

Paris, 30 March 2017

The draft performance contract between the State and SNCF Réseau misses the objectives set out in the Railway Reform Act

In its opinion dated 29th March, 2017, the French rail and road regulatory body (Arafer) delivers a detailed analysis of the draft performance contract to be signed between the State and SNCF Réseau and concludes that the objectives set out in the railway reform Act of 2014 are not met. The regulator underlines the absence of credible commitments from both contracting parties, thus depriving the railway sector of a long-term vision particularly vital in the prospect of the opening of the domestic market to competition.

On 21th December, 2016 Arafer was asked to deliver an opinion on the draft performance contract between the State and the infrastructure manager, SNCF Réseau. This ten year contract introduced by the Railway Reform Act of the 4th August 2014 should set out the priorities of the State in terms of management and development of the network and include some objectives of productivity, quality and security to be achieved by SNCF Réseau, while respecting a financial trajectory aiming at overcoming the railway system's current spiral of debt.

In its opinion dated 29th March 2017, Arafer deplores the insufficient preparation of the contract, especially given that more than two years have passed since the law was voted. Arafer underlines the absence of detailed feedback on the previous performance contract concluded with the infrastructure manager in 2008 as well as the lack of involvement of the stakeholders other than by means of a last-minute consultation.

In its opinion, the regulatory body sets out observations and recommendations to make the contract a real performance lever containing commitments and effective incentive mechanisms for both parties.

CONFIRMATION OF THE PRIORITY GIVEN TO THE MAINTENANCE OF THE NETWORK

Arafer welcomes the shift in the investment efforts in favour of renovating the rail network, consistent with the conclusions of the known audits, while calling for a clarification of the network perimeter, which is not clearly specified in the draft contract.

Moreover, Arafer invites the State to clarify its development priorities for the network, which should comply with the "golden rule"¹, in order to offer SNCF Réseau visibility over the means to be mobilised to undertake the selected projects. The decree implementing the "golden rule" still has not been published.

¹ This rule obliges SNCF Réseau not to become indebted above a certain ratio (debt/operational margin) when financing new development projects.

THE LACK OF PERFORMANCE INDICATORS LIMITS THE POSSIBILITIES FOR MONITORING

Arafer notes the shortcomings in the choice and definition of SNCF Réseau's performance indicators. Some crucial contractual indicators, such as the productivity of maintenance, the quality of service of freight and passenger traffic, as well as the quality of the infrastructure by route, are not defined in the draft contract. It is thus deprived of objectives on important criteria for the measurement of the performance of the infrastructure management.

COST CONTROL IS NOT GUARANTEED

The draft contract puts forward ambitious productivity objectives (1.2 billion euros per annum over time in 2026), which seem consistent with the result of the European comparison of railway infrastructure managers conducted by Arafer. However, SNCF Réseau has not been able to clarify the precise actions proposed to achieve this commitment and has instead put forward that a performance plan is currently being developed.

Arafer expresses doubts about SNCF Réseau's capacity to speed up its productivity effort as strongly as projected as of 2021 (€ 155 million per annum between 2021 and 2026 as against € 77 million per annum over the first four years of the contract). This marked acceleration in the second part of the contract, which is hardly substantiated by SNCF Réseau, is hardly credible.

THE APPROACH TO SETTING CHARGES SHOULD BE REVISED

The draft contract provides for a sustained revaluation of the charges for passenger trains (on average +2.8% per annum over the period 2018 - 2026). SNCF Réseau puts forwards budgetary considerations, but is not able to assess the impact of the tariff increases on traffic. In default of an in-depth analysis of the market and taking account of the uncertainty surrounding the evolutions of the economic environment, Arafer recommends for the increases to be restricted to the level of inflation.

The same budgetary concerns explain the high increase in freight charges (on average +6.7% per annum over the period and about +9% per annum as from 2024), in order to cover in 10 years the "direct cost" (the cost that is directly incurred as a result of operating a train service). Arafer notes the financial disengagement of the State, with the progressive suppression of the "freight compensation", which explains the substantial increases, and recalls to the government its recent commitment in favour of this mechanism.

The responses given indicate that the consequences of increasing rail charges on traffic have not really been assessed. The approach to setting charges taken in the draft contract seems to be dictated solely by budgetary considerations, with no connection to the economic realities and most notably to the current context marked by fierce competition between different modes of transport.

Finally, Arafer reaffirms the scope of its binding opinion on charges and that the performance contract will not lead to depart from the principles of European and national law, in particular regarding the requirement that market segments be able to bear any charges above the "direct cost".

THE FINANCIAL TRAJECTORY IS UNREALISTIC

Revenues derived from access charges are overestimated in the financial trajectory, especially as of 2020. Firstly, this forecast underestimated the negative impact of an increase of access charges on the evolution of traffic. Secondly, the estimates rely on a hypothetical budgetary support from the State yet to be confirmed. In regard of past practices, the 25% increase of subsidies intended over the course of the contract (+ 500M€ HT) would be remarkable.

It is therefore not guaranteed that the growth of SNCF Réseau's debt will be kept to an already 40% high increase compared to its present value (63 bn € forecasted in 2016). And the uncertainty surrounding the endowment from SNCF, which is mostly derived from the financial result of SNCF Mobilités, only adds to the frailty of this trajectory.

Even assuming that SNCF Réseau can keep up with the trajectory, its debt would not be stabilised as it would still increase by 400 M€ per year in 2026.

The contract fails to meet the objective set in the legislation of revenues covering the network costs at the end of the contract.

THE COMMITMENTS ARE UNCLEAR OR INSUFFICIENTLY BINDING

Arafer points out the asymmetric nature of commitments from both parties. The State only has to “oversee the consistency and proper functioning of the national railway system” and does not commit on the level of its financial support, nor does it explicit its long term vision for railway transport. Conversely, the commitments taken by SNCF Réseau are numerous, yet are not subject to truly binding incentive schemes.

Arafer's opinion makes recommendations, such as introducing a performance-related bonus for the company's executives or publishing a benchmark of the performance of SNCF Réseau's regional entities.

In conclusion, it is the opinion of Arafer that the performance contract fails to meet the requirements set in the Railway Reform Act by the legislator. Without improvement, the contract cannot be considered a binding roadmap for enhancing the performance of the rail network, offering the operators the visibility necessary to their economic model and guaranteeing the financial recovery of SNCF Réseau.

The draft contract, together with the opinion of Arafer, must now be submitted to Parliament.

- Consult the [opinion](#) (in French)
- Consult the [appendices](#) (in French)

About Arafer

Since 2010, the French railway sector has had an independent regulatory body which accompanies its gradual opening to competition. The “Macron” Act of 6 August 2015 extends the powers of the regulator to road activities: coach transport and motorways.

On 15 October 2015, the rail regulatory body became the rail and road regulatory body (Arafer). Its mission is to contribute to the efficient operation of the public service and competitive activities for the benefit of rail and road transport customers. Its public opinions and decisions are adopted by a group composed of seven independent members chosen due to their expertise in railway, road, legal or economic matters or because of their expertise in competition matters and has been chaired since August 2016 by Bernard Roman.