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**REPORT**

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| From: | General Secretariat |
| To: | Permanent Representatives Committee (Part 1) |
| No. prev. doc.: | 113146/15 TRANS 333 CODEC 1360 |
| No. Cion doc.: | 5960/13 TRANS 35 CODEC 209<br>5985/13 TRANS 36 CODEC 216 |
| Subject: | 4th Railway Package:<br>• Proposal for a Directive of the European Parliament and of the Council amending Directive 2012/34/EU establishing a single European railway area, as regards the opening of the market for domestic passenger transport services by rail and the governance of the railway infrastructure.<br>- Preparation of an informal trilogue |

Delegations will find hereafter some revised Presidency compromise proposals with a view to the upcoming trilogue on 26 January 2016.

The Commission explanatory note requested by some delegations at Coreper is in annex.

The Presidency proposes to include the following changes:

Line 181 - Article 7(3) - (prohibition of double mandates) - Addition of the following indent:

"**- as members of the supervisory board of an undertaking which is part of a vertically integrated undertaking and which exercises control over a railway undertaking and an infrastructure manager and as members of the management board of that infrastructure manager**."

Line 184 - Article 7(4) - (performance-based remuneration)

"4. In vertically integrated undertakings, the members of the management board of the infrastructure manager and the persons in charge of taking decisions on the essential functions shall not receive any **performance-based remuneration** ~~financial benefits~~ from ~~railway undertakings~~ **any other legal entities within the vertically integrated undertaking** or bonuses principally related to the financial performance of particular railway undertakings. They can however be offered incentives related to the overall performance of the railway system."

Line 234 - Article 7d (a) - (payment of dividends)

"While respecting national procedures applicable in each Member State, income from infrastructure **network** management activities, including public funds, may be used by the infrastructure manager only to finance its own business, including the servicing of its loans~~,~~. **The infrastructure manager may also use such income** ~~and~~ to pay dividends to ~~the~~ owners of the company, which may include any private shareholders, **but excludes undertakings that are part of a vertically integrated undertaking exercising control over a railway undertaking and that infrastructure manager**."

Line 234 - possible text for a recital on earmarking

**["While decisions on national public expenditure, including the use of revenues generated under this Directive, are, in line with the principle of subsidiarity, a matter for Member States, dividend payments by the infrastructure manager could be earmarked to be used for investment in the rail infrastructure."]**

**ANNEX**

**EXPLANATORY NOTE FROM THE COMMISSION**

**Line 181 - DOUBLE MANDATES**

One of the main goals of the Governance proposal is to safeguard the impartiality of the infrastructure manager, in particular in vertically integrated structures, in a more detailed and stringent way than is the case under existing legislation. The cornerstone of the Council's General Approach on this issue is that none of the legal entities of a vertically integrated structure should be able to exercise decisive influence on the key decisions which are liable to give rise to discrimination vis-à-vis new entrants seeking to operate railway services on the network concerned.

In the Council's General Approach, a clear distinction is made between the infrastructure manager's impartiality, which is the core objective of the governance rules and should enjoy the highest level of protection, and its independence as a legal entity. By allowing vertically integrated structure to continue to exist, the General Approach accepts that the infrastructure manager's independence should be subject to certain limits imposed by the corporate structure within which it operates, and that the objective of impartiality can be achieved without imposing disproportionate limitations on the command and control structure of a vertically integrated undertaking.

The balance achieved in the General Approach is based on two sets of provisions:

- Article 7(a) is the core of the proposal. It aims to protect through stringent and detailed rules the essential functions of infrastructure management (path allocation and infrastructure charging), which are those most critical to enable non-discriminatory access of new entrants to the network.

- Article 7 lays down general provisions preventing any legal entities within an integrated undertaking from exercising undue influence on the infrastructure manager as a legal entity, not only through its corporate structure, but also through personal links, i.e. top-managers. Member States have in particular accepted the safeguard that managers who are members of the top decision-making bodies of a railway undertaking should not hold equivalent positions in the decision-making bodies of the infrastructure manager, or be in charge of taking decisions on the essential functions. These provisions are referred to as the prohibition of 'double mandates'.

Article 7(3) of the General Approach states:

"3. Member States shall ensure that the same individuals cannot be employed at the same time:

- as members of the management board of an infrastructure manager and of a railway undertaking,
- as persons in charge of taking decisions on the essential functions and as members of the management board of a railway undertaking;
- where a supervisory board exists, as members of the supervisory board of an infrastructure manager and of a railway undertaking."

The EP has proposed to extend this provision to members of the holding company, and the Presidency's compromise proposal tabled at the Coreper meeting of 20 January reads:

"- **as members of the management board and/or supervisory board of an undertaking exercising control over a railway undertaking and infrastructure manager (i.e. the holding company) and as members of the management board of an infrastructure manager."**

However, this would not allow any measure of corporate control by the holding company over its subsidiary in charge of infrastructure management, which was opposed by some delegations as disproportionate and impeding the normal functioning of a vertically integrated undertaking.

A possible way forward could consist in a prohibition of double mandates between the management board of the infrastructure manager and the supervisory board of the holding, based on the consideration that a supervisory board takes strategic decisions and therefore can impact more substantively on the independence of the infrastructure manager. The wording could look something like:

**"- as members of the supervisory board of an undertaking which is part of a vertically integrated undertaking and which exercises control over a railway undertaking and an infrastructure manager and as members of the management board of that infrastructure manager."**

This solution would not oblige any Member States to modify their current corporate set-up.

**LINE 184 - BONUSES**

As regards line 184 on bonuses, the provision should be interpreted as stating that only the infrastructure manager can offer bonuses to its own staff. The wording 'performance-based remuneration' is clearer than 'bonuses and financial benefits, because it makes it clear that generic benefits such as those arising from the holding of shares are not caught by this prohibition.

**LINE 234 -TRANSFER OF DIVIDENDS**

This note aims to provide clarifications on the rationale and scope of the provision of Article 7d(a) which is designed to prevent undue flows of income (including public funds) from infrastructure management activities to transport operations by prohibiting dividends from infrastructure management from being redistributed within the vertically-integrated undertaking by the holding.

This provision is based on the consideration that, given the sectoral provision on the financing of railway infrastructure (in particular the charging rules and the obligation for Member States to balance the accounts of the infrastructure manager), any distributable profits arising from the management of infrastructure are generally possible only thanks to the public funds injected into the system. If such distributable profits (the dividends) were allowed to stay with the holding and be transferred to a railway undertaking, there would be a distortive flow of public funds into such railway undertaking. Infringement proceedings are ongoing before the Court on this important issue.

However, this risk of cross-subsidisation exists only for activities financed through public funds, i.e. for activities related to the management of infrastructure. This expression should be interpreted in the restrictive sense of Annex I of the Recast Directive 2012/34, which defines specifically what constitutes infrastructure, and which includes, in a nutshell, the railway tracks, engineering structures such as bridges and tunnels, access ways and technical equipment.

Any other revenue-generating activities carried out by the infrastructure manager which do not involve items of infrastructure, such as business carried out in railway stations and not related to items of infrastructure or the management of service facilities listed in Annex II of the Recast are NOT caught by the prohibition of Article 7d(a).

This is already spelled out in Article 7(a), which reads:

"While respecting national procedures applicable in each Member State, income from infrastructure management activities including public funds may be used by the infrastructure manager only to finance its own business…."

As a consequence of this provision, income from infrastructure management, to the extent that it generates dividends, cannot stay with the holding but must be transferred upwards, to the ultimate owner of the company, which is typically the State, but may include private shareholders if the railway undertaking is partly in private hands (the possible future Italian situation). The notion of ultimate owners proved controversial and in the General Approach it was decided to remove the word 'ultimate' and insert a recital clarifying how this notion is to be interpreted for the purpose of this specific provision. A possible way forward could be to revert to the original wording, completed and clarified by the proposed recital.

As clarified by the Council Legal Service, there can be no doubt that, in holding structures, the holding is the owner of the infrastructure manager, although it is not the ultimate owner.

During the discussions in the Council working group it was also agreed to clarify that, while dividends (and again, only dividends from infrastructure management) cannot remain at the disposal of the holding, they can transit through it (see recital in line 53) provided they are transferred upwards and not redistributed within the undertaking.

As regards the earmarking of dividends from infrastructure management, the Presidency proposal for a recital on earmarking is a 'could' clause which does not place any obligation on Member States to reinvest dividends in infrastructure. In any event, to put things in perspective, under Article 31 of the Recast Directive there is already an obligation for the proceeds of infrastructure charges to be used only to fund the business of infrastructure managers. This is existing acquis.

Furthermore, considering the regulatory set-up of the railway sector, the management of publicly funded infrastructure is not designed to yield profits, although it should not be loss-making either. Therefore, the real impact of any provision on earmarking, even assuming that it were to be included in an article (which is not what the Presidency is proposing) would appear to be limited.

As a possible way forward, some recitals could be added to clarify the scope of these provisions and how they should be applied, reflecting the content of this note.