from any RU.

Otherwise, independence would relate in particular to effective decision-making powers that IMs must enjoy. The directive provides for detailed incompatibility rules. Furthermore, cross-subsidies between IMs and RUs are prohibited, but payment of dividends by either entity to the ultimate owner is permitted. Additionally, services offered by other legal entities of a vertically integrated undertaking to the IM must be concluded in line with market conditions.
The directive lays down specific impartiality requirements regarding traffic management and maintenance planning in order to avoid conflicts of interests. That said, member states are invited to ensure appropriate coordination between their main IMs and all interested RUs and applicants for routes.

**Competitive tendering**

The objective of the revised PSO regulation was to establish the principle of competitive tendering for the award of public contracts for all means of land transport, including railways. However, given the numerous (additional) derogations to the principle that have been inserted into the text throughout the course of the legislative process, direct awards may remain the rule. Derogations to competitive tendering may be summarized as follows:

- The direct award of small contracts for internal operators and for emergency situations is still possible.
- New Article 5(3a) allows for the direct award of contracts in exceptional circumstances (eg a high number of competitive tenders already being run, or changes to the contract to optimize the provision of public services).
- New Article 5(4a)(a) allows direct award if justified by the structure and geographical characteristics of the market and network and if the contract would result in an improvement in quality of services or cost-efficiency compared to the previously awarded public service contract.
- Direct award is also made possible by new Article 5(4a)(b) for PSC covering passenger rail services by an operator that also manages (the majority or the entirety of) the infrastructure used, if the operator has been excluded by the member state from the application of the governance provisions because it manages a local/regional and low-traffic network.
- These possibilities are added to current Article 5(6), according to which, direct award of public transport contracts by rail is allowed, which will remain applicable until December 25, 2023.
- Finally, the PSO regulation would exempt the competent authority from organizing a competitive tender if it awards a public service contract to an internal operator, or for public service contracts of small amounts or of limited coverage.

To mitigate risks inherent in competitive tenders, the fourth railway package introduces two specific provisions:

- Firstly, to remove any asymmetry of information, competent authorities are required to make relevant information (eg passenger demand, fares, costs and revenues as well as details of the infrastructure specifications) for the preparation of bids available to all interested parties.
- Secondly, if necessary to ensure effective and non-discriminatory access to suitable rolling stock, competent authorities may acquire rolling stock, guarantee its financing, take it over at the end of the public service contract, or cooperate with other competent authorities to create a larger pool of rolling stock.

**The design of public service contracts and of public service obligations**

Any competent authority must define the specifications of public service obligations (PSOs) and the scope of their application. In doing so, they must comply with the principle of proportionality. Following the commission practice, the text now clearly specifies that PSOs can relate to a bundle of services, some of which may be profitable if combined with non-profitable ones. The amendment to the PSO regulation further states that the specifications of PSOs must be consistent with the policy objectives of the member states.