

POSITION PAPER

The Principal Purpose Test

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EXECUTIVE SUMMARY

The role of the Principal Purpose Test is to determine whether the principal purpose of a cross-border service is to carry passengers between stations located in different Member States, as opposed to entering a domestic passenger market.

According to EU law in force, namely Directive 2012/34/EU, where a railway undertaking intends to launch a cross-border service that would pick up and set down passengers at stations located in the same Member State, the regulatory body in that Member State must carry out a Principal Purpose Test if it receives a relevant request to that effect.

Recital 18 of Directive 2012/34/EU states that ‘criteria such as the proportion of turnover, and of volume, derived from transport of domestic or international passengers, and the length of the service should be taken into account’.

CER expresses a preference for a simple test based only on projected annual revenue and/or traffic volume shares, with the test result dependent only on whether the relevant shares exceed reasonable pre-determined and published thresholds. Other variables collected by the regulatory body should have the main purpose of facilitating the estimates of revenue and/or traffic volume shares.

The service should be deemed international at least where the cross-border share of traffic volume in passenger-kilometres and/or number of passengers and/or revenue is dominant. In practice CER would consider this to mean that, where the cross-border part is at least 50% ⁽¹⁾ of the sum of the cross-border part and the domestic part, then the service should always be considered as international by the regulatory body, where the term domestic should be understood as referring to the country of the regulatory body in question.

This should however not prevent a Member State or its national regulatory body from deciding that a more permissive threshold, i.e. a threshold of less than 50%, should apply.

Several Member States have already decided not to implement a Principal Purpose Test as a result of their national market opening. Such decisions should not be reversed.

A member state should have the right to decide to abolish the Principal Purpose Test as a result of a national market opening policy. Once such a decision is taken it may not be reversed.

In order to reduce commercial risk and facilitate market entry in the international segment, prospective operators of international services should have the right to request a binding Principal Purpose Test a reasonable number of years before the intended start of service. The corresponding decision of the regulatory body should then be binding on all parties concerned for a reasonable number of years after its notification.

The scope of the test should be limited to cross-border open access services, i.e. services that are operated on a commercial basis without state compensation. Public Service Obligations in the sense of Regulation 1370/2007 that cross one or more borders should not be subjected to the Principal Purpose Test, but should instead be treated in the same way as domestic market Public Service Obligations in accordance with whatever agreements have been reached between the relevant national and/or regional authorities in the Member States concerned.

¹ Some new entrants would prefer a lower maximum permissible threshold, e.g. 33%.

1. LEGAL BASIS

Directive 2007/58/EC opened up the European railway market for international passenger services. The intended scope of that reform was made clear in Recital 8 of that Directive which was identically taken over as Recital 18 in Directive 2012/34/EU (emphases added):

Recital 18

*“The introduction of new, open-access, international services with intermediate stops **should not be used to bring about the opening of the market for domestic passenger services**, but should merely be focused on stops that are ancillary to the international route. On that basis, their introduction should concern services whose principal purpose is to carry passengers travelling on an international journey. The determination of whether that is the service’s principal purpose should take into account **criteria such as the proportion of turnover, and of volume, derived from transport of domestic or international passengers, and the length of the service**. This determination should be made by the respective national regulatory body at the request of an interested party.”*

The relevant articles from Directive 2007/58/EC were taken over in the ‘Recast Directive’, i.e. Directive 2012/34/EU. These are the following:

Article 3 (5)

‘international passenger service’ means a passenger service where the train crosses at least one border of a Member State and where the principal purpose of the service is to carry passengers between stations located in different Member States; the train may be joined and/or split, and the different sections may have different origins and destinations, provided that all carriages cross at least one border;

Article 10 (3)

Following the request from the relevant competent authorities or interested railway undertakings, the relevant regulatory body or bodies referred to in Article 55 shall determine whether the principal purpose of the service is to carry passengers between stations located in different Member States.

Article 10 (4)

Based on the experience of regulatory bodies, competent authorities and railway undertakings and based on the activities of the network referred to in Article 57(1), the Commission shall adopt by 16 December 2016 measures setting out the details of the procedure and criteria to be followed for the application of paragraph 3 of this Article. Those implementing acts shall be adopted in accordance with the examination procedure referred to in Article 62(3).

Asymmetrical nature of Principal Purpose Tests

In the standard case, i.e. a two-country setting, interested parties from both countries may request a Principal Purpose Test, so that there may be one or two Tests, each carried out separately by the national regulatory body of each country.

Each national regulatory body is potentially interested in assessing whether the proposed international service may be an undue attempt to enter its domestic market. This means that the Principal Purpose Tests may be asymmetrical in their results, even if the methodologies and criteria used by the two regulatory bodies are identical. To see this one may imagine the example of a service between country A and country B, with an intermediate stop in country B but no intermediate stop in country A. In that case it is clear that the regulatory body in country A should not carry out the test at all, as the purpose of the service from the viewpoint of country A is fully international by definition; however the regulatory body in country B will have to carry out the test if requested to do so and may ultimately conclude that the principal purpose of the service is not international.

Notwithstanding the potential asymmetry in the test results, cooperation and exchange of information between the relevant regulatory bodies should be encouraged.

The scope of the test should be limited to cross-border open access services, i.e. services that are operated on a commercial basis without state compensation. Public Service Obligations in the sense of Regulation 1370/2007 that cross one or more borders should not be subjected to the Principal Purpose Test, but should instead be treated in the same way as domestic market Public Service Obligations in accordance with whatever agreements have been reached between the relevant national and/or regional authorities in the Member States concerned.

2. METHODOLOGICAL ASPECTS

Choice of variables

The legislation mentions proportion of turnover, of volume, and length of the service. CER considers that projected annual turnover (revenue), and/or projected annual traffic volume in number of passengers, and/or projected annual traffic volume in passenger-kilometres should be used as the main criteria for the result of a Principal Purpose Test. The Principal Purpose Test should focus on the variables that make the most sense for assessing what is ultimately a question of market penetration. The chosen variables should be considered over the medium term to prevent considering only a snapshot of a situation at one point in time.

Projection of traffic volumes and revenues

CER considers that the Principal Purpose Test must be carried out only on an ex-ante basis. It therefore must rely mainly on quantitative projections of future traffic and revenues, based on the quantitative and qualitative variables of interest identified by the relevant Regulatory Body.

The principles of the methodology for these quantitative projections should be developed by the regulatory body and published on its website. The principles of the methodology should be clear, pre-determined, transparent and non-discriminatory.

The assessment methodology may evolve over time, in particular in the light of experience gained by the regulatory bodies.

Computation of the shares of traffic or revenue

One needs to specify how the share of traffic or revenue should be computed. The numerator would clearly be the traffic volume or the revenue generated from cross-border passengers. For the denominator, CER recommends that the regulatory body uses the sum of the traffic volume or revenue (projected to be) generated on *its* domestic network and from cross-border passengers. With this approach, whatever would be generated from domestic passengers *in the other country* would not enter into the computation of the shares - it is indeed irrelevant in terms of the intended purpose of the test which is to protect the domestic market from unintended market entry.

Determination of the result of the test

The Principal Purpose Test should remain simple and cause no inadequate transaction costs. CER would prefer a test based on the computation of revenue and/or traffic volume shares, with the test result dependent on whether the relevant shares exceed reasonable pre-determined and published thresholds.

The thresholds should conform to a general principle according to which the service should be deemed international at least where the cross-border share of traffic volume and/or revenue is dominant. In

practice CER would consider this to mean that, where the cross-border share is at least 50% ⁽²⁾ of the sum of the cross-border part and the domestic part (where the term domestic should be understood as referring to the country of the regulatory body in question), then the service should be considered as international.

This should however not prevent a Member State or its national regulatory body from deciding that a more permissive threshold, i.e. a threshold of less than 50%, should apply.

² Some new entrants would prefer a lower maximum permissible threshold, e.g. 33%.

3. PROCEDURAL ISSUES

The legislation allows “interested railway undertakings” and relevant competent authorities to request the Principal Purpose Test. In CER’s view the former clearly includes the prospective operator of the international service.

Furthermore, in line with its position on the Economic Equilibrium Test and in order to reduce commercial risk and facilitate market entry in the international segment, prospective operators of international services should have the right to request a binding Principal Purpose Test a reasonable number of years before the intended start of service. The regulatory body should fix a deadline for its final decision, which should count from the time at which it receives the information it needs from the prospective operator. The deadline should preferably not exceed two months. The corresponding decision of the regulatory body should then be binding on all parties concerned for a reasonable number of years after its notification.

Regulatory bodies should request no more data or information than what is strictly necessary for a credible assessment of the Principal Purpose of the service. Furthermore, it is essential that regulatory bodies respect the confidentiality of business secrets.

Disclaimer

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