



STRICTLY CONFIDENTIAL

**Opening passenger rail traffic to competition in Finland – discussion
regarding a policy proposal prepared by the Ministry of Transport and
Communications of the Republic of Finland**

November 2016



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Background considerations

Part of the background of the reform is the ambitions contained in EU's 4th railway package, which actually coincide handsomely with the ambitions of the Finnish ministry responsible for transport. In short, there are the following concerns:

- The modal share of rail has remained modest, despite previous efforts to establish an internal market and to improve rail efficiency;
- Low efficiency and quality of some rail services, mainly the result of low competition, remaining market distortions and suboptimal structures;
- Inability to curb operational inefficiencies caused by a lack of appropriate competitive incentives;
- Necessary to tackle the remaining barriers to a Single European Railway Area

The targets related to addressing such concerns are in summary:

- Increase rail's capacity, efficiency and attractiveness for customers
- Encourage modal split from road and air;
- Complete the market openings already in place.

The key areas to address are:

- Infrastructure governance;
- Opening of the market for domestic passenger transport services by rail;
- Interoperability and safety;
- The social dimension

The second key area above is the relevant one for the purposes of the current policy proposal:

- Domestic passenger rail services to be opened up to new entrants and services from December 2019;
- Open for competition IN the market by offering competing commercial services (open access);
- Bidding for public service contracts – competition FOR the market – to become subject to mandatory tendering;
- Regional/local contracting authorities to establish public transport plans;
- Non-discriminatory access to integrated ticketing systems;
- Non-discriminatory access to suitable rolling stock – obligation to contracting authorities to take the financial risk of the residual value of rolling stock.

The key observation is thus that **unless competition IN the market is possible, EU's 4th Railway Package requires mandatory tendering based on non-discriminatory access** to rolling stock and mandatory ticketing systems. This important conclusion is based on the concerns listed first, in



particular the observation – which should be non-controversial – that a monopolist is highly unlikely to be able to address the overall concerns.

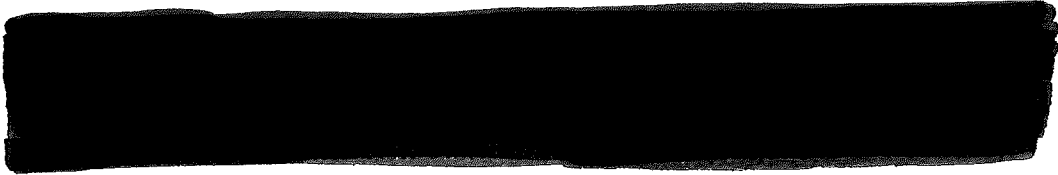
The question whether competition IN the market (open access) is possible was addressed in the previous review of the draft policy proposal, with the conclusion that open access passenger traffic is not a credible option. The main reasons were:

- The potential route for open access (Helsinki – Turku) has insufficient passenger volumes for open access, and would not have a viable scale in terms of rolling stock;
- No other origin/destination pairs have the characteristics necessary to attract new market entrants to establish an open access passenger service.

The current policy proposal is fully based on public service contracts (“PSC”), which is **fully supported**. (Concession agreements are regarded as a form of PSCs.)

Overall view of the policy proposal

The policy proposal embraces the general approach in EU’s 4th Railway Package, and the introduction of public service contracts based on competitive tendering comes with several consequences that dictate the design of other key elements of the policy proposal. The key concept is “non-discriminatory access”. This implies that competition among passenger rail operators should be based on a level playing field, and that no new market entrant should be dependent on any commercial relations with the incumbent operator – and hence also the worst competitor – VR.



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- A **rolling stock company** (“Rosco”) will be created, into which (at least) all rolling stock used for rail passenger traffic in Finland, other than the rolling stock used for the HSL commuter trains. This will secure non-discriminatory access to suitable rolling stock for all rail passenger operators. Given that there will be no open access passenger operations, there is no reason to split the relevant fleet up in more Roscos or let any rail passenger rolling stock remain in VR. The actual business model of Rosco is discussed in more detail below;
 - A **real estate** company will be created, into which all side infrastructure necessary for operations will be contributed. This will secure non-discriminatory access to all such side infrastructure for all operators. The core activity would be to manage, maintain and develop all such side infrastructure to support the attraction of the rail mode. In addition, such real estate company should have as one of its task to develop rail estate for other purposes that would strengthen the attraction of rail stations, such as various types of commercial developments, and to develop any real estate transferred to such company, but which is not needed in order to support rail operations, for other purposes. Inspiration examples for such tasks may be Jernhusen AB in Sweden and Grandi Stazione Rail SpA in Italy.
 - A **maintenance company** will be created, with the purpose of securing that maintenance services regarding rolling stock be available to all parties on a non-discriminatory basis.



All of the above measures in principle support the overall policy and are thus **fully supported**.

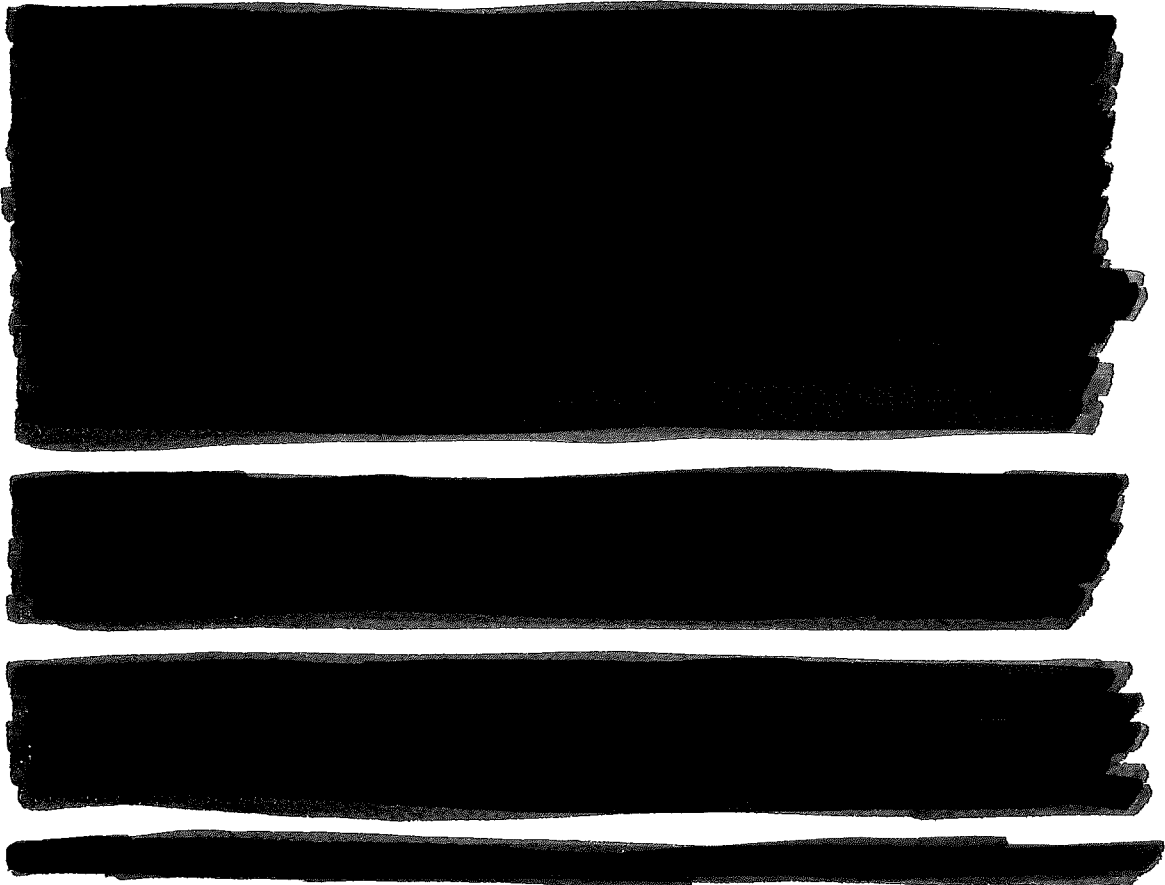
Additional considerations related to the policy proposal

It is mentioned as an observation that it is uncertain to which extent that timetable planning is done in VR. In line with the overall policy, it is argued here that allocation of time slots should also be made on a non-discriminatory basis, in order to ensure equal treatment of all parties. A competitive situation regarding timetable slots may come into play in situations like the following:

- Time slot allocations on routes where more than one PSC operator is active, 

- Time slot allocations on routes where any passenger train compete with freight services, which may occur all over the national network
- Time slot allocations where more than one rail freight operator is active, which also may occur all over the national network.

It thus seems clear that any functions regarding time slot allocations must be made by an authority being **independent from all operators**, including VR and VR Transport.

Attractiveness of the concession agreements from a business perspective



[REDACTED]

[REDACTED]

Foreseen timetable for the introduction of PSC

The overall **timetable** for the process as a whole has been redesigned so that no two PSCs commence at the same time; this is in line with previous recommendations, and is thus **fully supported**.

[REDACTED]

It might be of interest compare the timeline with the very recently commenced deregulation process in Norway, which has many features in common with the policy proposal for Finland. The timeline for the first package (Sør (South)) is in summary as follows (T=Start of traffic):

- | | |
|-----------------------------|-------------------|
| - Prequalification in place | T minus 32 months |
| - Invitation To Tender | T minus 22 months |
| - Deadline for tenders | T minus 19 months |
| - Contract signing | T minus 16 months |

As a further example, the most recent contract for the "Tåg i Bergslagen" traffic package in Sweden (described in our previous report) was made 13 months before start of traffic (due in December 2016; outgoing operator Tågkompaniet (a subsidiary of NSB), incoming operator SJ).

[REDACTED]

[REDACTED]



- It would possibly be an advantage if the last month of negotiations could be transferred to the traffic preparation period;
- For subsequent processes, it would be desirable to move two months from the negotiation to the traffic preparation period;
- Further detailing of the timeline in terms of prequalification, requests for proposals ("RFP"), evaluation of proposals, negotiations and contract signing is necessary as soon as possible in order to secure a full coordination of all other work streams related to the process (such as the preparation of RFPs, including the information data book associated therewith);

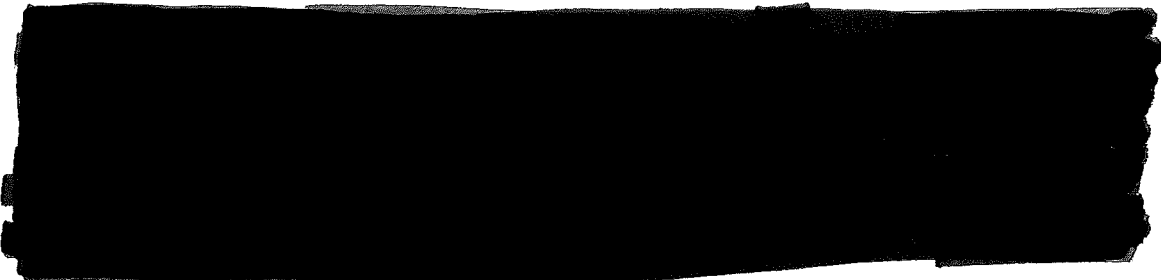


Rolling stock access and the function of Rosco

Given that all rail passenger services eventually will be performed under PSC, all passenger rail rolling stock will eventually have to be contributed to Rosco. The general principle in the policy proposal is thus **fully supported**.

Several observations should however be made:

The potential structural problem regarding VR's ownership stake in Pääkaupunkiseudun Junakalusto ("PJ") is no longer present, following a buyout of VR's interest. PJ will operate as a separate rolling stock company for the HSL traffic also going forward.





One or more rolling stock companies [REDACTED]

The chosen option calls for one rolling stock company to be established. [REDACTED] It is however extremely unlikely that any such alternatives will be attractive:

- There are only two rail transit authorities in Finland, of which one (PJ) will be responsible for a dedicated fleet of rolling stock only. This structure is unlikely to change in the foreseeable future.
- [REDACTED] Rosco should obviously stay in close contact with operators regarding the strategies regarding acquisition of new rolling stock and management of existing rolling stock, but such discussion would be focused primarily on means to increase the attractiveness of passenger rail in Finland as a whole.
- Again, Finland's unique gauge comes into play; no rolling stock synergies with the standard gauge area in Europe can be expected, and the technical standards used in the CIS/Baltic area are unlikely to be acceptable by the relevant Finnish authorities.
- Furthermore, it would be counterproductive to make Rosco a profit center; instead, the only feasible mode of operation is that Rosco would strive to have a net profit of about zero (like e.g. Transitio in Sweden), and thus basically serve as a tool for the sole public transit authority to make appropriate rolling stock available to operators.
- The main reason for having a zero net profit target is that in the event that a new part of the value chain like Rosco would add a RoI requirement, all operators bidding for a contract would have to require full compensation in their contract proposals. The benefit for the state from a profit in Rosco would thus be fully eliminated by a higher payment to operators and/or higher ticket prices, and the only effect would be that the rail mode would be weakened in comparison with other modes of transport. This would be totally contrary to the overall objectives with the policy and also the general objectives in EU's 4th Railway Package.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Also rail freight equipment in Rosco?


In the policy proposal, an option where also VR's freight rolling stock would be transferred to Rosco is advocated, although it is also stated that this would be a temporary solution and that no new rolling stock intended for freight would be acquired for Rosco.

[REDACTED]

[REDACTED]

[REDACTED]

In relation to the last point above, it would be valuable to consider how serious new market entrants in other countries have structured their rolling stock. Some examples:

- Hector Rail in Sweden has 46 electric locomotives, of which 21 are of modern standard types (Bombardier Traxx and Siemens Taurus);
 - LTE in Austria has 25 mainline locomotives (19 electric or hybrid and 6 diesel), all of which are modern. The fleet includes 9 Siemens Vectron, 5 Siemens Taurus and 1 Bombardier Traxx;
 - Crossrail in Switzerland has 37 mainline electric locomotives, of which 34 are modern (including 31 Bombardier Traxx);
 - RTC in Italy has 21 mainline locomotives, of which 17 are modern (including 5 Siemens Taurus and 4 Bombardier Traxx);
 - Inrail in Italy has 13 mainline locomotives (8 electric and 5 diesel), of which 12 modern (including 6 Siemens Taurus and 2 Siemens Vectron);
 - Lotos in Poland has 94 locomotives, of which 38 are modern (including 28 Bombardier Traxx, 5 Newag Dragon and 5 Newag Griffin);
 - Rheincargo in Germany – 90 locomotives in the fleet, with modern Bombardier Traxx being the backbone for all long distance services;
 - Furthermore, it can be noted than NR Rail in Finland intends to provide services with new locomotives.
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[REDACTED]

[REDACTED]

Summary of key concerns

- Time and activity schedule for the first PSC;
- Determination of the exact mechanism for the first PSC [REDACTED]
- Securing immediate access to all relevant traffic and rolling stock data for the relevant traffic packages [REDACTED]
- Creation of Rosco and the definition of Rosco's scope of services;
- Initiating processes to secure that VR will operate on the same terms as any other market participant.