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Good Practice Public Transport Concessions

Lessons learned from bus contracting in London and rail franchising in Melbourne

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GROUP OF EIGHT AUSTRALIA

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Introduction

Why

How

Melbourne Rail Franchising

London Bus Contracting

Lessons

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This paper explores lessons learned from PT contracting to identify good practices for concession design…

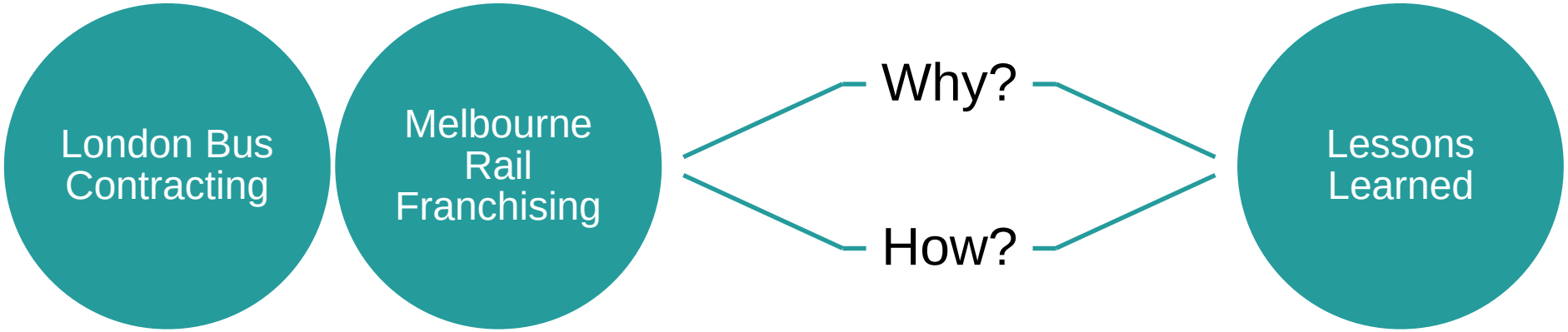
- This paper explores lessons learned from Public Transit contracting to identify good practices in concession design
- It is part of the ITF working group on Public Transport Market Organisation and Innovation
  - PTRG published DP10 – world experience
  - This is a new paper commissioned by ITF

Thredbo
International Conference Series on Competition and Ownership in Land Passenger Transport

OECD

…based on two case study cities with much experience in the field

Two case studies



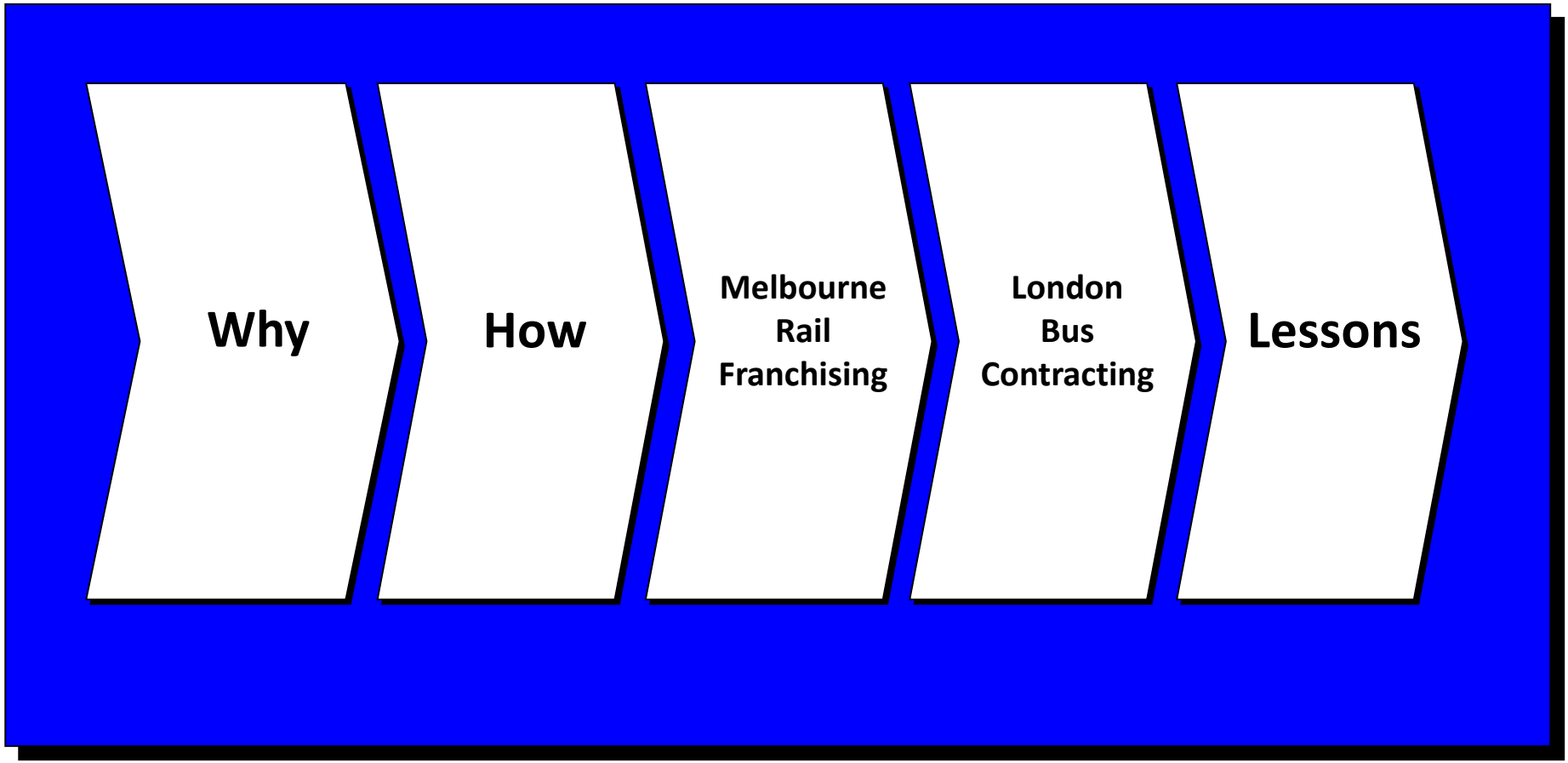
Methods

- Literature/practice reviews
- Industry interviews and surveys

Approach

- What are the facts
- What went wrong what went right; a 'warts and all' review

It is structured as follows



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There are ideological and practical factors which explain why private sector involvement is said to generate cost efficiencies

History

- Long held friction between public and private operation
- 20th Century - Government control increased in as commercial viability fell
- Late 20th Century - Interest in returning private sector influence to reduce costs, increase market orientation

Motivations

- Reduced costs
- Increase market orientation

Mechanisms

- Threat – risk of bankruptcy, loss of job
- Savings
  - Direct
  - Indirect (Run Up, Ripple Effect)

Why is Public Sector Inefficient?

- **Greater degree of Intervention from Government owners** (Giannopoulos,1989)
  - Long term as well as day to day management and policy making.
  - Management's freedom to act constrained by political concerns.
  - Relations with the labour force – particularly when Governments sympathetic to trade unions
  - General attitudes and productivity of personnel.
- **Public authorities cultural/attitude issues affecting productivity** (Cameron,1982)
  - Diminished board level authority
  - Depressed initiative – middle/ junior personnel
  - Diminished accountability
  - Centralization of authority and decision making
  - Ponderous decision making shared in committees
  - Business objectives confused by conflicting social, economic and political aims.

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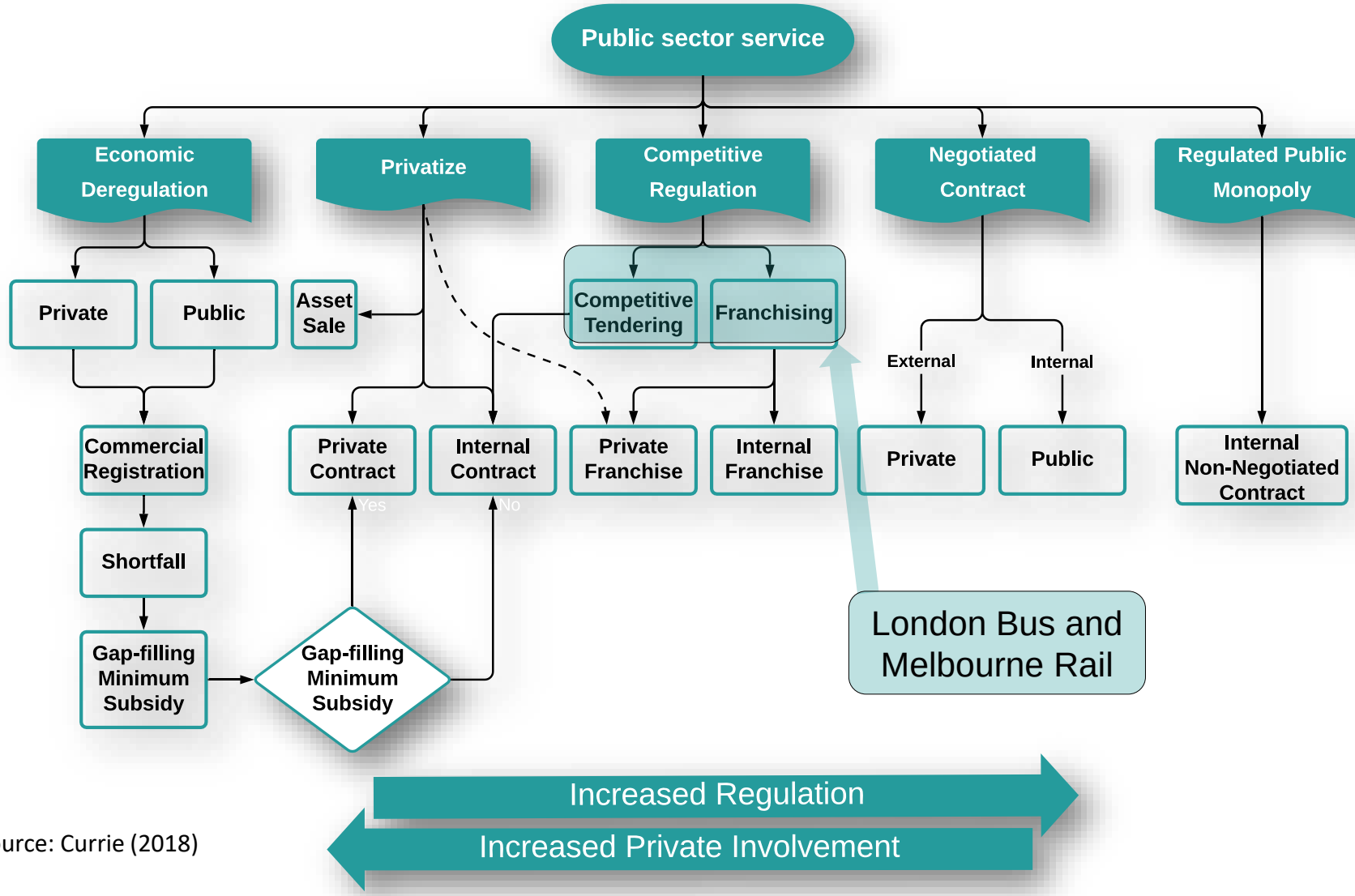
A 'menu' of models of private sector involvement are available – the case studies are of Competitive Regulation



Source: Currie (2018)

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Melb 1st Rail Franchise: let one of the worlds largest urban rail/tram networks with quite ‘unbelievable results’…

PUBLIC SECTOR OPERATION

Most savings already achieved under corporatisation

1st Franchise Model (1999-2003)

Competitive Regulation Using Franchising and Peer Competition

- **Vertical Integration** (Track/Ops)
- **Peer Competition** (2 train companies and 2 tram companies)
- **10-15 year contract** (based on performance)
- **Performance based** (incentive penalty)
- **Integrated multi-modal ticketing** – revenue pool and shared based on ridership

Tender Outcomes

- **Extremely Impressive initial outcomes**
- **Cost Savings: $A 1.8 Billion**
- **Avg. cost savings = -24%**
- ***Expected* Ridership Growth = 40-84% over 10-15 years**

“in short the government made a financial gain, shed most of the operating cost, revenue and investment risks and provided for better services” (Greig 2002, p8).

M>Trams

Yarra Trams

Hillside Trains

Bayside Trains

… but the results were ‘quite unbelievable’…a crises occurred – a second model quickly emerged…its in its 4th generation today

Early 2002
A crises emerges necessitates creation of a new model

Causes

Overly optimistic:
- revenue growth expectations
- cost cutting expectations

Contractual flaws:
- some innovative contract measures worked,
- others were difficult to implement in practice, e.g. the infrastructure maintenance regime

Revenue sharing:
- formula for splitting fare box revenue was complex
- prone to disputes

Dec 2002 – National Express Withdraws

- Loses $A135M Performance Bonds
- $A300M Financial Write-off

Government Action

Franchise Review

- $A110M injection to keep system going
- Increase in Operator Performance Bonds

Yarra Trams

Connex Trains
(Now Metro Trains Melbourne)

2nd Franchise Model (2004-2009)

CHANGES

- **Collaborative Performance based contract:** (incentive/ penalty)
- ***NO* Peer Competition:** (1 train company and 1 tram company
- **Fixed Revenue Sharing**
- **Single Marketing Agency**
- **Open Book accounting**

Current contract (4th term)

- **Same overall model** (1 train, 1 tram)
- **Performance centred** – Focus shifted on performance and reliability, not cost savings
- **Government investment** – Government heavily investing in infrastructure

Overall outcomes – a rocky and hard road – but reduced unit costs and improvements in service quality

1st Franchise Model Outcomes (1999-2003)

- **Rail punctuality/reliability improved** by an average 35%;
- **Service levels increased** by 10%
- **No strikes** - industrial action prior to franchising was common ;
- Some A$1.1 billion of new and A$143 million of refurbished **rolling stock was delivered on time and budget**;
- Overall the **customer satisfaction increased** from 61% to 68%; and
- **Patronage growth** of 3% p.a. was achieved (about twice that during public operation).
- **BUT WAS UNSUSTAINABLE**

(Williams et al, 2005)

2nd Franchise Model Outcomes (2003-2009)

Auditor General Review

- 'Reasonable Value for Money'

Benchmarking Study of Connex vs Sydney (Public) Rail (2008)

- annual rolling stock costs were 40% less;
- crewing costs which were some 17−29% lower;
- operating costs per station were 43% lower;
- overhead costs per employee were less than half of CityRail's; and
- employees per service kilometre (2006/7) were less than half of CityRail's.

Causes

Regulatory Capture?

- Unrealistic bids to 'WIN' the contract – then negotiate higher payments? [Gaming the system?]
- NO evidence BUT $110M payment for dispute mitigation wasn't in any contract

Dispute prone "peer competition"

- Sharing revenue and infrastructure responsibilities lead to contractual disputes

3rd Franchise Model Outcomes (2009-2017)

- **On-time performance** improved from 86.5% to 92.8% between 2009-2013
- **Train cancellation** remained relatively the same
- **Overall customer** satisfaction remained relatively the same
- **Ridership** experienced a modest 3% net increased from 2009/10 to 2012/13

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In 1984 Margaret Thatchers Conservative Government Contracted out buses in London – costs reduced but service quality declined

PUBLIC SECTOR OPERATION

London Regional Transport Act of 1984
Required "for-the-market" competition of bus routes

Gross-Cost Contracts (1984-1993)

Competitive Regulation
Using Competitive Tendering

- **Gross-cost contracts** – a fixed-fee awarded
- **Central planning** – Public sector control of planning, pricing, and quantity of services
- **Risk** – Public sector retained all risk of revenue/ridership drop
- **Government Bidder** – London Buses Limited was the government's bidder for services

Outcomes

- **Costs reduced** – Average -25% by 1993
  (Kennedy 1995a, Kennedy 1995b, Matthews et al. 2001)
- **Service quality reduced** – No performance incentives, primary incentive was cost reduction
  (White 2018)
- **Problematic management** – Public staff unaccustomed with contract management
  (Eno Center for Transportation 2017)
- **Weakened unions** – Unions lost collective bargaining power with single entity
  (Eno Center for Transportation 2017)

In 1993 net-cost contracting began; giving operators revenue risk; further cost reductions but no improvement in service quality

Net-Cost Contracts (1993-1998)

- **Operators keep fare revenue with subsidy paid by contract**
- **Risk** – Revenue risk placed on operator

Falling Service Quality

Outcomes

- **Costs reduced** further by approximately 40-45% (from 1984-1998)
- **Service quality decreased** – Fare revenue is small incentive compared to contract payments, cost cutting remained the primary operator incentive
- **Poor conditions** – Cost cutting resulted in little investment in buses, low staff wages and high staff turnover
- **Fares increased** as subsidies were reduced (A regulator issue)

(Matthews et al. 2001, White 2018)

In 1998 current performance based contracting began; service/service quality increased as did ridership/satisfaction – costs increased

Performance bonus model & authority restructuring (1998)

- **Integrated responsibility** – Mayor is official chairman of Transport for London (TfL), linking transport directly with policy makers
- **Gross-cost *with* quality incentives contracts** – Gross cost contracts awarded with bonuses/penalties based on performance targets
- **Staggered tendering schedule** – Tendering of 675 bus routes is staggered to make more manageable
- **Ongoing audits** – TfL conducts ongoing performance, reliability, and quality assurance surveys.

Outcomes

- **Service quantity increased** overall by about 50% (Eno Center For Transportation 2017)
- **Service quality improved** - Customer satisfaction increased nearly 90-100% since 2000 (Rowney and Straw 2014) - Ridership increased nearly 90-100% since 2000 (Rowney and Straw 2014)
- **Costs increased** – Unit costs have risen, but still less than 1986 levels (White 2018)
- **Fare/Service increased** – Fares initially decreased until 2003, but have risen 30% since 2000 – a regulator issue (Rowney and Straw 2014)

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Lessons Learned – Melbourne & London

A Significant Reversal of Fortunes

- Reduced unit costs
- Improves service quality, increased services
- Continued competitive pressures

Effective Regulatory reform takes **time**, **trial**, and **error**

- Many mistakes, adjustments essential
- A need for review and adjustment ongoing

Its **ESSENTIAL** to retain authority control of planning

- Place risks with those able to manage them
- The public interest in coordinated planning an essential requirement for growing future cities

Expect the unexpected – Contracts should be adaptive to unexpected change

- New technology disruptions, political swings (Cycle Super Highways), Level Crossing Removal Program
- Changes in base costs and on road congestion

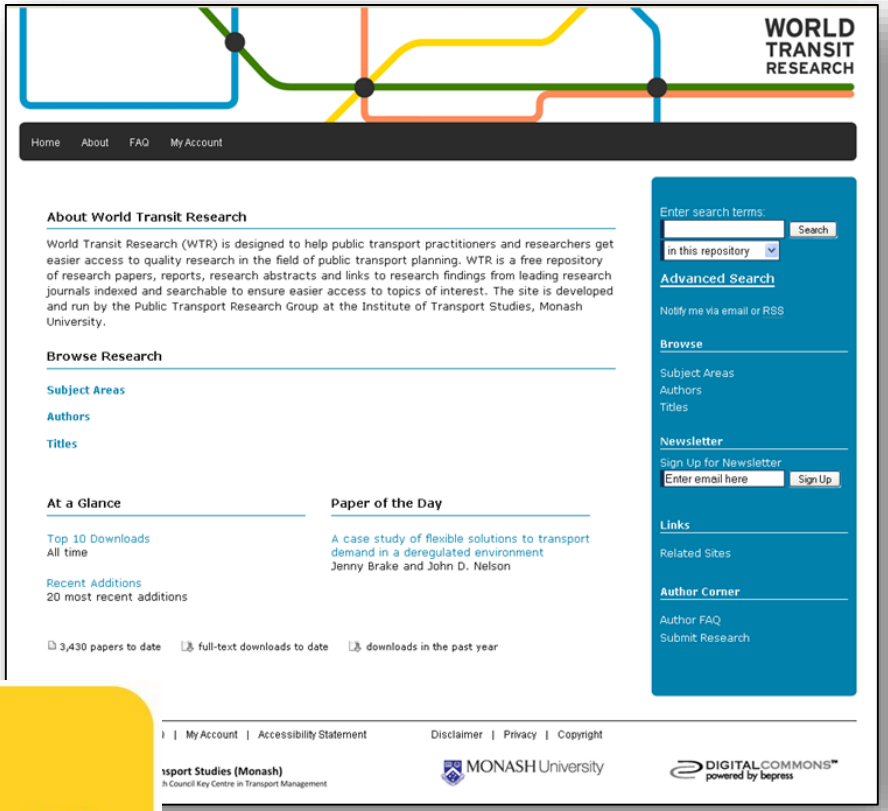
Regulatory Convergence – similar outcomes from different worlds

- Performance based contracting with strong central authority planning controls
- Competition for the market not in the market

Good Practice Concessions

Competitive Tendering – Costs Savings and Wider Benefits	• Refocussing on value for money – tendering cost savings reinvested in better service • Hidden benefits – stability from political swings
Avoid **Ideological Dogma** – be pragmatic in contract design	• Early models too ideologically based – target simple to understand pragmatic contracts with clear rewards and penalties **"If it looks is too good to be true then it probably is"** (Stanley and Hensher 2003)
Performance Contracting – with the right incentives/penalties	• Gross cost contracting simple to manage but incentives needed to better encourage improvement – clear statements and rewards focussed on authority goals
Risk Allocation – to those best placed to manage them	• Revenue risk no real incentive in a growing city; reliability risk in congested cities not a reasonable motivation for operators
Buyer Beware – Avoiding the 'Gaming' Issue	• EVERYONE losses with uninformed tendering – Regulators beware the Tender Gaming issue
Contract Length	• Contract extensions a major motivator to good performance – length suitable to risks/investment needs
Skilled Regulators	• Without good regulators – Governments risk 'outsourcing their brains'

PTRG runs World Transit Research; the global research clearinghouse for public transport research – check it out; its FREE



World Transit Research

- Commenced 2010
- 256,639 site users
- 8,000 towns and cities from 170 countries
- 6,896 journal papers
- World index of authors and topics

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