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Annual Report to the Parliament

Address by President

Andrea Camanzi

Chamber of Deputies

12 July 2017

Distinguished Guests, Ladies and Gentlemen,

I wish to thank the President of the Republic for granting us the privilege to present this address and the President of the Chamber of Deputies for hosting us today on the occasion of the presentation to the Parliament of the fourth annual Report of the Transport Regulation Authority.

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I present this address in a context of profound change in the transport sector.

The integration of economic systems and markets produces an increasing need for mobility of goods and people. Technological innovation is turning the sector into an industry of integrated services. Stricter is the constraint of economic and environmental sustainability.

The revolution of mobility

The degree of efficiency of mobility systems has become the key indicator of the development of a country and its infrastructures, as well as of its competitive capacity in global markets, including capital markets. These issues have been high on the agenda of the recent meeting of the Transport Ministers within the framework of the activities of the Italian G7 Presidency, too.

The development of the new mobility industry is associated with that of energy and digital technology. It should be not taken for granted that it will be the traditional players that will continue to direct its growth; indeed, new global operators, engaged in the collection and management of essential data for mobility services, have already entered the arena.

Both the World Bank and the EU reckon that, at present, mobility is the largest economic sector in terms of employment and

contribution to the gross domestic product and has the largest growth potential. Big 'technology unicorns' compete on traditional transport markets with innovative service models, either directly or through start-ups on which the stock market is betting.

We have already experienced something similar twenty years ago, at the time of the internet economy, when the capital market had rightly targeted digital technology.

From the viewpoint of independent regulation, what is happening with regard to mobility services recalls what has been already experienced in other areas which are sensitive to the evolution of digital technologies, such as energy and telecommunications.

A sweeping change

Given the scope of the change under way, it becomes necessary, for both the Authority and the other public institutions, to strengthen the supranational and international dimension of their activities. In the awareness of such change, the Authority is progressively increasing its participation in the relevant EU and international fora and I am going to take over the Chairmanship of IRG-Rail, the EU network of independent rail regulators, in 2018.

Many companies have already integrated a global vision into their development strategies and technological and competitive choices. Operations such as those announced for FSI group and Anas and for Atlantia and Abertis are moving in this direction. They are to be endorsed insofar as the markets remain open to new operators and they create opportunities for more advanced mobility services, which are made possible today also by the technological upgrading of infrastructures.

EU strategies

The European Union has captured these ongoing changes by promoting significant updates of the relevant regulations, which are undergoing extensive review (in particular, as for roads, road

transport and airports), or are the object of implementing acts (in particular, as it concerns the Fourth Package and both in the railway and local public transport areas).

The goal of creating a Single European Transport Area by 2020 has been partially revised. The focus on modal shift has been integrated by recognizing the centrality of mobility as a service in itself, based on digitalisation, sharing and sustainability. *A competitive and connected mobility for all* is the title of a recent Commission communication and the year 2018 is committed to multimodality.

In the above described scenario, the activity of the national regulatory body is part of the delicate exercise for balancing the benefits of competition against those of modal or intermodal integration and related economies of scale.

Even more apparent is the forward-looking vision of the national legislator that, already in 2011, provided in the transport sector for intrinsically multimodal functions to be entrusted with an independent economic regulator. We have tried to interpret this regulatory and institutional advantage by keeping a firm European outlook.

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While the Report contains the full description of the regulatory activities performed and the measures adopted, I would like to expand on a few examples related to four main issues underpinning the activity of the Authority.

ART's path

The first example concerns competition and how to ensure equitable and non-discriminatory access to infrastructures.

Equitable and non-discriminatory access to infrastructures

With reference to railway infrastructures and ancillary services, we have completed the verification of the charging system developed by the infrastructure manager (IM) in accordance with the measures adopted by the Authority.

As anticipated in last year's Report, these measures ensure the IM's independence and introduce a charging model based on the type of network. The model is designed so as to ensure the competitiveness of the services provided on an open access basis and the sustainability of those covered by public service obligations: these results would not have been achieved by modulating charges only on the basis of the added value of the services. This option would have led to reduced competition in the liberalised segments, which is contrary to the objectives underlying the Authority's mandate, that is actively pursued.

We have also adopted specific requirements for capacity allocation procedures - the well-known "scarce resource" - and for the associated system of fines and penalties in the event of failure to use allocated paths. These requirements have been included in the *Network Statement* which regulates, on an annual basis, the relations between infrastructure manager and railway undertakings.

More recently, we have conducted a survey on the innovative modes of rail transport operation, in particular in the high-speed segment, for the purpose of ensuring that new solutions - such as use of "double trainsets" or top speed increase - do not produce discriminatory effects on competing railway undertakings. Based on the findings of the survey, we have initiated a regulatory proceeding and taken supervisory action that is still in progress.

With reference to access to Corridors, which is also a fundamental issue in order to promote the logistical integration of rail freight transport, we carried on the activities involving the regulatory bodies of the countries concerned by the corridors crossing Italy. In particular, on the occasion of Croatia's entry into the Mediterranean Corridor, in our capacity as coordinator, we have promoted and concluded a new cooperation agreement among the regulatory bodies involved.

We regulated access to spaces in stations taking action upon the complaints from railway undertakings and, on our own initiative, access to marshalling services. In the latter case, as provided for by EU legislation, we have also regulated access to port service facilities.

With reference to port infrastructures, the legislative developments in the period covered by the Report deserve consideration. At the national level, the legislator introduced an important provision in Legislative Decree no. 169 of 4 August 2016 connecting the responsibilities of the Transport Regulatory Authority, as defined in the statutory law of 2011, with those of the newly established 'Port System Authorities'. For the purpose of enhancing this connection, we actively support the new governance system by deploying the tools of economic regulation.

At the EU level, the long-awaited Regulation has been adopted establishing a framework for the provision of port services and common rules on the financial transparency of ports. We trust that, in implementing the Regulation, the national legislator will consider the experience gained by the Authority in other areas where the determination of charging policies results from consultations between managing bodies and users: this is the case of airports where, in accordance with EU rules, should a dispute arise as the outcome of the provided-for consultation procedure, the settlement thereof is entrusted to the Authority as a third and independent body.

As regards regulatory activities, following the expected completion of the national and EU regulatory framework referred to above, the Authority has initiated, also on the basis of the complaints received from operators, a general regulatory proceeding in order to ensure equitable and non-discriminatory

access to port infrastructures, as well as individual procedures which are still in progress: in this respect we are receiving positive feedback and trust that the successful cooperation with Port System Authorities, the Ministry of Infrastructure and Transport and the National Anti-Corruption Authority (ANAC) will continue.

With reference to access to airports, the Authority has verified the compliance of all charging proposals received by airport managing bodies with its models adopted in 2014. We have also exercised our dispute settlement responsibilities in the cases where carriers have urged the Authority's intervention.

From the experience of the first three years of application of the models we have drawn evidence as to the dynamics of the demand-supply relationship of airport services and the interests involved, how the charges determination on the basis of a public consultation characterises the interaction between managing bodies and carriers in individual cases under consideration, and the importance of the independent supervisory functions in case of disputes.

Based on this evidence, in the context of the recent mid-term review of the models, the Authority has, *inter alia*, set for itself the objective of improving the effectiveness of the users' consultation procedure. Equally important was the adjustment of the net invested capital remuneration to market performance. As announced, the models shall be fully revised at the end of the current regulatory period.

With reference to motorways, which will be further discussed below, as provided for by the law establishing the Authority, we have developed a toll charging system and produced the relevant concession scheme in a practical case of award of a new concession.

In this context, regulation aimed at ensuring equitable and non-discriminatory access to motorway infrastructures involves taking action on the economic key features of the concession, such as subject and duration, risk allocation, quality targets, tariff dynamics, conditions for revision of economic and financial plans. Further, the measures developed by the Authority objectively identify minimum efficiency standards for those operators having an interest in competing for the management of the routes covered by the concession.

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The second topic refers to market contestability and public service obligations (PSOs). The description of a few relevant examples on this issue requires a brief preliminary remark.

Public service obligations
and market contestability

The markets of land transport services are subject to strong competitive dynamics. The expiration of existing service contracts in rail and road transport raises the interest of several operators, including new entrants. This is a recurring case in local public transport. Barriers to the market entry of more efficient competitors, even on one segment or niche only, must be avoided. The Fourth Railway Package provides a European regulatory framework for these developments.

Companies traditionally operating only in one mode of transport integrate diversification into their industrial strategies by showing interest in neighbouring markets. An example is the recent acquisition of Milan subway shares by FSI group.

Competitive dynamics are not limited to those between rail and road transport: they are also affected by the growing role of platforms providing technology mobility services.

New policy challenges arise; however, in the regulator's view, this represents an opportunity to re-evaluate market failures and

the resulting public intervention, taking advantage of new technologies, provided that markets remain open, users may benefit from the advantages of innovation and no new *de facto* monopolies are created.

Against this background, according to the methodology adopted by the Authority last April, the areas falling within the scope of PSOs and their financing are defined on the basis of the unexpressed demand for mobility. The latter enables us to identify types of services or ways to provide them which can be supplied under commercial conditions and do not require to be supported by public financial compensation. A relevant example is the case of scheduled transport services in a situation of "weak demand", which can be replaced by non-scheduled multiple-demand services or by using shared modes of transport and pooling.

The methodology applies to all modes and to both local and national transport. Its deployment may lead to a different sizing both of the services covered by public service obligations and of the contestable markets, opening up to new prospects for the provision of innovative and more efficient public services.

The definition of the area falling within the scope of PSOs is, in turn, functional to the award of service contracts in accordance with procedures that have been subject to the regulatory measures adopted by the Authority in 2015. Since then, the Authority has been regularly assisting the awarding bodies in the application of these measures and has been reporting cases of restriction of competition to the Competition Authority.

Further, where public service obligations are in place, the Authority is entrusted with identifying minimum quality standards in relation to territorial demand and supply characteristics: that is, the quality of transport services used by millions of "commuters" every day.

The methodology developed so far with regard to rail passenger transport identifies specific quality factors, procedures to calculate and monitor the relevant indicators by entities other than the contract managers, minimum quality standards to be covered in service contracts and general criteria for the imposition of penalties in case of non-compliance with the standards.

From the regulator's viewpoint, the data on the quality of the services provided must be public and the measure of quality corresponds to the time and cost of restoring full service functionality. Quality has therefore an economic value, too; however, it cannot be represented solely as an additional cost, since it is a direct expression of the company's operational efficiency.

With respect to non-scheduled local public transport, we still consider that the proposals included in the indications to the Government and the Parliament on taxi, car-and-driver hire and technology mobility services of June 2015 remain current; in this area, the Authority has adopted a number of opinions at the request of competent authorities.

The situation described above differs from the functioning of liberalised markets, as in the case of medium- and long-distance bus transport. In this respect, as a result of a survey, the Authority considered that any residual reference to the "public interest" or the "national interest" should be considered outdated by the present highly competitive market structure, as well as by the ways in which the service is used and the availability of platforms favouring the matching of demand and supply. We know these platforms, which are now operating all over Europe.

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The third topic is the protection of passenger rights: in this respect the functions already provided for by the law establishing the Authority are supplemented by EU regulations.

A significant outcome of the supervision exercised over the behaviour of companies, as it is shown in the Annual Report, is that it produces the desired deterrent effects. In the Authority's experience, most of the relevant proceedings are concluded with an admission of liability by the transport undertakings concerned. Also the contractual conditions provided by carriers increasingly include a number of arrangements on compensation and reimbursement for inconvenience suffered by passengers.

On the other hand, the first three years of application of the relevant EU legal framework and the fruitful dialogue with passenger representative associations point to the need for connecting and updating sectoral regulations. A typical example is the case of the deadlines for submitting complaints, which vary depending on the mode of transport. Quite contradictory of the overall regulatory system are the exceptions, particularly in bus transport, to the obligation of the carrier to ensure the transport of persons with reduced mobility.

Of particular significance is the EU Commission's initiative to introduce legislation providing for passenger protection throughout their travel experience and for all transport modes used. Similar issues are raised with respect to the introduction of through-ticketing and the related rules governing liabilities for poor service.

Having regard to the national rules implementing EU regulations, the Authority considers it useful to provide *ad hoc* indications as to the deficiencies resulting from the experience gained thus far.

Reference is made in particular to the failure to provide for appropriate measures to effectively ensure compliance with the

information obligations imposed on transport undertakings. Such deficiency is all the more remarkable insofar as the non-compliance with information obligations is the most frequently reported complaint.

Users' reports are, among other things, a significant source of information for the Authority to identify the minimum service quality standards, particularly with respect to PSO services .

In order to further facilitate our dialogue with passengers, we have set up an on-line tool for the submission of complaints which, in the short test period, received a positive feedback from passengers.

With regard to market-based services, the additional safeguards provided for with particular reference to the rights of passengers holding season tickets or travel cards for high-speed routes have produced results that the Authority will continue to monitor.

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The fourth topic is the efficiency of operation and the related cost containment for businesses, users and consumers. [The issue of efficiency](#)

This is a central issue for economic regulation. Achievable results depend partly on regulatory techniques and partly on the sizing of services, the supply structure and degree of concentration.

Indeed, the issue of efficiency impinges upon all the Authority's functions, either directly or indirectly, and applies to any field of its activity: airports, motorways, ports, railways, scheduled and non-scheduled local public transport and, last but not least, the mobility of goods and passengers.

With regard to access to rail infrastructure, the framework to ensure that the pursuit of efficiency complies with the economic equilibrium, of the IM is essentially enshrined in harmonised EU rules: directives and implementing acts. In this respect, the

Authority has developed its regulatory measures in accordance with these provisions, provided for accounting separation requirements and defined the relevant and efficient costs of the infrastructure manager including, for the first time, those related to the remuneration of the net invested capital through the method of the weighted average cost of capital. Having thus defined the eligible costs, the Authority identified the criteria for covering such costs on the basis of a multi-tier system for the determination of the charges payable by railway undertakings.

The same logical approach - that of the pursuit of efficiency - is applied in the Authority's recommendation that contractual agreements ('contratti di programma') with the IM include only investments that are subject to a cost-benefit analysis and an ex-ante evaluation in accordance with the relevant Guidelines issued by the Ministry of Infrastructure and Transport.

With reference to motorway infrastructures, too, the law identifies directly the framework to be applied for the purpose of pursuing efficiency. To this end, it sets out the parameters for defining the tariff system - five-year duration, application of the price-cap method and determination of X productivity indicator - and provides that the optimal management area of motorway sections be identified so as to promote "competition by comparison".

This method, known as yardstick competition, allows, *inter alia*, to estimate objectively the efficiency level that can be pursued by a company as compared to that of all other companies operating in the same sector. It further allows to measure the savings that could be obtained from a different level of concentration of the service supply and to monitor productivity developments in the sector as a whole.

In the implementation of these provisions, in addition to the definition of the concession scheme and tariff system in the case

referred to above, the Authority has defined the methodology to identify the optimal management area of motorway sections based on the stochastic efficiency frontier analysis.

Even where the law has not explicitly stated the principles for pursuing the management productive efficiency, it has provided for the horizontal nature of this purpose and for the objective, for the Authority, to apply methods that encourage competition or, depending on the market nature, allow the assessment of existing competition in any given segment.

In order to fulfil this function, the Authority has applied the competition-by-comparison methodology also to other areas falling within its remit. This method receives increasing attention in the economic literature and has been used in Italy for other regulated industries.

In addition to motorways, we have applied the method to a proceeding initiated on PSO regional rail passenger services. In this context, competition by comparison enables the awarding authorities to stimulate regulated companies to undertake efficient behaviour even in the case of markets where actual competition is hindered, where strong information asymmetries are in place and it is therefore more difficult to define the costs of a service and their charging on final prices. We expect to test the method also for airports on the occasion of the forthcoming full revision of the charging models.

Due to its relevance, this topic is the subject of the survey introducing our Annual report and we asked the Advisory Board to further expand work thereupon.

I wish to hereby renew our welcome to the members of the new Advisory Board of the Authority, which took office last 26 June.

To sum up, I have illustrated the Authority's activities by linking them to the fundamental issues addressed since the inception of our activities. Of course, they represent the cornerstones for our future action, too.

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Vision and strategy

I would like to resume a matter which has been already dealt with in our previous reports and which I care a lot about: the relationship between independent economic regulation and politics. In his latest work published in Italy, *Economics for the Common Good*, the Nobel Prize-winning economist Jean Tirole highlights the mistake of building this relationship in terms of antinomy and states that independent regulatory authorities represent "*one of the tools by virtue of which democracy can curb the excesses of electioneering temptation and ensure the independence of the State in the long term.*"

Independent regulation does not hinder political choices; it rather makes them measurable and comparable with possible alternatives. Regulatory measures result from participatory and transparent procedures and are underpinned by a sound impact assessment. Neither does independent regulation interfere with the alternative between competition in and for the market. Yet, should competitive mechanisms within a given market be lacking due to structural reasons, competition by comparison enables us to indicate to companies which are the efficiency targets to be achieved.

This is certainly a ground for regulation and active administration to express their complementarity.

Politics, regulation and business face the same challenge, i.e. finding appropriate responses to the new demand for mobility, taking advantage from the opportunities provided by innovation and complying with the constraint of environmental and economic sustainability.

An issue of strategic importance will be the regulation of technology platforms which, by accessing information pertaining to consumption habits of potential customers and deploying predictive and dynamic technologies of operating processes, may virtualize the behaviour of users and anticipate their needs: this is the data economy.

Physical transport infrastructures are also involved in the change induced by digitalisation, thus creating the conditions for a new family of mobility services. For independent regulation, these services raise a number of market access issues and demand mobilisation of different competences spanning from the assessment of the adequacy of structural separation levels and guaranteeing the absence of conflicts of interest, to actual technological competences and privacy protection.

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Having addressed the topics we currently deal with, let me briefly report on the Authority's resources and development.

Resources and
development

Half-way through the Board's mandate, our offices are working at full capacity and, as a result of public competitions, the staff is almost complete. Also, in light of the above considerations, we confirm the validity of the choice made by structuring the organisation based on the main functions performed by the Authority.

With regard to the Authority's funding, by a judgement released last April, the Constitutional Court ruled that the question of constitutionality raised in respect of the relevant provisions of the statutory rules was unfounded. In order to ensure the enforcement of the judgment, we have mapped the activities performed (Decision no 75 of 31 May 2017), whereupon the entities subject to the payment of the fee are identified. We therefore consider that conditions are in place for a successful conclusion of the disputes which are still pending.

Acknowledgments

I am pleased to turn to the part of the Report where, *midway upon the journey of our life*, more than half-way of the mandate of the Authority's Board, I wish to express my acknowledgments.

First of all, I would like to thank our staff, experts, Legal Adviser and Chief Economist.

I trust the extraordinary mix of skills and experience making up the Authority's family will continue to qualify its administrative culture, ensure its independence and quality of action and always keep on the straight and narrow. To them all, the Board and I wish to express our thanks and appreciation

I wish to especially thank the Parliament, the Council of State, the Regional Administrative Courts of Piedmont and Lazio and the State Attorney.

I also wish to thank the national, central and local authorities which the Authority cooperates regularly with and, in particular, the Prime Minister's Office, the Ministry of Infrastructure and Transport, the Ministry of Economy and Finance, the City of Turin and, last but not least, the Competition Authority, the National Anti-Corruption Authority and the regulatory Authorities for public utility services, which have been established before us and with which the opportunities for cooperation are ever increasing.

The activities I have described would not have been possible without the support of the Politecnico di Torino and the Customs Agency.

I would like to extend my thanks to the members of the Authority's Board of Auditors and Evaluation Committee and to the Guarantor of Ethics.

Finally, I wish to thank my colleagues Barbara Marinali and Mario Valducci, with whom I share this experience and, together with them, the Secretary General. A special thank goes to my Head of Cabinet.

