Remuneration of PT operators vs 1370 Regulation and guidelines 2014/C92 /01

„Operator experience in contributing to the definition of objectives and in reporting on achievement level.“
Nature of 1370 regulation

- **public service contracts** should be awarded in a fair, open, transparent and non-discriminatory competitive tendering procedure.

- **compensation** would have to respect the four conditions laid down by the European Court of Justice in the Altmark judgement, i.e. an open, transparent and non-discriminatory competitive tendering procedure.

- The selection criteria of public procurement procedures, including for example quality related, environmental or social criteria, should be closely related to the subject-matter of the service provided.

- **directly awarded public service contracts (PSO)** must comply with the provisions of Regulation (EC) No 1370/2007, in order not to constitute State Aid.
Nature of 1370 regulation

• “reasonable profit” must be taken to mean a rate of return on capital that is normal for the sector in a given Member State and that takes account of the risk, or absence of risk.

• „reasonable profit” must therefore be in line with normal market conditions and should not exceed what is necessary to reflect the level of risk of the service provided i.e. profit must be comparable with normal market conditions and should cover the level of risk of the service.

• A standard way in which to measure the return on capital of a public service contract is to consider the internal rate of return (IRR) that the company makes on its invested capital over the lifetime of the project.
Nature of 1370 regulation

• the level of reasonable profit should be assessed over the lifetime of the public service contract, not only during 1 year.

• the use of efficiency incentives in the compensation mechanism is generally to be encouraged

• competent authorities should be free to impose specific social and service quality standards’ to avert risk of social dumping

• Regulation (EC) No 1370/2007 aim to prevent any possible overcompensation for public service obligations, but also that they aim to ensure that the offer of public services defined in the public service contract is financially sustainable to reach and maintain a high level of service quality.
Nature of 1370 regulation

• public service obligation should be appropriately compensated so that the operator’s own funds under a public service contract are not eroded in the long run, preventing the efficient fulfilment – the aim of financial stability.

• compensation schemes should cover actual costs and provide few incentives for the transport company to become more efficient over time.

• any overcompensation should be determinate by ex-post & ex-ante audit.

• transport provider (PSO operator) needs a high degree of protection against uncertainty (i.e. fuel) - by risk which is covered by reasonable profit?
Return on invested capital should be relevant to IRR on the cash flows of the PSC / PSO contract.

EVA >0 if ROIC or IRR > WACC

ROIC (investment scope) = IRR (PT`s company scope)

**Request:**
As long as the company did not earn the amount in excess of its cost of capital, it shall bear the loss.

**GOAL:**
Establish the revenue growth, as the driving force of profitability.
Is Reasonable Profit generated by PSO is relevant to EBIT investment scope formula?

EBIT = Revenue – Operating expenses (OPEX) + Non-operating income

NET Financial Effect > Revenues max =

Costs PSO - Revenues generated by the PSO
– Potential Revenues Induced by network
+ Reasonable Profit

„Compensation must be limited to the net financial effect of the public service obligation. This is calculated as costs minus revenues generated by the public service operations, minus potential revenues induced by network effects, plus a reasonable profit.” - Official Journal of the European Union (2014/C92/01)

Compensation ( Revenues max ) =

PSO ( Costs + Financial Costs + CIT ) + Reasonable Profit

MINUS (Ticketing Revenue
+Non-tariff Revenues
+ Donations from public funds (financial resources and assets))
PSC / PSO REMUNERATION Idea

1. the level of return on invested capital by the operator should be revised on the basis of the analysis of the cash flow statement to the owners of the company operating throughout the period of validity of the contract for the provision of public services.

2. the level of reasonable profit could be determined by comparing the profit margin required by a typical well run undertaking active in the same sector to provide the service, so reasonable profit should not be limited!!!

3. A standard way in which to measure the return on capital of a public service contract is to consider the internal rate of return (IRR) that the company makes on its invested capital over the lifetime of the project, that is to say the IRR on the cash flows of the contract.

question: IS PSC/ PSO PROVIDE FEW INCENTIVES or HQ EFFICIENCY INCENTIVES ! TRUE or FALSE ?
Roles of PSO remuneration: experiences Warsaw City vs MZA

- Financial Risk is sharing between City and MZA
- NO rating issue of MZA obligation, No City guarantee
- Debt is guaranteed minority, by agreement (PSO) and company assets.
- Agreement (PSO) – cession of part fare revenue if default
- Agreement (PSO) is settled for 7 years (10 years – new one)
- Recover & restructure operating costs and capital expenditure – permanent management process, with ex-post & ex-ante auditor assessment.
- Return on capital employed – no dividend or profit on capital reserve
- Permanent remuneration and IRR assessment.
Thank You for attention

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