

11TH CONFERENCE ON COMPETITION AND OWNERSHIP IN LAND TRANSPORT

DIRECT AWARDS IN GERMANY – DESIGN AND EFFECTS

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INTRODUCTION

Regulation (EC) No 1370/2007 (PSO Regulation) enables authorities to provide public transport (PT) themselves or to award contracts directly to a legally distinct entity over which they exercise control similar to that exercised over own departments, Article 5 (2). This option was mainly inserted in the Regulation to avoid compulsory tendering of PT networks in big cities with municipal operating companies. This paper focuses on direct awards in cities in Germany (and some in Austria). Direct awards to regional railway operators and direct awards of small public service contracts (the other two main direct award options in the PSO Regulation) are not discussed here.

The direct award option in the European Regulation is explicitly conditional on national law. There are doubts if direct awards are permitted or prohibited by German law. We address these doubts only shortly: It is unclear, when and how the relevant national law (Personenbeförderungsgesetz = public transport law) will be amended after the elections in September 2009. Among the main issues are: enabling direct awards in German law, commercial services and exclusivity of concessions (“Genehmigungen”). Several federal state (Länder) transport ministries issue policy papers as guidelines for competent authorities, concessioning authorities and transport companies. There are attempts to achieve an “essentially coordinated” interpretation and approach of the legal framework (Public Transport Working Group of the Conference of Transport Ministers 2009). Coordination of the until now different positions of the federal states shall reduce legal uncertainty.

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Since they must act (e. g. because of ending concessions) and cannot wait for legal certainty, several authorities in Germany are preparing direct awards, or adjusting their current entrustments in order to make them comply with the requirements of the Regulation. Other authorities adapt existing entrustments or strive to achieve new entrustments before the Regulation enters into force (“new PSC under old regulation”).

We address:

how direct awards are being designed and implemented in Germany, and

what the results are (or what results can be expected).

There’s hardly any literature on the subject. That is: a lot is being written on the contents of the new Regulation and the requirements on authorities and operators. But hardly anything can be found on the actual implementation. Our descriptions and analyses are based mainly on examples from consulting work and other professional exchange. In view of the present legal uncertainty and the fact that most projects are not yet concluded, information is usually confidential. Some cities and companies are therefore not mentioned.

MARKET DEVELOPMENT

The direct awarding and transition rules of the PSO Regulation, though in principle exceptions to the general rule of open, fair, transparent and non discriminative competitive tendering procedures in Art. 5 (3), will in fact fortify the closure of wide parts of the PT market in Germany.

This holds certainly for PT in the cities: Direct award of a public service contract (PSC) is the preferred instrument for competent authorities. According to our knowledge, there is not one medium sized or big city with a municipal transport company that prepares for tendering of the public transport (PT) services on its territory.

USE OF INSTRUMENTS OF THE PSO REGULATION, TRANSITION

PSC before 3.12.2009

It seems that initially from 3 December 2008 on most cities and operators will finance PT on the basis of PSC that were concluded before the new Regulation (EC) No 1370/2007 (PSO Regulation on public service obligations) will enter into force. Obviously, this applies to

many entrustments and concessions with terms ending after the PSO Regulation will enter into force. But also a significant number of “new PSC under old rules” will be concluded until 3 December 2008. Both existing PSC and PSC newly concluded before 3 December 2009 will fall under the Transition rules in Article 8.

The design of these PSC – both old and new ones according to old regulation – must fulfil some requirements:

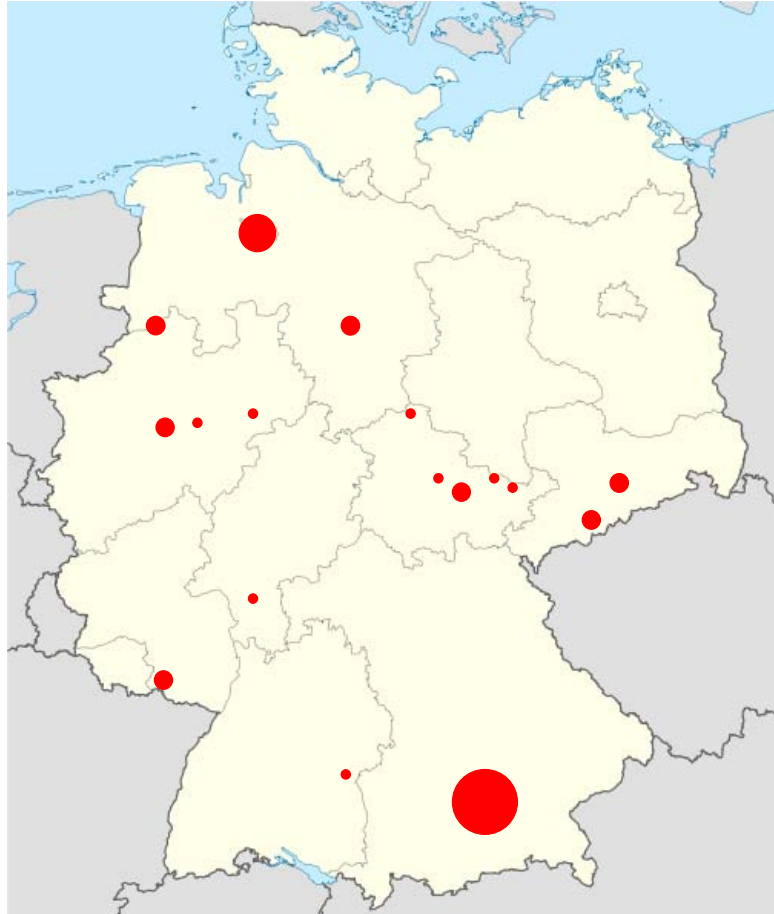
According to widespread opinion, all PSC regardless of their content are covered by the transition rules. Indeed it is true that Art. 8 does not put retroactive demands on old PSC, e. g. no reference to Art. 4 is made. But the transition rules are conditional on awards “in accordance with European Community and national law”. For Germany, this means – as far as tendering has not taken place, which is generally the case – that the four “Altmark”-criteria must be fulfilled. The result is, that PSC may only continue if clear PSO and compensation criteria have been defined, etc. In other words: the requirements are at best similar to Art. 4, but by no means less.

This means that clear definitions and at the same time substantial flexibility with regard to timetable development etc. must be built in the PSC. Changes beyond the scope of the PSO, that are defined for the contract term, cause a legal need for a new award, i. e. then according to the PSO Regulation. Therefore the adaptation of existing PSC or design of “new PSC under old rules” is quite demanding (though certainly not impossible, with the exception of fundamental changes of network, transport modes etc.). The problem is, that this challenge is often not recognised.

PSC according to the PSO Regulation

After 3 December 2009, PSC according to the new rules laid down in the PSO Regulation (“new” PSC according to Article 4, awarded according to Article 5) will remain exceptions. Only few direct awards have been announced in the Official Journal of the European Union according to Article 7 (2):

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The number of announcements is just an indicator for what is happening:

- Announcement is only necessary if the term of entrustments or concessions is running out.
- Some more announcements will probably be made in the months to come.
- Possibly, authorities interpret Art. 7 (2) so that announcements are not compulsory before 3. December 2009, also in case of an award in 2010.

The biggest cities that have announced a direct award to an internal operator are München, Bremen, Erfurt and Hannover. The Darmstadt PSC is a rare example of a journal article in some detail (Altenhein et al., 2009).

General rules

A few cities go still different ways: e. g. impose PSO in the form of general rules according to Article 3 (2). Thus they avoid the obligation to conclude a PSC.

IMPLEMENTATION VARIETY

The different initial circumstances in the German cities have led to numerous individual variants of direct awards (fulfillment of conditions: service concession contract, control by the authority, territory, subcontracting) and contract forms. We will first describe a few examples and then analyse some trends in the next chapter.

Berlin

A transport contract between the federal state of Berlin and the Berliner Verkehrsbetriebe (BVG), covering both operations and infrastructure, was negotiated before the PSO Regulation was passed by European Parliament. But the legislative process has been taken into consideration during contract development.

Berlin is non-typical for Germany: because no tax affiliation exists here, definition of the PT operations and infrastructure services and on compensation were subject to negotiation and not predetermined by tax constraints. This has led to a relative straightforward contract with real compensation and bonus malus schemes for quality. Political wishes have a “price label”, which wasn’t so before. Bad service reduces the compensation of the BVG.

Inhouse requirements (control, territory) could be fulfilled relatively easily. Nevertheless, even for the BVG as a public-law institution, a change of the law on companies owned by the state (“BetriebeGesetz”) was necessary in order to ensure sufficient control.

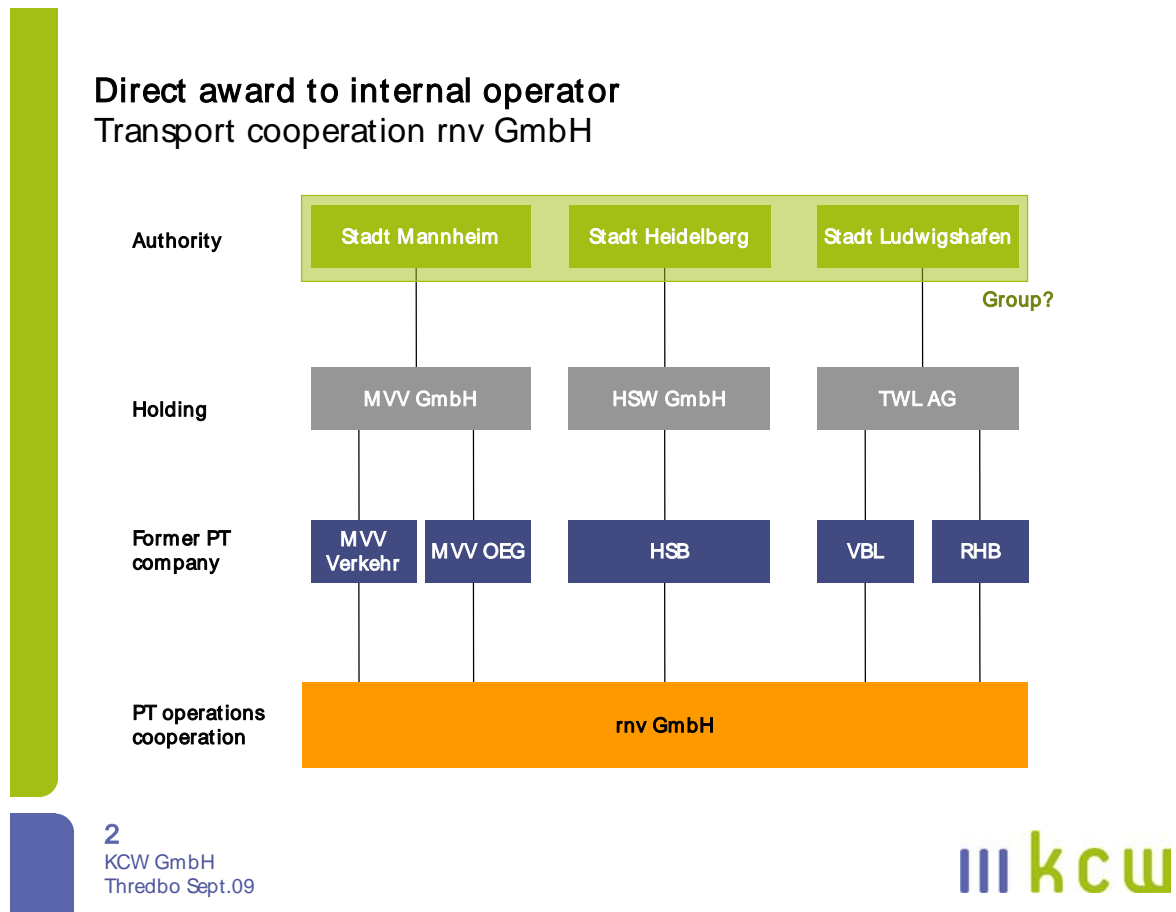
The contract is concluded by a very lean PT authority at the Senatsverwaltung für Stadtentwicklung and managed by a PT executive (PTE). The PTE tasks (5-year transport plan, coordinating time table changes with the BVG, monitoring of the contract etc.) is put to tender in regular intervals.

Initially, both sides had to get used to negotiating and to clear, bilaterally binding commitments. Interestingly, already the negotiation process led to a better mutual understanding of respective positions. Representatives have stated that clear commitments and “price labels” lead to more professional relationship und behaviour. Conflicts on time table priorities, malus payments etc. occur as well, but overall the contract seems to have improved the relationship.

The contractual compensation scheme cannot cover the growing compensation need of the BVG. A deficit of 90 Million Euro from own core business is expected for 2009, in addition substantial deficits are caused by vehicle leasing transactions (Bebber 2009).

rnv GmbH: Cooperation of 3 operators (Ludwigshafen, Mannheim, Heidelberg)

In the Ludwigshafen, Mannheim, Heidelberg region, a cooperation on operational level exists. This common operator is rnv GmbH. The former municipal transport companies and their respective mother (holding) companies of the three cities remained unchanged:



In order to enable a direct award to rnv as internal operator, rnv addresses the following problems and adaptations (rnv 2009):

- The multi-level control chain city – holding – former operator – rnv makes it hard to prove sufficient control
- Transport services are delivered by rnv in other territories
- Concessions were until now held by the former operators, rnv delivers services as subcontractor; conflict with limitation of subcontracting
- Control of public companies “AG” (holding and former operator level)
- Breach of the territorial criterion by activities of subcontractors?

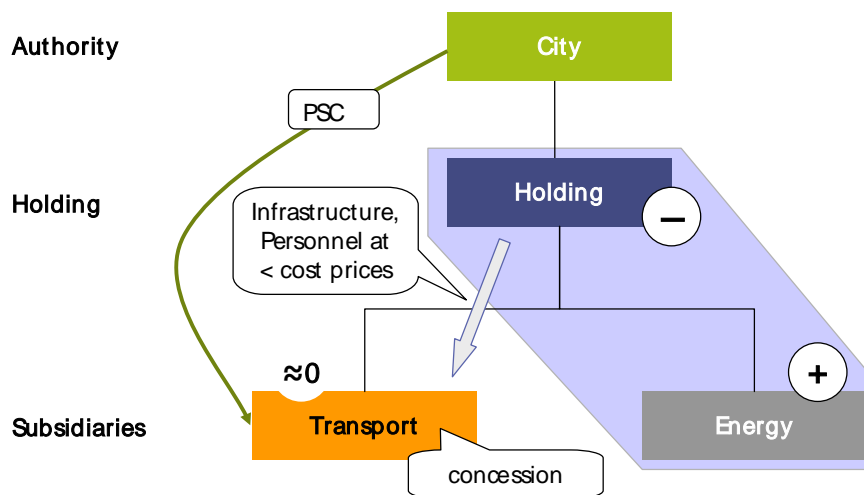
rnv, cities and the other companies involved plan a number of changes:

- Small direct participation of the cities and full control to take all decisions in important matters
- In future rnv will keep concessions and receive revenues
- New employees will be employed at rnv

- Proposal to reduce the power of the supervisory board (recommendation instead of decision), thus strengthening the shareholders

The tasks of the 3 former operating companies will thus be reduced to personnel provision (only existing employees), infrastructure provision and financing through the tax affiliation (“Querverbund”). The infrastructure responsibility of MVV, HSB and VBL shall maintain their status as public transport company. Without this status, the tax authorities would not allow consolidation of results in the holding, that would end the tax saving “Querverbund” construction. In order to use the full tax saving potential, the full deficit must be allocated to the former companies MVV, HSB and VBL. Deficits of rnv shall be avoided by lowering the prices for the infrastructure and personnel services if necessary.

Preservation of „Querverbund“ Suggested solution (1 simplified example)*



* No recommendation kcw, but discussion according to this principle (or similar) in several German cities

Hannover

The PT organisation in Hannover is also unique, mainly because the tram infrastructure responsibility has been transferred to a separate company “infra” owned by holding company VVG. VVG is owned by the City of Hannover and the Region Hannover.

The tram operator üstra AG pays the infra GmbH a very low price for the use of the tram tracks and other infrastructure. This has so far enabled quasi commercial (“eigenwirtschaft-

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liche”) tram operations. “Eigenwirtschaftliche” services according to German law are not to be confused with commercial services according to the definition in the PSO Regulation.

This difference will have to be considered in the adaptation of the Hannover organisation model to the requirements that will have to be fulfilled after the Regulation enters into force. We do not elaborate in detail on Hannover because kcw is not engaged in the preparations here.

In August 2008, the Hannover Region announced a direct award of 12,5 million kilometres p. a. (TED ID 2008/S 155-209546), corresponding with the number of bus kilometres p. a.. May 2009, üstra announced it wants to sell its subsidiary Wolters Reisen (TED ID 2009/S 84 - 121461), obviously to fulfill the territorial criterion needed for a direct award.

Medium size city

As a general rule, authorities are best off if they conclude a PSC with the operator(s). A PSC commits the operator to the levels of service and quality expected by the authority. From the point of view of the operator, a PSC guarantees that the necessary compensation payment does not violate state aid legislation.

Exceptions do confirm the rule. Particular circumstances sometimes lead to other recommendations, as in this case:

- Service level (frequency, coverage) is relatively modest.
- On this level, the municipal operator has sufficient incentives to maintain his performance and adapt to changing demands of the passengers.
- In the medium long run, the authority has the ambition to improve the PT system. But at present Thus there is no substantial need for PSO regarding timetables etc.
- The main public interest of the authority for now is only the establishment of maximum tariffs for pupils, students, apprentices and persons with reduced mobility.
- The appropriate instrument offered by the PSO Regulation for this aim is a general rule.
- General rules do not constitute an exclusive right, rather non discriminative access must be secured: “[The Regulation (EG) No 1370/2007] has withdrawn each and every exemption (“Bereichsausnahme”), except the possibility of general rules to establish social maximum tariffs in markets without access restrictions” (European Commission DG TREN 2009, page 3, translation and underscore kcw).
- This condition is fulfilled, whereas the probability of factual competition is rather small until the end of the concession term
- At the time a new concession term will start, the new PT Law may (depending on the outcome of the PT legislation process) clarify if concessions take the form of exclusive or non exclusive rights.
- General rules would then be either impossible, or they would come together with a freely accessible market

- Therefore, authority and operator have started preparations for a long term solution, this might be a PSC according to the PSO Regulation.
- Until then, the interim solution based on a general rule gains valuable time: Firstly the period of legal uncertainty can be overcome without having to act. Secondly, the future PSC and its direct award can be prepared with sufficient care: long term network and time table planning, line swaps and M&A in order to conform to the territorial and subcontracting restrictions, preparation of PSC documents etc.

ANALYSIS

The effects of the new PSO-Regulation on the design and performance of PSC (and general rules) are mostly still unknown in detail, but some trends are already clear.

The diversity of the implementation of the new PSO regulation shows, that no general “best way” for cities and municipal companies exists. Rather, the individual background in each city (existing concessions and financing, ownership relations, subsidiary firms active in competitive markets etc.) leads to a wide range of different solutions.

Fulfillment of direct awarding conditions

It is unclear in how far the requirements are fulfilled by all authorities (and companies) that announced direct awards based on Article 5 (2). Possibly, not all actors have fully recognized the exact conditions on the direct award option, as these are not explicitly mentioned in the PSO Regulation. For example, if a farebox ratio > 50 % cannot be realised, Article 5 (2) is legally risky, an inhouse award will usually be preferable. Of course only if the control and territory criteria of the inhouse jurisdiction of the European Court of Justice (ECJ) can be fulfilled.

Since they are similar to the corresponding requirements in the PSO Regulation but not identical, each city and municipal company should make an individual assessment which legal exemption (Art. 5 (2) PSO Regulation or inhouse exception or else) best legitimates the direct award.

This is increasingly important, since competitors get more possibilities of judicial review, Art. 7 (2). These obligations are not just in the PSO Regulation, but implemented in national legislation as well, see Altenhein et al. page 40 on the possibility to appeal against direct awards.

Preservation of the “Querverbund”

In spite of the diversing solutions that are being developed, one leading objective can easily be observed in (almost) all cities: The preservation of the “Querverbund”. This means the tax advantage resulting from profit and loss consolidation of PT and utility companies that are affiliated under the roof of a municipal public services holding. It contributes approx. 1,4

billion Euro p.a. to the financing of PT in German cities (Ude 2007). It is often overseen, that the tax advantage from the point of view of the cities is smaller. This is because the tax savings of the municipal companies are counterbalanced as far as municipal taxes are concerned. The net saving for the cities is only the federal tax component of the Querverbund.

Nonetheless, preserving the “Querverbund” is the main concern of cities as well as their municipal companies. To achieve this, seemingly contradicting requirements on the financing of PT from national German tax laws and European state aid regulation (especially the new PSO regulation) must be conciliated. This has far reaching consequences for the PSC, e.g. with regard to the definition of the PSO and their compensation:

- The possibility to exercise the Querverbund according to German tax laws requires that a direct relationship between obligations and compensation is avoided. PSC must be structured and formulated in such a way, that this does not lead to a violation of the requirements in Article 4: clear PSO and compensation parameters.
- As shown in the Darmstadt and Hannover (with respect to status quo) case studies, prices do not necessarily correspond to actual cost levels.
- Splitting up companies, multi level ownership relationships and performance contracts on infrastructure, vehicle and personnel services increase the complexity of the picture further.

All these measures are accepted as the Querverbund is a major financial basis of PT in the cities. But of course the result is often a highly complex compromise. Only very few experienced experts can handle this complexity.

Transport Alliances

Another specific characteristic of German PT organisation interferes with the PSO regulation, especially with regard to the direct award option in Article 5 (2): the Transport Alliances (“Verkehrsverbünde” = regional PT cooperations aiming at integration of timetables, fares and tickets).

The use of the direct award option of the PSO Regulation for bus and tram is only allowed if the PSC takes the form of a service concession contract as defined in Directives 2004/17/EC and 2004/18/EC. In a service contract, the duties of the operator are solely or mainly compensated by the exploitation rights of the concession.

In practice, this requires that the farebox income outweighs the compensation payments from the authority for PSO. Furthermore, the operator must have substantial marketing freedom, i. e. influence on timetable, tariff, ticketing and promotion. Otherwise he will not be able to exploit the concession adequately.

The marketing powers of the Transport Alliances, which is the core of the alliances and is considered to be a necessity to realise integration, clearly conflicts with the requirements posed on service concession contracts.

Darmstadt is an interesting example in which this conflict has been discussed openly resulting in the following balance (Altenhein 2009):

- The operator has far reaching freedom with regard to timetable
- Tariff freedom is not possible since Darmstadt is part of the huge RMV Transport Alliance. But the authority has agreed to consult the operator and consider his suggestions in the RMV committees.

PSC as steering and controlling instrument

In principle the instruments of the 1370 Regulation (PSC and general rules) and their wider applicability compared to former regulation (EC No 1191/1969) strengthen the position of the competent authorities to control and monitor PT service (both new and old PSC). Some authors expect that increased cost transparency and communal budget law will lead to quasi competition and cost efficiency (e. g. vrn 2009). This may also have been an expectation on the PSO Regulation of some EC and European Parliament representatives.

Probably, this expectation will prove to be too optimistic. PSC are often complex, intransparent, not representing true costs and lacking incentives. The main cause, quite understandably, are the tax optimisation requirements mentioned above. These problems come on top of the comparability problems that are well known by everybody who has ever engaged in benchmarking or cost comparison projects.

Of course this does not mean to question the Querverbund. Its importance for PT financing is not debatable. The important question is: How good a PSC can I conclude taking into account the complexity that inevitably result from the tax optimisation constraints?

This is is and will remain the challenge for single cities, both authorities and ambitious operators: to develop PSC that preserve tax profits and at the same time raise operational efficiency and optimise public expenditure for PT towards political objectives like e. g. service and quality of PT aiming at modal split, traffic safety, environmental, urban accessibility and neighbourhood development goals.

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