



**– Statement on Direct Awards for Rail Passenger Transport Services-  
(September 2012)**

**In brief**

**Background situation in Germany**

- A so-called **wave of awarding** in the years 2011 to 2015 as over 50 % of operating services in the suburban and regional heavy rail market in Germany (without metro/tram/light rail) will have to be re-awarded in this period.
- A noticeable **decrease in the number** of interested bidders and – as a consequence – in the number of offers submitted in formal awarding procedures.
- **Suspension of procedures** is already taking place as the offers submitted were or are not acceptable.
- A **trend towards concentration** is noticeable; declining participation by smaller enterprises.

The above developments threaten to intensify the wave of awarding. Essentially, the root of this wave lies in the as yet inadequately balanced scheduling of deadlines and lack of harmonisation, especially in the case of contract durations, and of awarding activities in general.

**The means of maintaining operating efficiency and variety in the provider structure**

VDV considers public tendering as an important instrument for the awarding of suburban/regional heavy rail passenger services covered by public service contracts.

Public tendering as single option will however prove impossible to respond effectively to the above developments. Public transport authorities (PTA) should therefore have the complementary option of **direct awarding** of suburban/regional passenger rail contracts. This option should be restricted to exceptional cases in which direct awarding offers macroeconomic benefits and promotes the medium-term development of a competitive market.

As direct awards may, to a certain extent, be flexibly structured and conducted, their implementation can be strategically focussed on targets such as the following:

- achieving harmonised, coordinated timing and
- avoiding generally complex procedures in cases for which competitive alternative offers are not to be expected for economic reasons.

**Conceptual development**

In order to promote a PTA-regulated market geared to competition and irrespective of the type of procedure selected (formal procedure, direct award of contract), **transparent, comprehensible rules of play** should be agreed upon. In this way the discretion of a PTA can be restricted to certain factors and, as such, concerns about the practical possibilities of malpractice can be taken into account.

**Objectives of the rail-operating member companies in the VDV Association**

- Ensuring the mid- and long-term efficiency as well as attractiveness of regional passenger rail services at all decisive levels.
- Maintaining a varied provider structure and range of options for PTAs.

The essential first step must be to **harmonise and coordinate awarding activities** so that participation in procedures will also be possible from an economic standpoint (particularly as regards the use of resources when creating an offer).

The second step should be to appropriately split tasks between operator and PTA (the key factors being: responsibilities, scope for action and the actual duties to be performed by each party). In principle, this split remains independent of the type of procedure and will not be covered in this paper.

## Preliminary observations

With regard to the “large“ public-transport contracts concluded between the German regional states/PTAs and the DB Group, direct awarding of contracts is generally viewed as an instrument with which the respective market leader can close off the market.

In a PTA-regulated market for regional passenger rail services so strongly marked by conflicting political interests, many PTAs are shying away from confrontation and instead choosing to award contracts on the basis of procurement law, an option which they assume is virtually non-contestable. However, they thus forego major advantages which, in certain cases, an award beyond the confines of formal procurement law can provide.

In recent years, VDV has expressly advocated greater freedom for PTAs to select between direct awarding of a contract and formal procedures on the basis of procurement law. The rail-operating companies organised within the VDV Association are of the opinion that, in the absence of an alternative to formal procedures, the common goal of sustainable market development will not be possible.

Whether existing side-by-side or interlinked, the various options of awarding contracts can only result in macroeconomic benefits, however, if the market partners agree on certain rules-of-play:

- Direct awards are neutral. Their purpose is not to maintain the dominance of individual operating companies or groups of companies.
- Direct awards for regional passenger rail services are exceptions for use in situations in which such awarding will lead to macroeconomic benefits and promote medium-term development of a competitive market. As a rule, a formal procedure should always take preference.
- Direct awards are a form of awarding, not a response to the need for appropriate structuring or further development of content.

Direct awarding does not stand in opposition to competitive structuring of the market. In the end effect, it will always be possible to tender out the respective contract.

## Challenges

The entire regional passenger rail sector currently faces an especially high level of challenges:

- a “wave of awarding” resulting from the numerous procedures or service contracts to be awarded in the years 2011 to 2015,
- a declining number of service providers active in the market and/or as bidders in procedures,
- the financing of substantial investments, primarily for acquisitions of rolling stock,
- high demand-peaks which also impact the rolling stock manufacturers and
- insufficient incentives, in certain cases, to encourage investment, a consequence of the disparity between contract duration and the operational life of a vehicle.

### 1. Wave of awarding

Current contractual relationships are compelling the public sector to re-award contracts up until 2015 for more than half of regional passenger rail services. Assuming that these approx. 320 million train kilometres were to be awarded in lots of between three and five million train kilometres<sup>1</sup>, a range which, as a rule, is regarded by VDV as beneficial to medium-sized companies, the PTAs and rail operators would, in pure mathematical terms, have to process between 60 and 100 procedures within a short period of time. Even a balanced mix of small, medium and large lots would not greatly

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<sup>1</sup> cf. VDV “Empfehlungen für die weitere Gestaltung des ÖPNV-Marktes” (Recommendations for further structuring of the regional passenger rail market), a joint discussion paper published by regional rail passenger operators and PTAs organized within VDV, Cologne 2009, available online at [www.vdv.de](http://www.vdv.de) (in German only).

alleviate the problem. Without significant levelling-out of current conditions in the awarding sector, this problem would theoretically arise every ten to fifteen years, the usual length of a contract period.

In order to create an awarding environment of lasting interest to rail operators – in other words “competitively fit” – it is necessary to distribute procedures and volume as evenly as possible over the course of time.

## **2. Number of service providers**

Recent years have already revealed that comparatively few companies and/or groups of companies have been participating in the individual procedures. In certain cases, no more than two acceptable bids have been submitted to the PTAs.

In the long term, very few companies will be able to provide the resources necessary for the creation of qualified offers during peak awarding periods. If these conditions remain unchanged, it is therefore likely that rail operators will concentrate on those procedures which, from their perspective, are considered essential. Not only the operators, but also the PTAs are in fact competing against each other in such cases (“PTA competition”).

Aside from the DB Group, approx. 60 rail companies are actively involved in the current operating programme in the German suburban and regional rail market. Approx. 40 companies co-operate as groups or joint ventures; 15 companies and/or groups each currently perform operating services amounting to more than 2 million train kilometres annually. The smaller rail operators or municipal public transport companies that submitted bids at a relatively frequent rate during the initial phase of the PTA-regulated market have participated in very few recent procedures. Intensification of these developments is likely unless the problems caused by the wave of awarding are adequately solved.

## **3. Investments**

Experience gained during the economic and financial crisis has revealed the importance of options and conditions for funding in a capital-intensive market such as regional passenger rail. In addition to the above-mentioned restrictions, the possibilities of obtaining the necessary level of investment are a further crucial factor on the basis of which the commitment of the rail operators either stands or falls. The procurement of rolling stock is a key “investment driver” as between EUR 2.5 and 4.5 million must typically be calculated per regional-rail vehicle.

Assuming an investment volume of approx. EUR 25 per train kilometre, an amount of between EUR 75 million and 125 million would already have to be financed in the case of smaller lots of three to five million train kilometres.

In all, the required level of investment over the next five years totals over EUR 8 billion.

## **4. Supplier industry**

The wave of awarding will also pose additional challenges for the rail-vehicle manufacturers, namely the four system vendors active in the German regional passenger rail market. For a receipt of enquiries or calls-for-tender from interested rail operators, these manufacturers, for their part, must prepare offers within a relatively short time frame. The more procedures that are conducted (almost) in parallel, the greater the corresponding strain on resources in the rail-vehicle manufacturing industry. In extreme cases, insufficient scope is available for service and support to the “small” customers.

On receipt of an order – and in exact reflection of the situation caused by the wave of awarding in the regional passenger rail sector – a large number of vehicles must be manufactured and accepted in parallel. It is therefore imperative to accurately assess the time frame required between the placing of an order up until the operational start-up. Depending on the mode of procurement

selected, and with the inclusion of the approval process, manufacturers meanwhile assume that a time span of between 36 and 44 months will be required.

## 5. Incentive effects

Transport contracts in the regional passenger rail sector are generally concluded for periods of between ten and fifteen years. In exceptional cases, longer durations are also possible.

If investment is required during a contract period, critical assessment from the business standpoint focusses strongly on whether the period of use of a vehicle will exceed expiry of a contract and whether or not alternative use is excluded.

If an option for the rail operator, contract extension can thus serve as an effective instrument in arousing the necessary commercial interest. The signal consequently given to staff, the “supporting pillar” of any service company, should also not be underestimated.

### Proposed solution: Direct awarding with sound judgement

As organiser of the market, the public sector must establish suitable framework conditions and thus assume responsibility for ensuring varied and well-balanced opportunities for development. The manner in which the PTAs decide to award contracts at present is the basis for the future structure and attractiveness of regional passenger rail services.

Although not a miracle cure, direct awarding is a suitable instrument to minimize incorrect development and create a secure, sustainable foundation for the PTA-regulated market.

Ultimately, the answer to the following question is decisive:

**In which cases does direct awarding transcend the short-term perspective and provide a better result in macroeconomic terms than formal procurement by tender and thus promote the medium-term development of a competitive market?**

As a rule, direct awarding should be admissible if:

- economically sound offers from third parties are unlikely to happen,
- the operational program is unknown and/or uncertain,
- Competition is to be initiated or sustained.

This list is not definitive. Other cases are in fact conceivable; it is important, however, to ensure that similarly positive results in macroeconomic terms will be obtained as in the defining examples described below in greater detail.

#### **Case group 1: Economically sound offers from third parties are unlikely to happen**

Direct awarding makes the complexity of conducting a formal procedure unnecessary in cases when the likelihood of economically sound offers from third parties is not generally assumed.

##### **Example 1a)**

In order to harmonise contracts in its sphere of influence, the PTA awards (follow-up) contracts for a comparatively short period, e.g. up to five years. As a rule, such contracts are only feasible for the incumbent rail operator on account of the relatively high start-up costs.

##### **Example 1b)**

Aside from demand-intensive cases, the PTA can only award operating services for a comparatively short period on account of an uncertain medium-term budgetary situation. As in Example 1a), this option is generally restricted to the incumbent operator.

##### **Example 1c)**

The PTA awards operating services with the intention of complementing an existing service offer, e.g. by re-activating disused branch lines. This makes sense economically for companies which are able to integrate new services into existing schedules and, as a rule, are already providing the “main offer”.

**Example 1d)**

Public transport contracts which concern railways that differ from standard construction or those offering other technical / operational particularities can be directly awarded or awarded within a negotiated procedure without request for information while respecting the general requirements of transparency and non-discrimination. This applies in particular to transport services with vehicles differing from standard gauge or transport services in networks using systems differing from regular technical systems.

**Case group 2: Unknown and/or uncertain operating programmes**

Formal procedures, particularly the frequently demanded public calls-for-tender, virtually preclude the opportunity of conducting negotiations during a procedure. An iterative process to ensure closer conformity with the optimal operating programme or an acceptable distribution of risk is therefore not possible, or only in an extremely restricted manner. The more strongly the future transport service offer deviates from the status quo, the more uncertainties will arise as to the formulation of a legally binding list of specifications and acceptable basis for calculation.

**Example 2:**

The PTA would like to award operating services which, as yet, have not been performed in the foreseen manner, e.g. commissioning of new S-Bahn rapid-transit rail systems or services for which the extent and quality of the available infrastructure is uncertain. The less empirical data that is at hand or, alternatively, can be transferred to the new transport services, the greater the risk that the conclusion of a formal procedure will be endangered by “false” description of services both in economic and/or legal terms.

**Case group 3: Initiation of a competitive environment**

Under public procurement law, business opportunities for smaller or medium-sized companies are promoted by appropriate creation of lots (“Mittelstandschutz”, the protection of medium-sized enterprises). In markets without a dominant rail operator, this provides adequate potential for varied development. In deregulated markets with a dominant operator, direct awarding can be strategically implemented so as to initiate or safeguard a competitive environment.

**Example 3:**

With future competitive tendering in mind, the PTA would, as an alternative to the obligation of relying exclusively on an operator with at least regional dominance, instead prefer to promote the establishment of further efficient companies.

**Case group 4: Maintaining dual-system rail networks/services (e.g. tram-train)**

In case of dual-system rail services (following two different technical rail systems and legal frameworks: in Germany EBO and BOStrab, e.g. tram-train), the connection of the network is very important in economical terms as well as in the interest of passengers. Such networks are typically operated with the same rolling stock equipped for two different technical systems. The risk of separation of an “urban rail” part/contract and a “regional heavy rail” part/contract with two different award regimes should therefore be avoided.

## Facts and figures on regional passenger rail services (situation in 2011)

Public Transport Authorities	currently 27
Rail operating companies	apart from the DB Group approx. 60, of which approx. 30 in the 6 larger company groups
Companies/Groups of companies providing at least 2 million train kilometres annually (in alphabetical order; each incl. participations)	<ul style="list-style-type: none"> <li>Abellio GmbH</li> <li>AKN Eisenbahn AG</li> <li>Netinera Deutschland GmbH (former services of Arriva Deutschland GmbH)</li> <li>* Albtal-Verkehrs-Gesellschaft mbH</li> <li>BeNEX GmbH</li> <li>Erfurter Bahn GmbH</li> <li>Hessische Landesbahn GmbH</li> <li>Hzl Hohenzollerische Landesbahn AG</li> <li>Keolis Deutschland GmbH &amp; Co. KG</li> <li>* Rhein-Neckar-Verkehr GmbH</li> <li>SBB GmbH</li> <li>SWEG Südwestdeutsche Verkehrs-AG</li> <li>trans regio Deutsche Regionalbahn GmbH</li> <li>Veolia Verkehr GmbH</li> <li>VIAS GmbH</li> </ul>
Operating performance	approx. 630 million train kilometres annually
Contract periods	10 to 15 years (standard)
Size of lots	2 – 5 million train kilometres (standard)
Total vehicle fleet	> 10,000 multiple units (incl. locomotives)
Length of lines	> 180,000 kilometres
Demand	approx. 2 billion trips annually
Length of journeys	approx. 22 kilometres per trip
New awards 2011-2015	approx. 320 million train kilometres
Investment need 2011-2015	> 8 billion €
Investment per lot	approx. 75 – 125 million € for lots of between 3-5 million train kilometres

Verband Deutscher Verkehrsunternehmen (VDV) is the sector association in Germany for public transport and railway transport. VDV has some 600 members in Germany, but also in neighbouring EU countries. Some 200 members are active in the area of rail passenger and/or rail freight transport.

\* Similar to light-rail operations / Dual-system operations

Sources: Sources: BeNEX, DB AG, VDV