



Extract from the report to the
Public Accounts Committee on
Kystbanen

September
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I. Introduction and conclusion

1. This report is about DSBFirst's economy and the tender for operation of the train services on Kystbanen and across the Oresund bridge.

2. DSB SOV (henceforward referred to as DSB) operated Kystbanen up to and including 10 January 2009, at which point DSBFirst Danmark A/S won the tender and took over operations. DSBFirst Sverige AB won the tender to operate train services on the Swedish side of Oresund. Both companies are owned by DSB and FirstGroup Plc. In this report, the term DSBFirst refers to the operating companies DSBFirst Danmark A/S and DSBFirst Sverige AB unless further clarification is required.

3. Kystbanen serves the section between Elsinore and Copenhagen Airport Kastrup, and in Sweden it connects Malmö with Gothenburg, Växjö and Karlskrona, respectively.

4. In November 2003 a political agreement determined that one third of DSB's long distance and regional train services should be tendered via competitive bidding before the end of 2013. In November 2004, a political decision prescribed that tenders should be invited to bid on Kystbanen. This decision was made on the basis of the report issued by the Danish Transport Authority: "Tendering train passenger services – basis for decision" and follow-up material, which stated that train punctuality could be improved through tendering.

It appears from Document no. 13 17/8 2006 that the objective of tendering Kystbanen was to test whether costs could be reduced and/or the service level enhanced if the rail passenger services operated by DSB were exposed to competitive pressure. The Danish Transport Authority, which is responsible for the tendering of train services and awarding of contracts, worked out the technical and legal basis for the tendering process in the period 2004 to 2007 and entered a contract with DSBFirst on the operation of Kystbanen in January 2008. On the Swedish side, DSBFirst entered a contract with Skanetrafiken.

5. The Ministry of Transport determines the terms relating to competition law and the accounting practice to be adhered to by DSB. In its capacity as owner of DSB, the ministry supervises DSB and ensures that the company acts in compliance with the terms relating to competition law, for instance, in connection with bidding. The board and management of directors of DSB are responsible for ensuring that business transactions are conducted in compliance with the terms relating to competition law and the agreed accounting practice.

6. In December 2009, the Public Accounts Committee requested Rigsrevisionen to prepare a memorandum, which should answer a number of questions regarding the tender of Kystbanen. On 19 February 2010, the auditor general submitted his memorandum to the Public Accounts Committee on a major examination of the Danish Transport Authority, DSBFirst and the Oresund/Kystbanen contract. The memorandum proposed the performance of a major examination to ensure that the questions put forward by the Public Accounts Committee would be appropriately answered. The Public Accounts Committee accepted this proposal in March 2010.

DSB SOV is a government-owned independent public enterprise. An enterprise performing a specific task on behalf of the government – in this instance operating train services – which generates income and capital and operates outside the government grant system may be characterised as an independent public enterprise.

Tendered train services

The contractual requirements concerning the services provided by the DSB that are not exposed to competition are determined in a contract between the Ministry of Transport and DSB on long and regional train services provided as a public service in the period 2005-2014.

Rigsrevisionen launched the examination in April 2010. However, developments in DSB-First have expanded the scope and perspective of the examination, upon agreement with the Public Accounts Committee, beyond what was originally planned.

7. The questions put forward by the Public Accounts Committee are listed below including reference to the specific sections and bullets in the report where the questions are addressed.

Questions put forward by the Public Accounts Committee	Answers
1. A description and assessment of the organisational structure set up to support the traffic across Oresund. Including: What is the objective and appropriateness of the organisation established to perform this task?	Chapter II, items 15-20
2. Has the Danish Transport Authority in the tender terms and/or in the contract included requirements to the gross margin generated by the operator – and are the requirements relevant?	Chapter IV, items 81-84
3. Has the Danish Transport Authority adhered to the four recommendations made by Rigsrevisionen concerning the implementation of tenders, cf. Report no 10/04 on the Ministry of Transport's handling of the contract with ARRIVA?	Chapter IV, items 85-89
4. How did the Danish Transport Authority ensure that the agreed penalty and bonus system provided adequate economic incentive for the operator to fulfil the key obligations of the tendered service?	Chapter IV, items 90-91
5a. What methods is the penalty and bonus system based on, and are the data on punctuality and customer satisfaction reliable?	Chapter IV, items 92-98
5b. In relation herewith, it should be determined who is responsible for considerable difference between DSBFirst's contractual quality and the quality as perceived by the customers.	Chapter V, items 135-136
6. Is it a competitive advantage for DSBFirst that DSB provides the trains?	Chapter IV, items 99
7. Has running 10 additional train sets in 2010 had the effect that DSBFirst has submitted a bid with less capacity than the other operators? Who is in charge of maintaining the 10 train sets?	Chapter IV, items 100-102
8. In what way is the Danish Transport Authority in its tenders and contracts ensuring that the operators are complying with the terms relating to competition law, and thereby preventing the operator selected – DSBFirst – from burdening DSB or the government with any losses relating to the operation of, for instance, the rail services across Oresund?	Chapter IV, items 104-105

8. The objective of the examination is to provide insight into DSBFirst's economy and the tendering of rail services on Kystbanen, and to answer the eight questions put forward by the Public Accounts Committee in this respect. Overall the report answers the following three questions:

- How did the economy of DSBFirst perform?
- How was the tendering and supervision of Kystbanen organized?
- How did punctuality on Kystbanen develop?

MAIN CONCLUSION

At the beginning of January 2009, DSBFirst started operating the train services on Kystbanen and across Oresund.

The audit of financial statement for 2010 severely questioned DSBFirst's financial position.

Rigsrevisionen and DSB's other external auditors of DSB qualified their opinion on the compliance audit of DSB's consolidated and annual accounts for 2010. The qualification concerned DSB's handling of the intercompany transactions with DSBFirst and the transfer of the maintenance of trains at Helgoland (train workshop), as neither had been carried out with the proper understanding and due consideration for the specific requirements applying to the activities of DSB that are exposed to competition.

Back then DSB maintained that DSBFirst's financial position was satisfactory.

On behalf of the Ministry of Transport, the legal adviser to the Danish government looked into the legal aspects of potential state subsidies relating to the intercompany transactions between DSB and DSBFirst and the transfer of the maintenance of trains at Helgoland. The assessment provided by the legal adviser coincided with the auditors' assessment according to which current guidelines concerning transactions made between DSB and those of DSB's activities that are exposed to competition, had not been complied with. The legal adviser to the government further concluded that in three instances intercompany transactions were state subsidized or possibly state subsidized, and as such required involvement of the European Commission, i.e. an intercompany account between DSB and DSBFirst, payment of interest on the intercompany account and the Helgoland transaction.

On the basis of this conclusion, DSB decided to reopen the accounts for 2010 and recognise considerable write-downs and provisions in the consolidated and annual accounts for 2010.

Rigsrevisionen and DSB's other external auditors then qualified the completeness and amount of the recognised write-downs and provisions for losses regarding DSBFirst. Moreover, they retained the qualification concerning intercompany transactions and maintenance of trains at Helgoland.

A projection made subsequently showed that DSBFirst during the tender period would generate a considerable deficit in the range of DKK 1.5 billion.

Following negotiations with the Swedish traffic authorities and on the basis of an overall assessment of the financial position of DSBFirst, DSB decided to cease its operations in Sweden.

The audit of DSB's consolidated and annual accounts is carried out by the external auditors (Rigsrevisionen, KPMG and Deloitte) and DSB's internal auditor.

Intercompany transaction is a transaction carried out between two units of the same company.

The Helgoland transaction refers to the transfer of the maintenance activities from DSBFirst.

The balance of payments relating to transactions carried out between DSB and DSBFirst is represented in an intercompany account.

The main conclusion is based on the following findings:

The financial position of DSBFirst

The economy of DSBFirst's tender was based on a minor surplus and was therefore sensitive to even minor changes in costs and revenue. The tender budget presented by DSBFirst was considered ambitious, yet not unrealistic.

Subsequently, DSBFirst expanded its activities and did not adhere to the original tender budget. After operational start-up, DSBFirst's economy was burdened with considerable cost increases. The financial management of DSBFirst was highly inadequate and did not provide the transparency required to enable monitoring of the financial position of the company.

DSB's handling of the intercompany transactions with DSBFirst and the transfer of the maintenance of trains at Helgoland was not carried out with the proper understanding and due consideration for the specific requirements applying to the activities of DSB that are exposed to competition.

The small loss recorded by DSBFirst Sweden AB and DSBFirst Danmark A/S in 2009 was further aggravated and grew into a considerable loss in 2010. Following negotiations with the Swedish traffic authorities and based on an overall assessment of the financial condition of DSBFirst, DSB decided that DSBFirst Sweden AB in December 2011 should cease its operations in Sweden.

Tender budget

- According to the assessment made by the Ministry of Transport, the DSBFirst's tender budget was based on ambitious yet realistic assumptions. Danish and Swedish complaint authorities subsequently arrived at the same conclusion and did not consider the bid unrealistically low.

Financial management

- The tender budget covered train operations and maintenance of 20 IR4-trains and 23 Oresund trains operated by DSBFirst on Kystbanen. DSBFirst was later awarded the contract to maintain DSB's remaining 24 IR4 train sets. The tender budget did not provide the basis for the financial management.
- DSBFirst's financial position was after start of operations adversely affected by considerable additional staff and train maintenance costs and lower revenue from bonus agreements.
- DSBFirst had less time than assumed in the bid to prepare for the start of operations, which put pressure on the organisation.
- DSBFirst had difficulties procuring reliable data for the financial management regarding, for instance, staff requirements and developments in pay levels. Moreover, the financial reporting did not include, for instance, adequate information on the background for the development in liabilities. Also information on gross margin generated by the train sections serviced in Denmark and Sweden, respectively, was inadequate.

Oresund trains are electrical trains that are used for passenger transport on Kystbanen, across Oresund and in Sweden, because they are equipped with a Danish/Swedish ATC system (automatic train control system).

IR4 trains are electrical trains that are used only for passenger transport on the Danish electric railway network as they are not technically equipped to cross Oresund and run in Sweden.

Gross margin is the amount that services or goods contribute to covering the fixed costs of a company.

Intercompany transactions

- The train workshop at Helgoland is located near Svanemøllen Station (S-train station) in Copenhagen and is used for maintaining and preparing Øresund trains and IR4 trains. In 2009, train maintenance at Helgoland was transferred free of charge from DSB to DSBFirst. Late in 2010, DSBFirst sold the maintenance activities to DSB Vedligehold A/S (company managing train maintenance) for a sum of DKK 80 million.
- In March 2011, Rigsrevisionen and DSB's other external auditors qualified their audit opinion on the compliance audit of DSB's consolidated and annual accounts for 2010. The qualification concerned DSB's handling of the intercompany transactions with DSBFirst and the transfer of the maintenance of trains at Helgoland, which had not been implemented with the proper understanding and due consideration for the specific requirements applying to the activities of DSB that are exposed to competition.
- In March 2011, the Ministry of Transport notified the European Commission of a potential state aid case in relation to activities exposed to competition. The European Commission has initially taken note of this information.
- Late in August 2011, DSB decided to adjust the price of the transfer of maintenance of trains at Helgoland from DKK 80 million to DKK 40 million. Rigsrevisionen is of the opinion that this adjustment will have an influence on the Ministry of Transport's and the legal adviser to the government's further treatment of the case in relation to the European Commission.
- Rigsrevisionen followed up its qualification of the audit opinion with a review of the intercompany transaction concerning maintenance and leaseback of the IR4 trains. According to Rigsrevisionen's examination, DSB did not check whether the price charged by DSBFirst for maintenance of DSB's IR4 trains was as initially assumed. The examination further showed that DSB leased back IR4 trains from DSBFirst, but that the latter should be compensated for any losses relating to the leaseback. DSBFirst may charge payment from DSB to cover costs incurred in connection with the leaseback. DSB paid DSBFirst although additional costs incurred by DSBFirst as a result of the leaseback were not documented. It is therefore not possible to determine whether DSBFirst in 2010 was compensated financially for costs incurred in connection with leaseback activities.
- Early in April 2011, DSB implemented a project on intercompany transactions to follow up on, clarify and eliminate the factors, which in March 2011 made DSB's external auditors qualify their audit opinion on the compliance audit.

Financial result

- The preliminary total result for DSBFirst Sweden AB in 2010 was a loss of approximately SEK 388 million (approximately DKK 318 million) after tax, which resulted in a negative equity capital of approximately SEK 369 million (approximately DKK 302 million). DSBFirst Sweden AB will cease its activities in December 2011, as DSB has concluded that the train services run by the company are not profitable.

State aid

Generally, if an enterprise is government funded, its transactions with sister and subsidiary enterprises must take place on market conditions. Otherwise the enterprise may have received unlawful state aid. The European Commission determines whether state aid is conflicting with EU rules.

- The total result for DSBFirst Danmark A/S in 2010 was a loss of approximately DKK 270 million after tax, resulting in a negative equity capital of approximately DKK 191 million. The loss is attributable primarily to losses on receivables from DSBFirst Sweden AB.
- DSB reopened its annual accounts for 2010 in April 2011 and reduced the result for 2010 by DKK 725 million to a loss of DKK 551 million before tax. This adjustment was made to counter possible losses relating to traffic tenders and claims for repayment relating to state aid, etc. Significant uncertainty is associated with the provision of DKK 725 million, and the extent to which it will be utilized cannot be accurately determined at this point. DSB is, however, expecting to utilise only DKK 475 to 525 million of the provision due to the agreement made with the Swedish traffic authorities on DSBFirst Sweden AB. Rigsrevisionen and DSB's other auditors then qualified their opinion on DSB's consolidated and annual accounts for 2010 concerning the completeness and size of the write-downs and provisions made to cover losses relating to DSBFirst ApS, DSBFirst Danmark A/S and DSBFirst Sweden AB.

Tender and supervision

The Danish Transport Authority is responsible for tendering train services and supervising compliance with the contract entered with DSBFirst.

The Danish Transport Authority has followed the recommendations made by Rigsrevisionen in 2005 concerning tendering and has introduced an adequate and reliable penalty and bonus system that serves as an economic incentive for DSBFirst to fulfil the key obligations of the tendered service.

It rests upon the Ministry of Transport to supervise and control DSB. Up to the spring of 2011, the ministry did not receive adequate information on the financial position of DSBFirst. Based on the information provided to the ministry by DSB on the financial position of DSBFirst, the supervision conducted by the Ministry of Transport has been satisfactory.

Tasks of the Danish Transport Authority

- The Danish Transport Authority, which managed tendering of rail services on Kystbanen, did not include in the terms of the tender nor in the contract any requirements concerning gross margin, because the Authority had in advance assessed the bidder's financial and technical capacity to perform the task. However, for the bidder it could be relevant to project gross margin. The bidder also had the option to submit a strategic offer based on a projected low gross margin. It should be noted, though, that according to DSB's policy, investments in Denmark must generate profits over the course of the contract period, whereas the minimum requirement to gross margin for investments in Sweden is five per cent.

The Danish Transport Authority's contract with DSBFirst on the operation of the train service on Kystbanen and across Öresund is included in the main contract entered between the Danish Transport Authority and Kystbanen A/S on public rail passenger services.

Tasks of the Ministry of Transport

- The Ministry of Transport is, in its capacity as owner of DSB, supervising and controlling that DSB is complying with the terms relating to competition law.
- DSB has not provided the Ministry of Transport with adequate information on DSB-First's financial position. The Ministry has since April 2010 repeatedly asked DSB to enhance the quality of the information that is providing the basis for the ministry's assessment of the profitability of DSB. The ministry actively and persistently supervised DSB in its efforts to get correct information on DSBFirst's economy.

Punctuality of Kystbanen

The punctuality on Kystbanen has been most unsatisfactory.

The political parties behind the decision to tender rail services on Kystbanen expected punctuality to improve beyond the 91.6 per cent average recorded in the period 2003-2004.

The timetable that provided the basis for the tender was ambitious as, for instance, departures on Kystbanen were frequent. On account of the poor punctuality, the timetable was adjusted with effect from August 2010 and, for instance, the number of departures to and from Elsinore during peak hours was reduced.

Tender timetable

- In 2004, the Danish Transport Authority informed the political parties behind the tender traffic agreement that the tender of Kystbanen would make it possible to improve punctuality beyond the average of 91.6 per cent in the period 2003-2004. A train was at that time defined as "on time" if it arrived within five minutes and 59 seconds or less of the planned destination arrival time.
- Departures during peak hours were frequent in the tender timetable. The Ministry of Transport failed to allocate responsibility for the tender timetable between the Danish Transport Authority and Banedanmark (railway enterprise, operating and developing the Danish state railway network). As from 2010, Banedanmark has been made responsible for working out and approving timetables in relation to tenders.

Punctuality

- The punctuality on Kystbanen averaged approximately 85 per cent in the period 2009-2010. A train was at that time defined as "on time" if it arrived within five minutes and 59 seconds or less of the planned destination arrival time. Punctuality was thus lower than the average of 91.6 per cent recorded in the period 2003-2004.

- In 2010 it was politically agreed to improve punctuality. This should be achieved, among other things, through a reduction of the number of train departures during peak hours to and from Elsinore. The goal was to achieve a punctuality of 90 per cent before the end of 2010. A train was now defined as “on time” if it arrived within four minutes and 59 seconds or less of the planned destination arrival time. In 2010, punctuality was 80.2 per cent and in the first half of 2011 it was 85.6 per cent.