

The regulation of franchising bidding in urban and regional public transport by the Italian Regulator for Transport

Ivana Paniccia

ART – Turin

www.autorita-trasporti.it

Email: i.paniccia@autorita-trasporti.it

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Outline of the presentation

1. Governance of the Italian local and regional public transport industry (LRPT) and the role of the Regulatory Authority for Transport (ART)
 - Functions and powers of ART
2. A snapshot of the Italian local and regional public transport
3. Pitfalls of “regulation by contract” and competitive tendering in the Italian LRPT
4. A case study: the design of an effective competitive tendering framework: **ART resolution n. 49/2015)**
5. (The way forward: contract regulation + central regulation by the Italian Regulation objectives/aims in LRPT
6. Object of regulation
 - a) Access to essential facilities and calculation of the terminal value
 - b) Access to essential information
 - c) Social clause
 - d) Requisite specification for an open, fair, transparent and non-discriminatory tendering design
 - e) Fair and innovative awarding criteria
 - f) Public service contracts (content and regulatory)
 - g) Fair timing (days/weeks to prepare and submit an offer or to operate rolling stocks)

GOVERNANCE OF THE LRPT AND THE ROLE OF THE ITALIAN REGULATORY AUTHORITY FOR TRANSPORT

The Italian Regulatory Authority for Transport (1)

- The **Regulatory Authority for Transport (ART)** has been established by art. 37, Law Decree n. 201/2011, revised and integrated by law decree n.1/2012. Not a law, but an article in a decree\bill => not a systematic view of functions and powers
- **Start up in January 2014**
- **A European “uniqueness”:**
 - Italy is the first among the market economy countries to introduce an independent regulation in the transport sector (only **one single regulator for several transport sectors**).
- The institutive decree entrusts the ART with a quite general regulatory responsibility and, precisely:
- **Horizontal regulatory functions/areas of competence in different transport sectors (because of intermodal effects in different transport sectors):**
 - Tolloed Highways (new investments)
 - Airports and Ports
 - Railways infrastructure and (passenger, freight) service
 - **Local public transport (LPT)** and Maritime cabotage
 - Taxi
- **Vertical regulatory functions on infrastructure and services (Functional interdependence governed at different territorial levels; limited contestability of final service markets):**
 - Tariffs, fees,
 - Quality standards
 - Customer rights
 - Control and supervision
 - **Defines the schemes for tendering and the content of the contracts of service in Local public transport and in railways sector, including regional passenger service**, verifies the absence of discriminatory conditions, with reference to rolling stocks

The Italian Regulatory Authority for Transport (2)

Concerning LRPT (and other sectors), it has to be remarked that ART has functions of direct and (more often) indirect regulation:

A) ART direct regulatory functions:

- Defines minimal quality standards, including rebates (*art. 37, comma 2, lett. d*)
- Guarantees fair and not discriminatory access conditions [...] with respect to urban and local mobility (*art. 37, comma 2, lett. a*)

B) ART indirect regulatory functions:

- ART does not set tariffs or fees, but criteria only (*art. 37, comma 2, lett. b-c*), to be implemented by administrative entities, such as Ministers, Regions, Local councils, Mobility Agencies
 - Sanctioning powers are referred to undertakings turnover only
- Defines (binding?) schemes for tendering and of the contracts of service (not an auctioneer) pursuant to *art. 37, comma 2, lett. f*)
- Advocacy functions (*art. 37, comma 3*):
 - Pushes and supports administrative entities (including local ones) in the identification of public service obligations and geographical perimeter of public service and efficient methods of financing
 - Proposes the withdrawal, suspension, or revocation of concessions, contracts of public service, etc.
 - Favours (but is not responsible for) alternative disputes resolution

The governance structure of LPT

Why ART indirect functions prevail on direct ones in LPT?

- ART and, specifically, a regulator for LRPT was established more than 15 years after L. 481/95 establishing Energy and TLC authorities (nowadays, still “waste disposal and collection” has not a central regulation in Italy)
- Legislative decrees 422/97 and 400/99: **transferring of legislative, financial, regulation (price, quality, quantity, access, environmental, etc.) and planning responsibility for the whole system of LPT services from central to regional and local governments**, respecting general rules and principles fixed by the national government and unless competition issues prevail = decentralization of administrative responsibilities, according to the principle of vertical subsidiarity
- 2001 Constitutional Reform (**Regionalization**) gave exclusive legislative competence to regional government as far as local public services are concerned; State intervention in defining the main features of the form of the market in which economic services are supplied (public monopoly, competition in the market, competition for the market) is justified in terms of competition policy and promotion, which remain exclusive central prerogative.
- *Industrial municipalism*: coincidence between ownership and planning of LPT companies= Lack of true independence between local competent authority & provider

ITALIAN LOCAL AND REGIONAL PUBLIC TRANSPORT (LRPT) POLICY ISSUES AND REGULATORY FLAWS

A snapshot of Italian LRPT market structure (1/2)

Competition model: “competition for the market”

Bus, tram, metro and ferry-boat

- Prevailing direct award to company fitting with the in-house criteria (*in-house provision*);
- Although competitive tendering was mandatory since 2001 (with many stops and go ...), few competitive tenders so far
- Local incumbent operators (often associated with others) have won most of the few tender procedures
- Supply fragmentation. Nearly 1.000 undertakings operate in the bus service market (not an Italian exception), but the largest LPT companies are few and often not competitive (ATAC in Rome has an annual loss of > 100 mln euro)
- the five leading providers have a share of 30% of total veh-km, while the same portion is around 60% in the main European countries
- Public-owned leading operators are oversized in terms of personnel (mostly in the undirect or administrative roles/qualifications)
- The major part of companies (around 90%) is mono-utility, i.e they run only local public transport services

Regional railways

- Prevailing direct award to Trenitalia (100% state-owned subsidiary of the FS holding) for a minimum period of 6+6 years (more than 76% of the mkt)
- Trenitalia (incumbent in many regions) owns most of the depots, workshops and rolling stock and most of the PSCs contain a put clause concerning rolling stocks

A snapshot of Italian LRPT market structure (2/2)

Policy issues

- Weak planning and programming capacity by regional and local authorities =>
 - Mismatch between demand and supply of mobility, no rigorous, homogeneous or transparent criteria of identification of minimal services, transport basins
 - Limited intermodal integration and costly overlapping between railways and bus services
- Striking territorial disparities concerning operative costs, labor productivity, fares and commercial revenues/operative costs ratio, levels of quality of service
- => large unsatisfaction of citizens, commuter especially (European Barometer surveys)
- => Low patronage levels
- Legal uncertainty (stop and go policies)
- Unfair compensation (no criteria to identify over or undercompensation) for public service obligations
- Uncertainty of financial public transfer, both at the national, regional or county level, either for current expenses or for investments
- only a few “service contracts” satisfy the mandatory minimum ratio of 35% for coverage of operative costs through fare income
- Delays in transfer of public financial resources
 - => difficulties in medium-to-long term planning and industrial development (investments) with consequences on the quality performance of services
 - => negative impact on financial accounts of operators (high debt levels, financial cost burden and low profitability);
 - Scant industry attractiveness for investors
 - = vicious circle between financial shortage, the lowering of quality and declining patronage

Critical issues in local (“contract”) regulation

Uncomplete and ineffective regulatory framework until now => local and contract regulation proved very weak:

- Local transport authorities (regions, local administration, etc.) (LTAs) do not own and control the essential information for planning and essential facilities
- Tariffs have not played a signalling role for orienting demand and investments. They are set according to electoral/consensus concern
- Limited tariff integration and no independent clearing
- *Price cap* is not applied
- Public service contracts suffer from:
 - Missed identification of PSOs
 - Under or over-compensation
 - Not credible mechanisms of control and penalty
 - Weak incentives to:
 - Improve operation efficiency, Patronage levels and Revenues
 - Invest in new vehicles and infrastructure
 - Improve quality standards
 - Unfair risk allocation between operator and purchaser

Regulatory issues in competitive tendering

- Limited room for manoeuvre left to operators to organize productive inputs and to gain productive efficiency (prevalence of gross cost contracts, rigid mobility plans, strict social clauses, high weighting of economic awarding criteria)
- strict existing relationship between the buyer/regulator and the incumbent provider has undermined the credibility of auctions, making difficult for most efficient operators to expand beyond their regional (and even national) borders.
- Not transparent, uncertain or unfair definition of compensations for public service obligations (see above),
- Asset ownership proved as a high barrier to entry. In some cases, calls for tender have required participants to provide essential instrumental goods (depots, vehicles, stations, rolling stock, shelters), tailoring the qualifying requisites to the incumbent and reducing the number of competitors.
 - The national law establishes that call for bids has to grant that essential facilities are placed at the disposal of operators entrusted of the provision of the service, but this provision doesn't emerge as decisive.
- Limited information on the demand characteristics of mobility basins
- Too large territorial scale for tendering basins (=limited contestability)

ART resolution n. 49/2015

THE REGULATORY DESIGN OF COMPETITIVE TENDERING - A FOCUS ON SELECTED REGULATORY ISSUES

Regulatory design of tendering

Regulatory measures aimed at:

A. Promote contestability of franchise markets and **level playing field** conditions for all bidders

- Access to instrumental goods and essential information

B. **Reduction of risks and costs** for all participants (incumbents and new entrants), franchisors (public finance), customers (commuters), tax payers, workers

- Content of public service contracts (PSCs)
- Rules for public service obligation (PSO) compensation

C. **Protection of customers, tax payers** (effects on public finance), transparency and public accountability:

- Minimal quality standard
- Rules and procedure to guarantee customer participation (engagement) and transparency

Access to essential facilities

Guidelines/regulatory measures:

- A. if assets are financed by public resources => transfer to the new entrant (who buys or pays a fee for rental use, usually to a public body)
- B. If assets are under a regime of “third party access”=> new entrants pay a fee for the use of the asset to a specialised supplier
- C. if assets are financed by a private undertaker=> transfer to the new entrant only by *ex ante* negotiation or mandatory clauses (i.e. established by a national law)
 - Similar principle in the “Recast” Directive (in railways industry)
 - Consequences: in case C), there is a high barrier to entry, but most of the assets receive public funding and are therefore subject to **State Aid rules**: rolling stock may be used only on the same track/line or basin

Access to essential information

- EC 2014/C 92/01: *“To make the competitive tendering procedure more transparent, competent authorities should provide all the relevant technical and financial data, including information about the allocation of costs and revenues if available, to potential bidders to assist in the preparation of their offers.*
- Information on:
 - Mobility Demand in the franchise area:
 - Effective demanda (traffic):
 - Potential demand (determinants): demographic features, pro-capita income, etc.)
 - Management (revenues, quality performance, commercial speed, etc.)
 - technical characteristics of the service (routes, schedules, fleet, personnel...)
 - pricing conditions
 - *Asset* (depots, stations, shelters, maintenance workshops) and rollings stocks
 - Personnel (content of social clause)
- Subject obliged to transfer information: LTA and not the incumbent!
 - Strong orientation to let LTAs to assume responsibilities in controlling and monitoring operators performance

Public service contracts (1/2)

Common rules and recommendations on:

- Minimal content of public service contracts (“contract completeness”)
- Suitable criteria to calculate compensation for PSO as auction base-prices or contract prices
 - Efficient costs (or standard)
 - Eligible costs
 - net financial effect on costs incurred and revenues generated in discharging the PSOs, taking account of revenue relating thereto kept by the operator (Regulation EC 1370/09)
 - “reasonable” profit (Regulation EC 1370/09)
- Price cap and subsidy cap mechanisms as incentive mechanisms for the most appropriate objectives in different contexts (efficiency, performance quality, patronage, revenues, etc.) and carry out benchmark studies. Each LTA has to set its own target objectives
- Tariff criteria oriented to a regulatory logic (flexibility, price cap)

Public service contracts 2/2

- *Jus variandi*
 - Flexibility of programs and compensations
- Effective and homogeneous (comparable) reporting schemes, control and monitoring mechanisms (to do);
- Social reporting
 - Procedure for the involvement of customers (passengers) and their associations in the process of setting and monitoring of quality standards
 - Guarantees for the new entrant at the end of the contract awarding concerning personnel, assets and rolling stocks
 - Duration and renewal

THANK YOU!

