



JASPERS Horizontal Task Outputs - Working Paper 3

State Aid Issues in Financing Urban Transport in Poland

Report prepared on the basis of a Consultancy Contract with
Ove Arup & Partners Ltd

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JASPERS Project 2007 003 PL HOR MUN State Aid in Transport Projects



Foreword

The Polish authorities requested JASPERS support in the area of EU funding for urban transport and related state aid issues. JASPERS provided support in this area via a consultancy contract with Ove Arup & Partners Ltd. This report contains the full version of the Final Report under this consulting assignment.

JASPERS has decided to disseminate this report because it provides a general overview of competition issues relevant to the financing of urban transport projects with EU funds, and the Guidelines may be helpful for other member states in the implementation of similar projects.

The report provides an overview of state aid rules and attempts to identify potential state aid issues. On that basis it recommends a certain approach and proposes some practical solutions for handling state aid issues in urban transport projects. While it is based on the example of Poland most findings are transferable to the situation in other Member States. The report has been edited for general readers.

We would like to thank the team of consultants led by Arup, supported and co-ordinated by JASPERS who were responsible for the preparation of this report. We would also like to thank Polish Ministry of Regional Development ("MRD") and the Ministry of Infrastructure ("Mol") as beneficiaries of JASPERS support under this Action, for their close cooperation and support.

This is the third report of a series of JASPERS outputs from "horizontal" tasks aimed at addressing generic issues which impact the development of projects anticipated for EU-funding during 2007-2013.

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JASPERS

**Competition Issues
related to Urban Public
Transport Projects
submitted by Poland**

Final Report and
Guidelines for Financing
urban public transport

This report was drawn-up taking into account our client's instructions and requirements.
It is not intended for and should not be relied upon by any third party and no responsibility is extended to any third party

Job number 122384-01

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The Guidelines

(issue 1 : March 2008)

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1 Introduction

1.1 Study Objectives

The main objective of the assignment was to advise the Government of Poland and prospective beneficiaries on how to handle state aid issues related to urban transport projects and to identify the possible and most effective ways of absorbing EU funds. At the same time, the projects' compliance with European Community regulations (on EU funds, transport and public service delivery) and national rules on realising public utility tasks must be ensured.

Initially the study was conducted in order to provide the framework solutions for the cities of Krakow and Lublin, thereafter the scope of study included setting out the rules for development of urban transport schemes in Poland in general and led to preparing detailed guidelines for the Polish municipalities.

The detailed objectives of this assignment were to:

- Provide relevant information on state aid rules.
- Identify potential state aid issues.
- Recommend the appropriate approach for handling state aid issues in urban transport projects.
- Propose practical solutions to handling the identified state aid issues.

This Report provides a general overview and the background on the subject of financing urban transport projects with EU funds and the Guidelines are to provide for practical guidance on implementation of those projects.

1.2 Work Programme

The study began in February 2007. Initially it was focused on two urban transport projects, one in Lublin and a second in Krakow. Following this, at the Polish authorities' request, as agreed with JASPERS, the scope of works was widened and the study team prepared a draft of general guidelines for urban public transport projects supported within the framework of Operational Programmes (the "Guidelines").

A first draft of the Guidelines contents was drawn-up on 5 November 2007 and this document was subsequently presented to the Ministry of Regional Development ("MRD") on 15 November 2007. Further work was undertaken to elaborate the first draft of the Guidelines and the Term Sheet by the end of November 2007.

Since then further versions of the Guidelines and issues related to them have been the subject of a number of meetings with all the concerned parties.

1.3 Study Team

The study was carried out by a team of consultants lead by Arup supported and coordinated by JASPERS in close cooperation with the Ministry of Regional Development ("MRD") and the Ministry of Infrastructure ("Mol").

ARUP team:

Peter Burgess – Project Manager

Paweł Malinowski – expert on financial aspects and a specialist in compensation calculation. He prepared the study's financial examples.

Domański Zakrzewski Palinka sp. k. (DZP)

Domański Zakrzewski Palinka (DZP) is the largest law firm in Poland. DZP advises *inter alia* on state aid law, administrative law (including public procurement law), EU law, competition law and transport law.

DZP team:

Aleksandra Auleytner, Senior Associate – specialist in state aid law and selected aspects of administrative law;

Piotr Duda, Senior Associate – specialist in state aid law and selected aspects of administrative law and legislation.

European Institute of Public Administration team

Professor Phedon Nicolaides – State Aid expert

Dr. Mihalis Kekelekis - State Aid expert

The advisor's team co-operated on a daily basis with Jaspers and MRD/MoI representatives (the MRD team consisted of Marek Michalski, Jaroslaw Orłinski, Agnieszka Kapciak, Jakub Ostalowski, Anna Glapa, Marta Cerkownik, Grzegorz Kokoszkiewicz, and Magdalena Braczkowska; the MoI was represented by Jaroslaw Pasek and Jacek Wisniewski).

The Consultant team met with the representatives from the municipalities, the largest municipal companies and representatives of various Polish state authorities, in particular the Polish Competition Office and the Association of Public Transport Companies.

2 Summary of Relevant EU legislation, Commission Practice and Community Jurisprudence

2.1 EU Legislation

2.1.1 Introduction: General rules on state aid on transport policy

The transport sector, as far as the application of state aid rules is concerned, is split into two groups:¹

- Inland and combined transport are subject to extensive secondary legislation, namely Regulation Nos 1191/69 and 1107/70;²
- Maritime and air transport are subject to the Treaty rules and Commission Guidelines.

The legal basis for the European Community's transport policy in the area of transport by rail, road and inland waterway, which is the focus of this report, is laid down in Articles 70 – 80 EC.

During the study, a new regulation was introduced, Regulation No 1370/07³, which comes into force on 3 December 2009.

2.1.2 Article 73 EC

Article 73 EC gives Member States the right to grant state aid to the types of transport given above if the aid:

1. "meet[s] the needs of co-ordination of transport", or
2. "represent[s] reimbursement for the discharge of certain obligations inherent in the concept of a public service".

Article 73 applies if the conditions of Regulation Nos 1191/69 (1370/2008) or 1107/70 are met, as mentioned above.

Co-ordination of transport means the need of intervention by the state for the purpose of correcting market imperfections such as absence of competition or externalities caused by congestion or environmental pollution or for redressing uneven bearing of costs of transport infrastructure [N 464/03; N 219/01; Decision 1999/590].

For state aid to be compatible with the common market for the purpose of co-ordination of transport, the following conditions must be satisfied by the granting authorities [N 464/03]:

- Aid is necessary and proportional to the minimum necessary by not exceeding the amount of externalities (i.e. the cost advantage enjoyed by competing modes of transport). This means that it must be shown that undertakings would have no incentive to shift from one mode of transport to another without state intervention and that aid must not exceed the amount of externalities and the extra costs of shifting from one mode to another.
- Aid is granted on non-discriminatory and transparent terms and it is time-limited. This means that aid is open to all companies, the terms of compensation are published in advance and that aid does not exceed the minimum required length of time (e.g. 3-5 years).

¹ Stefan Tostmann, "Sense and Serendipity – Towards a Coherent Commission State Aid Approach in the Intermodal Transport Sector", *World Competition*, (2002) 25, p.103.

² Among others, important in our context are: Regulation (EEC) No 1191/69 of the Council of 26 June 1969 on action by Member States concerning the obligations inherent in the concept of a public service in transport by rail, road and inland waterway, OJ L 156, 28.06.1969, as amended by Council Regulation (EEC) No 1893/91 of 20 June 1991, OJ L 169, 29.06.1991; Regulation (EEC) No 1107/70 of the Council of 4 June 1970 on the granting of aids for transport by rail, road and inland waterway, OJ L 130, 15.06.1970, as amended by Council Regulation (EEC) No 3578/92 of 7 December 1992, OJ L 364, 12.12.1992.

³ Regulation (EC) No 1370/2007 of the European Parliament and of the Council of 23 October 2007 on public passenger transport services by rail and by road and repealing Council Regulation (EEC) Nos 1191/69 and 1107/70 (OJ L 315/2007).

- Aid must not distort competition to an extent contrary to the common interest. Aid which is intended to put costs at the same level for different modes of transport is normally regarded as restoring competition. It is also thought in the common interest to reduce congestion and pollution. Non-discriminatory provision of aid also reduces distortion of competition.

Article 73 EC, however, does not replace the general state aid regime in Articles 87 and 88 EC, but is rather a *lex specialis* constituting a legal basis for certain types of aid which would otherwise not be compatible with the common market. Article 73 EC is enforced in conjunction with the above mentioned secondary legislation. Subject to certain exceptions, aid measures falling within the scope of Article 73 EC will have to be notified under Article 88 (3) EC, and when assessing the aid measure the Commission will have to apply the Procedural Regulations⁴.

Moreover, when the state aid does not fall under Article 73 EC and the relevant Regulations, the Commission has the possibility to examine the compatibility of the aid in the light of paragraphs 2 and 3 of Article 87 EC and the General Block Exemption Regulation (GBER), where applicable⁵.

2.1.3 Community Regulations concerning transport (i) Regulation No 1191/69

This Regulation lays down the rules on obligations assumed by undertakings for the operation of public transport services.

Article 2 of Regulation No 1191/69 defines public service obligations as “*obligations which the transport undertaking in question, if it were considering its own commercial interests, would not assume or would not assume to the same extent or under the same conditions*”.

While, in order to speed up the liberalisation process, Member States are required to terminate all public service obligations thus defined and imposed on transport by rail, road and inland waterway, pursuant to Article 1(3), the Regulation permits the conclusion of public service contracts with transport undertakings “*in order to ensure adequate transport services which in particular take into account social and environmental factors and town and country planning, or with a view to offering particular fares to certain categories of passengers, in accordance with Article 1(4)*”.

Furthermore, the obligation to terminate public service obligations does not *always* apply to urban, suburban and regional passenger transport services. The Regulation provides the Member States with two possibilities:

- Article 1(1) authorises them to exclude any undertakings whose activities are confined exclusively to the operation of urban, suburban or regional services from the scope of this Regulation in which case the obligation to terminate public service obligations does not apply as well.
- If a Member State decides not to exclude these undertakings from the Regulation’s scope, it may still decide to maintain or impose public service obligations on the basis of Article 1(5). It must then, however, comply with the conditions and details of operation which are laid down in the Regulation.

Concerning the scope of public service obligations, these should comprise three components:

⁴ Council Regulation (EC) No 659/1999 of 22 March laying down detailed rules for the application of Article 93 [now Article 88] of the EC Treaty, OJ L 83, 27.03.1999, p.1; Commission Regulation (EC) No 794/2004 of 21 April 2004 implementing Council Regulation (EC) No 659/1999 laying down detailed rules for the application of Article 93 of the EC Treaty, OJ L 140, 30.04.2004, p.1.

⁵ Commission Regulation (EC) No 800/2008 of 6 August 2008 declaring certain categories of aid compatible with the common market in application of Articles 87 and 88 of the Treaty (General block exemption Regulation), OJ L 214, 09.08.2008.

- The 'obligation to operate', that is to say, the obligation of a transport undertaking to take all the necessary measures to ensure the provision of a transport service satisfying fixed standards of continuity, regularity and capacity;
- The 'obligation to carry', meaning any obligation imposed upon a transport undertaking to accept and carry passengers or goods; and
- 'Tariff obligations', meaning those obligations imposed upon a transport undertaking to apply for certain categories of passengers, goods or on certain routes rates fixed by the public authorities.

Regulation No 1191/69, as amended by Regulation No 1893/91, refers also to the concept of 'public service contract', an optional instrument that adds to the transparency of the system and which is at the disposal of the Member States if they wish to resort to the implementation or extension of a public service obligation. These are contracts made between the competent authorities of a Member State and the operators in order to provide the public with adequate *transport services* [emphasis added] and which are to provide for transport service details, such as duration, price of the services, which will either be added to tariff revenue or will include the revenue, and details of financial relations between the two parties.

Though, the subject of PSC's under 1191/69 is the public service delivery, it does not provide for the compensation for the operator but it is based on price for delivered services.. That service price (including the tariff revenues) as well as the detailed financial relations between two parties are described in the contract.

In view of the above, the exemption from the notification requirement that Regulation No 1191/69 provides, applies only to public service compensation for the discharge of public service obligations imposed and not for the conclusion of public service contracts.

According to Article 14(3) furthermore, assets involved in the provision of transport services, which are the subject of a public service contract, may belong to the undertaking or be placed at its disposal.

Member States are exempted from the obligation to notify to the Commission the measures they take to grant compensation payments (pursuant to Regulation No 1191/69), however, as provided for in Article 17(2) of the Regulation, they are required to forward to the Commission details of the payments made. The Regulation's compensation procedure aims mainly at ensuring that the companies in question receive an appropriate financial support without being over-compensated.

Section II of Regulation No 1191/69 provides for common principles for the termination and maintenance of public service obligations. If a transport undertaking suffers financial disadvantages because of public service obligations, it may apply, pursuant to Article 4, to the competent national authorities for the termination of whole or part of the obligation in question. By virtue of Article 6 of Regulation No 1191/69, the decision, which the competent authority takes with respect to that request, provides for compensation for the financial burdens resulting from that decision.

(ii) Regulation No 1370/2007

Following amendments to Regulation No 1191/69 contractual systems have been established in most Member States, particularly as a result of tendering.

The new Regulation No 1370/2007 brings everything under the umbrella of a "public service contract". However, it has created an extremely wide definition that is not restricted to purely civil law instruments⁶. According to Article 2 (i) of the Regulation:

⁶ Besides the purely civil law contracts, public service contract according to the definition in Regulation 1370/2007, includes normative and administrative acts, as well as regulatory acts containing conditions under which the competent authority itself provides the public services or entrust the provision of the services to an internal operator.

“public service contract means one or more legally binding acts confirming the agreement between a competent authority and a public service operator to entrust [...] the management and operation of public passenger transport services subject to public service obligations; depending on the law of the Member State, the contract may also consist of a decision adopted by the competent authority:

- taking the form of an individual legislative or regulatory act, or
- containing conditions under which the competent authority itself provides the services or entrusts the provision of such services to an internal operator”.

Consequently, any public instrument can be covered by the above definition. The Regulation does not exclude the possibility of public service obligations emanating from a legislative act.

In addition the new Regulation:

- Extends the scope of application to national and international operation of public passenger transport services by rail and other track-based modes and by road;
- Provides clear definitions as to what constitutes, for example, “internal entity”, “direct award”, etc;
- Regulates the way public service contracts are awarded by the competent authorities;
- Envisages the possibility of competent authorities providing public transport services (whatever the mode of transport) itself or to award public service contracts to an internal operator without competitive tendering. In the case of the rail sector, competent authorities may decide to make direct awards of public service contracts, with the exception of other track-based modes, such as metros or tramways. However, the competent authority or the internal operator should be prohibited from taking part in competitive tendering procedures outside the territory of that authority (with exceptions);
- Permits (contrary to current legislation) competent local authorities to provide the service as above by themselves;
- Applies detailed rules for the proper calculation of compensation related to public service contracts in such a way that prevents overcompensation;
- Provides for compensation granted by the competent authorities to be exempted from the prior notification requirement of Article 88(3) EC;
- Allows Member States, without prejudice to the application of, among others, state aid rules to compensate undertakings that have to bear expenditure relating to the infrastructure used by them, while other undertakings are not subject to a like burden.

The method of compensation for public service delivery must promote the maintenance or development of effective management by the public service operator, which can be the subject of an objective assessment, and the provision of passenger transport services of a sufficiently high standard.

According to the provisions of Regulation No 1370/2007 and its annex, compensation may not exceed an amount corresponding to the net financial effect equivalent to the total of the effects, positive or negative, of compliance with the public service obligation on the costs and revenue of the public service operator.

In order to calculate the net financial effect, the competent authority will be guided by the following scheme:

- costs incurred in relation to a public service obligation or a bundle of public service obligations imposed by the competent authority/authorities, contained in a public service contract and/or in a general rule,
- minus any positive financial effects generated within the network operated under the public service obligation(s) in question,
- minus receipts from tariff or any other revenue generated while fulfilling the public service obligation(s) in question,
- plus a reasonable profit.

As the critical input to the compensation calculations is the appropriate level of “reasonable profit”, each Member State is therefore obliged to establish the rate of return on the capital for the investment, which is normal for the sector in a given Member State. According to the Regulation No 1370/2007, the level of that rate should reflect the risk, or absence of risk, incurred by the public service operator by virtue of public authority intervention.

Costs and revenue must be calculated in accordance with the accounting and tax rules in force.

Regulation No 1370/2007 sets out clear rules on how the public service contract is awarded. The possible ways are:

- Providing public transport by the public entity itself;
- Direct award – awarding the contract to the public service operator without providing for the competitive tendering procedure. This method can be used with respect to the internal operator;
- Tendering procedure, according to the public procurement directives rules.

With respect to buses and trams contracts, the award of the contract is carried out according to the public procurement directives, unless a service concession is awarded⁷.

With respect to above mentioned it must be noted that:

- the procurement directives, in the light of the ECJ jurisprudence, as well as the procurement rules of many Member States, permit direct award of contracts to fully municipally owned municipal transport companies;
- service concessions are connected with the transfer of the traffic risk to the operator, which is relatively unusual in central and eastern Europe, especially for trolleybus and tram services.

With respect to rail transport (with the exception of trams and metros), a Member State can decide to award public services contracts using direct awards to all types of entities, unless it is prohibited by national law.

If all the requirements of Regulation No 1370/2007 are met, compensation for public service is considered to be compliant with the common market rules and does not require notification to the Commission.

Regulation No 1370/07 will come into force on 3rd December 2009. According to Article 8 of Regulation No 1370/07 the award of the public services contracts should comply with the Regulation rules as from 3rd December 2019 (without prejudice to Article 5.1 of the Regulation – see also comment above – footnote 7). During this transitional period Member States should undertake the appropriate measures to gradually comply with the rules of Article 5 of the Regulation and after the first half of the transitional period, Member States shall provide the Commission with an implementation progress report.

Regulation No 1370/07 excludes also from its scope and provides separate rules for public service contracts awarded, according to EU Law as well as national rules, before 3rd December 2009 (Article 8.3).

2.2 Commission Practice

The following decisions have been identified. The majority of these are not relevant to urban public transport in Poland. Relevant decisions are quoted in support of the arguments made in the course of the study.

- N 517/98, South Wales rail freight terminal, UK (construction and operation of rail terminal).
- N 617/98, Utrecht container terminal, the Netherlands (construction and operation of rail terminal).
- NN 47/99, Tax exemption for trolley buses, Germany (reduction of costs of electricity used by trolley busses).
- N 199/99, Exemption from corporate taxation of municipal transport undertakings operating local transport services, the Netherlands.

⁷ Regulation 1370/2007, Article 5.1: “Public service contracts shall be awarded in accordance with the rules laid down in this Regulation. However, service contracts or public service contracts as defined in Directives 2004/17/EC or 2004/18/EC for public passenger transport services by bus or tram shall be awarded in accordance with the procedures provided for under those Directives where such contracts do not take the form of service concessions contracts as defined in those Directives. Where contracts are to be awarded in accordance with Directives 2004/17/EC or 2004/18/EC, the provisions of paragraphs 2 to 6 of this Article shall not apply.”

- Commission Decision 1999/590, Restructuring of road haulage and the development of intermodality, Italy [OJ L227, 28/8/1999].
- N 219/01, Aid to inland shipping, Austria.
- N 337/02, Aid to adapt vehicles for use by persons with reduced mobility, Spain.
- N 588/02, Grant for long-distance coach services, UK (half-rate fares for elderly and disabled passengers).
- N 206/03, Waterborne freight grant, UK (incentive to transfer freight to inland waterways).
- Commission Decision 2003/227, construction of infrastructure in relation to a Spanish theme park [OJ L91, 8/4/2003].
- N 464/03, Company neutral revenue support scheme, UK (aid to companies to transfer movement of freight from road to rail).
- N 478/04, State guarantee for capital borrowings for infrastructure investment, Ireland (guarantee on borrowings of state-owned body for transport infrastructure).
- N 604/05, Aid to a bus operator by setting a fixed price per passenger, Germany.
- N 149/06, Traffic guarantee, Ireland (construction and operation of new road infrastructure through a PPP).

2.3 Community Jurisprudence

2.3.1 Introduction

In this section we refer to the two most important ECJ rulings on the study's subject matter – the *Altmark* ruling and the *Combus* ruling. Both rulings had a significant impact on the interpretation of Regulation No 1191/69 and will have to be taken into account when Regulation No 1370/07 comes into force.

2.3.2 Case C-280/00, *Altmark*

Aid to companies entrusted with public service obligations has become an issue of controversy for many years. The *Altmark* ruling, however, has provided guidance in a case that involved aid granted to companies required by law to provide public transport services. This ruling laid down four cumulative conditions in order for compensation for public service obligations not to constitute state aid and thus be exempt from the notification requirement of Article 88(3) EC:

- (i) “First, the recipient undertaking must actually have public service obligations to discharge, and the obligations must be clearly defined.
- (ii) Second, the parameters on the basis of which the compensation is calculated must be established in advance in an objective and transparent manner.
- (iii) Third, the compensation cannot exceed what is necessary to cover all or part of the costs incurred in the discharge of public service obligations, taking into account the relevant receipts and a reasonable profit for discharging those obligations.
- (iv) Fourth, where the undertaking which is to discharge public service obligations is not chosen pursuant to a public procurement procedure which would allow for the selection of the tenderer capable of providing those services at the least cost to the community, the level of compensation needed must be determined on the basis of an analysis of the costs which a typical undertaking, well run and adequately provided with means of transport so as to be able to meet the necessary public service requirements, would have incurred in discharging those obligations, taking into account the relevant receipts and a reasonable profit for discharging the obligations.”⁸

2.3.3 Case T 157/01, *Combus*

The *Altmark* approach was confirmed in the *Combus* judgement⁹, which annulled a Commission decision on the basis of an erroneous interpretation of the term ‘public service obligation’ in the Regulation No 1191/69 (according to the decision State payment was

⁸ Case C-280/00, *Altmark* (cited above at no. 5, at paras 88-93). It must be noted that these criteria are different from the Article 86(2) EC test in that firstly, there is an additional requirement that the parameters of compensation be calculated in advance and secondly, the fourth criterion on the benchmarking is more objective than the proportionality test of Article 86(2) EC.

⁹ Case T-157/01, *Danske Busvognmaend v Commission*, 2004 ECR II-917.

compensation for future losses associated with public service obligations and thus satisfied the requirements of Regulation No 1191/69). It additionally introduced two novelties in the jurisprudence:¹⁰

- Contractual obligations under a public service contract do not necessarily constitute public service obligations. Public service obligations must be pre-defined as such and losses incurred under other contractual obligations may not be compensated as if they are public service obligations,¹¹ and
- Aid granted to cover losses endured in executing a public service contract that aims solely at internal rationalisation of an undertaking is classified as restructuring aid that may not be compatible with the common market.¹²

¹⁰ Olivier Chassagne, “*Overview of State Aid Control Policy in Transport*”, quoted in *The EC State Aid Regime: Distortive effects of state aid on competition and trade*, 2006, p. 414.

¹¹ Case T-157/01 (cited above, para. 98).

¹² *Ibid.*, at para. 113.

3 Poland : Legal Context

3.1 Introduction

While implementing urban transport projects appropriate Polish regulations will have to be applied beside the EU regulations mentioned above. Polish regulations presented below provide for general rules on:

- (i) Scope of public authorities actions (public utility tasks);
- (ii) Possible ways of implementing those actions;
- (iii) Procedural regulations concerning public utility tasks realisation.

The guides for granting support for public transport projects within EU funds are described in point 3.5.2.

3.2 Act on Municipal Government

In accordance with Polish law, under article 7 section 1 item 5 of the Act on Municipal Government, the obligation to meet the citizens' needs for local public transport is a task of the municipality ("gmina"). In order to ensure that this task is performed, municipalities may exercise their rights to oblige/commit operators to provide the public service in local transport in different ways described below.

3.3 Act on Municipal Economy

3.3.1 Entities performing public utility tasks

Municipalities can perform public utility tasks in the following ways:

- (i) **Through budgetary establishments (*zakład budżetowy*)** – this is formed by a municipal council in a resolution in accordance with the Act on Public Finances. When forming a budgetary establishment, the municipal council adopts (also in the form of a resolution) the budgetary establishment's articles of association setting out inter alia the objects and purpose for which the establishment was formed, as well as the assets of the establishment. A budgetary establishment is not an 'internal operator' within the meaning of Regulation No 1370/2007 since it is not a separate legal entity as required by art. 2 point j. of this regulation.
- (ii) **Through commercial companies under the municipalities' control (municipal companies) (*spółka komunalna*)** – a municipality establishes a municipal company (limited liability company or joint-stock company) in a resolution adopted by the municipal council (or by joining an existing company). Most (but not all) of the municipal companies created under the Act on Municipal Economy can be recognised as an 'internal operator' within the meaning of Regulation No 1370/2007 ("internal operator" is defined in point 3.3.2 below).
- (iii) By entrusting the utility tasks to **private entities based on civil law contracts** – these can be either an individual, or a legal person or an organisational unit without legal personality.

Depending on the chosen way of performing a task, there may be other structures of entrusting the task to a given entity, which can influence the scope of the entrusted task.

3.3.2 Forms of performing public utility tasks

Taking the above into account, municipalities ensure the performance of public service obligations (in this case orders for public passenger transport services) by way of:

- (i) imposing the public service obligation upon the operator in a regulatory act (budgetary establishment, municipal company); or
- (ii) executing a civil law contract with such an operator (private entity).

According to national administrative court jurisprudence¹³, the basis for the performance of a public utility task by an entity may be the act of the relevant municipal body that created the entity. Concluding a service contract with such an entity is not required. The municipality which established the municipal company (i.e. the parent municipality) does not have to execute a separate contract with the municipal company in order to entrust this company with the task of meeting citizen needs e.g. for local public transport in the territory of this municipality, however it is advisable to conclude a contract (supplementary to the act of entrusting the task to the company) to set out detailed rules on the parties' co-operation and especially the rules of calculating the compensation.

3.4 Public Procurement Law

3.4.1 General remarks

Polish Public procurement law is in compliance with EU directives 2004/18/WE and 2004/17/WE and contains:

- (i) provisions securing the implementation of general EU public procurement rules, such as equality of treatment, non-discriminatory rules and transparency;
- (ii) provisions concerning the available tendering procedures;
- (iii) provisions concerning other procedural issues.

According to national jurisprudence, the Public Procurement Law does not apply when a municipality entrusts the performance of public utility tasks to an entity created by the municipality (with the goal of performing these tasks). This therefore applies to both budgetary establishments and municipal companies (see point 3.3.1(I) and (II) above).

The selection of an external operator (see point 3.3.1(III) above) for service delivery should be carried out in compliance with public procurement rules, according to the appropriate tendering procedure.

3.4.2 Internal entity/operator

With respect to public transport, according to Article 2 letter (j) of Regulation No 1370/2007, "internal operator" means a legally distinct entity over which a competent local authority, or in the case of a group of authorities at least one competent authority, exercises control similar to that exercised over its own departments.

Taking this and the jurisprudence of the European Court of Justice into account, an "internal operator" should meet the following criteria:

- be a legally distinct entity;
- control should be exercised over it by a competent local authority, i.e. a local governmental unit, such as a community or voivodship or in the case of a group of authorities at least one competent local authority, to an extent similar to the control this authority exercises over its own departments;
- the internal operator and any entity over which it exerts even a minimal influence should perform their public passenger transport activity within the territory of the competent local authority;

¹³ Highest Administrative Court, judgment dated 11.08.2005 (II GSK 105/05)

- the internal operator and any entity over which it even a minimal influence should not take part in competitive tenders concerning the provision of public passenger transport services organised outside the territory of the competent local authority;
- the internal operator should perform the major part of the public passenger transport service itself (and not by subcontracting).

The status of an internal operator is crucial in respect to the direct award of a public service contract.

Polish Public Procurement Law does not include a definition for an internal operator. The analysis reveals that some of the municipal companies created on the basis of the Act on Municipal Economy can fulfil the above mentioned criteria of an internal operator. However, the interpretation should be carried out on a case by case basis, with regard to the jurisprudence concerning the municipal economy and in some cases a new municipal act or amendments to the company's articles of association may be needed to ensure compliance.

According to the procurement rules and adequate jurisprudence in this respect the direct award is only possible in case where the entity is 100% publicly owned. However it must be mentioned that the wording of Regulation No 1370/07 does not exclude the internal operators owned to some extent by private entities (provided that other conditions are fulfilled).

3.5 Act on Development Policy Principles and Operational Programmes

3.5.1 EU funding between 2007-2013

The basic document defining Poland's growth objectives over the years 2007–2015 is the National Strategic Reference Framework ("**NSRF**"). It defines provisions and sets out institutional frameworks for co-ordinating the execution of various horizontal policies, set out in the development policy – in particular those policies which are the mainstays of the European financial perspective in the years 2007–2013: competitiveness policy, cohesion policy, the Common Agricultural Policy and the Common Fishery Policy.

In the period 2007–2013 Poland will be the major beneficiary of the European cohesion policy. Under this policy Poland could obtain a total of more than EUR 67 billion divided into interventions within the European Regional Development Fund, the European Social Fund and the Cohesion Fund.

The NSRF's horizontal objectives are:

- (a) Improving the functioning standard of public institutions and development of partnership mechanisms;
- (b) Improving the human capital quality and enhancing social cohesion;
- (c) Establishment and modernisation of technical and social infrastructure crucial for better competitiveness of Poland;
- (d) Improving the competitiveness and innovativeness of enterprises, including in particular the manufacturing sector with high added value and development of the services sector;
- (e) Increasing the competitiveness of Polish regions and preventing their social, economic and territorial marginalisation;
- (f) Balancing growth opportunities and supporting structural changes on rural areas.

These aims are to be achieved via activities undertaken within the framework of the following operational programmes ("**OP**") within the Convergence Objective:

- (a) OP Human Capital;
- (b) OP Innovative Economy;
- (c) OP Infrastructure and Environment;
- (d) OP Development of Eastern Poland;
- (e) OP Technical Assistance;

(f) 16 Regional OPs.

The main rules concerning regional policy at the national level, both in a strategic as well as an operational sense, are set out in the Act on Development Policy Principles of 6 December 2006.

According to Article 28 of the Act, within the operational programmes the possible projects' selection procedures may fall under the heading of individual procedures, system procedures and competition procedures. The final decision on the procedure applied is undertaken by the managing institution.

Urban public transport projects will be supported within the appropriate priorities of the OP Infrastructure and Environment, OP Development of Eastern Poland and 16 Regional OPs.

3.5.2 Granting of support for projects in relation to urban public transport service delivery

An operator providing public services within urban transport may apply for community funds to finance the purchase (or modernisation) of infrastructure used in urban or suburban public transport or the purchase (or modernisation) of rolling stock.

The cost eligibility period commenced on 1 January 2007.

A detailed description of the financing application procedures under the Operational Programmes is available at the official website of the EU structural funds in Poland www.fundusze-strukturalne.gov.pl and for Regional Operational Programmes the description is also available at the websites of the voivodships concerned.

Additionally, with regard to urban transport projects, taking into account the characteristics of this sector, the Guidelines have been elaborated in order to clarify the rules for subsidies for the purchase (or modernization) of the rolling stock or infrastructure respectively (see section 5 of this report). The Guidelines provide both the rules for implementation of the Regulations Nos 1191/69 and 1370/07 as well as some practical advice and formal requirements concerning urban transport projects.

According to the provisions of the Guidelines, if the entity applying for financing is:

- (i) **a municipality which intends to provide public services by acting as a budgetary establishment** - the municipality should attach to the application form inter alia: the budgetary establishment's statute and the appropriate internal law act setting out the scope of the obligation to provide public transport services.
- (ii) **a municipality which intends to provide public services through its municipal company or a municipal company** which intends to provide public services to the parent municipality - the financing application form should be filed together with inter alia the documents confirming the detailed principles on which the municipal company provides public services (i.e. a resolution on establishing the company, the articles of association, the by-laws, and the executory contract) and the financing model showing that in the event of the municipal company receiving funds from the relevant Operational Programme, the compensation will not exceed the amount allowed by Regulation No 1370/2007. If rolling stock is to be handed over to the municipal company based on a contract other than the executory contract, this contract must also be attached (the contract may be a conditional contract).
- (iii) **a municipality which intends to entrust public services to an external entrepreneur or an external entrepreneur** - the financing application form should be filed together with inter alia the public service contract executed with the external entrepreneur. This contract should include the principles for calculating compensation pay if financing is obtained from the relevant Operational Programme. If the public service contract has not yet been executed, the financing application should be accompanied by a term sheet document containing the parties' commitment to execute the contract by a certain deadline (if necessary – after obtaining the financing).

- (iv) **an entity which executed a public service contract before** the announcement of the Guidelines that does not meet the conditions laid down in the Guidelines - the financing application form should be filed together with this contract amended by an annex specifying inter alia the principles for providing public services in accordance with these Guidelines, including the principles for calculating compensation pay if financing is obtained from the relevant Operational Programme.

4 Potential Forms of State Aid

4.1 Subject of the support

Within the context of public transport, the subject of support can be:

- Infrastructure – both common user facilities and infrastructure owned and used exclusively by the beneficiary of the support;
- Rolling stock.

Transfer of public resources to transport undertakings is in most cases a form of state aid irrespective of the fact that some transport services (e.g. urban transport) are local in nature. This is because such local services can be provided by foreign companies establishing a commercial presence in the local market.

There may also be state aid (because of a risk of distortion of competition) when there is risk for overcompensation for public service obligations.

As long as the infrastructure is accessible to any user, the public funding is deemed not to be selective, which means that Article 87(1) EC does not apply to users of that infrastructure¹⁴.

There is no state aid in certain situations such as the following:

- The service in question is not an economic activity. This is the case when an entity, wholly owned by the state, builds and/or manages transport infrastructure which is open to all users on a non-discriminatory basis [Decision 1999/590; N 478/04; N 149/06]. By contrast, construction of road infrastructure by a private company constitutes economic activity when the infrastructure is not open to all users or when public financing may lead to overcompensation [N 149/06; Decision 2003/227]. The management of infrastructure by a private company is an economic activity [N 149/06].
- There is no distortion to competition. This is the case for example when aid aims to reduce the number of road hauliers through incentives for early retirement of single-vehicle road hauliers. The recipients are no longer undertakings operating in the market. This is also the case where aid supports infrastructure or transport terminals which are open to all transport operators [Decision 1999/590].
- There is no effect on trade. This is the case where the service is truly local as for example, when aid is granted to all operators of urban taxis which are adjusted for use by persons with reduced mobility [N 337/02]. In principle, the Commission concludes on the existence of an effect on trade even in cases where markets are not completely open to competition, and this approach has been upheld by the Court of First Instance (“CFI”) in the case of *Regione Friuli Venezia Giulia v Commission*, where the CFI considered that “[...] in matters relating to State aid, it is sufficient that the market concerned be open, even partly, to competition for aid to be capable of affecting trade between Member States”.¹⁵

Public funding of infrastructure construction or mobile assets through open and non-discriminatory public tenders, performed according to public procurement rules does not normally involve the state aid.

To determine whether particular aid is in line with the common market principles the criteria indicated in the ECJ Altmark judgment (24.07.2003, C-280/00, see point 2.3.1. of the Report) can be applied. It is assumed that the current Public Procurement Law regulations are compliant with the community regulations, and if the operators are chosen in line with the Public Procurement Law, the so-called fourth Altmark premise is met in most cases.

¹⁴ As reported in the XXVth Report on Competition Policy: “In principle, as long as access and usage remains public and general, such intervention will not constitute State aid but will be normally regarded as being in the public interest. For there to be a distortion that might qualify as aid, the infrastructure-related activities, should be conferred selectively with the aim of helping specific firms”.

¹⁵ Case T-288/ 97, 2001 ECR II-01871, at para. 95.

4.2 Regional Aid

4.2.1 Infrastructure

The Commission has not yet adopted any rules on state aid for infrastructure. In its daily decision practice however, it has traditionally considered that public funding of infrastructure is not state aid.

However it can not be excluded that, in case where public funding provides a selective advantage for given entity, the construction, use or management of infrastructure might be considered not compliant with the common market on the basis of Article 87(1) EC.

Such aid can be exempted through either Article 73 EC, Article 87(3)(c) or in the case of Poland Article 87(3)(a) EC.

The rules on national regional investment aid can be applied as well, if its conditions are satisfied.

Aid for initial investment in infrastructure under regional investment aid will be considered compatible with the common market and will be exempted from the notification requirement of Article 88(3) EC provided among others that:

- the aid is granted in regions eligible for regional aid; and
- the aid intensity in present gross grant equivalent does not exceed the respective aid ceiling determined for the region in which the investment takes place.

4.2.2 Mobile assets (rolling stock)

Investment in mobile assets in the transport sector can be exempted, on the basis of either Articles 73, or 87(3)(a) and (c) EC or finally under certain circumstances on the basis of the provisions of the new General Block Exemption Regulation (GBER), and those of regional aid.¹⁶

Regional aid for equipment in the transport sector is excluded from the scope of GBER on the basis of point 35. To this end, Article 2(10), which defines the various terms used in the GBER, states that: “‘tangible assets’ means assets relating to land, buildings and plant/machinery. In the transport sector, except for the road freight and air transport, transport means and transport equipment shall be considered as eligible assets except as regards regional aid.”

This means that mobile assets and rolling stock in the urban transport sector may not receive regional investment aid (transport equipment covers mobile assets and rolling stock). But they may receive, for example, other kind of aid such as environmental aid or investment aid for small and medium enterprises (SME). This, however, would allow for a very small amount of public assistance¹⁷.

4.2.3 Conclusions

Regional investment aid can be used as a tool to support both public transport infrastructure and certain mobile assets.

However there are certain significant limitations e.g. eligible costs and low aid intensity ceilings (in Poland according to the regional aid map – basics - 30-50%) that may not satisfy the needs of Polish municipalities.

¹⁶ In the transport sector, investment in the acquisition of transport equipment is not eligible for aid under the block exemption Regulation on national regional investment aid. State aid to mobile assets in the transport sector is not eligible also under the regional guidelines 2007-2013, OJ C 54, 04.03.2006, p.13.

¹⁷ As a derogation, the acquisition of rolling stock for the railway sector is possible under regional investment aid within the frame of new, recently published Community guidelines on state aid for railway undertakings (2008/C 184/07) – this regulation came into force after the Guidelines within this study were prepared. It is important to note that point 1.2.15 of the guidelines states that “Chapter 3 also applies to urban, suburban and regional passenger transport undertakings” (where Chapter 3 concerns the possible kinds of aid for the purchase and renewal of rolling stock). That provides a potential opportunity to apply the guidelines to public transport projects.

4.3 Public Service Contracts (PSCs)

4.3.1 Introduction

Urban public transport services are one of the public utility tasks that municipalities are obliged to deliver to citizens and taking into account its social dimension, this activity is usually not profitable.

Bearing the above in mind, the most appropriate approach to perform the public utility tasks concerning public transport is through a service contract providing adequate compensation.

It should be noted that when applying compensation rules there are no limitations similar to those when regional investment aid is being applied (see point 5.2.3. of the Report).

4.3.2 PSC under Regulation No 1191/69

According to article 14(2) of Regulation No 1191/69, a public service contract ("**PSC**") must cover the following points:

- (i) the nature of the service to be provided, notably the standards of continuity, regularity, capacity and quality;
- (ii) the details of financial relations between the parties;
- (iii) the rules concerning amendment and modification of the contract;
- (iv) the period of validity of the contract;
- (v) the penalties in the event of failure to comply with the contract;
- (vi) the owner of the assets used to provide transport services, in particular the rolling stock and infrastructure.

Regulation No 1191/69 does not provide the maximum term for which public service contracts may be awarded.

It is, however, recommended that this period be no longer than 10 years for bus and coach services and 15 years for tramway and metro services (such duration of contracts is set out in Regulation No 1370/2007). In justified circumstances, especially when, in order to provide public services, the operator buys the rolling stock or infrastructure – the public service contract may be awarded for a longer period (maximum 30 years), provided the contract was awarded to the operator on the basis of a tendering procedure in accordance with the Public Procurement Law (the provisions of the contract have to be examined each time to check whether the conditions specified in the Public Procurement Law for executing the contract for a given term have been fulfilled) and further provided that the contract meets the other adequate requirements.

According to Regulation No 1191/69, the contractual system does not provide for compensation for the discharge of public service obligations but provides for a remuneration for services delivered (see also point 2.1.2(I)). Therefore it is not excluded from the notification upon the Article 17(2) of the Regulation.

If a contract is concluded before 3 December 2009, it is recommended, without prejudice to the requirements laid down in Regulation No 1191/69, that a public service contract should also cover the points which are described in Regulation No 1370/2007 as obligatory elements of such contracts, within the scope in which they do not overlap with the elements set out in Regulation No 1191/69.

4.3.3 PSC under Regulation No 1370/2007

In accordance with Regulation No 1370/2007, public service contracts must:

- (i) define the public service obligations and the geographical areas concerned;
- (ii) establish, in an objective and transparent manner, the parameters on the basis of which the compensation payment, if any, is to be calculated and the nature and extent of any exclusive rights granted in a way that prevents overcompensation;
- (iii) determine the arrangements for the allocation of costs connected with the provision of services;

- (iv) determine the arrangements for the allocation of revenue from the sale of tickets (whether the revenue may be kept by the operator, municipality or shared between the two);
- (v) determine the service quality standards;
- (vi) indicate whether, and if so to what extent, subcontracting may be considered; and
- (vii) indicate the owner of the assets used to provide transport services, in particular the rolling stock and infrastructure.

A public service contract may be executed for a period not longer than 10 years (for coach, bus and trolleybus services) and 15 years (for metro and tramway services). The duration of public service contracts relating to several modes of transport (for instance, bus and tramway services) may not exceed 15 years if transport by track-based modes (tramways or metro) represents more than 50% of the value of the contracted services. In justified circumstances, the duration of the public service contracts may be extended (by a maximum of 50% - in accordance with Regulation No 1370/2007. The above rules may be applied if permitted under the Public Procurement Law.

According to Regulation No 1370/2007 *“public service compensation means any benefit, particularly financial, granted directly or indirectly by a competent authority from public funds during the period of implementation of a public service obligation or in connection with that period”*, so it has a wider meaning with respect to Regulation No 1191/69. This compensation is to be exempted from the prior notification requirement of Article 88(3) EC.

5 Development of Guidelines

5.1 Introduction: key elements of context

The status of the public transport system in Polish cities varies significantly according to the different size of towns and cities, levels of motorisation, the quality of technical infrastructure, and the organisation of public transport. The provision of local public transport is the responsibility of local authorities. Operators mainly act in the form of municipal companies, however, a number of towns have decided to separate the functions of organiser and operator.

Local governments still fail to allocate sufficient financial means for local public transport. The quantity and the range of investments are insufficient. Solutions giving priority to trams, trolleybuses and buses (e.g. separated lanes, separated streets, traffic lights) are applied rarely. The carriages are in a very poor condition – most often they are out-dated, worn-out and not adjusted to passenger needs, including disabled persons. As a result, and as car ownership rises, the share of public transport in total transport decreases in most cities, particularly in medium-sized towns.

Therefore, there is a need for investments in public transport. One of the possible methods is the absorption of European funds. However, this requires ensuring compliance with Community and national/local legal regulations concerning both structural funds, as well as transport and public services provision regulations.

In the light of Community legislation, one of the major obligations of the Member States is to guarantee public transportation services to be provided by public or private undertakings which are fit for such purposes and use public passenger transport equipment (referred to as the “operators”).

The requirement to guarantee public transport is linked with the so-called ‘public service obligation’. The key normative act regulating obligations to provide public services at the community level is Regulation No 1191/69, which will be superseded by Regulation No 1370/2007 on 3 December 2009. The main features of the Regulations have been described above.

In accordance with Polish law, under article 7 section 1 item 5 of the Act on Municipal Government, the obligation to meet the citizens’ needs for local public transport is a municipal task. In order to ensure that this task is performed, municipalities may exercise their rights under community legislation to oblige operators to provide the public service in local transport.

Municipalities ensure performance of the public service obligation (i.e. orders public passenger transport services) by way of (i) entrusting the public service obligation upon the operator in a regulatory act; or (ii) executing a civil law contract with such an operator.

Proper discharge of the public service obligation within the scope of passenger transport may require use by the operator of infrastructure used in urban or suburban public transport (in certain instances, this infrastructure must be purchased or modernised), or purchase (or modernisation) of rolling stock, i.e. public transport means.

Financing projects using EU funds is granted based on an agreement for project financing referred to in article 5 item 9 of the Act on Development Policy Principles. The amount of financing for a given project, calculated as the share of funds from the EC budget (and in part from the state budget in some instances) is laid down in the relevant documents concerning Operational Programmes. The remaining amount of funds for the project i.e. own funds – depending on the beneficiary – may be national public funds (funds from the budget of the relevant local government unit) or private funds.

5.2 Objectives of the Guidelines

Recognising the importance of ensuring that prospective EU-funded urban transport projects are consistent with the state aid rules, the Polish MRD requested JASPERS and its

Consultants to develop suitable guidelines, in close cooperation with the Ministry and other interested parties.

The aim of the Guidelines is to lay down the rules for subsidies granted to operators under the Operational Programmes for the purchase (or modernization) of the rolling stock or infrastructure respectively. The Guidelines are now published on the MRD web site at www.mrr.gov.pl, and are to be followed by beneficiaries in preparation of for EU funded urban transport projects.

As it is presumed that providing the operators with funds for the purchase of the rolling stock or the infrastructure respectively as an element of remuneration/compensation on general terms laid down in Regulation no. 1191/69 or Regulation no. 1370/2008 is in line with the common market principles and thus does not require a notification to the European Commission, the support may according to this procedure, be given quickly and no additional administrative encumbrances arise in connection with the notification requirement – either on the part of the operators or the public authorities and community authorities. Also, giving support on the terms and conditions laid down in the regulations does not lead to a violation of the principles of unrestricted competition.

Due to the advantages indicated, Guidelines lay down in detail the principles of entrusting a public service obligation on operators (or determining in civil law actions the operators' obligations to provide public services) in the light of community regulations, taking into account the Polish legal environment and the Polish business environment.

It is expected that the Guidelines shall be applied in the number of urban public transport projects that are planned to be supported within the appropriate priorities of Operational Programme Infrastructure and Environment, Operational Programme Development of Eastern Poland and 16 Regional Operational Programmes.

5.3 Rationale/approach adopted

As the rules of financing public service delivery within the public transport sector are about to change and the new regulation will replace the existing one, the Guidelines, for the purpose of transparency, has been divided into two parts – the regime under Regulation 1191/69 (till 2009 December 3rd) and the regime under Regulation 1370/1008 (from 2009 December 3rd). Having that in mind as well as the fact that operational programmes cover the financial perspective 2007-2013 it is recommended that, without prejudice to the requirements laid down in Regulation No 1191/69, public service delivery rules (set out before 2009 December 3rd) should also cover the points which are described in Regulation 1370/2007, within the scope in which they do not overlap with the elements set out in Regulation 1191/69.

Additionally the scope of the Guidelines is presented according to the entity engaged in public services delivery - budgetary establishments, municipal companies and external entrepreneurs, as the rules of entrusting public transport tasks vary with respect to type of the operator.

Taking into account the national administrative jurisprudence the assumption has been made that in case of the municipal companies the obligation of delivering services is imposed. The municipal company is established in the resolution adopted by municipal council (or by joining the existing company) and that act is the basis for the performance of a public utility task. Concluding a separate service contract in order to entrust this company with the task of meeting citizen needs e.g. for local public transport in the territory of the parent municipality is not required.

To provide for the best quality and adequacy of the Guidelines, during the works wide consultations on the content of the Guidelines has been performed. Additionally the ministerial working group for the purpose of elaborating guidelines has been established.

Amongst the consulted parties were:

- public administration (Ministry of Regional Development, Ministry of Infrastructure, Office of Competition and Consumer Protection);
- EU administration – DG TREN and DG REGIO representatives.

- Operators, Association of Public Transport Companies, municipalities.

5.4 Key features of the Guidelines

5.4.1 Budgetary establishments

A budgetary establishment is formed by the municipal council in a resolution in accordance with the Act on Public Finances. When forming a budgetary establishment, the municipal council adopts (also in a resolution) the articles of associations of the budgetary establishment which set out *inter alia* the objects and purpose for which the establishment was formed, as well as the assets of the establishment.

The public service obligation is imposed on a budgetary establishment by way of incorporating in its articles of association a provision defining the purpose and objects of the budgetary establishment. The decision that public services will be provided by a budgetary establishment is made based on an independent internal decision by the municipal council.

The public service obligation cannot be imposed on a budgetary establishment by executing a civil law contract between the municipality and the establishment.

The scope of the public service obligation imposed on a budgetary establishment is set out in detail in the by-laws adopted by the municipal council. Alternatively, the municipal council may impose on the Mayor of the municipality the obligation to set out in detail the scope of the public service obligation to be performed by the budgetary establishment.

A relevant internal act in law will specify in particular the scope of the public service obligation, its duration and territorial scope, transportation routes, transportation frequency parameters for every route, fares for each type of transport services on every route, including fare discounts for persons entitled to such discounts under relevant regulations, obligations of the budgetary establishment towards service recipients, and the rules of using public services provided by the establishment.

A budgetary establishment is not an 'internal operator' within the meaning of Regulation No 1370/2007 (since it is not a separate legal entity from the municipality).

5.4.2 Municipal companies

Municipal companies carry out business under the Code of Commercial Companies yet are primarily governed by the provisions of the Act on Municipal Economy. The municipality establishes a municipal company in a resolution adopted by the municipal council (or by joining an existing company). The tasks carried out by a municipal company are financed from the company's equity. The municipality must provide assets to the municipal company it established so that the company can carry out municipal tasks.

The public service obligation is entrusted to a municipal company in a municipal council resolution on establishing the company. The resolution must provide that the purpose of the company will be to carry out municipal tasks of meeting citizen needs for local public transport. The purpose of the company should be reflected in a detailed description of its objects.

The scope of the public service obligation entrusted to a municipal company is set out in detail in the by-laws adopted by the shareholders' meeting of the municipal company (in accordance with article 13 section 1 of the Act on Municipal Economy).

The municipality which established the municipal company (the "**parent municipality**") does not have to execute a separate contract with the municipal company in order to entrust this company with the task of meeting citizen needs for local public transport in the territory of this municipality – indeed under Polish law, the parent municipality may only entrust a public service obligation by way of a resolution, and not by executing a contract.

However, without prejudice to the by-laws adopted by the Shareholders' Meeting, the parent municipality may execute a contract (the "**executory contract**") with the municipal company it established, defining in detail the scope of the company's public service obligation (i.e. the obligation to perform municipal tasks). The contract may also provide for detailed rules of compensating the municipal company for the loss sustained in connection with providing public services. The contract cannot provide for separate imposition of the obligation to

perform municipal tasks (since this obligation arises at an earlier date, it is imposed on the company in a regulatory act when the municipal company is established and the purpose of its business is defined). The executory contract does not constitute a public services contract within the meaning of Regulation No 1191/69. However as the definition of public service contracts is much wider in Regulation No 1370/2007, the executory contract itself forms a part of it and therefore must meet the conditions concerning public sector contracts, set out therein.

A tendering procedure is not required to select a municipal company to provide services in the parent municipality (this company provides services for the municipality in the performance of an obligation under a legal title other than a contract).

5.4.3 External entrepreneurs

A municipality may entrust the performance of municipal tasks to an entrepreneur being an individual, or a legal person or an organisational unit without legal personality (the “**external entrepreneur**”).

The tasks are entrusted based on a civil law contract executed according to general principles. A contract executed in order to perform tasks of ‘meeting citizen needs for local public transport’ takes the form of a public service contract within the meaning of community law and must meet the requirements specified for such contracts (respectively the provisions of Regulation Nos 1191/1969 or 1370/2007).

Without prejudice to the requirements laid down in Regulation No 1191/69, a public service contract concluded before 3 December 2009 should also cover the points described in Regulation No 1370/2007 as obligatory elements of such contracts within the scope in which they do not overlap.

The external entrepreneur to be awarded the public service contract is selected in accordance with the rules set out in the Public Procurement Law, in principle based on a tendering procedure (and other procedures in situations specified in the Public Procurement Law) in a tender organised after the municipal council adopts a resolution authorising the head of the municipality to hold a tender and execute a contract with the external entrepreneur for performing local public transport tasks.

5.4.4 Notification obligation and state aid

As regards an external entity selected by way of a tender based on objective and transparent criteria, if the fee due is calculated in accordance with the regulations (that is, the fee is established in a competitive manner via the tender process), the fee paid to the operator should comply with the common market principles and does not have to be notified to the European Commission¹⁸.

As regards an external entity selected in a way other than by tender based on objective and transparent criteria, even if the fee due is calculated in accordance with all the rules set out in Regulation Nos 1191/69 and 1370/2007, the fee paid to the operator will in most cases comply with the common market principles but has to be notified (until such time as Regulation No 1370/2007 comes into force) to the European Commission.

If the funds (compensation) provided to municipal companies under executory contracts are calculated in accordance with all the rules set out in Regulation Nos 1191/69 and 1370/2007 they are compatible with common market principles and they do not have to be notified. It should also be noted that the executory contract is not a public service contract within the meaning of Regulation 1191/69 (though it does form a part of it under the Regulation 1370/07) – the municipal company provides services under an obligation imposed on the municipal company by the owner, i.e. the parent municipality, in a regulatory act.

If the compensation or fee paid to the operator is in excess of the outcome from the application of the rules set in Regulation Nos 1191/69 or 1370/2007 (also if the compensation has not been proportionally reduced in connection with the rolling stock or infrastructure being provided), this does not imply that it is consistent with the common

¹⁸ In this case it should be assumed that all the criteria set in the judgment of the European Court of Justice in the Altmark case have been fulfilled.

market principles. Thus it is subject to the notification requirement. This rule also applies if a given operator – external entrepreneur or municipal company providing services outside the area of the parent municipality – was selected in a procedure other than public procurement (or possibly based on subjective or non-transparent criteria).

Depending on the method used to select an operator, support provided may or may not constitute state aid.

- (i) In the case of a municipal company, compensation provided by the municipality in most cases is state aid (a municipal company is in most cases not chosen through a tender – applying procurement rules depends on the scope of activities performed by the municipal company). This aid complies with the rules of the community market, if the calculation rules set out in the attachment to Regulation No 1370/2007 are observed and would not need to be notified.
- (ii) In the case of an external entity selected by way of a tender based on objective and transparent criteria, the compensation paid does not constitute state aid.
- (iii) As regards an external entity which was selected in a way other than by tender, the compensation paid to it constitutes state aid. This aid in most cases complies with community market rules, if the compensation is calculated according to the rules set out in Regulations Nos 1191/69 and 1370/2007 and it would need to be notified to European Commission until such time as Regulation 1370/2007 comes into force.

5.4.5 Issues concerning compensation and examples of its calculation.

Due to the ambiguities relating to the manner of calculating compensation pay, as laid down in Regulation No 1191/69, calculation of compensation (remuneration) pay before 3 December 2009 should be made according to the rules set out in Regulation No 1370/2007 (which are considered as adding precision to the rules specified in Regulation No 1191/69) and the recommendations presented below.

Compensation rules do not apply to budgetary establishments.

The costs of providing public services will cover various categories and kinds of costs, depending on the type of activity (buses, metro, trams). In each case, relevant explanations for the included cost items should be provided.

The calculation of costs of services under a public services contract should account for all costs in connection with these services, both fixed and variable costs, including *inter alia*:

- (i) all the costs related to transport operating activities (including depreciation costs) calculated in accordance with accountancy rules;
- (ii) costs related to the use and maintenance of the necessary technical infrastructure if they are incurred by the operator;
- (iii) financing costs in direct connection with the provision of services (including cost of financing investment purchases for the purpose of the provision of services)
- (iv) the income tax, since the anticipated profit used to calculate the return on equity is calculated based on profit after taxation.

The operator's costs which are customarily connected with passenger transport services yet have not been specified directly in the public service contract, such as for instance ticket control costs, bus/tram/train stop maintenance, if the operator incurs such costs, should be reasonably allocated to calculate compensation as the operator's normal costs.

Costs of additional services that are not connected with public services (such as tourist services, employee transport at the request of industrial plants, services provided to sports clubs, etc.) should not be included in the calculation unless they are required under separate provisions of law or are specified in documents regulating the rules of providing public services.

Revenue from the provision of additional services should, by the same rules, also be excluded from the calculation of compensation.

Costs and revenue must be calculated in accordance with the accounting and tax rules in force.

It is recommended that the rate of return on the capital invested by the operator be reviewed based on analysis of cash flows to the owners of the operator company over the whole period covered by the public service contract. The operator's profit may be reviewed based on the calculation of cash flow to and from the owner of the operator company in connection with the public service business, taking into account the invested capital and the investment value (of the part of operations covered by the public service contract) after termination of the public service contract. Such calculation should be carried out on a regular basis based on the operator's up-dated financial figures in order to review the level of the operator's profit throughout the term of the public service contract. This interpretation will permit eliminating effects of any discrepancies between bookkeeping records and the actual cash flows of the company. In order to arrive at initial financial forecasts for the need of concluding a public service contract, the net financial profit earned in each financial year may serve as a good approximation of the level of profit on equity.

The recommended rate of return on equity for transport ventures is up to 6% (six percent) in real terms. This level was recommended given that municipal public transport companies fall between heavily regulated public utility enterprises (which typically carry a lower return) and private utility enterprises performing municipal services (which would typically carry a significantly higher return).

The method of calculating compensation pay may be used for verifying the validity of granting assistance from EU funds. The calculation should demonstrate that the operator will not be overcompensated as a consequence of granting EU assistance (e.g. in case a service contract has already been concluded). In the case when granting a maximum amount of assistance would result in possible occurrence of overcompensation, the value of assistance from EU funds should be reduced by the real value of overcompensation which would occur over the whole period covered by the contract. Alternatively (where it is feasible and justified), the compensation paid to the operator can be reduced to the allowable level.

The amount of compensation is usually reviewed annually by the authority contracting the services based on the financial figures for the previous year. The rules for compensation payments should account for (a) making adjustments to payments at the end of a given year for overcompensation (and crediting overcompensation, if any, against the compensation for services provided in the next period); and (b) entrusting penalties if the operator failed to provide the required standard of services.

Public service contracts should promote enhanced effectiveness of transport management by the operator. Any mechanisms promoting enhanced effectiveness should be clearly defined and explained in the public service contract.

The Guidelines provide for the examples of calculating the compensation depending on different organisational structure of the project (ownership of the infrastructure and sources of financing). Relevant financial examples are included in Appendix B to this Report.

5.5 Limitations

Bearing in mind the scope of the Guidelines and their purpose it must be said that there are certain limitations and there might appear certain difficulties with regard to their implementation.

The first limitation is the status of the Guidelines. Even though they are issued on the basis of the Act on Regional Development Principles by the Minister of Regional Development, they are not an act of law and as a result do not have a binding character. However, taking into account the fact that the Guidelines are to be applied to projects co-financed from EU funds and that Minister of Regional Development is either the Managing or Co-ordinating institution in this aspect, it may be stated that the framework rules are going to be respected.

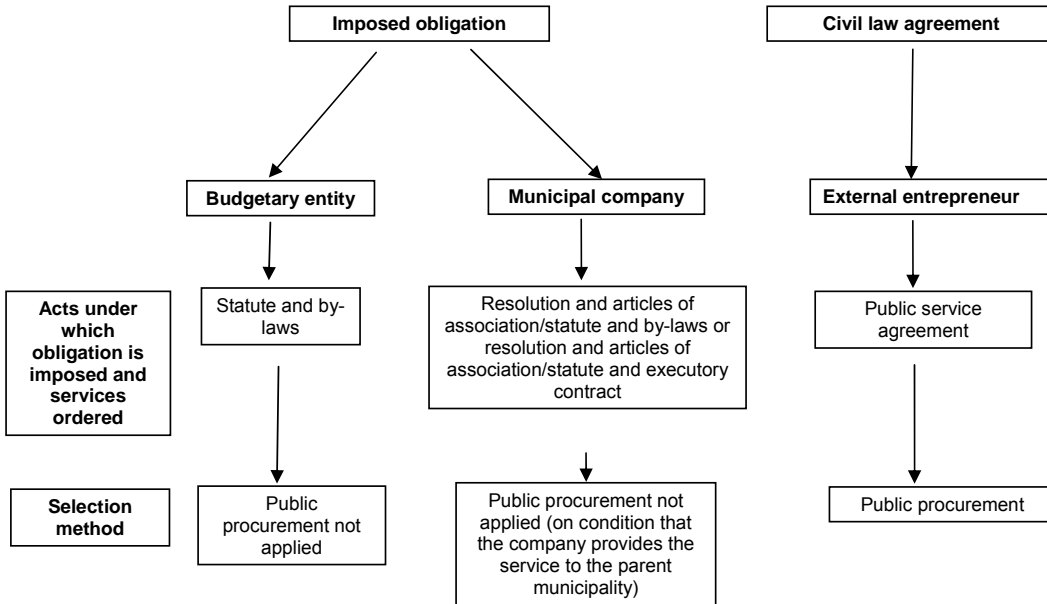
Furthermore, it has to be stressed that the Guidelines have a general character and provide for basic rules concerning public service delivery within urban transportation. It is impossible on this level to provide detailed solutions for all cases as there are wide ranges of legal and

economic relations with different levels of complexity that may occur. In this respect the Guidelines provide room for their interpretation within the framework of a specific project.

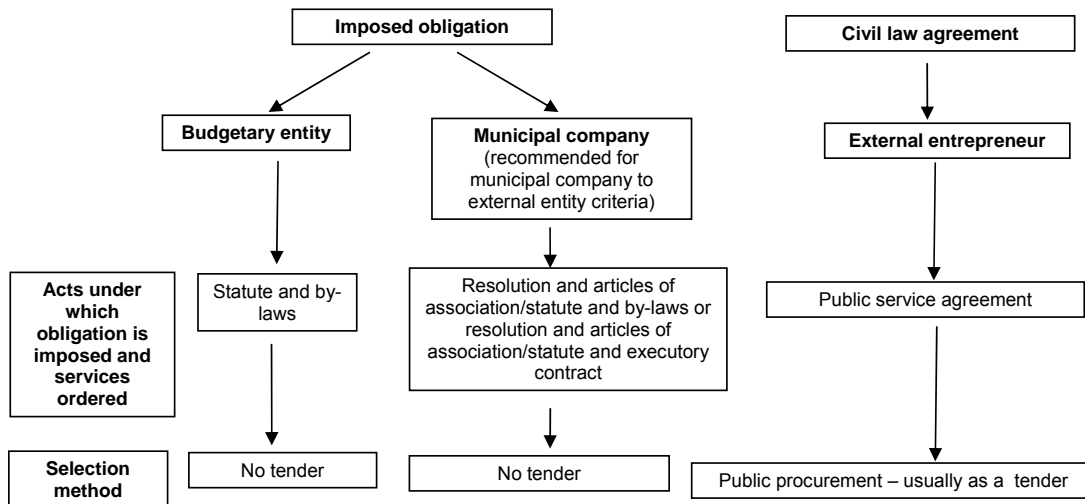
Finally it should be noted that the railway sector is excluded from the scope of the Guidelines though there are some potential projects within the operational programmes that could be realised according to the methods foreseen in the Regulation Nos 1191/69 and 1370/2007. From a practical point of view it is recommended to provide for unity of the rules concerning public transport services delivery irrespective of the kind of transport (urban or rail), however with recognition of the characteristic features of each type of transport.

To conclude, taking into account the issues described in this report as well as the Polish structure of organizing urban transport, the tables below present the information concerning the basis for entrusting the task and the way of entrusting it, with respect to the given category of the entity (operator).

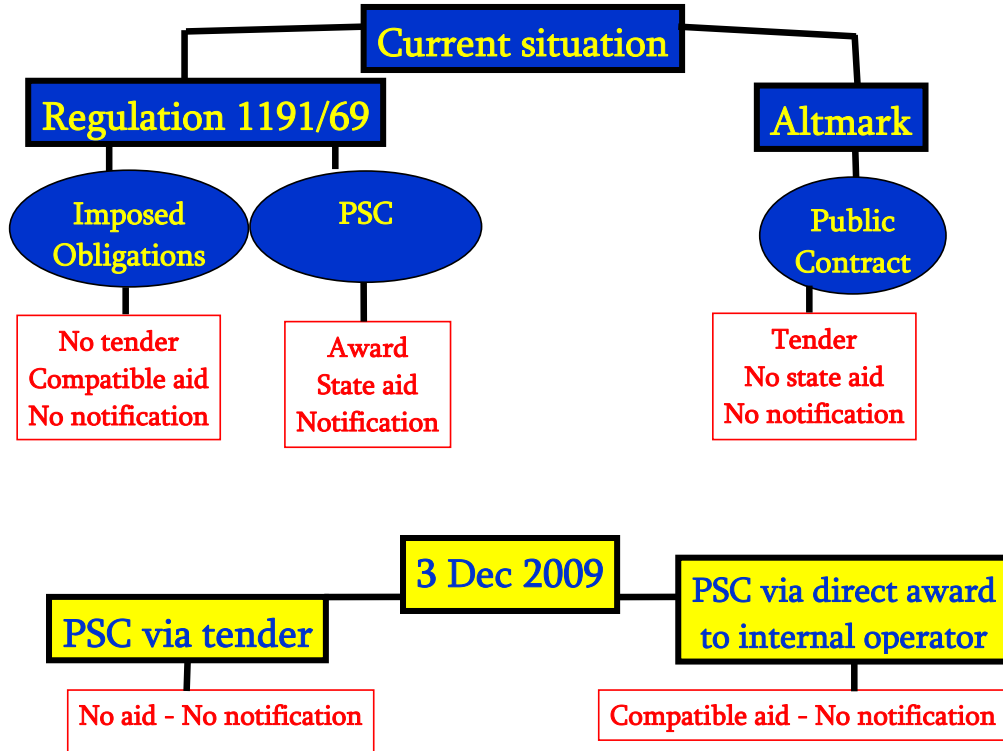
Regulation No 1191/69



Regulation No 1370/00



The diagram below illustrates the general approach to financing urban public transport services delivery, basing on the currently applied rules as well as the rules that will come in force after 3rd December 2009. It presents the possible ways of entrusting the tasks, and respectively the status of the granted support (state aid/no state aid) as well as the necessity of the notification procedure. The detailed provisions of granting support concerning each of the below mentioned ways has been described in the report.



6 Example Public Transport projects

The Consultant was asked to examine the application of a suitable state aid approach for two projects included in the JASPERS Action Plan for Poland:

- Krakow Urban Transport – Phase 2 (anticipated for funding under the OP Infrastructure and Environment)
- Lublin Urban Transport (listed as an indicative major project under the OP for Eastern Poland).

The key features of these projects are indicated below. They illustrate two of the different structures which are analysed in the Guidelines.

6.1 Krakow

6.1.1 Key features of the project.

This is stage 2 of an integrated public transport project in the Krakow agglomeration.

Table 6.1: Krakow Urban transport project stage 2: key features

Project size	Euro 138 million
Use of proceeds	Tram track modernisation/extension, tram depot refurbishment, road extension, purchase of tram rolling stock
Proposed beneficiary	Public Transport Company (though a legal agreement would be signed with the City, which would retain ownership of the infrastructure)
Existing relationship between City and Operator	City is the owner of the Public Transport Company (the “ Operator ”) via a 100% municipally owned holding company Commercially-oriented Public Service Contract (“ PSC ”) in place, 14 years for tram, 8 years for bus (awarded through direct award on basis of approval by Polish procurement authorities). PSC provides for long-term public service compensation via agreed vehicle km price with mechanisms for indexation.
Other features	Project is second stage of a European Regional Development Funds project approved in 2005 with same structure (but at that time “existing aid” provisions in public transport were applied). City created a public transport authority (a separate City department) to regulate the PSC City owns existing infrastructure; Operator owns the rolling stock (bus, tram) MPK operates the tram system exclusively via the PSC. MPK operates most of the bus network but the City plans to gradually open up bus transport to competition through tendering for private operators for a part of the network, applying a PSC similar to the one which MPK has signed with the City.
Project approach for handling state aid	Revise the existing PSC in accordance with the Guidelines, in order to bring it into line with the new Regulation 1370 and to confirm that there would be no need to notify the proposed grant.

6.2 Lublin

6.2.1 Key features of the project

Table 6.2: Lublin Urban transport project: key features

Project size	Euro 90 million
Use of proceeds	Trolleybus infrastructure modernisation/extension, new trolleybus depot, new bus station, upgrade of bus depot, purchase of new CNG buses and trolleybuses, integrated traffic control system
Proposed beneficiary	City
Existing relationship between City and Operator	City is 100% shareholder Relationship managed via company charter City provides an end-of-year subsidy to cover losses
Other features	City owns existing infrastructure; operator owns rolling stock (bus, trolleybus)
Project approach for handling state aid	City/MPK considering development of a public service contract for the new project to address state aid issues and ensure long-term financial sustainability City considering restructuring programme for MPK possibly as a part of the project City considering to establish a Public Transport Authority to improve urban public transport planning and regulation.


Appendix A

**The Guidelines
(issue 1 : March 2008)**

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A1 The Guidelines (issue 1 : March 2008)

Appendix B

Financial Examples

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B1 Financial Examples