

courtesy translation

Opinion No 1/2017

Opinion to the Ministry of Infrastructure and Transport on the 2016 Update of 2012-2016 Contractual Agreement - Investment (CdP-I) between the Ministry of Infrastructure and Transport and *Rete Ferroviaria Italiana S.p.A.*, released by the Transport Regulation Authority pursuant to article 15, paragraph 2, of Legislative Decree No 112 of 15 July 2015.

The Transport Regulatory Authority (hereinafter the Authority), in its meeting of 24 March 2017

Whereas:

- the Ministry of Infrastructure and Transport ("**MIT**"), in order to implement the provisions of article 15, paragraph 2, of Legislative Decree No 112 of 15 July 2015, forwarded to the Authority, by letter dated February 1, 2017 (ART ref.no. 644/2017), the 2016 update scheme ("**Update**") of 2012-2016 Contractual Agreement - Investment ("**CdP-I**") between MIT and R.F.I. S.p.A. ("**RFI**");
- based on the information report, attached thereto, the Update, signed on June 17, 2016, was discussed at the meeting of 10 August 2016 by the Inter-ministerial Committee for Economic Planning (*Comitato Interministeriale per la Programmazione Economica - CIPE*), which delivered its favourable opinion. Article 10 of Law No 255 of 1 December 2016, converting the so-called Tax Decree, later approved the update by law, and only after such approval, the Authority was asked to deliver its mandatory opinion as referred to in Article 15, paragraph 2, of Legislative Decree No 112/2015;
- following the approval, the Update was also published on RFI website, in order to provide information to "potential applicants", as provided for by the a.m. Article 15, paragraph 2;
- the Update on which the Authority is asked to deliver its opinion, has been, to the extent described above, already formally approved in the legislative process and signed by the parties;

and underlining that timing and modes for definition of the CdP-I shall ensure the necessary synergies and consistencies with the technical and economic regulatory processes of the railway system as a whole, so as to prospectively allow its optimal operation, wishes to make the following considerations.

I. Legal and regulatory aspects

Under Article 15, paragraph 2, of Legislative Decree No 112/2015, the Authority shall be informed by MIT on the content of the Contractual Agreement concluded between the national

railway infrastructure manager and the Government, in order for the Authority to be given the opportunity *“to express its views on the content of the contractual agreement before it is signed, especially as regards projects in terminals and freight terminals, urban nodes, stations and port connections”*. Further, according to the provisions of paragraph 1 of the above Article, the Contractual Agreement shall be signed *“for a period of at least five years, in accordance with the basic principles and parameters set out in Annex II of this decree”* and *“the terms of the contractual agreement and the structure of the payments agreed to provide funding to the infrastructure manager shall be agreed in advance to cover the whole of the contractual period”*.

Article 15 of the a.m. decree also provides that the funding provided in contractual agreements is one of the benchmarks to be taken into account by the infrastructure manager when drawing up and updating of the *“business plan”*, which is also to be transmitted to the Authority, in order to ensure - *inter alia* - optimal and efficient use, provision and development of the national railway infrastructure¹ and with respect to which the infrastructure manager itself is required to ensure consistency with the contractual provisions².

In the exercise of the regulatory activity falling within its remit, with particular reference to article 37 of the law establishing the Authority, which attends to *“ensuring, according to methods that encourage competition, management production efficiency and cost containment for users, businesses and consumers, as well as equitable and non-discriminatory access to rail infrastructures”*³ and for the purpose of implementing, *inter alia*, the provisions of article 17, paragraph 1, of Legislative Decree No 112/2015, the Authority defined the criteria for determination of charges for use of the railway infrastructure by the national railway infrastructure manager as well as the fees for the related services (ART Decision No 96/2015 of 13 November 2015, *“Criteria for determination of charges for access and use of the railway infrastructure”*).

With particular reference to investments covered by the CdP-I, the above decision provided that:

- a) efficient total costs to be remunerated with charges for access to the infrastructure be calculated net of the surpluses from commercial activities resulting from the railway infrastructure management (Measure 6);
- b) net book value of long-term assets, for the purpose of its remuneration, be represented by historic values, net of any public contributions on plant and equipment, including the part financed through CdP-I (Measure 16).

¹ Art. 15, paragraph 5: *“Within the framework of general policy determined by the Government and taking into account the Strategy referred to in article 1, paragraph 7, and the financing provided referred to in paragraph 1, the infrastructure manager shall draw up and update a business plan including investment and financial programmes, to be transmitted to the Ministry of Infrastructure and Transport and to the regulatory body. The plan shall be designed to ensure optimal and efficient use, provision and development of the infrastructure while ensuring economic equilibrium and financial balance and providing means for these objectives to be achieved”*.

² Article 15, paragraph 7.

³ As provided for by article 37, paragraph 2 (a) of Legislative Decree No 201 of 6 December 2011, while paragraph 6-b of the same article clarifies that *“[t]he powers of Ministry of Infrastructure and Transport, Ministry of Economy and Finance and Inter-ministerial Committee for Economic Planning (Comitato interministeriale per la programmazione economica-CIPE) as for the approval of contractual agreements and conventions, with particular reference to public finance implications, shall remain unchanged.”*

Finally, it is highlighted that CIPE, at its meeting of 1 December 2016, took note of the "Guidelines for assessment of investments in public works in the sectors falling within the remit of the Ministry of Infrastructure and Transport" provided for by Legislative Decree No 228/2011 and preliminary to MIT's Multi-year Planning Document.

The principles to be followed for the ex-ante assessment of investment needs in public works include (paragraph 2.1 of the aforementioned Guidelines):

- "analysis of the current supply and demand scenario;
- identification of future scenarios to be analysed (...);
- demand forecasting in such scenarios;
- estimate of the demand-supply system operation (e.g. degree of infrastructure saturation) and related impact on external environment (...)"

The above document, on account of:

(i) the practical impossibility to apply the procedures described therein within a limited period and

(ii) the need to ensure continuity with respect to past commitments, in cases where such commitments gave rise to legally binding obligations, or, *a fortiori*, in case of completion of works already in progress,

introduced a "provisional" procedure (upon first implementation⁴), i.e. a temporary departure from the rigorous assessment process outlined therein, but not from the principles that inspired its drafting.

II. The Authority's remarks

In light of the above, and in order to provide a preliminary benchmark for drawing up the new 2017-2021 CdP-I, which shall, *inter alia*, necessarily take into account both the regulatory measures taken by the Authority in the exercise of its functions, and the "Guidelines of the Ministry of Infrastructure and Transport for assessment of investments in public works", it is considered appropriate to make the following remarks.

As regards the field of application provided for by article 1, a substantial part of the 2016 new resources (approximately 59%) is intended for the network infrastructure development, according to the following classification:

⁴ Referred to the "evaluation and selection methods by which, pending the full implementation of the rules of the Procurement Code in force since 18 April 2016, the works shall be identified that will be included into the first Multi-Year Planning Document" (to be approved, pursuant to article 201 of the Procurement code referred to in legislative decree No 50 of 18 April 2016, one year after entry into force of the Code).

- A3 area *"upgrading and development"* (divided into *"Metropolitan areas and regional lines"*, *"Passenger corridors"*, *"Freight corridors"*), with reference to *"RFI proposals to overcome bottlenecks"* (see CdP-I, page 10, Table 1, line 03);
- A4 area *"infrastructure upgrading and development"* (on a regional basis and in accordance with the development strategies of EU corridors) with reference to *"Conventional/High Capacity Network"* (see CdP-I, page 10, Table 1, line 04).

Besides, in terms of the final service offered to users (passengers and freight), it is considered, also pursuant to the provisions of article 37, paragraph 2, of Legislative Decree No 201/2011, that the relevant parts of the contract should provide, with respect to the detailed tables already available therein (pp. 9-76), appropriate contents in line with the explicit provisions set out in Annex II (Basic principles and parameters of Contractual Agreements) to Legislative Decree No 112/2015, which provides under paragraph 3 that the CdP-I shall include *"performance and quality indicators covering elements such as: (a) train performance, such as in terms of line speed and reliability, and customer satisfaction; (b) network capacity"*; thus, especially for each of the financial measures relating to A3 and A4 areas, the expected benefits in terms of performance, for the benefit of railway undertakings and, ultimately, of users would be better identified.

Paragraph 3 of Annex II to Legislative Decree No 112/2015 also provides that the CoP-I defines *"the performance and quality indicators covering elements such as: [...] (c) asset management, (d) activity and annual expenditure volumes, (e) safety levels; (f) environmental protection"*, which at present are not all included or appropriate in the document at issue.

As for *"asset management"* the need should be stressed that the information contained in the CdP-I tables be also functional to the fulfilment of:

- a. the obligation for the infrastructure manager, as provided for by article 15, paragraph 8, of Legislative Decree No 112/2015 ⁵, to develop and maintain a *"Register of Assets" which "shall be accompanied by details of expenditure on renewal and upgrading of the railway infrastructure and is used to assess the financing needed to repair or replace them"*;
- b. the regulatory accounting requirements as defined in Title IV (Regulatory accounting) of the Authority's Decision No 96/2015.

Again with reference to *"asset management"*, it is known that a detailed database of the managed assets is available to RFI, this database including four views (physical maintenance, cadastre, lease and assets): each of them is functional to the performance of specific activities in the extensive set of processes involving the asset management of the infrastructure manager. In this area it could be particularly significant to include into the relevant contractual parts, specific indicators for the level of commercial exploitation of the relevant assets.

⁵ *"Within one year from the entry into force of this legislative decree, Infrastructure managers shall develop and annually maintain a register of their assets and the assets they are responsible for managing, providing appropriate information to the Ministry of Infrastructure and Transport. The register shall be accompanied by details of expenditure on renewal and upgrading of the railway infrastructures and is used to assess the financing needed to repair or replace them"*.

With reference to the *"activity and annual expenditure volumes"*, the CdP-I includes *"performance and quality indicators"* containing such elements, as well as an associated manager's performance measurement function (article 8), which is limited to a basket including all relevant investment projects for which final design has been already approved. In this respect it is appropriate to identify additional monitoring tools, aimed at encouraging optimizing behaviours by the infrastructure manager for the fulfilment of its contractual obligations, taking into account the limited impact of the relevant penalty system compared with the significant financing volume covered by the contract under review (about 9 billion Euros for 2016 alone).

In general, contractual agreements, and any updates thereof, shall appropriately follow a timescale which is consistent with the regulatory measures taken by the Authority, also in compliance with the provisions of No. 9) of Annex II to Legislative Decree No 112/2015 and shall be structured by taking into account the following:

1. penalties (use of uniform terminology, always employing the term "penalty" and not "fine") in line with the extent of damage suffered by the client, so as to make them proportional to the delay or non-performance, and in particular giving them a greater deterrent effect, both with respect to total amount of works and performance deviation;
2. review of the exemption of liability clause, so that the due diligence exercised is proportionate to the professional rather than the ordinary one;
3. definition of the legal effects arising from non-performance, by specifying whether it constitutes or not cause for termination of contract under article 1456 of Civil Code (express termination clause);
4. connection of non-performance to a quantification of the relative damage, in addition to the right to claim compensation for further damages (article 1382 of Civil Code - penalty clauses);
5. identification of faster dispute resolution mechanisms as compared to ordinary jurisdiction.

With respect to *"safety levels"* and *"environmental protection"* the contract should include *"performance and quality indicators"* including such elements, together with related manager's performance quantitative measurements.

With particular reference to the procedure for approval and any updating of Contractual Agreements and the related strategic framework, it is fundamental that these be conceived, structured and finalized in accordance with the following principles:

- adoption of timeframes and procedures for definition of the contractual text such as to ensure the necessary synergies and consistencies with the technical and economic regulatory processes of the railway system as a whole – being it understood as the harmonious set of supply and demand sub-systems - as well as with the institutional planning processes in the transport sector at different territorial levels, in order to allow the optimal operation of the system, in a future perspective, both short- and medium-long term;
- highlighting the functional link and consistency between Contractual Agreement and Business Plan, in particular with regard to financing and investment programmes and optimal

infrastructure development, as referred to in article 15, paragraph 5, of Legislative Decree No 112/2015;

- inclusion only of the investments which have been subject to the application of the *"Guidelines for assessment of investments in public works in the sectors falling within the remit of the Ministry of Infrastructure and Transport"* as provided for by Legislative Decree No 228/2011, which are preliminary to MIT's Multi-year Planning Document.

The President
Andrea Camanzi