

DELIVERING TRUSTING PARTNERSHIPS FOR ROUTE BUS SERVICES: A MELBOURNE CASE STUDY

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ABSTRACT

In a paper to the Thredbo9 Conference, Stanley, Lucas and Betts outlined a framework for the creation and sustenance of a trusting partnership at the tactical level for public transport services. Since that time, the Victorian (Australia) bus industry has been in negotiation with the Victorian State Government about the future development of the State's route bus services and about implementation of supportive service contracts. This paper outlines the system development directions that are being implemented and the way that a broad-based constituency has been built to support those directions. It then illustrates the extension of the tactical trusting partnership approach between purchaser and provider to the level of the individual operator contract, showing how this should create a flexible yet disciplined environment to manage and cope with change and growth. The broad nature of the new contracts is summarised and, building on the findings from Workshop B at Thredbo 9, processes that are being implemented to manage the on-going relationship between purchaser and providers are outlined. Finally, the paper argues for extending KPIs beyond the operator to encompass the authority/regulator and the partnership of authority/operator, to extend performance pressures beyond the operator and recognise the interdependence of partners in a true partnership.

CONTEXT

In May 2006, the Victorian State Government announced the largest ever public funding increase for metropolitan bus services (in Melbourne). That increase, provided under a program called Meeting our Transport Challenges (MOTC), amounted to an additional \$A1.4 billion support for metropolitan bus services over the next ten years, the major components being:

- \$A660 million to create a major new cross-town trunk bus network in Melbourne, called *SmartBus*. When complete, this network will be longer than Melbourne's famous tram system;
- \$A650 million to improve local metropolitan bus services;
- \$80 million to upgrade radial trunk bus services in the Doncaster Corridor to Melbourne's east (as bus rapid transit, in a radial corridor that lacks heavy rail services).

Melbourne has a population of about 4 million people. The city has an extensive radial rail network and one of the world's largest tram networks, the latter being located mainly in the inner and middle suburbs. Route bus services are mainly concentrated in middle and outer suburbs but there are also some major radial route bus services to the Central Business District, essentially in corridors lacking rail services.

All route bus services are provided by the private sector, under contract to the State Government, which supports the services financially. Most of the bus services were in fact initiated by the private sector and have been always provided by the private sector. In 2006-07, total contract payments for route bus services in Melbourne (including attributable government departmental costs) were about \$A335 million. These payments will increase by about one third under the *Meeting our Transport Challenges* program.

As outlined in Stanley et. al. (2007) to the Thredbo 9 Conference, bus service levels in Melbourne have been well below comparable train and tram service levels. In particular, at the time of Thredbo 9, most weekday services finished before 7.00pm, weekend services were thin, especially on Sundays, and peak frequency levels were typically low (e.g. 40 minutes average). The new MOTC initiative rectifies these weaknesses, to establish much improved service levels on a 24/7 basis.

THE CASE FOR IMPROVEMENT

Stanley et. al (2007) outlined how the Victorian bus industry is entering a new round of contract negotiations with the Victorian Government, for metropolitan route bus contracts that will commence on 1st January, 2008. The industry's position in those negotiations includes the strong conviction that contractual negotiations must be couched within a well developed framework of strategic (or policy) directions, tactical (or system design) detail, with key operational elements closely linked to the S and T levels (STO). Meeting our Transport Challenges delivers on the Strategic and most of the Tactical elements within this framework, providing the platform for contractual negotiations that frame the operational side.

The case for service improvements as embodied in MOTC derived ultimately from the State Government's acceptance that providing a sustainable land transport system for Melbourne requires a significantly higher public transport mode share than is currently the case (20% target by 2020, compared to 9% current), this change being predicated on the need to:

- reduce annual congestion costs (currently estimated at \$A3-4 billion in Melbourne);
- reduce greenhouse gas emissions from road transport (the road transport sector is Australia's third largest GHG emitting sector and the second fastest in terms of emissions growth);
- provide transport choices for people who might otherwise be socially excluded for reasons of transport disadvantage, with consequences for their life chances and well-being; and,
- improve transport safety.

A comprehensive integrated public transport improvement program was prepared by the Victorian Government, with substantial input from the bus industry. In particular, the bus industry undertook extensive primary and secondary research into how transport disadvantage can lead to social exclusion and the ways in which improved bus services can mitigate this risk (see, for example, Stanley and Stanley 2004; 2007). That research concluded that

implementation of minimum bus service levels (details provided later in the paper) would be likely to provide most people with a travel option at most times, sufficient to avoid most prospective transport service-related social exclusion. Those service levels were confirmed by the State Government's own research and were subsequently built into MOTC as minimum route bus service standards for Melbourne. They provided the intellectual foundation for the increased funding of local bus services in MOTC, which accounts for about half the total funding increase. This initiative has been labelled "social transit".

The second major rationale for increased bus service funding was the congestion costs and environmental damage that could be avoided if a modal shift in favour of public transport could be achieved for trunk travel. The cross-town service improvements and Doncaster corridor upgrade are premised primarily on this basis and constitute the other half of MOTC, labelled "commuter transit".

Integrated public transport proposals, including bus proposals that were very similar to those that were announced in MOTC, were put to government by public transport operators as a group in the lead up to the MOTC announcement, through their marketing body Metlink. The bus elements of these initiatives were summarised at Thredbo 9 in Stanley et. al. (2007). The bus initiatives were developed by Bus Association Victoria (BAV), the peak industry body, in close consultation with the government public transport agency and with peak social welfare, environmental, local government, labour and industry bodies and also with individual members of parliament. The strong political support provided by these wide ranging groups, for the proposed service upgrades, was very important in clinching governmental funding agreement. Print media support was also very important in selling the case for improvement.

The joint public transport operators' proposals (train, tram and bus) were subjected to detailed cost-benefit analysis by BAV, showing an expected benefit-cost ratio of 3.0. Congestion cost savings were very significant in these results. State Government in-house evaluations are understood to have produced similar findings. This is consistent with expected returns from major road upgrading proposals. The evaluation results were important in helping to win State Cabinet support for the package to proceed.

IMPLICATIONS FOR CONTRACTS

MOTC provides the tactical level development directions for bus services in Melbourne that the bus industry has been seeking for a number of years. A quid pro quo offered by the industry for implementation of such a development program was agreement to a major program of bus reform, to be implemented through the contracting process (Stanley et. al. 2007).

Having started most bus routes in Melbourne and run them from the fare box for decades (until the early 1970s), but with government regulation of entry for much of this period and with budget funding support since that time, bus operators claim they hold some ownership rights over their routes. This position is not accepted by the Victorian Government. The primary quid pro quo from metropolitan bus operators, for the increase in State Government service funding of local bus services, has been a relinquishment of claimed "ownership rights" over premium cross-town routes. Provided a significant increase in services on local bus routes was provided, bus operators have said they would:

- not legally challenge the State if it decided to tender the provision of the Orbital cross-town network services;

- agree to an accountable and transparent costing process in setting gross contract prices and to use of efficient costs in setting contract rates (this process would include cost substantiation for apparently “high costs”, to demonstrate that service provision is efficient. BAV’s comparison of Melbourne bus service costs with those in a number of comparable overseas cities suggests most operators are currently efficient by most measures. The possible tendering of Orbital services will provide a future comparator for benchmarking purposes);
- agree to a process of comprehensive service reviews, to ensure that funding is allocated to best effect, in terms of government service provision goals;
- agree to patronage, operational performance and service quality incentives in contracts, subject to caps on scale (of about 2% of contract value, which is consistent with much international practice).

Contracts are currently being negotiated to embody these agreements, with new contracts to apply from 1st January, 2008. The end result will be a set of negotiated performance-based contracts that will reinforce the government’s strategic goals, while delivering the bus services that have been conceived at the tactical level and maintaining performance pressure for cost-effective service delivery. Further detail is provided on some key points in the following sections.

PARTNERSHIP FOCUS

Hensher and Stanley (2003; 2005) at Thredbo 8 argued that a trusting partnership between authority and operator is likely to deliver the best outcomes in terms of system development and service delivery. Various papers at the Thredbo 9 Conference Workshop B on Creating and Maintaining Trusting Partnerships discussed elements that would strengthen the likelihood of a successful trusting partnership. The Workshop B report (Stanley 2007) summarised key findings, made a number of policy recommendations and presented several ideas that it thought should be taken up at Thredbo 10. The Melbourne contracting process has closely followed those workshop findings and suggestions and will provide a live case study of Thredbo thinking.

Thredbo 9 suggested that the authority and provider should devote considerable effort to developing the foundations for a trusting relationship during the pre-contractual phase. In Melbourne this has been done in two major ways: in preparing system development ideas; and, in contract development.

The authority and industry have worked closely for a number of years on key research tasks that focus on building bus patronage and on identifying and valuing the benefits of bus service improvements, including extensive work in the area of public transport and social exclusion. This has included jointly funding several case studies and also jointly funding a Chair in Public Transport at Monash University. The relationships and understandings developed during this work have been vital in reaching clear agreement about system development directions, which have been subsequently implemented through MOTC.

Having reached agreement about system development directions, the next stage has been establishment of a joint departmental(authority)-industry task force to develop the route bus service contract that will be signed by operators. This has involved a negotiating process with three people from each side, extending over two years, with both sides taking specialist consulting advice from commercial and legal advisers. Authority positions have required broader support within government, to Cabinet level. Industry positions have been developed

through joint operator meetings. Formal documentation of responsibilities of all parties, their confidentiality obligations, design of the negotiation process, detailed contractual documentation and procedures for negotiations on price in individual contracts have been established. This has been in part due to the need to assure accountability and transparency, in the absence of tendering for local services, but it has also been central to providing clarity in negotiations and to establishing a clear foundation for a partnering relationship, in line with the proposals presented by Duncan (2007) to Thredbo 9.

The considerable joint effort that has gone into Tactical system planning work and the subsequent detailed contractual negotiation and design phase has given the authority and bus industry the opportunity to clearly understand each other's motivations. Workshop B at Thredbo 9 highlighted this requirement for the development of trusting partnerships. Strong agreement between the parties about the core goals from service provision, in particular, has been critical in this process and it has been reinforced by many activities that have demonstrated that the parties will behave in accordance with expectations based on trust (e.g. if someone says something will be done, it is done).

Once the contracts are signed and the relationship moves to the implementation phase (January 2008), following Duncan (2007), the possibility of establishing a Relationship Management Committee is being discussed. This Committee will be implemented to keep a watching brief over industry and operator performance as well as to provide a non-contractual forum of open communication between the industry and the authority. This Committee will again have equal membership from the authority and operators, as in the contract negotiation phase. It will monitor a wide range of matters that might potentially lead to call-in events and/or possible termination under the contracts, to seek to avert them before they arise. It is recognised by all that avoiding such situations will mean that efforts can be focussed where they should be: on achieving the best value for money in service delivery.

It seems highly unlikely that relationships of the type outlined above could develop in Europe under current European law, where discussions between the authority and potential operators in the pre-contracting phase is severely constrained. It is arguable that this will mean that service providers are not able to contribute to their potential on tactical system design matters, weakening the effectiveness of outcomes and that the opportunity to closely connect the tactical and operational (contracting) phase will also be weakened.

KPIS IN CONTRACTS

Workshop B at Thredbo 9 stressed the importance of key performance indicators being included in service contracts to encourage efficient and effective performance. Negotiated performance-based contracts are predicated on having the right KPIs, both to encourage performance and to guard against regulatory capture by the operator in the absence of tendering (other mechanisms also help in this regard, such as benchmarking, transparency in costing, etc, as outlined further below). The new Melbourne contracts are considering three types of incentives.

Patronage incentives will reward operators who grow patronage at more than two per cent a year above recent growth rates. Service elasticities are incorporated into the patronage incentive formula, to ensure that operators are not receiving patronage incentives simply because they are being funded by government to run extra services.

An Operational Performance Regime (OPR) will reward or penalise operators for how they well measure up against a small number of key operational indicators. These mainly relate to service provision, the timeliness of service provision and the timeliness of data provision on service/timetable changes to Metlink, the system marketing body (for use, for example, in its Call Centre and internet-based Journey Planner). Because of the scarcity of bus priority treatments throughout Melbourne, the initial focus of the on-time running KPI will be on having no early departures. Discussions are continuing on whether complaints handling might also be included within the OPR regime. The bus industry view is that this is not needed because there are existing procedures in place for managing complaints handling.

Bus operators have also indicated a willingness to be assessed under a **Qualitative Performance Regime (QPR)** against a small number of customer satisfaction indicators, particularly relating to key service qualities thought likely to influence patronage and/or industry image. Copenhagen is known to be a leader in this area. Bus driver performance and vehicle cleanliness are likely to be measured, provided this can be done cost-effectively at the level of the individual contract (of which there are about 30 in Melbourne).

In addition to KPIs as performance incentives, Workshop B at Thredbo 9 was supportive of possible contract roll-over at end-of-term being used as a performance incentive for operators. Under consideration for Melbourne's new bus contracts is a base term, with the possibility of a contract extension depending on performance. The contract will spell out criteria to be taken into account in deciding on the extension, encompassing partnership and KPI elements. Contract terms beyond ten years (including extensions or roll-overs) are not possible under current Victorian legislation, so the contracts will need to operate within this constraint.

THE REQUISITE SKILLS

Thredbo 9 emphasised that genuine partnering is made easier if the parties have the requisite skills to undertake the tasks required of them. Both the authority and bus industry have highly skilled people leading their system planning and contract negotiating work. By virtue of access to resources, the authority has greater potential skills available than the bus industry. However, as an expression of the genuine intent to foster a partnering relationship, the Victorian State Government has supported the bus industry's efforts to research and plan improved bus services and to participate in a partnered contract negotiation process. For example, the accountability mechanisms agreed, to establish start costs under the new contracts, is resource intensive. Government has agreed to meet the major part of the costs required to establish the cost base.

MARKETING

Market research into factors supporting and hindering bus use in Melbourne continually indicate that knowledge of services ranks about number three or four in importance. The more important factors are service frequency and coverage, reliability and travel speed. MOTC deals with most of the higher order issues (but on-road priority is still in need of further attention in Melbourne, to increase speed and improve reliability). As MOTC initiatives are rolled out, a new marketing campaign to promote knowledge of, and hence use of, bus services is being rolled out. This is a multi-media campaign, jointly agreed between the government authority, the bus industry and Metlink (the system marketing body for all public transport operators), and funded by Government.

The incorporation of marketing into the relationship between the authority and operators serves to extend the partnership relationship across another set of people within the respective organisations, further reinforcing its strength.

MINIMUM SERVICE LEVELS

Thredbo 9's Workshop B emphasised the importance of the authority specifying a minimum service level and providing a contractual environment within which operators had some scope to maximise patronage from additional service provision beyond this point. This approach was thought likely to ensure that both social obligations and commercial/economic/environmental goals were achieved. The new Melbourne contract has been structured in this way.

BAV's research suggested that, to provide most people with the opportunity to undertake most activities that are important to their daily lives, minimum public transport service levels in Melbourne should be as follows:

Weekdays: start 0600; last run 2200 (hourly frequency; Friday night extend to 2400)

Saturdays: start 0600; last run 2400 (hourly frequency)

Sundays: start 0800; last run 2200 (hourly frequency).

These are minimum standards and higher frequencies would be expected at peak times. MOTC essentially delivers these standards. Bus operators will have some flexibility in their contracts to place kilometres above these minima in locations and at times that will maximise patronage (called "flexible kilometres"). The capacity to have some flexible kilometres has been an industry requirement for being subject to a patronage incentive.

ACCOUNTABILITY AND TRANSPARENCY

Thredbo 9 emphasised the importance of having adequate accountability and transparency mechanisms in contracts. This is particularly important for negotiated performance-based contracts, because these are less subject to market tests than tendered contracts.

Melbourne's initial experience in franchising its train and tram services has been that open competitive tendering is no guarantee of achieving sustainable service delivery prices. The failure of the initial Melbourne train and tram franchises was reported at Thredbo 8, where unsustainably low bids were submitted and accepted, with the major franchisee subsequently failing and all contracts being re-negotiated. In short, tendering does not guarantee sustainable service contracts, even if the process may apparently be accountable and transparent.

In a negotiated performance-based contract, alternative mechanisms are required to assure accountability and transparency. The authority knows what it is paying and can benchmark service delivery costs against other systems. That provides a first layer of accountability and transparency.

Independent financial experts can be engaged to prepare costings of service provision at the level of the individual contract, working with common templates. Using this independently prepared data, operators within a city like Melbourne can be compared to each other in terms of typical service comparators (e.g. cost per bus km; cost per bus hour; cost per peak bus; margin; etc). Operators with costs to the high end on particular measures can be required to

“please explain”. Inadequate answers may lead to revised payments. Operators at the low end might be given an opportunity to argue for improved remuneration arrangements.

Combinations of the above mechanisms are being considered in the Melbourne process to help assure accountability and transparency. This is further assisted by the use of a probity auditor, whose role is primarily focussed on the integrity of the negotiation process. The sum total of these measures should help to ensure that there is no capacity for operators to play “capture the regulator” and, equally, they should help ensure that the outcome is a sustainable service delivery system at fair cost (i.e. that it represents sustainable value for money, given the tactical level processes and other contractual elements that are in place).

RISK ALLOCATION

Risk allocation in public transport has been a hot topic in Melbourne since the failure of the first train and tram franchises. In the 2008 bus contracts, operators will carry production risk and some cost risk. Cost indexation means that some of the risks on the cost side are covered by government but indexation provisions in the current contracts show that cost indexation provisions still leave operators exposed to cost risks. For example, current wage costs in contracts are indexed by average weekly adult ordinary time earnings, which are showing much less growth than expected at present, probably for reasons to do with rapid growth in low wage jobs. Labour agreements have locked in pay increases at typical expected rates of increase in AWE (e.g. the Federal Reserve Bank targets 4-4.5% growth in AWE annually, for macro-economic control purposes), leaving operators to carry the costs of actual AWE increases falling sort of expectations.

As in the current arrangement, revenue risk in the 2008 bus contracts will largely be carried by government, although patronage incentives provide operators with a stake in the quantity side of the revenue equation (not the price side).

KPIS ON THE AUTHORITY!

The Thredbo 8 and 9 conferences both argued that reforming the regulator should be a high priority for the improvement of public transport service outcomes. One way to help facilitate such change is to establish KPIS on the regulator’s performance, particularly with respect to those matters that impinge directly on operator performance. For example, the rate of provision of bus priority measures and enforcement of in-place systems impacts on the productivity with which bus operators use their fleets and labour and also affects on-time running and reliability. Public transport service contracts can seek to define the circumstances or degree to which particular operator-focused KPIS apply, or not apply, depending on the extent to which the regulator delivers on its contribution to such “joint outcomes”. This is consistent with good risk management practice and with the Quality Contract approach in the UK.

Going further, however, it is arguable that the authority/regulator should be publicly and directly accountable for its own performance in respect to public transport service outcomes, at least as much as the operator. Such “pressure” applied to the authority may help to improve both performance and accountability. By way of example, relevant KPIS for an authority might include service enhancements funded, on-road priority treatments implemented, enforcement notices served on traffic illegally using priority lanes, etc. Performance against such measures could be publicly available and could also feedback to the operator’s risk-reward frontier.

JOINT KPI'S

Consistent with the idea of public transport service delivery being a partnership between the authority and operator (in a private delivery model), there is a case to be made for KPIs being developed that measure the performance of the partnership. Some of these KPI's might include traditional high level measures such as cost-efficiency, patronage performance, fare evasion, accessibility, passenger safety, environmental performance, customer complaints/compliments, etc. They could also include measures that target the relationship between authority and operator. The Thredbo 10 workshop could consider whether this is feasible and desirable.

CONCLUSIONS

Hensher and Stanley (2005) and Thredbo 8 outlined arguments why negotiated performance-based contracts had much to commend them in terms of delivering better (including more sustainable) value for money than tendered contracts, where a quality operator was the incumbent. Ken Gwilliam, in the closing session of Thredbo 9, expressed the view that negotiated contracts with roll-over provisions were ripe for operators to play capture the regulator. The current paper has outlined a range of provisions being built into the 2008 metropolitan route bus contracts in Melbourne to help assure value for money is delivered and that accountability and transparency are preserved, to mitigate any risks of regulatory capture.

Careful attention is being devoted in the Melbourne bus contracts to relationship development and management, to foster the trust that has been built up between the government (and its public transport authority) and operators. This trust has allowed government to progress a development and reform agenda and operators to look forward to a healthy future, provided they perform. Competitive pressures are built into contracts and risks are being allocated to those thought best able to manage them. The nature of the trusting partnership that exists will mean that flexibility can be built into service delivery and contracting arrangements as the contracts progress. The outcomes will be a good test case for what is possible under negotiated performance-based contracts.

Finally, the paper has argued that risk-reward frameworks would benefit from extending the scope of KPIs to encompass measures of authority/regulator performance and performance of the partnership as a whole. This extension recognises the interdependence that characterises partnerships and adds pressure for both parties to perform in the pursuit of better value for money.

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