

COMPETITION FOR PASSENGER TRANSPORT CONTRACTS

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EXECUTIVE SUMMARY

1. THE PROJECT

This is the Task 1 report of a proposed four-task research project into the level of competition for passenger transport contracts in New Zealand and into factors affecting competition and the efficient use of public funds. The research was terminated after the completion of Task 1.

The overall objective of the project is:

To assess the need for, and possible means of, increasing competition for passenger transport subsidies, so as to better achieve the efficiency and other Competitive Pricing Procedures (CPPs) objectives of Clause 19(3) of the Transit New Zealand Act. These means of increasing competition may be achievable within the present (mandatory) CPPs, may involve changes to the CPPs, and/or may involve changes to the Transit New Zealand Act or associated legislation.

Within this overall objective, four specific issues were defined for research:

- (1) *Is the current low level of competition merely a transitional problem that will go away; or are the features of the New Zealand industry and situation environment such that it is likely to be a permanent feature under the existing rules?*
- (2) *Is the low level of competition a substantial problem, in terms of not providing the efficiencies required/hoped for?*
- (3) *What changes to the present CPPs (within the present legislation and while retaining a competitive tendering process) would encourage/force greater competition and lower costs, and what would be the advantages/disadvantages of these? (Note that the project is not to involve a formal review of the CPPs as such, but is a research project about means of increasing competition, which could potentially have implications on the procedures in the CPP Manual.)*
- (4) *What changes to present procedures outside the CPPs (and maybe involving legislative changes) could encourage/force greater competition, and what would be their advantages/disadvantages.*

The project was divided into four main tasks, as follows:

- **Task 1: Investigation of Competitive Market Issues**
This research task is the subject of this report. It addresses issues (1) and (2) above and identifies potential changes to procedures as inputs to issues (3) and (4). It involved discussions with present and potential bus operators and

regional councils, review of overseas competition in the passenger transport sector, analysis of tender bids in a sample region in New Zealand and comparison between New Zealand and overseas experience on key contract aspects.

- **Task 2: Potential Changes to Procedures in CPP Manual**
Drawing on the findings of Task 1, this task would involve identification and appraisal of potential changes to procedures embraced within the CPP Manual (within the existing legislation and competitive tendering system) which would result in greater competition and improved efficiency. (The project is not to involve a formal review of the CPPs as such; but is a research project about means of increasing competition and improving efficiency, which could potentially have implications on the procedures in the CPP Manual.)
- **Task 3: Potential Changes to Associated Procedures and Legislation**
As for Task 2, this would draw on the findings from Task 1 to identify and appraise potential changes to procedures outside the scope of CPPs (maybe involving legislative changes) which would result in greater competition and improved efficiency.
- **Task 4: Conclusions and Reporting**
This task would bring together the work undertaken in the previous three tasks and report the findings to Transit New Zealand.

2. SCOPE OF TASK 1

Task 1 involved the following eight sub-tasks:

- Survey of present and potential operators
- Survey of regional councils
- Survey of other parties
- Review of overseas evidence on contestability of bus market and the implications
- Review of overseas experience on development of competitive markets
- Review of overseas evidence on key contract aspects
- Analysis of New Zealand tender bids and contracts in a sample region (Wellington)
- Review of New Zealand experience on key contract aspects

Seven specific questions were defined to be addressed through these sub-tasks. These questions and the research findings are contained in Section 4 below.

Task 1 has enabled us to draw some tentative conclusions on the main factors influencing the level of competition and the efficiency of use of public funds in the tendering process.

3. COMPETITIVE SITUATION AND ISSUES – AN OVERVIEW

3.1 The Importance of Contracted Services in New Zealand

Around 70 million vehicle kilometres per year in total are operated by fixed route urban public transport services in New Zealand. With the introduction of transport law reform legislation, some 22% of these were registered to operate "commercially" from July 1991, and the remaining 78% were subject to competitive tendering procedures. (The "commercial" services included some rail and trolley bus services which received separate infrastructure funding and other services for which operators were reimbursed for offering concessionary fares.)

The proportion of services in the different regions which were registered commercially varied between 0% (Southland) and 100% (Taranaki). Of the larger regions, Auckland had 8% commercial services, Wellington 51% (including train and trolley bus services) and Canterbury only 2%.

The low overall proportion of commercial services in New Zealand may be contrasted with the situation in the United Kingdom following the deregulation of local bus services there in 1986. In the UK, around 85% of all services were registered "commercially" (including these subject to reimbursement for concessionary fares). Thus there is a major difference in the true markets: in the UK, the commercial market is dominant and the contracted market fills limited gaps in this market; while in New Zealand the contracted market dominates and thus the regional councils have the major say in determining the overall service levels and fares in most regions.

3.2 Types of Contract

The 75% of contracted services (about 55 million vehicle kilometres per year (vk/yr)) were competitively tendered through some 520 separate tenders and involved around 1000 peak buses (i.e. about 2 peak buses, 100,000 vk/yr per tender on average).

By contrast, in the UK the average tender size is considerably smaller than in New Zealand. A large proportion of UK tenders involve only a few "gap-filling" trips to supplement commercial trips, particularly in evenings and at weekends. Most tenders therefore involve less than 50,000 vk/yr.

Most New Zealand tenders (94%) were of the net cost type, where the revenue is retained by the operator.

Over half the regions decided on contracts of between one and three years' duration; while others including Auckland decided on durations of 3-5 years. Because of the dominance of Auckland, most (83%) of all contracts were of 3-5 years duration.

3.3 Initial Extent of Competition in New Zealand

Table 1 shows the proportion of all requests for tender (RFT) receiving different numbers of bids in the initial (pre-July 1991) tender round. Some 57% of RFTs received only one (or no) tenders; while only 12% received 3 or more tenders.

Table 1. Number of Tender Bids by RFT.

Number of Bids ⁽¹⁾	% of Total RFTs
0	0.2
1	57.1
2	31.0
3	7.2
4+	4.5
Total	100.0
Average Bids per RFT	1.6

(1) Multiple bids by some operator for a single RFT only counted once.

Overall, there was an average of 1.6 tenders per RFT. However this average varied considerably between regions, from a low of 1.0 tenders per RFT (Hawke's Bay) to a high of 3.4 tenders per RFT (Waikato). For the three largest regions:

- Auckland - average 1.4 tenders/RFT (70% of RFTs with only one bid)
- Wellington - average 2.1 tenders/RFT (30% of RFTs with only one bid)
- Canterbury - average 1.2 tenders/RFT (78% of RFTs with only one bid).

In the initial tendering round, it was notable that none of the major urban operators made serious inroads into "new" regions; and most incumbent operators stuck to their home area within their established region.

3.4 Subsequent Trends in Competition in New Zealand

Up to mid-1992 (when the analyses for this project were undertaken), only a small proportion of the initial July 1991 contracts had been re-tendered. This re-tendering has occurred mainly in Wellington (32 contracts, 24% of the region's total) and in Canterbury (13 contracts, 26% of the region's total).

While it is rather early to draw firm conclusions, all the evidence so far indicates significant increases in the initial level of competition in the subsequent re-tendering:

- Wellington: for re-tendered contracts, the overall average number of bids per RFT has increased from 2.3 in July 1991 to 3.1 in April 1992 (a 35% increase). In the Hutt Valley, three tenders showed an increase from three bids per RFT average in May 1991 to five bids per RFT in April 1992.
- Canterbury: whereas the July 1991 average was one to two bids per RFT, in the re-tendering process this had increased to typically about four bids per RFT for services requiring larger buses to six to eight bids per RFT for services suitable for smaller vehicles.

In addition, in Wellington some tendency has been for some services that were originally contracted to be notified commercially, indicating a modest increase in the proportion of commercial services.

It is premature to conclude that the extent of competition for tenders throughout New Zealand will increase when the original (July 1991) contracts come up for re-tendering, although it seems quite likely that this will happen. The extent of competition in the July 1991 tendering round may be regarded as "artificially" low, because of the novelty of the process and the simultaneous tendering of so many services. These factors produced a very steep learning curve for operators, stretched their resources very thinly, and made them concentrate on defending their existing territories rather than attempting to expand into other territories.

However, the "underlying" tendency for increases in competition over the next few years may be at least partly offset by:

- continuation of the current reluctance of many operators to tender for services outside their traditional operating areas;
- the emergence of large dominant operators in some areas - as shown by the Stagecoach purchase of Wellington Transport Ltd and Cityline (Hutt Valley and Papakura).

3.5 Overseas Trends in Levels of Competition

When passenger transport services in the **United Kingdom** were deregulated in 1986, some 3800 RFTs were issued in the 7 major conurbations (excluding London). These received an average of 1.8 bids/RFT, only a little higher than the 1.6 initial average in New Zealand. For individual conurbations, the average bids/RFT varied between a low of 1.3 and a high of 2.5 (New Zealand range 1.0 - 3.4).

In the UK, initially greater competition occurred between operators from different areas than occurred in New Zealand. This is probably largely a result of the different demographic and geographic patterns in the two countries. For example, in UK the distances between adjacent centres are much less than in New Zealand. In tender rounds since 1986, the level of competition in the UK conurbations has shown significant increase. In 1987, the average number of bids per RFT in the conurbations

increased to about 2.7 and in 1988 further increased about 3.2 (some 87% over the 1986 level). Similar trends have occurred in non-metropolitan countries.

Tyson (1989) noted:

"Competition has been on a much larger scale than anticipated by many people, with at least thirty operators in the market in each area and an average of three bids for each tender for subsidised service".¹

The increases in competition in the UK have come primarily from existing firms, although there has been a steady flow of new entrants. There are now over 200 instances of "established" operators that have expanded outside their traditional operating areas, with their expansions in most cases based at least partly on tendered operations.

In the United States, competitive tendering for passenger transport services was relatively rare before 1985, and still accounts for only a small proportion of the total market. For 8 RFTs issued before 1985, the average number of bids was 1.8 (close to the UK 1986 average and the New Zealand 1991 average).

Since 1986, the average level of competition in the USA has increased to a level of around 4 bids per RFT in the last few years.

Comparison of the levels of competition for contracted services in New Zealand, relative to those in key overseas countries (UK and USA), show that:

- The initial (July 1991) average level of competition in New Zealand was not much lower than the corresponding initial levels in the UK and USA. The comparisons with the UK in particular must be seen in the light of:
 - the much greater number of operators in the UK with established operations within a given distance of any contract location;
 - the much smaller proportion of the total UK market accounted for by contracted services.
- The indications to date are that the level of competition in New Zealand experienced in July 1991 has increased quite substantially as services have been re-tendered, and this trend is likely to continue as the original contracts expire. This increase in competition parallels experience over recent years in UK and USA.
- The medium to long-term expectations on the level of competition in New Zealand are not clear, although on average a lower level than in the UK seems probable. (A longer-run average of around 3-5 bids/RFT would seem plausible, unless a few major operators come to dominate the market in the larger centres.)

¹ Tyson, W.J. 1989. *A review of the second year of bus deregulation*. AMA, London.

3.6 Tender Prices and Public Funding

Between 1990/91 and 1991/92, the total public funding for passenger transport services fell by some \$19M pa (Section 2.5): this represents about 18% in money terms, or over 20% in real terms. In the three main regions, the reductions were 10% in Auckland, 16% in Wellington and 32% in Canterbury.

In general, service levels changed little between 1990/91 and 1991/92; and fares generally remained unchanged or were adjusted only for inflation. Thus the \$19M pa saving is a reasonable reflection of the (short-run) saving in public funding to provide broadly unchanged levels of services at generally unchanged fare levels.

It is too early to draw any firm conclusions about the impacts of re-tendering since July 1991 on public funding requirements. In Wellington, these re-tendered RFTs were mostly not directly comparable with the original RFTs. However in Canterbury the re-tendered contract prices have averaged around 17% lower than the equivalent initial contracts. Canterbury Regional Council anticipates that in some cases interpeak service levels may be able to be doubled within the original contract price.

3.7 Impacts of Competition on Contract Prices

This project is concerned with the need for and means of increasing competition in order to better achieve the efficiency and other objectives of Clause 19(3) of the Transit New Zealand Act. While the main focus of the project is on **competition**, this is regarded primarily not as an end in itself but as a means to secure improved efficiency in the use of public funds. Thus it is important to examine not only what measures might help to increase competition, but also whether such measures will result in improved efficiency; and in particular to examine the relationship between increased competition and reductions in public funding for contracted services.

Prima facie, it might be expected that contract prices would tend to decrease as the level of competition increases, purely on the basis that if tender prices are distributed randomly round a "true" value, then the price of the lowest tender will tend to reduce as the number of tenderers increases.

In the United Kingdom, there is certainly some evidence that contract prices reduce as the level of competition increases. An analysis of West Midlands contract price showed that:

" ... other things being equal, contract price was 17% lower when there were two bidders rather than one, and 30% lower when there were three or more bidders rather than one" .²

Other UK evidence also supports this finding for gross contracts but not for net contracts. (It is hypothesised that in the case of gross contracts, more bidders means

² Pickup et al. 1991. *Bus deregulation in the metropolitan areas*. Avebury, Aldershot.

more smaller operators, and the more such bids there are the lower the primary bid is likely to be. For net contracts, the smaller operators tend to include a larger premium for revenue risk, and hence are unlikely to be successful so that however many of them bid, the contract is still likely to be won by a larger operator.)

Beesley and Glaister³ hypothesised that contract prices would rise as the number of bidders increased, but their analysis of 122 RFTs indicated a slight decline in prices (but not statistically significant).

In New Zealand, there is as yet no clear evidence on the relationship between the level of competition and contract prices. However, given the evidence that has been analysed on the pattern of pricing for net contracts in the July 1991 tendering round, it seems likely that the starting hypothesis will be valid for both gross and net contracts, i.e. contract prices decrease as the number of bids increase (this result occurs because many smaller operators appear not to be allowing a sufficient premium for revenue risk). This view would be supported by recent evidence from Canterbury where net contract prices reduced by around 18% (for identical services) from the July 1991 tender round (average one to two bids per RFT) to the November 1992 tender round (average 4.8 bids per RFT).

However, it is not clear whether the starting hypothesis will remain valid for net contracts in the medium term, as operators learn to better allow for revenue uncertainty.

Thus it appears that there is not a simple general relationship between the actual level of competition and the final contract price. While so far in New Zealand greater competition appears to have resulted in lower prices, this may not necessarily remain true in the longer term as operator knowledge improves.

Also noted are the many features of the tendering and contracting process which may impact on tender prices and administrative costs (and hence the overall efficiency in use of public funds), without necessarily affecting the level of competition. Examples include contract negotiation procedures and details of service specification. The report addresses the impacts of different features on efficiency as well as on competition.

4. SPECIFIC QUESTIONS

The project Research Brief sets out seven specific questions to be addressed in the Task 1 work. This section discusses our findings and conclusions in relation to each of these questions in turn, building on the findings outlined in the previous section.

³Beesley and Glaister. 1989. *Bidding for tendered bus routes in London*.

4.1 *What factors have limited the competition for contracted services in New Zealand to date; and what changes in procedures (CPPs or otherwise) would help to increase future levels of competition?*

Two main influences appear to have limited competition. These are the ability to compete and the need to compete. The ability to compete has had the greatest impact on potential new entrants and on smaller operators wishing to expand. Main factors which have limited these operators' ability to compete appear to be:

- (i) RFT size beyond their financial scope.
- (ii) Group tenders which, while they have not actually stopped new and small operators from competing, have seriously limited their likelihood of successful tendering.
- (iii) RFTs for net cost contracts which do not include reliable patronage and revenue information. This is important because new and small operators generally do not have the resources to accurately assess revenues on the services of other operators.
- (iv) The general absence of RFTs for gross cost contracts.
- (v) The difficulty of procuring buses which are suitable for operating contracted services (at a price comparable to that which previously funded operators themselves paid for similar vehicles).

The need to compete mainly relates to incumbent operators. These operators certainly feel that they need to compete for their own "home patch". The main factors which have limited these operators' needs to compete in new areas appear to be:

- (i) The initial concentration on retaining their own "home patch".
- (ii) Future uncertainty regarding contract tenure and adoption of a "wait and see" attitude.
- (iii) Fear of retaliation from an unsuccessful incumbent tenderer.

4.2 *What are the explanations of the differences in the level of competition experienced to date in different regions of New Zealand?*

Differences in the initial July 1991 level of competition appear to be mainly related to the following:

- (i) **Fairness and Equity.** Competition is more likely to have occurred where potential tenderers perceived that the tendering authority seriously wanted to attract competition.
(The possibility of the adoption of Ministerial Directive A⁴ in Auckland to favour an incumbent operator obviously showed a preference for the incumbent operator, even if the Directive was rarely applied in evaluating tenders).

⁴Minister of Transport. 1990. Directive A. *Ministerial Directive to Transit New Zealand*.
Issued on 27 November 1990.

- (ii) **Fear of Retaliation.** Most incumbent operators felt threatened by the possibility of retaliation, particularly if they competed against the dominant operator. This seems to be the main reason that most existing private urban operators did not tender against the ex-municipal operators, particularly in Auckland and Wellington. In Waikato, where the previous main operator had advised that it would not be tendering, there was no fear of retaliation, and a high level of competition occurred.
- (iii) **Number of Previous Operators.** In some areas (Canterbury, Hawke's Bay) few existing operators were familiar with urban operations. This tended to result in lower levels of competition. In other areas (Auckland, Wellington, Waikato) with more, experienced operators the amount of competition tended to increase. (Note however that in some cases this may have been partly off-set by the fear of retaliation!)
- (iv) **Size and Market Share of the Dominant Operator.** Where the dominant operator is both very large and has a high market share (compared with other potential tenderers) the initial level of serious competition is likely to be low. For example, in Auckland, c.70% of RFTs received only one tender. In Canterbury a new competitor overcame this with a scatter-gun approach and tendered for more contracts than could be operated, then declined to accept some contracts offered. This suggests that the effective level of competition in Canterbury was less than the number of tenders per RFT would suggest.

In Waikato, where high levels of competition occurred, there was no previous dominant operator to contend with.

- (v) **Number of concurrent RFTs.** Competition is likely to be less when there are a large number of concurrent RFTs as the task of sifting through all the RFTs to identify the best opportunities can be daunting! This is likely to be an even more serious impediment to competition where patronage and revenue estimates also have to be made.
- (vi) **Market Information.** Economic theory would suggest that a market is likely to be more contestable, and encourage greater competition, if it has (or is supplied with) good information. For net cost contracts, the most difficult information to obtain is the patronage and revenue on a competitor's services. This suggests that greater competition is likely where this information is either:
- unnecessary, as in the case of Waikato's gross cost contracts; or
 - more easily obtained, because RFTs are smaller and more easily surveyed.

4.3 *Is the present low level of competition in New Zealand to be a permanent feature of the New Zealand situation (under the present legislation/procedures), or is the level of competition likely to increase significantly over the next few years?*

This question has largely been addressed in Section 3 above (3.5 in particular). Conclusions are, in summary:

- The initial (July 1991) level of competition in New Zealand was not much lower, in terms of average number of bids per RFT, than the initial levels in the UK and USA. (Thus it is perhaps misleading to refer to the **low** level of competition in New Zealand.)
- The level of competition in New Zealand experienced in July 1991 appears to have increased quite substantially in subsequent re-tendering rounds, and this trend seems likely to continue as the original contracts expire. This increase parallels experience over recent years in UK and USA.
- The medium/long-term expectations on the level of competition in New Zealand are not clear, although on average a lower level than in the UK seems probable.

Within the present New Zealand legislation and procedures, changes may occur which would tend to conspire against the apparent trend to greater competition. Examples are:

- (i) Emergence and continuation of a dominant operator in an area with sufficient resources and market share to effectively control the market. This is most likely to occur in areas where there are currently few competitors, and existing procedures may deter new entrants.
- (ii) Where perceived risks associated with market entry increase. This could occur if a number of contracts are **actually** cancelled because of funding shortages and/or registration of replacement commercial services.

4.4 *Is the low level of competition experienced to date, a major problem in terms of achieving potential efficiencies, or is there sufficient threat of competition that the market may be regarded as reasonably contestable?*

This question was largely addressed in Section 3.7 above, where it is concluded that there is not a simple general relationship between the actual level of competition and the final contract price. While so far in New Zealand greater competition appears to result in lower tender prices (partly because of the random chance effect), this may not necessarily remain true in the longer term as operator knowledge of the tendering system improves.

Provided that there is a real threat of competition, the actual extent of competition is likely to have little (or no) effect on the price of an individual tenderer. Each tenderer will be forced to price keenly, as he is unaware of the prices of other bidders.

Provided that there is a real threat of competition, the actual extent of competition is likely to have little (or no) effect on the price of an individual tenderer. Each tenderer will be forced to price keenly, as he is unaware of the prices of other bidders.

It appears that where there is a threat of competition and a reasonable amount of actual competition (say 3-5 tenders per RFT on average), the achievement of potential efficiencies will not be a major problem.

4.5 *What are the implications of the low level of competition on tender and contract prices?*

This question is also partly addressed in Sections 3.7 and 4.4 above.

Provided there is a perceived threat of competition, the number of perceived or actual competitors is unlikely to affect the price(s) submitted by each tenderer. However a greater number of tenders tends, in most cases, to result in a lower contract price (if only because of the random chance effect).

This suggests that low levels of competition will tend to result in higher than otherwise contract prices. In principle, this could be overcome by negotiation with the lowest priced tenderer. However the present CPPs prohibit tendering authorities negotiating where there is more than one tenderer for a given RFT.

In practice this means that where there is only one tenderer, negotiation can be used to attempt to achieve an efficiently priced contract from an excessively priced tender. Where there is any actual competition the tendering authority has no choice but to accept the preferred tender, or to re-tender. This approach does not necessarily result in the achievement of efficient contract prices, because of the restriction on negotiation when more than one tender is received (and given that authorities may be reluctant to re-tender, given time constraints, etc.).

In situations of low levels of competition, negotiation becomes a key component in securing efficient tender prices. This suggests that further attention should be paid to:

- permitting negotiation in cases where there is more than one tenderer;
- negotiation strategies, including benchmark tender pricing.

4.6 *How might a higher level of commercial services be encouraged, and would such measures be worthwhile in terms of achieving the objectives of the Act?*

A higher level of commercial services could be encouraged by:

- Requiring tendering authorities to cancel contracts where commercial notifications are received.
- Prohibiting tendering authorities from contracting over commercial services.

The first of these approaches would considerably increase risks associated with insecurity of contract tenure, and may well result in increased compensation payments.

The second approach would seem to usurp a regional council's role of primary responsibility for service planning within its region. Retention of a "free" low quality commercial service may well incur higher overall net costs.

It is not clear at this stage that either of these approaches would be worthwhile in terms of achieving the objectives of the Act.

4.7 *What changes to the present procedures (additional to those covered above) would help to reduce public sector costs (contract costs plus administrative costs) and provide better value for public funds?*

We have investigated in some detail the key features of the tendering/contracting process and whether changes to the current procedures in respect of each feature would help to increase competition and provide more efficient use of public funds. (As noted earlier, these two objectives are not necessarily directly associated with each other.) Our conclusions to date (November 1992) are summarised in Section 5 of this Executive Summary.

5. CONCLUSIONS ON COMPETITIVE FACTORS

Findings to date on the key features of the tendering and contracting process that impact on the level of competition and the efficient use of public funds are summarised below:

High Priority for Further Investigation

- **RFT Size**

Large RFTs both discourage competition and lead to higher than otherwise necessary contract prices. This could be overcome by changes to the CPPs.

- **Group and Combined Tenders**

These tenders can discourage competition and lead to higher than otherwise necessary tender prices. This is particularly so where the incumbent operator has considerable market share. This could be overcome by changes to the CPPs.

- **Gross v Net Contracts and Patronage Information**

Net tenders can strongly favour the incumbent operator, particularly when patronage information is not published with the RFT. This could be overcome by changes to the CPPs.

- **Security of Contract Tenure**

Good security of tenure is considered fundamental to attracting serious competition. The impact of this feature on likely tender prices is not clear. Security of tenure could be improved by changes to the CPPs.

- **Contract Negotiation Procedures Before Contract Award**

The inability to negotiate with the lowest priced tenderer where there is more than one tenderer is likely to lead to higher than otherwise necessary contract prices. This could be overcome by changes to the CPPs.

- **Vehicle Availability**

The general unavailability of new and/or good quality secondhand buses at reasonably short notice may effectively lock out potential competition. This could be overcome by legislative change permitting tendering authorities to own buses for lease, or by other moves to encourage a bus leasing industry in New Zealand.

Medium Priority for Further Investigation

- **Non-Performance Penalties**

Low non-performance penalties may result in unstable service provision and increased costs caused by the need to re-tender. High performance bonds may lead to higher than otherwise necessary contract prices. This could be overcome by changes to the CPPs.

Low Priority for Further Investigation

- **Contract Duration and Phasing**

Present practices are in line with international experience and sector views.

- **Manner of Service Specification**

Industry familiarity with process improving over time.

- **Tender Evaluation Factors**

Ongoing improvements are apparent.

- **Contract Negotiation Procedures After Contract Award**

Current procedures are appropriate.

Table 2 presents this summary and includes suggestions on options to be investigated for each feature in future research.

Table 2. Features discouraging competition and efficient contract pricing.

Feature	Likely Impact of Current Practices/Procedures		Comment	Indicative Options for Further Consideration
	Increasing Competition	Achieving Efficient Pricing		
High Priority For Further Investigation RFT Size	High	High	Large RFTs are a strong deterrent to smaller operators	<ul style="list-style-type: none"> No change to CPPs Adopt "horses for courses" approach Specify RFT sizes in terms of size of potential tenderers
Group and Combined Tenders	High	High	Can deter smaller operators, particularly where incumbent operator has considerable market share	<ul style="list-style-type: none"> No change to CPPs Specify mandatory evaluation to trade off lowest overall v lowest individual tender prices Specify maximum market share/no. and size of group tenders
Gross v Net Contracts and Patronage Information	High	Not Clear	Can strongly favour incumbent operators	<ul style="list-style-type: none"> No change to CPPs Re-impose previous CPP requirements for information for net contracts Specify maximum percentage of net : gross contracts Prohibit net contracts
Security of Contract Tenure	High	Not Clear	Good security of tenure fundamental to attracting serious competition. Perception of security likely to improve, provided that few contracts cancelled due to lack of funds and/or commercial registrations	<ul style="list-style-type: none"> No change to CPPs or other legislation Require long term funding commitment by funding authorities (Central Government and tendering authorities); would necessitate legislative changes Prohibit contract cancellation on "availability of funding" grounds Legislative changes to allow/require tendering authorities to proceed to contract if unsuccessful tenderer notifies commercial service
Contract Negotiation Procedures - Before Contract Award	Low	High	Tendering authorities would need to develop benchmark prices	<ul style="list-style-type: none"> No change to CPPs Permit tendering authority to negotiate with lowest tenderer, irrespective of number of tenderers Would require tendering authorities to develop benchmark prices No further study
Vehicle Availability	High	High	May effectively lock out potential new (and possibly innovative) tenderers	<ul style="list-style-type: none"> No change to CPPs Permit tendering authorities to own and lease buses to tenderers Encourage bus leasing industry in New Zealand
Medium Priority for Further Investigation Non-Performance Penalties	Low	Medium-High	'Easy-out' allows for unstable service provision. Being addressed by tendering authorities. May increase operator costs	<ul style="list-style-type: none"> No change to CPPs Specify tender vetting procedures Specify appropriate levels of performance bonds
Low Priority for Further Investigation Contract Duration and Phasing	Medium	Low	Present practice in line with overseas experience and sector views	<ul style="list-style-type: none"> No change to CPPs Specify/suggest minimum contract durations
Manner of Service Specification	Low	Low	Industry familiarity improving over time	<ul style="list-style-type: none"> No change to CPPs Other ?
Tender Evaluation Factors	Medium	Medium	Ongoing improvements apparent	<ul style="list-style-type: none"> No change to CPPs Specify how tendering authorities should publish tender evaluation factors so that tenderers can readily determine their impacts on each tender
Contract Negotiation - After Contract Award	Low	Medium	Current 'no negotiation' requirement appropriate.	<ul style="list-style-type: none"> No further study

ABSTRACT

In 1989 the New Zealand Government introduced legislation to reform the process whereby public funds were spent on the procurement of public passenger transport services, and to take effect from 1 July 1991. Under this legislation Transit New Zealand is responsible for approving Competitive Pricing Procedures (CPPs) which must be followed before passenger transport services are eligible for public funding.

To identify if the required efficiencies were being achieved, an extensive review of international public transport tendering and contracting practices, especially in the United Kingdom and the United States of America, and discussions with funding authorities and operators in New Zealand, were undertaken. Key issues have been identified that have the potential to impact on competition and contract pricing. They include RFT size, Group and Combined Tenders, Gross v Net Tenders and Patronage Information, Security of Contract Tenure, Contract Negotiation Procedures, Vehicle Availability, Non-Performance Penalties and a range of other issues.

The key issues that have the greatest impact on competition and contract pricing are accorded high priority for further investigation. Broad options to improve procedures are also identified.

Conclusions are provided on seven specific questions relating to:

- Factors that have limited competition;
- Why competition has varied throughout New Zealand;
- Whether competition is likely to increase;
- Whether current levels of competition are a major problem;
- The implications of low levels of competition;
- How a greater number of commercial services might be encouraged;
- Changes to the present procedures which would help reduce public sector costs and provide better value for public funds.

1. INTRODUCTION

1.1 Overall Objective

The **overall objective** of this research project is: to assess the need for, and possible means of, increasing competition for passenger transport subsidies, to better achieve the efficiency and other competitive pricing procedure objectives of Clause 19(3) of the Transit New Zealand Act (1989). These means of increasing competition may be achievable within the present (mandatory) CPPs, may involve changes to the CPPs and/or may involve changes to the Transit New Zealand Act or associated legislation.

Clause 19(3) of the Transit New Zealand Act (1989) requires that, in exercising its powers in approving Competitive Pricing Procedures (CPPs), Transit New Zealand shall have regard to:

- "(a) The efficient application of the Account:*
- (b) The safety and other interests of the public in respect of the project or the class of project:*
- (c) The desirability of encouraging competition in the sector of industry likely to supply goods or services in relation to the project or the class of project:*
- (d) The undesirability of excluding from competition for the project or the class of project any party who might otherwise be willing and able to compete:*
- (e) The costs of administration associated with the pricing procedures or of any contract formed pursuant thereto."*

1.2 Research Issues and Tasks

The four specific issues identified for research are:

- (1) Is the current low level of competition merely a transitional problem that will go away; or are the features of the New Zealand industry and environment such that it is likely to be a permanent feature under the existing rules?
- (2) Is the low level of competition a substantial problem, in terms of not providing the efficiencies required/hoped for?
- (3) What changes to the present CPPs (within the present legislation and while retaining a competitive tendering process) would encourage/force greater competition and lower costs, and what would be the advantages/disadvantages of these? (Note that the project is not to involve a formal review of the CPPs as such but is a research project about means of increasing competition, which could potentially have implications on the procedures in the CPP Manual.)
- (4) What changes to present procedures outside the CPPs (and maybe involving legislative changes) could encourage/force greater competition, and what would be their advantages/disadvantages?

The project brief also noted that it was not intended that the project should investigate abandoning the competitive tendering system in favour of another system.

To address these issues, the research project was divided into four main tasks, as follows:

Task 1: Investigation of Competitive Market Issues

This task involved discussions with present and potential bus operators and regional councils, review of international competition in the passenger transport sector, analysis of tender bids in a sample region in New Zealand and comparison between New Zealand and international experience on key contract aspects.

Task 2: Potential Changes to Procedures in CPP Manual

Drawing on the findings of Task 1, Task 2 would involve identification and appraisal of potential changes to current CPPs, and would make appropriate recommendations. (The project is not to involve a formal review of the CPPs as such, but is a research project about means of increasing competition and improving efficiency which could potentially have implications on the procedures in the CPP manual.)

Task 3: Potential Changes to Associated Procedures and Legislation

As for Task 2, Task 3 would draw on the findings from Task 1 to identify potential legislative changes, and would make appropriate recommendations.

Task 4: Conclusions and Reporting

This task would bring together the work undertaken in the previous three tasks and report the findings to Transit New Zealand.

Prior to the completion of Task 1, Transit New Zealand advised that work on subsequent tasks should be deferred, pending Transit New Zealand review of this Task 1 report. However, the research was terminated after the completion of Task 1.

1.3 Task 1 Issues and Questions

For Task 1, the following issues and questions were identified for research:

- (a) What factors have limited the competition for contracted services in New Zealand to date; and what changes in procedures (CPPs or otherwise) would help to increase future levels of competition?
- (b) What are the explanations of the differences in the level of competition experienced to date in different regions of New Zealand?
- (c) Is the present low level of competition in New Zealand likely to be a permanent feature of the New Zealand situation (under the present legislation/procedures), or is the level of competition likely to increase significantly over the next few (0-5) years.

- (d) Is the low level of competition experienced to date a major problem in terms of achieving potential efficiencies, or is there sufficient threat of competition that the market may be regarded as reasonably contestable?
- (e) What are the implications of the low level of competition on tender and contract prices?
- (f) How might a higher level of commercial services be encouraged, and would such measures be worthwhile in terms of achieving the objectives of the Act.
- (g) What changes to the present procedures (additional to those covered above) would help to reduce public sector costs (contract costs plus administrative costs) and provide better value for public funds?

1.4 Task 1 Overview

For Task 1 New Zealand and international views have been sought on key issues and the information obtained has been compared and reviewed.

1.4.1 New Zealand Views

- Discussions with selected present and potential operators on key factors which influence competition, possible means of increasing competition and factors influencing tender prices.
- Discussions with selected regional councils on similar issues (to above).
- Discussions with finance/bus lease organisations. Details of these discussions are included in Appendix 1 which also includes a list of New Zealand transport sector organisations contacted and topics discussed.
- Analysis of operator tender pricing and revenue estimation policies and actions. Operator tender pricing policies are described in Appendix 2 and analysis of Wellington Regional Council tender prices is included in Appendix 3.

1.4.2 International Views

- Review of international evidence on contestability of the bus market (focusing on the United Kingdom (UK)).
- Review of international development of the competitive market.
- Review of international evidence on key contract aspects.

For information relating to the UK passenger transport industry, input was sought from Mr John Dodgson, Reader in Economics at the University of Liverpool in England. Mr Dodgson has recently (1992) completed a study on the deregulated bus industry in the UK, partly funded by the UK Department of Transport. Mr Dodgson's contribution is included as Appendix 4.

For information relating to other international countries, input was sought from Mr Wendell Cox, Principal of Wendell Cox Consultancy based in St Louis, USA. Mr Cox is an expert on issues relating to deregulation of passenger transport services and is well known to the New Zealand passenger transport sector. Mr Cox's contribution is included as Appendix 5 (Wendell Cox Consultancy 1992).

Where appropriate, relevant international experience contained in each of these two appendices is included or referred to within the body of this report.

The work has focused on competition issues relating to road-based passenger transport services. No specific consideration has been given to the particular issues relevant to rail-based services (or other services operating on dedicated rights-of-way).

1.4.3 Review

- Review of New Zealand and international experience.
- Identification of key issues for further consideration in Tasks 2 and 3.

1.4.4 Report Structure

The remainder of this Task 1 report is structured as follows:

- Section 2 provides an overview of the competitive situation in New Zealand.
- Section 3 discusses general competitive issues.
- Section 4 discusses specific issues relevant to achieving competition and efficient pricing.
- Various appendices contain supporting information.

2. OVERVIEW OF COMPETITIVE SITUATION IN NEW ZEALAND

2.1 Extent of Commercial v Contracted Services

Available data from 9 (of the 14) regions shows that before July 1991, a total of 68.3 million bus kilometres were operated per annum. By 1 July 1991, 8.9 million bus kilometres per annum (13%) had been registered as commercial. This left the remaining 59.4 million annual bus kilometres, or 87% of services (on a kilometre basis), to be operated under contract or cancelled. Table 1 summarises the extent of commercial services in these nine regions as at 1 July 1991.

Table 1. Extent of commercial services in the nine regions as at July 1991.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land	Tara-naki	Wai-kato	Well-ton	Total
Existing Services - Existing total services in region (000 vk)	37,250	260	8,500	432	1,100	560	750	1,522	17,900	68,274
Commercial Services - % existing services registered commercially	8	c30	1.7	14	99	0	100	39	51	c13
- % commercial services not using standard buses	<5	0	0	0	99	0	0	0	9	<4.5

Additional comments on Table 1 are as follows:

- (i) **Auckland.** No commercial services operated by main (ex-municipal) operator. Most commercial services operated by pre-existing private operators, 6am to 6pm weekdays. No significant change since 1 July 1991.
- (ii) **Manawatu-Wanganui.** Almost all previously subsidised bus services were replaced by commercial "taxi-bus" operation by pre-existing taxi operator. Still in operation.
- (iii) **Taranaki.** Previously subsidised bus service replaced by new operator providing similar service level commercially. Operator has now ceased trading and services now provided commercially by a mixture of buses and taxis.
- (iv) **Waikato.** Significant commercial registration of previously subsidised bus services by a number of operators. Main commercial operator has now ceased trading and these services are now operated under contract.

- (v) **Wellington.** Commercial services include all trolley bus and a large proportion of urban rail services which have benefited from separate infrastructure funding (c.\$11M total, 1991/92). The extent of commercial registrations remains largely unaltered though there have been a number of commercial notifications / withdrawals for mainly tactical reasons by bus operators.

2.2 Types of Contract

Table 2 shows the revenue type (gross v net) and contract duration for contracts entered into in the July 1991 tendering round.

2.2.1 Contract Revenue Type

Most 1 July 1991 contracts were of the net revenue type; the two main exceptions being contracts let by Manawatu-Wanganui and Waikato regional councils. In both cases, neither regional council considered that it could meet in all cases the then-required CPP ruling that *"The tendering authority shall not invite or accept a net contract tender unless passenger count and composition information relating to the previous year is provided in the RFT"* (Manual of Competitive Pricing Procedures - Volume 2; Public Passenger Transport, January 1991, Section 3.3.5).

Table 2. Types of contract issued in the nine regions as at July 1991.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land	Tara-naki (1)	Wai-kato	Well-ton	Total
Total no. of RFTs(2) issued	285	4	50	8	16	12	1	7	132	515
Total service covered by RFTs:										
- 000 vk/yr	34,300	c180	8,360	370	1,100	363		591	8,700	53,964
- Peak Buses	666(3)	?	121	9	25	10		19	?	N/A
% tendered services by revenue type:										
- Gross Cost	0	25	4	0	96	0		0	15	5
- Net Cost	100	75	96	100	4	100		0	85	94
- Other	0	0	0	0	0	0		100	0	1
% tendered services by contract duration:										
- Up to 1 year	0	0	26	100	1	0		0	24	9
- 1 + to 2 years	0	25	34	0	97	0		0	61	8
- 2 + to 3 years	30	75	32	0	2	16		0	15	27
- 3 + to 4 years	40	0	8	0	0	42		29	0	27
- 4 + to 5 years	30	0	0	0	0	42		71	0	29

(1) No tenders awarded since all required services notified as being commercial.

(2) RFT = Requests for Tender.

(3) As stated by tenderers (some peak vehicles could cover more than one RFT); excludes rail.

Waikato Regional Council entered into gross contracts which converted to net contracts at a later date once the required patronage data became available.

Contracts let since July 1991 to replace expiring contracts (mainly in Wellington and Canterbury) have been almost universally of the net revenue type.

2.2.2 Contract Duration

Contract durations range from the minimum allowable (1 year, excluding seasonal, experimental or special event services and contracts to cover emergency situations) to the maximum allowable (5 years). Overall, most of the contracted services (in vehicle kilometre terms) are covered by contracts of three years duration or more (73%). This is largely caused by the Auckland Regional Council's preference for such contract durations and the size of the Auckland market as a proportion of the total New Zealand market.

2.2.3 Group Contracts

A significant number of operators submitted one tender price for a group of individual RFTs. This became known as a group tender, a tendering method not envisaged in the January 1991 CPP. Group tenders were received by almost all regional councils, and the majority of services were awarded based on these group tenders. For example both the Yellow Bus Company (Auckland) and Wellington City Transport (Wellington) were awarded all their initially contracted services based on their group tenders.

Some regional councils placed restrictions on group tenders, as follows:

- Auckland - group tenders not to cross existing company boundaries,
- group tenders not to involve more than one time period.
- Wellington - in the case of group tenders including RFTs with differing
expiry dates, the tenderer also had to provide a price for
that portion of the contract continuing as each successive
shorter term portion expired.
- Otago - group tenders not to include RFTs with different contract
expiry dates.

The January 1992 CPPs now specifically permit group tenders and include cautionary guidelines on how they should be evaluated in order to avoid the group tendering technique being used by operators as an anti-competitive device.

2.3 Extent of Competition

Table 3 shows the extent of competition for contracted services in the July 1991 tendering round.

Table 3.

Extent of competition for contracted services in the nine regions in the July 1991 tendering round⁽¹⁾.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land (2)	Tara-naki (3)	Wai-kato	Well-ton	Total
Number of tender bids by RFT (separate operators)										
- 0 bids	0	0	1	0	0	0		0	0	1
- 1 bid - incumbent operator	199	0	33	8	6	0		0	39	285
- 1 bid - other operators	0	0	5	0	0	2		0	1	8
- 2 bids	74	3	10	0	9	7		1	55	159
- 3 bids	8	0	1	0	1	3		2	22	37
- 4 + bids	4	0	0	0	0	0		4	15	23
Total	285	3	50	8	16	12		7	132	513
Average number of bids/ RFT	1.4	2.0	1.2	1.0	1.7	2.1		3.4	2.1	1.6
Number of bids/awards by vehicle type(4):										
- Articulated bus	0/0	0/0	0/0	0/0	0/0	0/0		0/0	0/0	0/0
- Standard bus (35-50 seats)	255/202	6/3	?/27	8/8	27/3	18/3		31/7	362/97	707/350
- Small bus (13-34 seats)	1/1	0/0	0/0	0/0	1/1	7/7		0/0	24/11	32/20
- Taxi/van	27/12	0/0	?/8	0/0	1/1	0/0		0/0	49/15	77/36
- Train/Ferry	105/70	0/0	1/1	0/0	0/0	0/0		0/0	13/9	119/80
Total	388/285	6/3	?/36	8/8	29/5	25/10		31/7	448/132	935/486
Number of bids/awards by operator type:										
- Bus operator-providing services in region	276/199	3/3	?/15	8/8	28/4	4/0		7/3	306/100	622/317 (5)
- Bus operator - other	8/0	3/0	?/12	0/0	0/0	0/0		24/4	71/8	88/12(5)
- Taxi/van operator	28/13	0/0	?/8	0/0	1/1	0/0		0/0	49/15	78/29(5)
- Other operator	76/73	0/0	?/1	0/0	0/0	21/10		0/0	13/9	110/92(5)
Total	388/285	6/3	?/36	8/8	29/5	25/10		31/7	439/132	926/486 (5)
Number of awards to existing/other operators:										
- Existing operator & awarded	252	3	?	6	2	0		3	79	345
- Existing operator bid, awarded to other operators	12	0	?	0	2	0		0	42	56
- Existing operator did not bid	0	0	?	0	0	10		4	3	17
- New service	0	0	?	0	1	0		0	8	9
Total	264	3	?	6	5	10		7	132	427

- Notes:**
- (1) Numbers not consistent in some aspects because of information provided.
 - (2) Excludes "group" bids.
 - (3) RFT subsequently withdrawn.
 - (4) For some Regional Councils (e.g. Wellington) includes all primary and alternative tenders received by any operator in respect of any one RFT.
 - (5) Excludes Canterbury for which data are not complete.

2.3.1 Number of Tenders per RFT

Overall an average of 1.6 tenders were received per RFT, ranging from one RFT (Canterbury) which received no tenders, to 23 RFTs (Auckland 4, Waikato 4, Wellington 15) which received four or more tenders.

Actual competition occurred in all regions shown in Table 3, except in Hawke's Bay where the incumbent operator was the sole tenderer.

Overall, there was no actual competition for around 57% of all RFTs; 293 of the 513 RFTs received only one tender, 285 of which were submitted by the incumbent operator.

Other than for Hawke's Bay, Auckland had the highest percentage of RFTs for which there was no actual competition; 199/285 or c.70%.

In Wellington, an average of 2.1 tenders were received per RFT with c.30% receiving only one tender. Analysis of subsequent tendering results in Wellington is shown in Table 4 and suggests that the level of competition is increasing.

From Table 4 it is apparent that:

- Three Hutt Valley contracts relinquished by the operator subsequently received five to seven (average of six) tenders per RFT, whereas in the initial July 1991 tender round these same contracts had received two to four (average of three) tenders per RFT.
- When these same contracts then came up for tender in April 1992 (along with 16 other contracts), four to five (average of 4.7) tenders were received per RFT.
- In April 1992, 6 Wellington City contracts were re-tendered. Previously each RFT had received one to four tenders (average of 2.5); now three RFTs received commercial notifications and were registered, and the remaining three RFTs received three tenders each.
- In April 1992, six Northern Suburbs contracts were re-tendered, along with one previously operated as a commercial service. The previous commercial service received four tenders, one of the contracted services which previously received five tenders was notified as being commercial, and the number of tenders for renaming services generally increased from one to two.
- For the services listed in Table 4 overall, the average number of tenders per RFT increased from 2.3 to 3.1.

In Canterbury competition is also increasing. For recent contracts suitable for larger buses, four tenders were received per RFT and for contracts suitable for smaller vehicles six to eight tenders were received per RFT. The tendering authority now expects at least four tenders per RFT. Compared with the July 1991 tendering round, there has been a 350% increase in competition!

Table 4. Trends in tenders per RFT from May 1991 to April 1992 in Wellington.

RFT No.	May 1991			Nov 1991			April 1992		
	Duration (months)	Type	Bids	Duration (months)	Type	Bids	Duration (months)	Type	Bids
HV 371/2 Lower Valley Circuit	19	Net	2	5	Net	7	7	Net	4
HV 331/2 Naenae Evenings & Saturdays	19	Net	4 ⁽¹⁾	5	Net	6 ⁽²⁾	7	Net	5
HV 261 Wainuiomata Weekends	19	Net	3	5	Net	5 ⁽³⁾	7	Net	5
Hutt Valley Average			3.0						5
WN 628 Miramar Heights, Saturdays	12	Gross	3				12	Net	3
WN 529 Southern Shopper	12	Gross	2				12	Net	3
WN 520 Mt Victoria-Highbury, Weekdays	12	Net	2				24	Net	0(4)
WN 226 Strathmore, Sunday	12	Gross	3				12	Net	3
WN 519 Western Wanderer	12	Net	1				24	Net	0(4)
WN 329 Breaker Bay/Scorching Bay	12	Gross	4				6	Gross	0(4)
Wellington Average			2.5						3.0
PK 436/2 Whitby School	12	Net	2				24	Net	2
PK 531/2 Whitby Shoppers'	12	Gross	3				19	Net	2
PK 536/2 Whitby Peak	12	Net	1				27	Net	2
Porirua Average			2.0						2.0
NS 222 Tawa shoppers			0(5)				19	Net	4
NS 349 Johnsonville Evenings	12	Gross	5				12	Net	0(4)
NS 351/2 Churton Park, Interpeak	12	Gross	1				12	Net	2
NS 452/2 Churton Park, Schools	12	Net	1				12	Net	2
NS 479/2 Grenada Village, Schools	12	Gross	1				12	Net	2
NS 578/2 Grenada Village, Peak	12	Gross	1				12	Net	3
NS 771/2 Newlands Sunday	12	Net	2				12	Net	2
Northern Suburbs Average			1.8						2.5
OVERALL AVERAGE			2.3			6.0			3.1

- (1) Previously 3 tenderers for one part, 4 tenderers for the other.
- (2) Previously let as two contracts, 6 bids received for each part.
- (3) Previously let as two contracts, 5 bids received for each part.
- (4) Notified as being commercial.
- (5) Previously operated commercially.

2.3.2 Tenders and Awards by Vehicle Type

Overall, c.86% of road-based passenger transport contracts were awarded to operators proposing to use standard (or articulated) buses. The remaining 14% were awarded for taxi or van operation (c.9%) and small and midi-bus operation (c.5%). These percentages are hardly surprising given that the passenger transport market, and hence the services being contracted, was dominated by standard size buses before 1 July 1991. It is also worth noting that in the two instances (Wanganui and Palmerston North) where taxis or vans have almost completely replaced pre-existing bus services, taxis or vans are operated commercially. Therefore they are not included in analysis of tenders and awards by vehicle type.

The greatest use of smaller vehicles (small bus or taxi or van) on contracted services has occurred in Wellington. In 1991, these vehicles operated 26 of the 123 (21%) road-based contracts. However these contracts, particularly in the case of taxi or van vehicles, tended to be the smaller "interpeak shoppers" type services.

Since July 1991 there has been no substantial change in the type or size of vehicles operated. Some instances have occurred of taxi or van operators successfully tendering against bus operators, but there have been no known instances of major routes being converted from bus to van operation (or vice versa).

2.3.3 Tenders and Awards by Operator Type

Bus operators already operating services in the region tendered for were the most successful tenderers, winning c.80% of all road-based contracts. In terms of contracts awarded v tenders submitted, these operators had a 50% success rate. Bus operators tendering in a region where they did not currently provide services were the least successful tenderers, winning c.3% of all road-based contracts. Their success rate (contracts awarded to tenders submitted) was only c.14%.

Generally, the scale of bus operators tendering outside their "home" regions was low; of the 710 tenders submitted by bus operators, only 88 (c.12%) were submitted by operators who did not currently operate services in the region. Within each region incumbent operators generally didn't tender outside their "home patch". The single greatest success by a bus operator tendering in a "foreign" region occurred in Canterbury. There a predominantly tour-oriented operator (who also operated urban services in Auckland), successfully tendered for 25-30% of the region's contracts.

Since July 1991 there have been a small number of instances of existing bus operators expanding operations into non-traditional geographic areas. Wellington City Transport recently purchased the former Cityline operations in both Wellington (Hutt Valley) and Auckland (Papakura). As a result of these purchases, Wellington City Transport has considerably increased its market share in Wellington and will obviously be a contender for some future Auckland contracts.

The 1991/92 annual report of Christchurch Transport Ltd (1992) hints at that company's possible expansion into other regions. It states:

"The Company has not yet seriously considered establishing services in other centres around New Zealand but now that our operating structure is very competitive with the other substantial operators in the country, this option may be given closer consideration".

2.4 Tender Prices and Trends

Table 5 shows the contract prices for the July 1991 tender round in nine regions. In general, service levels were retained at close to their pre-July 1991 levels. Fares also remained largely unaltered, or were adjusted for inflation.

Table 5. Overall outcome for contract prices in the nine regions for July 1991 tendering round⁽¹⁾.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land	Tara-naki	Wai-kato	Well-ton	Total
Total service to be provided compared to previous service	Similar	Similar	Similar freq. Red.veh. cap.(3)	Similar freq. Red.veh. cap.	Similar freq. Smaller veh.	Some red. serv.	Similar	Similar	Similar	
Total public funding 90/91 - \$M	48.0	0.085	14.768	0.295	1.400	1.157	1.10	1.258	37.5	105.6
Total est.public funding 91/92 - \$M(2)	43.3	0.104	10.000	0.147	0.446	0.637	0	0.424	31.5	86.6
Funding Reduction -\$M	4.7	-0.019	4.768	0.148	0.954	0.520	1.10	0.834	6.0	19.0
-%	9.8	-22	32	50	68	45	100	66	16	18.0

- (1) All dollar figures relate to public funding; operators may also have had to draw on funds from other sources to maintain service levels (e.g. Yellow Bus Co, Auckland).
 (2) Includes contingency amounts in a number of regions (e.g. Auckland, Wellington).
 (3) Abbreviations: red. = reduced; freq. = frequency; veh. = vehicle; cap. = capacity

2.5 Funding Requirements

Overall the total public funding for passenger transport services in the nine regions referred to in Table 4 has reduced from \$105.6M pa in 1990/91 to \$86.6M pa in 1991/92. This represents a reduction of \$19.0M pa or 18.0%. This reduction is in money terms: if allowance were made for inflation, the real reduction would be over 20%.

In percentage terms, the greatest funding reduction has occurred in Taranaki (New Plymouth), where there are now no publicly funded services. Of the remaining regions, Manawatu-Wanganui has achieved the greatest funding reduction in percentage terms (68%).

Of the three main regions (Auckland, Wellington, Canterbury), Auckland has achieved the smallest reduction in funding in percentage terms, only 9.8%, compared with 32% for Canterbury and 16% for Wellington. Even in dollar terms, the savings in both Canterbury (\$4.8M pa) and Wellington (\$6.0M pa) exceed the \$4.7M pa savings made in Auckland. To some extent, savings in Auckland will have been affected by some private operators submitting successful tenders at prices higher than their previous year's subsidy.

Only one regional council (Bay of Plenty) has incurred a funding increase, although this is very small (\$19,000 pa).

Since July 1991, the greatest number of contracts have expired and been re-tendered in Wellington and Canterbury. In Wellington it is not clear whether competition is continuing to result in lower tender prices. This is because a number of "second round" RFTs were not strictly comparable to their first round equivalents. On a number of occasions two RFTs have been combined into one RFT and some initially gross cost RFTs have been re-issued as net cost RFTs.

In Canterbury the evidence is more clear. There, the average number of tenders per RFT has increased from 1.2 to 5.4. Also, tender prices have continued to fall; post-July 1991 contract prices are around 17% lower than their July 1991 equivalents. Canterbury Regional Council anticipate that in some cases interpeak service levels may be able to be doubled with no net increase in contract payments.

One useful indicator used to determine whether tenderers are becoming more competitive in their tender pricing is the ratio of highest tender price to lowest tender price. Analysis of the West Midlands (Pickup et al. 1991) showed that the ratio of highest to lowest tenders averaged 5.28 in the initial pre-October 1986 phase, but had fallen to an average of 2.28 in the February to May 1988 period. This ratio tends to reduce as tenderers become more used to estimating revenues and adjusting costs and prices based on previous tendering success or failure.

Table 6 shows the average ratios of highest to lowest price tenders in Wellington for the July 1991 tendering round, and for subsequent tenders.

From Table 6 it appears that in Wellington the divergence in tender prices is narrowing over time and tenderers are responding to the effects of competition in their tender costing and pricing.

Table 6. Ratio of highest : lowest tender prices in Wellington for July 1991 tendering round⁽¹⁾.

Item	July 1991	Post July 1991
Ratio	5.40 ⁽²⁾	4.01

- (1) Conforming primary specification tenders only. Excludes RFTs for which only one tender was received.
- (2) Weighted average; gross ratio 3.46, net ratio 5.74.

3. GENERAL COMPETITIVE ISSUES

3.1 Introduction

This section focuses on whether the level of competition is likely to increase, and whether efficient pricing will be achieved, as the market matures.

3.2 Initial Level of Competition

3.2.1 Competition in New Zealand

In the July 1991 tendering round in New Zealand:

- Overall 1.6 tenders per RFT were received.
- The number of tenders per RFT varied between regions, from an average of 1.0 (Hawke's Bay) to 3.4 (Waikato).
- 53% of RFTs received only one tender.
- Only 12% of RFTs received three or more tenders.
- Most incumbent operators stuck to their home patch within each region.
- No incumbent urban operators made serious inroads into other regions¹.

3.2.2 Competition in United Kingdom

Competitive tendering for passenger transport services was introduced in the United Kingdom (excluding London) in 1986.

Analysis of initial tender results (Table 7) in seven conurbations shows that the level of actual competition in the United Kingdom was broadly similar to that which has occurred in New Zealand:

- The weighted number of tenders per RFT averaged 1.79 (New Zealand weighted average: 1.6).
- For individual conurbations, the number of tenders per RFT ranged from 1.3 (New Zealand low: 1.0) to 2.5 (New Zealand high: 3.4).
- For individual conurbations, the percentage of RFTs which received only one tender ranged from 19% (New Zealand low: 0%) to 80% (New Zealand high: 70%).
- For individual conurbations, the percentage of RFTs which received three or more tenders ranged from 5% (New Zealand low: 2%) to 46% (New Zealand high: 28%).
- In the United Kingdom initially greater competition occurred between operators from different areas than in New Zealand. This is probably because of the greater number of operators and higher population densities in the United

¹ Ritchies Transport Holdings Ltd did make serious inroads into Canterbury, and also operated urban services in Auckland. However this should not be regarded as an expansion of the Auckland urban operation into another region; rather it is more akin to a new operator commencing services in Canterbury.

Kingdom compared with New Zealand. Dodgson (Appendix 4) notes that this has been an important feature of bus competition in the United Kingdom since each operator "knows that there are many other quite sizeable operators located not too far away eyeing their market". Dodgson observes that this competition between neighbouring operators from different areas may be less likely to occur in New Zealand for the reasons noted above. Consequently the perceived threat of competition from operators based in different areas may be less in New Zealand than is the case in the United Kingdom.

Table 7. Tenders per RFT for selected UK conurbations for 1986 tender round.

Item	Greater Manchester	Mersey -side	South Yorkshire	Strath -clyde	Tyne & Wear	West Midlands	West York-shire	Total
Total RFTs	386	453	1001	876	122	403	555	3796
Number of tenders ⁽¹⁾ by RFT								
1	73	195	731	237	97	234	388	1955
2	135	208	220	307		145	139	1154
3	104	41		193		20	22	380
4	54	9		96	25	4	6	194
5	15	50	50	26				91
6-10	3			17				22
Av.	2.53	1.70	1.32	2.36	1.30	1.49	1.36	1.79
Percentage of tenders by RFT								
1	19	43	73	27	80	58	70	51.5
2	35	46	22	35		36	25	30.4
3	27	9		22		5	4	10.0
4	14	2		11	20	1	1	5.1
5	4		5	3				2.4
6-10	1			2				0.6
Total	100	100	100	100	100	100	100	100

(1) Based on percentage of tenders by RFT multiplied by Total RFTs for each conurbation.

Since 1986 competition has tended to increase, as evidenced by the increase in the average number of tenders per RFT. This increase in the level of competition is discussed in more detail in Section 3.3.

3.2.3 Competition in United States

In the United States, competitive tendering for passenger transport services was comparatively rare before 1985. Analysis of 8 RFTs issued before 1985 shows that on average each RFT received 1.8 tenders, similar to the level of competition initially received in both the United Kingdom and New Zealand. Since 1985 the average number of tenders per RFT has increased, as discussed in more detail in Section 3.3.

3.3 Is the Level of Competition Likely to Increase?

This section discusses whether competition in New Zealand is likely to increase as the market matures, even in the absence of possible procedural and regulatory changes.

The level of competition may increase for two reasons. First, the market will mature over time; tenderers will become more familiar with the tendering process and better at costing and pricing tenders. Similarly, tendering authorities will become more adept at developing attractive service packages in RFTs. Also, the number of services up for tender at any one time will tend to reduce. Thus operators will not have to assess as many RFTs at once as time goes on.

Second, procedures and regulations may be altered with the specific objective of stimulating increased competition.

3.3.1 United Kingdom Evidence

Since 1986, competition in the United Kingdom for passenger transport contracts has tended to increase in the absence of major procedural or regulatory changes.

Table 8 shows the average number of tenders per RFT in seven United Kingdom conurbations over the three years, 1986-1988. Over this three year period the amount of competition (tenders per RFT) has increased overall by 87%. For each conurbation, competition has increased annually, except for two occasions (Greater Manchester: -4% 1986 to 1987, and West Midlands: -6% 1987 to 1988).

Table 8. Tenders per RFT for seven United Kingdom conurbations.

Conurbation ⁽¹⁾	Year				
	1986 Tenders	1987 Tenders	Change ⁽²⁾	1988 Tenders	Change ⁽²⁾
Greater Manchester	2.53	2.45	-4%	4.00	+58%
Merseyside	1.70	2.77	+63%	3.10	+82%
South Yorkshire	1.32	2.43	+84%	2.87	+117%
Strathclyde	2.36	3.20	+35%	3.40	+44%
Tyne & Wear	1.30	2.75	+111%	3.16	+143%
West Midlands	1.49	3.22	+116%	3.01	+102%
West Yorkshire	1.36	2.00	+47%	3.01	+121%
Average ⁽³⁾	1.72	2.69	+56%	3.22	+87%

- (1) All conurbations used net cost contracts only, except Tyne and Wear which used gross cost contracts as well.
- (2) Compared with 1986 tenders per RFT for same conurbation.
- (3) Unweighted averages pa.

Given this increase in the level of competition, it is worth comparing the initial level of competition in these seven conurbations with the initial level of competition in New Zealand. This comparison reveals that five of the United Kingdom conurbations had fewer tenders per RFT than Wellington and two had more. Four United Kingdom areas had more tenders per RFT than Auckland and two had fewer. All seven United Kingdom conurbations generated more tenders per RFT than Canterbury.

At the end of the first full year of deregulation, Tyson (1988) stated:

"Overall, it is fair to conclude that there has been a reasonably high level of competition in providing services from all types of operator".

By the end of the second year, the increased level of competition led Tyson (1988) to state:

"Competition has been on a much larger scale than anticipated by many people, with at least thirty operators in the market in each area and an average of three bids for each tender for subsidised services".

Outside the main conurbations, competition also increased over time, as shown in Table 9.

Table 9. Tenders per RFT for smaller United Kingdom conurbations.

Conurbation	Tender Round	
	1986	Subsequent
Bristol	2.5	4.0, 3.8 (1987, 1988)
Warwickshire	3.8	5.0, 6.8 (1989, 1990)
Portsmouth	2.0	3.8 (1990)

The increase in competition came primarily from existing firms, though there had been a small but steady flow of new entrants. There are now over 200 instances of pre-existing operators starting operations outside their traditional operating area. Over $\frac{3}{4}$ of these operations are wholly or partly based on tendered operations. Dodgson notes that *"this cross competition between operators from different areas has been an important feature of UK bus competition"* (Appendix 4).

As already noted above, Dodgson also suggests that this may not be the case in New Zealand because of the lower number of operators and the lower population densities in New Zealand compared with the United Kingdom.

As competition has increased, so too the ratio of highest to lowest tender has reduced. Analysis of West Midlands tenders showed the ratio averaged 5.28 prior to October 1986 but by May 1988 had reduced to 2.28. It has been suggested that this reduction is likely to be because of the "learning process" which operators have had to go through

and "highlights the need for adequate information provision for potential tenderers about aspects of the tendered service, particularly revenue (for net cost contracts)" (Pickup et al. 1991).

3.3.2 Other International Evidence

In the United States, as in the United Kingdom, competition has increased for competitively tendered passenger transport services. This is shown in Table 10.

Table 10. United States trends in tenders per RFT by time.

Year	No. of RFTs	Average Tenders per RFT
1984 and earlier	8	1.8
1985-86	14	4.1
1987-88	17	4.2
1989-90	20	4.0
1991-92	19	4.7
Total	78	4.0

United States evidence suggests that the amount of competition is related to the size of the contract (measured in terms of the number of buses required). As Table 11 shows the amount of competition drops off steeply for the largest contracts.

Table 11. United States trends in tenders per RFT by contract size.

Number of Buses	No. of RFTs	Average Tenders per RFT
75+	7	2.0
50-74	7	3.7
30-49	24	4.5
15-29	24	4.4
< 15	16	3.8
Total/Average	78	4.0

3.3.3 New Zealand Evidence

Only around 9% of the initial July 1991 contracts were for one year's duration and have now been re-tendered. This re-tendering has occurred mainly in Canterbury (13 contracts, 26% of Canterbury total) and Wellington (32 contracts, 24% of Wellington total).

Because of the limited number of contracts which have now been subject to two tender rounds, it is probably too early to draw definitive conclusions based on the level of competition. Nonetheless, it is still worthwhile to look at the early signs of competitive trends.

In both Canterbury and Wellington, the number of tenders per RFT has increased (refer also to Section 2.3.1). In Canterbury the tendering authority now expects to receive at least 4 tenders per RFT compared with the 1.2 average in July 1991. This represents a 300% + increase in the level of competition. Likewise, in Wellington recent contracts have averaged 3.1 tenders per RFT, representing an almost 50% increase on the previous level of competition.

3.3.4 Discussion

International evidence shows that the level of competition does increase over time as the market matures. Available though limited New Zealand evidence shows that the New Zealand market is behaving in a similar way in that competition is increasing.

In the United Kingdom competition between operators from different areas has been an important feature of competition. So far in New Zealand such competition is relatively rare, with almost no inter-regional operator competition. The Wellington experience is that most incumbent operators tend to concentrate on areas closest to their home patch. For example, incumbent Hutt Valley operators tend to concentrate on tendering for Hutt Valley contracts.

If the current low level of inter-regional operator competition continues and at the same time incumbent operators continue to concentrate on areas close to their home patch, then future competition is likely to arise mainly from:

- Incumbent operators in/close to the area being tendered; and/or
- New operators entering the market.

In such a situation an important feature of retaining competition will be the retention of a number of operators in each area, none of whom on their own has such dominance that they can effectively control the market.

Of course, the amount of competition between operators from different areas may increase in future. Within a given region operators may be forced to compete for contracts in different areas as a safeguard against losing their home patch. Also, inter-regional competition may increase. Wellington City Transport, having purchased Cityline's Auckland operation, would be well placed to compete for other Auckland contracts. Also, Christchurch Transport Ltd has hinted in its 1991/92 Annual Report that it might consider operating services in other regions.

3.3.5 Conclusion

Competition is likely to increase in New Zealand as the market matures. This expected increase in competition could however be reduced or offset by:

- The emergence of large dominant operators in any area, which will tend to reduce the level of competition in that area,
- Continuation of current operator reluctance to tender for contracts outside their traditional operating areas.

3.4 Limited Competition as an Impediment to Achieving the Act's Objectives

3.4.1 Objectives to be Achieved

Section 19(3) of the Transit New Zealand Act specifies the five specific objectives listed in Section 1.1. Objective (b) focuses on safety issues, which can obviously be achieved in the absence of competition. Objectives (c) and (d) focus on the desirability of encouraging competition and undesirability of discouraging competition. Obviously competition is necessary for the achievement of these two objectives.

Objectives (a) and (e) focus on efficiency issues of both the efficient use of public funds and the costs of administering the competitive pricing procedures. Section 3.4 of this report discusses to what extent limited competition is an impediment to achieving these efficiency objectives.

3.4.2 Evidence on Tender Prices v Number of Tenders

Identification of a strong correlation between tender prices and the number of tenders received would provide an insight into how important actual competition is to achieving efficient tender pricing².

United Kingdom evidence is that contract prices reduce as tenders per RFT increase, i.e. increased competition lowers the price paid. Analysis of West Midlands contract prices showed:

"... other things being equal, contract price was 17% lower when there were two bidders rather than one, and 30% lower when there were three or more bidders rather than one" (Pickup et al. 1991).

Other United Kingdom evidence also supports this finding that costs reduce as competition increases, but **not for net cost contracts**. Tough's (1992) explanation for this is that gross cost contracts are more attractive to small operators and the more tenders that are received from such operators, the lower the likely winning bid. For net contracts the larger operators are more likely to be able to accurately predict revenues than are small operators. Therefore small operators need to include a larger revenue-risk premium. Consequently even if net cost contracts do attract tenders from smaller operators, the smaller operators are unlikely to be successful, and the increased competition will not result in lower contract prices.

² Excluding any post tender contract negotiation provisions.

Beesley and Glaister (1989, Appendix 4) have an alternative hypothesis about the relationship between the number of tenders and the price per tender. This hypothesis is that tender prices will rise with the number of tenderers because tenderers will be worried about the "winner's curse"³.

However their statistical analysis of 473 tenders for 122 RFTs indicates that tender prices decline (though not in a statistically significant manner) as the number of tenderers increase. One factor in the correlation between the number of tenders per RFT and contract price may also simply be that, for each additional tender submitted, there is a probability that its price is less than the pre-existing lowest tender price!

New Zealand evidence also supports the premise that contract prices reduce as competition increases. For example, in Canterbury contract prices have reduced by around 18% and the average number of tenders per RFT has increased from 1.2 (July 1991) to 4.8 (November 1992).

3.4.3 Actual v Perceived Competition

At the time of tendering, no tenderer can know (barring collusion) in absolute terms the level of competition (amount or price) and tender prices can only be determined on the basis of perceived competition. However in successive tenders, the amount of perceived competition will itself largely be based on actual previous competition. For example where a contract previously received (say) five tenders per RFT then, all things being equal, each tenderer in the next tender round would be price-based on that level of competition. Even if only one tender were received, it would still have been competitively priced.

This does not mean that the resulting contract price would be as low as if the other four previous tenderers had also tendered this time. In simple mathematical terms it means that there is a 4 out of 5 chance that one of the other tenderers would have submitted a lower tender price!

3.4.4 Role of Negotiation Procedures in Achieving Lower Prices

Where contracts are not efficiently priced, negotiation can in principal be used to achieve efficient pricing. This negotiation can occur:

- Before contract award to ensure the contract is efficiently priced from day one (dealt with in this section); or
- After contract award to adjust contract price related to changed service or fare levels (discussed in Section 4.9).

³ Winner's curse is when the tender price has to be so low to win the tender that it is unlikely to be financially viable.

As noted above, even the lowest tender price for any contract may be higher than otherwise necessary where:

- Tenderers perceive that the level of competition will be low, and/or
- The level of actual competition is low.

In such circumstances, one way to help ensure that contracts are efficiently priced is for the tendering authority to negotiate the price with tenderer(s) before contract award.

In the United Kingdom tendering authorities have the right to reject all tenders and negotiate with anyone they choose. While we are unaware of it actually happening, this does allow, at least in principal, a tendering authority to play one tenderer off against another in a "dutch auction". Cox (Appendix 5) notes that unfairness (real or perceived) in the tendering process is often cited by private companies in the United States as a reason for not competing in the tender process.

In the United States tendering authorities are generally permitted to negotiate with the lowest tenderer for any RFT. If those negotiations cannot be satisfactorily concluded then the tendering authority is generally required to re-tender the services.

In New Zealand, tendering authorities are only permitted to negotiate tender price where only one tenderer has tendered for a contract. Where there is more than one tenderer, even if the tendering authority considers the lowest price tender to be too expensive, its only options are to accept that price or re-tender. This may result in an inefficient use of funds for the following reasons:

- Acceptance of excessively priced tenders particularly when the tendering authority has insufficient time to re-tender.
- Costs associated with re-tendering particularly when it will be unclear before such re-tendering whether lower tender prices will be received.

One solution to this would be to allow tendering authorities to negotiate with the lowest priced tenderer, irrespective of the number of tenderers. To avoid placing tenderers in a dutch auction situation, tendering authorities would only be permitted to negotiate with the lowest tenderer (for each contract).

To choose when to negotiate and to then negotiate from a position of strength each tendering authority needs to develop benchmark prices. Without such benchmark prices to aim for the tendering authority would not know whether efficient pricing was being achieved in the first place. These benchmark prices would ideally be based on tendered and negotiated contract prices for similar services throughout New Zealand, adjusted for any regional variations.

Where tendering authorities find that the lowest price tenders frequently exceed their benchmark price, publishing the benchmark prices may well have merit. In many respects, this would be similar to publishing a budget maximum for a contract for Professional Services. Tenderers would have a better appreciation of an acceptable price and would be encouraged to price down to that level. Negotiation costs might also be reduced.

If the lowest price tender is usually at or below the benchmark price, publication of benchmark prices is unlikely to achieve more efficient tender pricing.

In our view, the ability to negotiate with the lowest priced tenderer is unlikely to impact on the level of competition. Its advantage is most likely to be the reduction of contract prices which would otherwise be paid and secondarily the avoidance of costs incurred in re-tendering.

4. SPECIFIC ISSUES

4.1 Introduction

Specific issues which may affect competition and efficient pricing for passenger transport contracts are discussed. This discussion is based on international evidence (included in Appendices 4 and 5) and our discussions with New Zealand operators and tendering authorities (Appendix 1). The term "large operator" is used to apply to incumbent urban operators in an area with around 40 or more standard size buses. The term "small operator" applies to all other operators.

4.2 RFT Size

4.2.1 The Issue

At first glance, it would seem probable that RFT size has the potential to impact on competition and efficient pricing. Large RFTs requiring resources and/or capital beyond the scope of all but a very small number of tenderers might be expected to receive less tenders per RFT and be less efficiently priced.

4.2.2 New Zealand Procedures and Practice

The CPP specify maximum RFT size in terms of maximum annual seat kilometres and seats in service at any one time. For standard (45 seat) bus operations, maximum RFT size equates to about 11 buses in operation at any one time.

However with the advent of Group Tenders (where the tenderer submits one tender for a group of RFTs), RFT size in itself has become largely irrelevant. In many instances contract size is effectively being determined by the tenderers submitting group tenders rather than by the tendering authorities' specification of individual RFT size.

4.2.3 Operator Views

All operators considered that RFT size was important to competition, though views how RFT size would affect competition varied between large and small operators.

Large operators generally believed that large RFTs were necessary in order to offer "parcels" of work large enough to attract the large operator to enter or stay in the market. In contrast, the general view of small operators was that large RFTs would discourage competition since small operators would effectively be excluded from tendering. These small operators consider that RFTs need to be small enough to enable them to tender without having to undertake major expansion of fleet size, depot size, administration, etc.

Waikato Regional Council was quoted by one Auckland operator as a tendering authority that had got its RFT size right and had encouraged competition. There, RFT

sizes ranged from 1 to 8 peak buses which, for a c.28 peak bus operation, gave a good range for various sized operators to select from.

4.2.4 Tendering Authority Views

To encourage competition, tendering authorities consider that there needs to be a range of RFT sizes. The size of any given RFT should be based on:

- The nature of the service in question, and an assessment of the practicable options for "splitting" a service into a number of constituent RFTs,
- The size of other RFTs and the size of probable tenderers, to ensure that there are RFTs of a size which will be attractive to all potential tenderers.

Auckland Regional Council considers that the current CPP formula specifying maximum RFT size is not sufficiently flexible and is inappropriate.

4.2.5 International Experience

- UK (Appendix 4)

In a recent study into the level of competition for passenger transport contracts in the West Midlands (Pickup et al. 1991), it is reported that "*...the level of competition is greatest for small contracts*". However, in the sample analysed, the range in the number of tenders per contract is comparatively small, as follows:

Less than 1,000 miles pa	1.91 tenders per contract
1,000-10,000 miles pa	1.66 tenders per contract
More than 10,000 miles pa	1.84 tenders per contract

Note however that they are all very small contracts by New Zealand standards.

Analysis of the UK market shows that receiving serious competition for large contracts may also be very important. In October 1986 the ex-Passenger Transport Executive operator (West Midlands Travel) held 82% of all contracts covering 77% of all contracted bus miles in the West Midlands. By May 1988 this latter figure had been reduced to 67% as a result of competition from other large operators. This shows that while competition may be considerable for small contracts a large incumbent may not be seriously challenged unless another larger operator enters the market and challenges for the larger contracts.

- USA (Appendix 5)

Analysis of 78 RFTs issued in the USA since c.1984 shows that the greatest competition has occurred for RFTs requiring between 15 and 49 peak buses (3.7 to 4.5 tenders per RFT). For contracts outside this range, there is more competition for smaller rather than for larger contracts: the 7 RFTs requiring more than 75 buses received on average only 2.0 tenders per RFT whereas the 16 contracts requiring less than 15 buses received 4.8 tenders per RFT.

This finding is consistent with the structure of the US private bus industry, whose most frequent participants in the public transport tendering process are large national school bus companies. These companies are unlikely to enter new markets in response to the small tender packages, while they are sometimes deterred by the barriers to entry for large tender packages (such as the perception of incumbent preference and the high cost of preparing large tenders).

Most US contracts are large by New Zealand standards, since the market is much larger. Because the New Zealand market is much smaller than the US market, the reduction in the level of competition for large New Zealand contracts can be expected where contract size is still comparatively small by US standards.

4.2.6 Discussion

The US experience shows that competition for contracts tapers off for both very large and very small contracts. This is to be expected since most operators will not have the resources to tender for very large contracts and also the costs associated with tendering will tend to discourage competition for very small contracts. However smaller contracts do tend to attract more competition than larger contracts.

Because the New Zealand market is much smaller than the US market the change in the level of competition by RFT size can be expected to occur at a low vehicle requirement threshold. This suggests that New Zealand tendering authorities should err on the side of smaller rather than larger RFTs.

On the other hand attracting competition between some of the larger operators may also be important in receiving serious competition (cf. UK experience). Large operators will find large contracts more attractive than small contracts. This suggests that there may be specific instances where New Zealand tendering authorities may receive greater competition and more efficient tender pricing by publishing some large RFTs.

In New Zealand, because of the widespread use by operators of group tenders and because of the way these have been evaluated by tendering authorities, "effective" RFT size has been increased well beyond the maximum RFT size prescribed in the CPPs.

RFT size is clearly important in encouraging or discouraging competition. In principle tendering authorities should specify RFT sizes to encourage competition from all potential tenderers so that there is competition (or the threat of competition) for all RFTs. It may be possible to increase a tendering authority's scope for increasing competition by allowing a tendering authority greater latitude to set maximum RFT size based on an assessment of the size of potential tenderers. Conceptually this could assist potential small tenderers and large tenderers since each would be assured that the tendering authority would publish RFTs of an attractive size. In such a system there would however need to be safeguards to ensure that RFT size could not be manipulated for the purpose of favouring any particular operator over another.

4.2.7 Conclusions

- A predominance of unreasonably large RFTs will be anti-competitive and would be likely to result in higher than otherwise necessary tender prices.
- In some specific situations some large RFTs may be warranted, particularly to "kick start" competition between large operators who tend not to compete.
- In the longer term, a range of RFT sizes tailored to attract different sizes of operators will attract the greatest number of tenders and achieve the keenest competition.
- RFT size has a high impact on the level of competition. Options for increasing competition between large non-competing operators through more attractively sized RFTs include:
 - Relaxing CPP requirements to permit a "horses for courses" approach where this can be expected to achieve more efficient contract prices.
 - Amending CPPs to allow RFT sizes to be based on the size of potential tenderers.

These options should be accorded a high priority in subsequent project tasks.

4.3 Group Tenders and Combined Tenders

4.3.1 The Issue

In this discussion, the following definitions are used:

- A **group tender** is a single tender submitted for a number of individual RFTs grouped together at the operator's, as distinct from the Regional Council's, volition.
- A **combined tender** is a tender submitted in response to a combined RFT. A combined RFT is an RFT which contains up to three individual RFTs combined together at the tendering authority's volition.

As noted in Section 4.2, group tenderers have largely subordinated the issues relating to RFT size. If large RFTs can be anti-competitive, then so too group tenders may be anti-competitive. This section discusses the impact of group tenders and combined tenders on competition and competitive pricing.

4.3.2 New Zealand Procedures and Practice

The January 1991 CPPs allowed tendering authorities to publish combined RFTs thus permitting operators to submit tenders on any combination (or all) of the individual RFTs contained within the combined RFT. The CPPs limited the number of individual RFTs which could be included in a combined RFT to three.

In the event few combined tenders were issued, and even fewer contracts were awarded on the basis of combined tenders. Instead, many operators, regional councils (and Transit New Zealand also) adopted or endorsed the group tender concept, which was not envisaged in the then current CPPs.

Because of the wide ranging use and acceptance of group tenders in the July 1991 tendering round, the concept of combined tenders became largely irrelevant.

Contracts awarded pursuant to group tenders have received some considerable criticism:

- In Auckland, all the contracts awarded to the largest incumbent operator were won as a result of that operator submitting a small number of large group tenders (plus an accompanying individual tender for each constituent RFT as required by the tendering authority).

Tenders were evaluated on the basis of achieving the lowest overall price to the tendering authority. As a consequence a small operator's individual lower priced tender (compared with the individual tender submitted by the winning incumbent tenderer) could only win if it, plus a combination of other tenders, covered all RFTs (included in the combined tender) at a lower overall price.

This did not occur for two reasons:

- (i) The sum of the incumbent operator's individual tender prices was high, compared with the group tender price.
 - (ii) Insufficient other tenderers submitted tenders for all services to be covered by the predominant use of such tenders.
- In Dunedin, group tenders were also evaluated on the basis of achieving the lowest overall price to the tendering authority. This (plus other aspects of the tendering process) was challenged in court by an unsuccessful tenderer. On this group tender topic, the Court of Appeal (1991) ruled:

"Combining tenders in large contracts would have the effect of excluding small operators from competing. It is apparent that the encouragement of competition from smaller operators has been deliberately preferred to the provision of services at lower overall costs by taking advantage of any available economies of scale.

It was submitted to us that since operators of all sizes were able to tender for individual routes the acceptance of combined tenders should not be seen as excluding competition thereafter. That may be true in the short term but we are not satisfied that in the longer term such a practice would not prejudice the enhancement of competition. To tender for the provision of passenger transport services requires capital resources which if not used will not be retained. The combining of contracts to the advantage of the big operators eventually would drive out the potential competition from smaller operators, and when that disappears so too will the incentive for the big operators to operate efficiently. "

The Court did not rule (in respect of this issue) that the contracts should be overturned. However the Court did note:

"It is of course to be borne in mind that failure to comply with the CPP even in respect of this important element goes to the eligibility for subsidies, reasonableness and fairness and not legality."

Subsequent Transit New Zealand audit showed that the breaches in the CPPs were not sufficient to warrant withdrawal of Transit New Zealand and other public funding for these contracts.

- In Wellington, contracts were also awarded based on group tenders. Analysis of contract prices in the Wellington region (Appendix 3) suggests that group tenders achieve considerable savings in contract price, these savings were between 10% and 48%, and averaged 33% over the sum of the constituent individual tender prices. However it is not clear how seriously the individual RFTs were priced and they may well have been priced at such a level in order to make the group tenders comparatively attractive. Had group tenders not been permitted it is by no means certain that the same individual tender prices would have been submitted.

The January 1992 CPPs now formalise the group tender concept (and retain the combined tender provisions also). In respect of group tenders, the CPPs (S3.6) now state:

"3.6 Group Tenders

- 3.6.1 Any tendering authority which permits group tenders shall require tenderers to also tender separately for each single RFT.*
- 3.6.2 Any tendering authority which permits group tenders shall include in the relevant RFTs:*
 - (1) any special conditions covering group tenders; and*
 - (2) the method to be used in evaluating group tenders.*
- 3.6.2 Any tendering authority shall be permitted to specify that all RFTs, or any particular RFT, can not be included in a group tender."*

Transit New Zealand expected that the extent of the anti-competitive nature of group tenders would be considerably reduced by not allowing so many RFTs to be tendered for at once within any region.

On this topic the CPPs (S3.7) state:

"Contract expiry dates shall be:

- (i) reasonably spaced over the years so that a similar number of contracts expire each year,*
- (ii) reasonably spaced throughout any given year."*

Transit New Zealand hoped that those changes would overcome the potentially anti-competitive nature of group tenders. This seems unlikely to be the case since:

- Group tenders are specifically permitted in the 1 January 1992 edition of the CPPs but options for overcoming such problems associated with group tenders are only given as guidelines; and
- Group tendering can be used as an anti-competitive strategy even when only a small number of RFTs are grouped together by the tenderer.

4.3.3 Operator Views

Large operators considered that group tenders should be permitted with little or no restriction since this would allow operators to achieve economies of scale and to pass on these economies to the tendering authority by way of reduced tender prices. This would achieve an efficient use of public funds.

Small operators considered that group tenders are equivalent to large RFTs and that they were effectively locked out from competing against large operators. These operators believed that they were locked out because:

- They did not have the resources to tender for all services, and
- No matter how competitively they priced any individual tender it would be "swamped" by the group tender when the tendering authority evaluated tenders so as to achieve lowest **overall** price.

These small operators considered that the resulting absence of effective competition would result in higher than otherwise necessary tender prices and an inefficient use of public funds.

4.3.4 Tendering Authority Views

Tendering authorities are generally receptive to the "economies of scale" arguments, usually advanced by the larger operators. This is hardly surprising since, so far in New Zealand, group tender prices have invariably been lower than the sum of their constituent lowest price individual tenders. Tendering authorities considered that group tenders should be permitted because they are helpful in encouraging competitive pricing.

4.3.5 International Experience

- **UK (Appendix 4)**
In its initial advice to authorities, the UK Department of Transport (DoT) warned of the dangers of inhibiting competition if tender packages were too large and thus beyond the resource capabilities of smaller operators. The DoT suggested that tenders be invited for the smallest economic units and that

operators be given the opportunity to submit group tenders where economies could be achieved. This is standard practice.

Group tenders can result in lower overall tender prices where cost savings can be achieved by "inter-working" or by some savings in overhead or administration and supervision costs. Obviously this helps the larger operators. In some instances tendering authorities have rejected group tenders in favour of slightly higher individual bids in order to encourage competition (e.g. Hampshire County Council).

Group tenders did create problems in London. Beesley and Glaister (1989, Appendix 4) noted that, initially in competitive tendering, London Regional Transport (LRT) were adopting a policy of offering larger and larger local networks. London Buses Ltd (LBL) were successful in winning these networks, as there were no other tenderers large enough to compete. LBL were also offering a price to operate a network, and individual prices for separate routes which appeared to have much higher mark-ups over costs. In effect, LRT were faced with the choice of accepting the network tender from LBL, or a combination of route tenders from LBL and independents which would have cost more. Beesley and Glaister concluded that there was a problem because there was no effective comprehensive alternative tenderer(s). Two lessons implemented as a result of this were:

- That packages of routes offered should not be too big; and
- That some of the packages should be for routes that could not be combined as a unitary network.

LRT now require that any operator who submits a group tender must also tender individually for each constituent RFT. Group tenders from bigger operators generally do include a discount for the whole package, but it still has been possible to save on these costs by accepting lower tenders from smaller firms for parts of the total.

LRT said they prefer networks to be split up between operators because there is then some form of (service performance) competition between operators (and also someone to take over if a contract has to be cancelled).

- **USA (Appendix 5)**
Most contracts are not awarded as a result of combined tenders, though combined tenders have been used by some large tendering authorities (Dallas, Denver and Houston). Where combined tenders are permitted, contract award is usually at the combined level.

Pricing strategies of large companies have favoured combined tenders rather than individual tenders. Tendering authorities tend to prefer combined tenders because of perceived economies of contract administration. However indications are that the tendency to avoid awarding constituent components of combined tenders to separate tenderers is deterring competition from smaller companies.

In the USA, any tender which proposes a combination of RFTs that the tendering authority has not specified (called a group tender in New Zealand), is judged to be non-conforming and is disqualified.

4.3.6 Discussion

The group tender concept obviously has the ability to reduce the amount of competition, both in terms of:

- The likely success of an individual tender; and
- The desire of a smaller operator to tender if that small operator perceives that the "odds" are against him.

In accepting and evaluating group tenders, the issue is that of reaching the right balance between achieving lowest overall price as against lowest price for an individual tender, taking into account both short-term and long-term impacts on competition and tender pricing.

To date in New Zealand, where group tenders have been permitted, the tender evaluation process has sought to achieve the lowest overall price. This approach results in the lowest level of external funding required in the short term. However, if the rules regarding group tenders had been different (or they had not been allowed), it is not clear how individual tender prices may have varied and therefore how resulting contract prices would have compared. In the longer term, the inability of small operators to win contracts, almost irrespective of price, may lead to higher than otherwise necessary group tender prices by the incumbent operator.

Table 12. Example of group tender evaluation.

RFT No.	Operator		
	A	A	B
1	100		80
2	100		-
3	100		-
4	100		-
Group		350	
Total	400	350	380 ⁽¹⁾

(1) Includes Operator A's tenders for RFT 2, 3 and 4.

Table 12 shows a simplified example of how a group tender price can achieve lowest overall price for all constituent tenders, but in doing so can exclude a competitively priced individual tender from being successful. If Operator B's tender for RFT 1 were accepted, total contract price for the four RFTs would be 380; 30 units more expensive than Operator A's group bid price of 350. As can be seen from Table 12, the group

tender debate can arise even when only a small number of RFTs are issued by a regional council at any given time.

Clearly the tendering authority would need to make an assessment of the merits of encouraging competition against the disbenefits of receiving a higher than otherwise necessary overall tender price.

To assess the short-term impact on price, an analysis was undertaken of tenders won in the Wellington region by group tenders. (Rail services are not included in this analysis because of the absence of comparable published data.)

The results of this analysis are shown in Table 13, which shows that:

- Overall, group tenders achieved an apparent saving of c.\$3.4M pa, or 33 % over the sum of the individual tenders.
- For separate group tenders, savings ranged from 1 % to 48 % (\$112 pa to c.\$3.2M pa).
- The largest saving in dollar terms arises from Wellington City Transport Ltd's (WCTL's) group tender, representing a saving of 41 % or c.\$3.2M pa over the sum of the comparable lowest price individual tenders.

However, these results do need to be interpreted with considerable caution. First, had operators not been permitted to submit group tenders, and had therefore been forced to rely upon their individual tenders to win contracts, then the individual tenders are likely to have been more keenly priced.

Second, it is likely that those tenderers who favour group tenders (generally the larger incumbent operators) will have "overpriced" their individual bids to demonstrate the validity of the economies of scale argument that they hold generally.

Third, it is not evident whether there is any overall difference in respect of qualitative features offered between individual and group tenders which might have impacted on price.

Fourth, and arguably most important, there is doubt as to whether the savings shown in respect of group tender C11 (WCTL) are strictly related to the group tender issue. The successful group tender is understood to have been submitted at the eleventh hour after Christchurch Transport Ltd's apparent lack of tendering success in Christchurch. If this was indeed the case then part of the saving (unquantified) is obviously attributable to WCTL's perceived threats of competition, rather than to any intrinsic economy associated with group tenders.

This would support the view that the dominant force influencing tender price is the perceived threat of competition while factors such as discounting to allow for revenue risk, contract tenure, etc. are subordinate to this factor.

Table 13. Analysis of group tender contract prices v individual contract prices in Wellington. ⁽¹⁾

Reference	Duration (Months)	Type	Group Tender (\$)	Sum of Individual Tenders ⁽²⁾ (\$)	Av. No. Tenderers	Savings	
						\$	%
WCTL C11	12-24	Net	4,599,000	7,770,552	2	3,171,552	41
Other Contractors							
C1	24	Net	81,500	85,000	1	3,500	4
C2	19	Net	631,483	763,455	2	131,972	21
C3	19	Net	27,240	30,544	4	3,304	11
C4	19	Net	197,500	248,200	3	50,700	20
C6	12	Net	7,455	7,567	2	112	1
C7	19	Net	421,212	433,849	1	12,637	3
C8	36	Net	602,329	620,399	1	18,070	3
C9	12	Net	174,600	179,100	3	4,500	3
C10	19	Net	100,000	109,700	3	9,700	9
C12	12	Gross	115,067	126,622	3	11,555	9
C13	5		21,499	41,645	5	20,146	48
Total Other (Non-WCTL) Contractors			2,379,885	2,646,081		266,196	10
Total All Contractors			6,978,885	10,416,633		3,437,748	33

(1) Group tenders ref. C1 to C12 commenced 1 July 1991, C13 commenced February 1992.

(2) Sum of all applicable lowest price conforming primary specification individual tenders, not necessarily sum of lowest priced conforming primary specification individual tenders submitted by successful group tenderer.

It appears that:

- Group tenders have the potential to be strongly anti-competitive in favour of large (and usually incumbent) operators. This is particularly the case where the average number of tenders per RFT is low.
- New Zealand evidence is insufficient to suggest whether group tenders will achieve lower prices in the long term (through economies of scale) or higher prices in the long term (through reduced competition).
- In the short term, group tenders appear to have achieved lower prices than would otherwise have been received. This conclusion needs to be treated cautiously, since it is likely that operators, given the opportunity to submit group tenders, artificially inflated their individual tenders (or did not adjust the individual tenders in response to increased threat, but did adjust the group tenders).
- Group tenders, if evaluated so as to achieve lowest overall price, can effectively have a similar impact as large individual RFTs. Group tenders are not likely to be such a deterrent to smaller operators as large individual RFTs. With respect to RFT size, a wide range of RFT sizes will tend to maximise competition and achieve keenest tender prices.
- The requirement for contract expiry and commencement dates to be reasonably spaced over the years and within each year may reduce but will not eliminate the opportunity for group tenders.
- Tendering authorities need to consider the implications of group tenders much more carefully than they have in the past. Tendering authority group tender policies and evaluation methodologies need to be published at the time of publishing RFTs.

4.3.7 Conclusions

Group tenders can be highly anti-competitive, particularly where the average number of tenders per RFT is low and where they are evaluated in such a way that achieves lowest **overall** price.

Options to decrease their anti-competitive nature include:

- Specifying in the CPPs mandatory evaluation procedures for group tenders. This could involve rewording some of the group tender guideline information and placing it in the mandatory section of the CPPs.
- Specifying in the CPPs limitations on maximum operator market share and/or group tender size.

These options should be accorded a high priority in subsequent project tasks.

4.4 Contract Duration and Phasing

4.4.1 The Issue

In our experience, contract duration is one of the issues most widely debated by operators. This is probably because of the unclear benefits/disbenefits associated with almost any contract duration. For example revenue prediction for a one year net contract may be comparatively simple but the successful tenderer is subject to competition again very soon. On the other hand, a 6 year contract protects the operator from competition for a longer time, but makes revenue prediction much less certain.

This section discusses experiences and views to determine a "happy medium" between the various pros and cons.

4.4.2 New Zealand Procedures

The January 1991 CPPs specified contract durations of one to five years for the initial round of contracts, with the maximum contract length reducing to three years for subsequent contracts. This reduced contract length was removed from the January 1992 CPPs and (apart from seasonal, trial, special event and emergency replacement services) contracts must be between one and five years. Contract expiry dates are also required to be reasonably spaced over the years so that:

- a similar number of contracts expire each year, and
- contract expiry dates are reasonably placed throughout any given year.

The effects of this will be:

- An unsuccessful tenderer should have another opportunity to tender in the near future; and
- Tenderers will not have to absorb the requirements of so many RFTs at once.

4.4.3 New Zealand Practice

In Auckland current contracts are for 3, 4 and 5 years duration. This means that the rolling programme of contract expiry dates within any year will only start to come into effect on the expiry of the next round of tenders (July 1995 at the earliest)⁴.

The national average contract length (unweighted) for contracts entered into for the July 1991 tendering round is 3.6 years, as shown in Table 14.

Table 15 shows a summary of contract duration and tenders received for the 1 July 1992 tender round in the Wellington region.

⁴ Based on a first round contract expiring in July 1994 and subsequent contract expiry dates staggered throughout each year. First "staggered" contract would have July 1995 expiry date.

Table 14. Summary of contract durations in eight New Zealand regions for July 1991 tendering round.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land	Wai-kato	Well-ton	Total
Total no. of RFTs issued	285	4	50	8	16	12	7	132	515
Total no. of tenders	388	6	?	8	27	25	31	448	935
Average number of bids/RFT	1.4	2.0	1.2	1.0	1.7	2.1	3.4	2.1	1.6
% tendered services by contract duration:									
- Up to 1 year	0	0	26	100	1	0	0	24	9
- 1 + to 2 years	0	25	34	0	97	0	0	61	8
- 2 + to 3 years	30	75	32	0	2	16	0	15	27
- 3 + to 4 years	40	0	8	0	0	42	29	0	27
- 4 + to 5 years	30	0	0	0	0	42	71	0	29
Average contract duration (years)	4.00	2.75	2.20	1.00	2.00	4.26	4.71	1.91	3.59

Table 15. Tenders received for July 1991 tendering round, by contract duration in Wellington Region.

Contract Duration (Years)	No. of RFTs	No. of Tenders ⁽¹⁾	No. of Tenders/RFT
0-1 (gross)	18	45	2.50
0-1 (net)	12	27	2.25
1-2 (net)	78	169	2.17
2-3 (net)	20	33	1.65
Total	128	274	2.14 (Ave)

(1) Conforming primary specification individual tenders only.

It is notable (Table 15) that, in Wellington, competition (tenders per RFT) has declined as contract duration has increased. In our view, this is likely to be an atypical result, for the following reasons:

- The shorter contracts tended to be the smaller contracts and, as noted previously smaller contracts are likely to be more keenly contested than larger contracts.
- None of the net contracts included detailed patronage and revenue information on which tenderers could base their revenue estimates. The risks to the contractor of incorrect estimation are likely to be greater for longer rather than for shorter contracts.

4.4.4 Operator Views

Operators generally consider that contracts of 3 to 5 years duration are desirable because they strike a good balance between:

- Locking-out an unsuccessful tenderer for too long a period v having to estimate revenues (for net contracts) too far in advance; and
- Having to incur tender costs, and gear up/invest for excessively short (1-3 year) contracts.

The generally held view of short (1-2) year contracts is that they are impracticable because of the perceived need to depreciate vehicles over a short time frame. Logically then one would expect longer contracts to be more keenly priced than shorter contracts (given a constant level of competition). From the discussions however contract duration per se appeared to have little impact on pricing policies for which it was very much subordinate to that of perceived risk from competition.

All operators are in favour of contract roll-over provisions, whereby a contract could be extended without re-tendering provided the existing operator achieved a series of pre-defined performance targets.

The general operator view is that the longer the contract (given good contract tenure) then the more attractive it would be, and hence the more keenly it was likely to be priced.

4.4.5 Tendering Authority Views

Tendering authorities are also generally in favour of 3 to 5 year contracts on the grounds that they struck the right balance between:

- Attracting competitive tenders;
- Minimising disruptions to passengers when contracts come to an end;
- Minimising administrative costs associated with the tendering process.

Both Wellington and Canterbury Regional Councils are now moving towards longer contract durations with expiry dates arranged so that tenders are called for either two (Wellington) or three (Canterbury) times each year.

4.4.6 International Experience (Appendices 4 and 5)

Table 16 shows the contract durations used in a number of countries.

In London, the tendering authority has recently started calling for tenders for three to five year durations. Dodgson (Appendix 4) notes that they expected tender prices to be lower for five years contracts than for three year contracts, but this has not occurred. Apparently " ... operators are prepared to take the risk that contracts for three years duration would be extended." In the West Midlands, a study by Pickup et al. (1991) identified that contract duration was one of the two important factors in

Table 16. Contract durations used in different countries.

Country	Duration (Years)
New Zealand	1-5
UK (London)	3-5
USA	3-5
Sweden	3-5
Denmark	4 ⁽¹⁾
South Africa	3
Chile	1.5 ⁽²⁾
Australia (NSW)	3

- (1) Up to 8 years permitted by law; tendering authority chose 4 year maximum to maximise competition.
- (2) With 1.5 year renewal option.

increasing competition⁵. That study found that the greater competition occurred for contracts of three or more years duration.

In the USA, the average contract duration is 3 to 5 years. Contract durations of more than 5 years are almost non-existent though a small number of contracts permit renewal beyond 5 years.

4.4.7 Discussion

In New Zealand average contract duration is a little over 3.5 years and is on par with typical overseas practice.

In the discussions with those in the passenger transport industry, support was strong for 3-5 year contracts. Shorter contracts were considered to unreasonably raise the element of risk and longer contracts were seen as being anti-competitive because they would lock out a potential operator for too long a period. Additionally, the increased risk factor of attempting to estimate revenue for net contracts more than 5 years into the future was also seen as a potential problem.

From the discussions with operators, little account appears to have actually been taken of the possible cost impacts associated with different contract durations. Operators have however generally adjusted tender prices in recognition of actual or perceived competition. Given that operators have expressed a preference for longer rather than shorter contracts it might be expected that there would be more tenders for longer contracts. This expectation should encourage keener tender prices. Also, once the rolling programme of contract expiry dates is established, longer contracts will no longer have the effect of "locking out" an unsuccessful tenderer for the duration of that contract because other tendering opportunities will arise fairly frequently. (Note however that some operators may still choose to scale down or cease operations rather than compete in an area new to them.)

⁵ As reported by Dodgson in Appendix 4. The other important factor is contract size.

4.4.8 Conclusions

- Contract duration is important in attracting competition.
- Operators appear much more likely to adjust tender prices based on the perceived threat of competition than on the changed costs associated with longer or shorter contracts.
- Alternative contract durations within the accepted norm of 3-5 years are unlikely to significantly affect an operator's perception of likely competition.
- Nationwide, average contract duration of 3.5 years is on par with typical overseas practice.
- Contract durations of 3 to 5 years are preferred by almost all operators and tendering authorities.
- Initial short duration contracts are now being replaced by longer contracts of 3 to 5 years duration.
- The rolling programme of contract expiry dates within any year will mean that unsuccessful tenderers will not be "locked out" for the duration of the contract for which they unsuccessfully tendered. (Unsuccessful tenderers, however, may choose not to take advantage of work opportunities in other areas.)
- The present CPPs are satisfactory and tendering authorities are adopting contract durations that are most likely to encourage competition.

For these reasons it is recommended that contract duration should be accorded a low priority in subsequent tasks.

4.5 Gross v Net Contracts and Patronage Information

4.5.1 The Issue

Net cost contracts require the tenderer to estimate both costs and revenues. Therefore accurate revenue estimates are needed to tender successfully and profitably for net cost contracts. Gross cost contracts only require the operator to estimate costs. Because incumbent and large operators generally have better revenue information, or have greater resources to collect accurate revenue information, net cost contracts are considered by some operators as being anti-competitive. This understandable criticism can be overcome by the publication of recent historic patronage and revenue data. Alternatively, tendering authorities can opt for gross cost contracts. These contracts are often criticised for being open to operator revenue fraud and allowing the contractor to be disinterested in patronage/revenue levels and service quality.

Section 4.5 discusses the impact of gross and net cost contracts on the level of competition and on efficient tender pricing and contract administration.

4.5.2 New Zealand Procedures

The 1 January 1991 CPPs (S3.3.5) stated:

"The tendering authority shall not invite or accept a net contract tender unless passenger count and composition information relating to the previous year is provided in the RFT."

Prior to the awarding of contracts, Transit New Zealand's General Manager advised regional councils that:

"If Regional Councils cannot supply the information required in (Section) 3.3.5 (of the CPPs) I would expect them in calling for net tenders to give the numbers of people they wish to be carried, detailed into the appropriate fare groups." (Letter to Wellington Regional Council, 23 January 1991)

That letter also accepted that it would be satisfactory to provide patronage information in RFTs on a "total for the operator" basis with little or no detailed breakdown to the individual RFT level, for 1991 only.

The requirement that tendering authorities publish passenger count and composition information before entering into net contracts has been removed from the January 1992 CPPs.

4.5.3 New Zealand Practice

Most tendering authorities opted for net contracts and analysis shows that in the July 1991 tender round, 94% of all contracts were of the net cost type. In most cases minimal passenger count and composition information was given in the RFTs.

For example:

- In Wellington, patronage information in RFTs for net contracts only included a statement that minimum actual patronage levels were expected to meet or exceed broad service level guidelines.
- In Auckland, the total patronage and revenue carried by one large operator (Cityline) was described in one sentence, viz: *"The operator estimates that in the 1989/90 year the urban scheduled services operated by Cityline Auckland carried approximately 1.25 million passengers"*.

For some RFTs issued in 1992, Wellington Regional Council did include some patronage composition data. However most tenderers considered that this was likely to be unreliable and, it is understood, placed little confidence in that information. Wellington Regional Council no longer includes any patronage composition information in any of their RFTs.

The main issues thus arising are whether the non-provision of patronage information for net contracts is anti-competitive or results in higher than otherwise likely tender prices, and whether gross contracts are likely to overcome these two latter problems.

From analysis of Wellington Regional Council tender prices (Appendix 2) (Hutt Valley services only), the following points are noted:

- In the absence of patronage information provided in the RFTs, almost all tenderers overestimated revenues. Not surprisingly, successful tenderers tended to overestimate revenues by the greatest amount.

This strongly suggests that (in terms of price alone) Wellington Regional Council is receiving very good value for money. If the regional council had published accurate patronage (and revenue) statistics on which tenderers could confidently base their revenue estimates it is probable that tender revenue estimates would have been lower and contract prices correspondingly higher. However some operators may still have discounted prices to retain market share.

- If these services had been awarded on a gross, rather than net, basis (and assuming the same gross costs for each contract), then the level of public funding for these contracts would have increased by up to 90% (assuming 50% cost recovery through fare revenue, refer Appendix 3, Table A3.1). Though, once again, some tenderers may still have discounted gross tender prices to retain market share.

The above analysis is particularly notable, since it tends to contradict the conventional view that gross contracts result in lower overall subsidies.

- The greatest competition has occurred for gross tenders (2.5 tenders per RFT for gross tenders, 2.1 tenders per RFT for net tenders). However this result needs to be interpreted cautiously since:
 - The gross contracts were confined to contracts of 12 months duration;
 - Except for two large rail replacement contracts (one requiring 35-39 peak buses, the other requiring 45-49 peak buses), all gross contracts were small, requiring less than 5 peak buses.

4.5.4 Operator Views (Appendix 1)

Almost universally, incumbent operators were strongly in favour of net contracts on the grounds that:

- The operator has an incentive to increase patronage and revenue; and
- Opportunities for operator fraud are reduced (compared to gross contracts), thus maximising the available funds to pay for contracted services.

Incumbent operators also believed that tendering authorities should not publish patronage or revenue information as part of any RFT, be it for one of their "own" or another operator's services. These operators considered that this information was commercially sensitive and that potential competitors should gather their own information.

Equally strongly, aspirant operators favoured gross contracts on the grounds that:

- Tendering is simplified (and less costly);
- Gross contracts reduce operator risk since future revenue streams are largely outside the control of an operator;
- Net tenders are anti-competitive since they place the incumbent operator in an advantageous position, particularly if the RFT does not include reliable and detailed patronage and revenue information.

4.5.5 Tendering Authority Views (Appendix 1)

Most tendering authorities favour net contracts because of the perceived reduction in contract administration costs, particularly in respect to minimising the scope for operator fraud. Another argument advanced in favour of net contracts was that, if the operator were able to be disinterested in patronage and revenue, the responsibility for making even the most detailed operational or timetable changes would fall to the tendering authority.

In contrast, one tendering authority (Manawatu-Wanganui) has expressed a strong preference for gross tenders which, in its experience to date, have achieved significant reductions in the cost of public funding required. In November 1991 one net contract was re-tendered as a gross contract with a reduction in public funding of 33%.

It is also worth noting that in 1991 the greatest competition occurred in Waikato where all tenders were for gross cost contracts.

4.5.6 International Experience

- **UK (Appendix 4)**
In the UK it is generally agreed that net tenders favour larger operators with experience of revenue measurement, either because they themselves have operated the routes out to tender in the recent past, or because they are simply more skilled in assessing the revenue prospects of different types of service. Larger operators might however favour net tenders on their home patch, but prefer to tender for a gross contract basis elsewhere. On the other hand, smaller less experienced operators generally prefer gross tenders.

Some tendering authorities use both methods, either seeking some contracts under one method and some under another, or seeking tenders on either (or both) bases. To reduce the advantage of an incumbent operator when tendering for a net contract many authorities include recent revenue figures in the RFTs. They can do this now that they have six years patronage and revenue data, but they could not do it initially.

From analysis of contracts in four authorities (Essex, Oxfordshire, Wiltshire and East Sussex) and discussions with tenderers, Tough (1992) notes:

" ... MS⁶ contracts cost considerably more than MC⁷ contracts and in no way is this difference removed by the additional expenditure required to monitor and administer MC contracts, or is it affected by the (tendering) authorities' risk estimates".

Tough also notes that operators had consistent reasons for preferring net contracts, and cites one typical operator view:

"Because of staff resources allowing extensive surveys, and (because) many tendered services were formerly operated by his company, he believed that his revenue information was accurate, and that no other companies (except the incumbent) could match this. Therefore he would expect to win more tenders on MS (net) contracts, as companies with poor information would have to overcompensate for revenue for fear of "getting their figures burnt". Many others would not bid at all, thus stifling competition."

Tough goes on to suggest that gross cost contracts result in lower overall subsidies because:

- (a) With poor patronage and revenue information, the revenue risk added to net cost tenders caused a significantly higher price over gross cost tenders;
- (b) Small operators have lower costs than larger operators and small operators are more successful in tendering for gross cost contracts than for net cost contracts. Gross and net contract prices will reflect the difference in operator cost structures;
- (c) Gross cost contracts attracted more competition because the majority of (small) operators have a preference for this type of contract. With net contracts, more competition did not reduce the winning price because the additional tenders were rarely competitive with the additional tenders being submitted by small operators allowing generous margins for revenue risk.

In terms of service quality, reliability and publicity, Tough concludes that net contracts are marginally preferable to gross contracts for both quality and reliability. This marginal preference for net contracts would, Tough concludes, hold little weight in any assessment of the two tendering methods (net or gross) once the cost savings of gross contracts are taken into account.

Tough's overall conclusion is that in the UK net contracts are considerably more expensive than gross contracts in terms of net funding requirements, even allowing for increased contract administration costs.

⁶MS - "minimum subsidy", and refers to net cost contracts.

⁷MC - "minimum cost", and refers to gross cost contracts.

- **USA (Appendix 5)**
Almost all contracts in the USA are of the gross contract type, for two main reasons:
 - Most operators are accustomed to receiving payments based on the amount of service provided (e.g. buses) rather than on passengers carried, because of their predominant school contract, charter and tour background;
 - With the limited US discretionary ridership, little potential exists for operators to increase patronage and revenue through better service.
- **Other Countries (Appendix 5)**
In countries other than UK or USA, a preference is generally for either net or gross contracts. In Denmark and Sweden contracts are predominantly gross; in South Africa and Chile contracts are predominantly net.

4.5.7 Discussion

The UK experience and New Zealand experience of gross and net contracts are somewhat contradictory. Whereas UK experience shows a clear price advantage (in terms of the level of public funding required) for gross contracts, analysis of Wellington (Hutt Valley) tenders suggests that gross cost contracts would be more expensive to fund. This is because of the general overestimation of revenues for those contracts. It is not clear how the regional council's non-supply of passenger count and composition information has impacted on the extent of competition or on price.

Based on views expressed by aspirant operators, the non-supply of this information may have reduced competition. On the other hand because operators did not have access to this information they had to make their own entirely independent revenue estimates. As it turns out, these estimates were almost invariably optimistic.

It therefore seems possible that by not providing passenger count and composition information, regional councils may be discouraging competition (from aspirant operators) yet still be receiving very keenly priced tenders. However a real danger is that successful tenderers on net cost contracts will surrender these contracts when they find that the actual revenue falls below their tender estimates.

It is notable that no regional councils or operators raised other gross v net issues, such as:

- Whether one method is preferable if region-wide multi-operator integrated ticketing were to be introduced. The Melbourne experience of integrated ticketing with multiple operators and the complexity of revenue sharing arrangements would tend to increase any case for gross contracts.

- How contract price is to be adjusted in the event of a regional council-imposed fare increase/decrease. This is likely to become important in the near future since fares on contracted services have not altered since contract award. This is also likely to be more important for longer (3-5 year) contracts than for shorter (1-2 year) contracts.

4.5.8 Conclusions

This topic raises a large number of contradictory viewpoints. In the UK gross contracts are considered more cost-effective but our analysis of New Zealand (Hutt Valley) tenders suggests that gross contracts would require higher subsidy levels. This is because operators have overestimated revenues in their tenders. Generally regional councils prefer net contracts but one regional council's experience has been that gross contracts are more cost effective.

Both UK and New Zealand evidence suggests that gross cost contracts attract more competition than net cost contracts.

Given the impact on competition, and the uncertain impact on efficient pricing, the topic of both gross v net contracts and the provision of patronage and revenue information in net contracts should be accorded a high priority for review in subsequent tasks.

Specific issues to be addressed in that review would include:

- To what extent gross contracts will, in the longer term, result in lower costs to the public purse? (The New Zealand operator views which are generally in favour of net tenders as a means of ensuring efficient use of public funds, conflict with overseas and some New Zealand evidence but supports other available New Zealand evidence.)
- If so, to what extent the potential savings will be offset by increased contract administration costs incurred by the tendering authority?
- If net public cost savings are achievable through gross contracts, are they sufficient to outweigh any lower standards of service as a result of lack of operator fare revenue incentives and operator preferences for net cost contracts?
- Whether there are other as-yet unidentified reasons for favouring gross or net contracts. Possible reasons include:
 - Issues relating to inter-operator integrated ticketing;
 - Issues relating to tendering authority-imposed fare change and contract price adjustments.

4.6 Manner of Service Specification

4.6.1 The Issue

In the initial tendering round, services were specified by regional councils in different ways. This section considers whether this is important to attracting competition and efficient pricing.

4.6.2 New Zealand Procedures and Practice

The 1 January 1991 CPPs (S3.3.1) required that each RFT contain:

"...a primary service specification, which defines the proposed service including route, termini, minimum frequencies and minimum passenger capacities by time of day, revenue type (gross contract or net contract), and fares to be charged (if determined by the tendering authority)."

This requirement was approached by tendering authorities in one of two ways, either by including the primary specification timetable (either current or proposed) in the RFTs (Auckland, Waikato, Wellington) or by specifying desired frequencies and headway (Otago, Canterbury).

The January 1992 CPPs provide tendering authorities more flexibility in how they specify service requirements. The CPPs now require that each RFT specifies *"any conformance requirements which a tender must satisfy in order to be a conforming tender"*.

In the initial tendering round most parties experienced some problems with the manner of service specification, such as identifying capacity requirements and assessing whether the required service differed from the then current service. In our view these difficulties arose because most tendering authorities had a large amount of work to do in preparing RFTs in a very short time period, and potential tenderers had a great deal of information to interpret before tendering. Also of course both parties were relatively inexperienced with the tendering requirements.

4.6.3 Industry Views (Appendix 1)

The general view of all sectors was that each RFT should specify frequency, headway, capacity requirements and also include a workable suggested timetable.

4.6.4 International Experience (Appendix 4)

In the UK, the almost universal approach is for tenders to be sought on the basis of a firm tendering authority-developed specification. However it should be noted that most UK services are small, and are often marginal extensions (in time or place) to commercial services.

4.6.5 Discussion

In future, difficulties encountered by tendering authorities and tenderers are likely to reduce as:

- RFT publication dates and tender closing dates become staggered, regional councils do not have to prepare so many RFTs at once and tenderers do not have to absorb so much information at once;
- Tendering authorities become more experienced in preparing RFTs;
- Tenderers become more familiar with interpreting RFT requirements; and
- All parties become more familiar with the both process, and resolving difficulties.

4.6.6 Conclusions

Initially most New Zealand parties experienced some problems with the specification and interpretation of RFT requirements. While this may have deterred some potential tenderers from actually tendering we are unaware of any such cases. Now that the initial July 1991 tendering round is over, RFTs will be published more frequently, with less contracts available for tender at any time. This rolling programme, plus the fact that tenderers and tendering authorities are becoming more familiar with tendering procedures, will reduce future RFT specification and interpretation problems.

Past difficulties experienced by tendering authorities and tenderers are likely to resolve themselves, for the reasons stated above. This is likely to be assisted by the fact that all parties have similar views as to how each RFT should specify service requirements.

For these reasons we consider that this issue need not be addressed in subsequent tasks.

4.7 Security of Contract Tenure

4.7.1 The Issue

Business confidence is normally regarded as an important pre-requisite to investment. In a contracting environment, winning the contract may provide the necessary confidence. However if the contract is likely, or perceived to be likely, to be terminated before normal expiry date, business confidence is likely to reduce.

This section discusses issues relating to contract tenure and whether this impacts on the level of competition and efficient tender pricing.

4.7.2 New Zealand Procedures and Practice

In New Zealand, funding for contracts usually comes from two sources:

- From ratepayers in the area served, and
- From Central Government via Transit New Zealand.

The level of Transit New Zealand contributions has been reducing in recent years, and is now in the order of 35-40% of the total funding requirement. This Transit New Zealand funding is regarded by operators and tendering authorities as an important contribution.

Because of future uncertainty regarding the level of Central Government funding for passenger transport contracts, most contracts include a caveat that contract continuation is subject to available funding. This clause, plus contractor concerns regarding reduced funding levels, reduce the security and contractor-perceived security of contract tenure.

In Auckland for example the tendering authority, at the time of tendering, did not know the level of Government (Transit New Zealand) funding available for the current year, let alone for future years. Consequently services were divided into two categories: those which would be contracted (based on funding which could be confidently expected for the next twelve months) and those which would only be contracted subject to funding availability. However, because the tendering authority had no certainty about future Transit New Zealand funding levels, all contracts include a let-out clause whereby contract continuation is subject to the availability of funds. Operators were aware of this before tendering.

The largest operator in Auckland, the Yellow Bus Company, considers that this future funding uncertainty is partly the cause of " ... *an industry wide loss of confidence*" which acts as a significant barrier to competition.

In Wellington, in addition to similar funding uncertainties described above, contracted operators have faced an additional factor that reduces security of contract tenure. This has been the Regional Council's policy to cancel contracts when notifications of commercial services are received.

The Transport Services Licensing Act (1989) S(49)(2) gives regional councils the powers to decline to register commercial services and states:

"A regional council may decline to register a passenger service under this section where the service proposed:

- (a) Is likely to have a material adverse effect on the financial viability of any contracted service; or*
- (b) Is likely to increase the net cost to the regional council of any contracted service; or*
- (c) Is contrary to sound traffic management or any other environmental factor identified by the regional council as being of importance to its region."*

It is notable that this only **permits** regional councils to decline to register services in particular instances; it does not **require** that notifications be declined in these circumstances.

Also in Wellington, a number of contracts have not been awarded because a tenderer, on finding out that their tender has been unsuccessful, has submitted a commercial notification for that same service.

Tenderers are aware of these risks, and need to take them into account in their tendering/pricing strategies.

4.7.3 Operator Views (Appendix 1)

Most incumbent operators consider that security of contract tenure is very poor, and maintain that if they had not already been involved in the passenger transport industry they would not have sought to become involved, primarily because of the poor security of contract tenure. However this has not deterred them from tendering, at least for their "home patch". It is unclear whether improved contract tenure would encourage operators to tender in other areas.

Aspirant operators also recognise the poor security of contract tenure. One such operator suggests that, while poor security of tenure should at least theoretically result in higher tender prices, tenderers in practice probably make little allowance for poor contract tenure in determining tender price. It is worth noting however that improved contract tenure is likely to assist new operators in raising capital. This in turn is likely to attract more entrants to the industry (though the increased competition may in turn lead to lower returns!).

4.7.4 Tendering Authority Views (Appendix 1)

Tendering authorities generally consider that operators have poor security of contract tenure, and that this is a major disincentive to competition. Points raised include:

- Improved security of tenure requires improved certainty of future funding. One year funding horizons are inappropriate for 3 to 5 year contracts.
- Without improved security of contract tenure, operators will be even less inclined to invest. This will reduce both the degree of competition and the quality of service.
- The high risks associated with poor security of contract tenure will be reflected in higher than otherwise necessary tender prices.

4.7.5 International Experience

In the United Kingdom tendering authorities regard contract payment as being a firm financial commitment and contracts do not get cancelled simply because the tendering authority is short of money.

In commenting on a draft of this report, Dodgson advised *"I am not surprised that the possibility of (contract) cancellation (because of funding problems) is regarded as a barrier to new competition in New Zealand"*.

4.7.6 Discussion

Contracted operators do have poor security of contract tenure because their contracts can generally be cancelled because of lack of funding or as a consequence of another operator submitting a commercial notification. Both of these are beyond the operator's control.

For incumbent operators this poor security per se may in fact have little impact on tender price since tenderers consider it to be less of a threat than actual or perceived competition. However, if and when tenderers perceive that poor security of contract tenure is tending to discourage competition, then that will give the opportunity to increase tender price to compensate for the perceived risk of early contract termination.

This poor contract security has the greatest impact on potential new operators. Raising capital will be made more difficult especially where, as in Wellington, the contract may be cancelled because a competitor submitted a commercial notification. Likewise small operators will be reluctant to tender in a larger operator's area for fear of commercial retaliation in their own area.

While Wellington Regional Council's policy to accept commercial notifications and to cancel or not let contracts will reduce public expenditure (at least in the short term), it will also tend to reduce competition.

4.7.7 Conclusions

Poor security of contract tenure has the potential to be a major disincentive to possible new operators. Raising capital will be difficult, and risks will be high. However, poor security of contract tenure per se may have little impact on tender prices provided there is a perception that competition is likely to occur.

Poor security of tenure is most likely to deter some potential new operators from competing. It may also deter some existing smaller operators from competing in other operators' traditional areas. However despite this deterrence, the amount of competition is tending to increase.

This suggests that, generally, the advantages of competing for contracts outweigh the risks. Poor security of tenure therefore may be reducing the rate at which competition is increasing but is not stopping competition from increasing.

For those operators who did tender, it is doubtful whether poor security of tenure did in fact affect tender prices. As with a number of other issues, risks associated with poor contract tenure were very much subordinate to the perceived threat of competition.

Provided that there is adequate competition, Transit New Zealand need not be overly concerned about operator views on this topic. However where there is little or no sign of competition, then this issue should be reconsidered. Possible options for improving security of tenure are:

- To introduce longer term funding horizons: this would require legislative changes;
- To require compensation for contract cancellation: this would require changes to CPPs;
- To prohibit contract cancellation on "availability of funding" grounds: this would require changes to CPPs;
- To require tendering authorities to proceed to contract award and to not cancel a contract even if another operator submits a commercial notification: this would require changes to legislation and CPPs.

4.8 Tender Evaluation Factors

4.8.1 The Issue

Tendering authorities are not obliged to accept the lowest price-conforming tender. Where optional evaluation factors are specified these must also be taken into account in evaluating tenders.

In the initial July 1991 tender round, different tendering authorities adopted different approaches. This section discusses the impact of these approaches on the level of competition and efficient pricing.

4.8.2 New Zealand Procedures and Practice

The January 1991 CPPs included guidance notes (as an appendix) on tender evaluation and selection procedures. These notes gave an example which demonstrated the importance of specifying as many factors on a mandatory, rather than optional, basis.

However, in the initial tender round, tendering authorities put comparatively little emphasis on the specification of mandatory and/or optional evaluation factors and because of time constraints resources were put into other areas which were considered to be of a higher priority.

For example, before tender closing date neither Auckland Regional Council nor Otago Regional Council published any optional evaluation factors to be taken into account when evaluating tenders. In Otago, a range of features and weightings were used in the actual evaluation. From the subsequent litigation it is apparent that:

- The application of these factors did not alter the choice of preferred tenderer;
- The process used to apply weightings to tender prices was complex and not readily understood by most tenderers.

The January 1992 CPPs (S3.2.1) require that each RFT

- (1) specifies those features which a tender must satisfy in order to be a conforming tender,
- (2) each optional feature which will be considered in tender evaluation, and
- (3) the basis of tender evaluation.

This revised procedure will greatly assist operators to identify, before tender submittal, the relative price advantage of various tender options for each RFT.

Now that the initial tender round is over, many tendering authorities are turning their attention to developing robust, easily understood and fair non-price evaluation factors to apply to subsequent tenders.

4.8.3 Operator Views (Appendix 1)

Operators generally believe that non-price service quality factors should be taken into account when tenders are evaluated. The recent school bus tendering method where price alone was considered is often cited as an example of how **not** to evaluate tenders.

Many operators expressed concern at the weightings given to various factors in tender evaluation. For example, Wellington Regional Council's bus age factor of 2.5 % means that the gross tender price of a service to be operated with solely brand new buses is discounted by only 2.5 % of the gross tender price of the lowest conforming tender. This percentage figure is considered too low to encourage an operator to invest in improved vehicles.

Operators generally consider that a clear statement specifying which are mandatory and which are optional features, and the weightings to be applied to optional features, will encourage competition.

4.8.4 Tendering Authority Views (Appendix 1)

All tendering authorities spoken to agreed that there was considerable scope for improvement in this area, in terms of:

- The features to consider;
- Whether features should be mandatory or optional;
- If optional, the weightings to be applied; and
- Clearly explaining the system so that it could be easily understood by tenderers.

Tendering authorities recognise that requiring higher standards will result in increased operator costs (at a time of funding constraints) and that, at some point, increased standards will reduce competition.

4.8.5 International Experience (Appendix 4)

In London, in addition to price, tenders are evaluated on:

- Adequacy of proposed resources;
- Competitiveness of wages and conditions vis à vis recruitment and retention;
- Operational feasibility (remoteness from depot);
- Control and supervision proposals;
- Suitability of vehicles;
- Trade record and experience.

4.8.6 Discussion

Instances where different approaches taken by tendering authorities have either encouraged or discouraged competition and as a consequence have influenced contract price have not been able to be identified.

However, competition will tend to be encouraged where;

- Operators can readily understand and quantify the impacts of any optional evaluation factors on alternative tenders;
- Minimum quality standards are set at an appropriate level that encourages operators to improve service quality but not set so high that the number of potential competitors is severely reduced.

Tendering authorities are becoming increasingly aware of the need for the development of appropriate evaluation factors and at least two (Canterbury Regional Council and Wellington Regional Council) are undertaking such work, in conjunction with operators in their respective areas.

4.8.7 Conclusions

The January 1992 CPPs improve procedures regarding tender evaluation, and the industry itself is tackling this issue now that the initial tendering round is over.

Any instances where different approaches taken by tendering authorities have encouraged or discouraged competition and as a consequence influenced contract price have not been able to be identified.

For these reasons it is recommended that this topic should be accorded a low priority for consideration in subsequent tasks.

4.9 Contract Negotiation Procedure

4.9.1 The Issue

Potentially, contract negotiation could be permitted:

- Before contract award to ensure efficient contract pricing;
- After contract award to adjust contract price to allow for cost/revenue changes which could not have been foreseen.

This section addresses the topic of post-contract negotiation. (Pre-contract negotiation was discussed in Section 3.)

4.9.2 New Zealand Procedures and Practice

The January 1991 CPPs and January 1992 CPPs both prohibit the adjustment of contract price after contract award other than for inflation indexation and for service and fare level changes. For inflation, adjustment is made by applying an inflation

indexation (up to but not exceeding the index provided by Transit New Zealand). For service level changes, adjustment is made by applying the variable rate submitted by the contractor of the time of tendering to the change in resources required by the service level change.

In addition the January 1992 CPPs permit tendering authorities to adjust contract prices to pay for any changed service qualitative feature (such as lower step heights, larger vehicle destination signs, etc.).

In the initial tendering round, some tendering authorities permitted operators to submit only one variable price per RFT. This is obviously simplistic and unreasonable since it does not allow for different cost impacts of different types of service change (e.g. an additional 10km may require an additional bus at peak times but will not at off-peak times). In other instances, operators have been able to specify a variable price per unit of resource (\$X per peak bus, \$Y per bus km, \$Z per bus hour). In Otago, one operator specified a variable price of "up to \$3.84" per kilometre. When a service level variation was required, Transit New Zealand approval was sought as to what actual rate per kilometre was applied to the changed kilometres.

Most operators have attempted to specify realistic variable prices, though some operators have submitted reduced variable prices where they think service reductions are likely, and conversely increased variable prices where they think service additions are likely.

No tendering authorities have taken into account the difference in variable prices between operators when evaluating tenders, though this could be important, particularly if the contract is for a comparatively long period in an area with changing travel demands.

4.9.3 Operator Views (Appendix 1)

Those operators with views on this topic generally considered that after contract award there should be more scope to negotiate revised contract payments especially in the case of service, patronage and revenue changes outside the contractor's control. Operators considered that this would not reduce competition since the integrity of the tendering process would be retained. Also for the successful tenderers to be able to "get alongside" the tendering authority to resolve unforeseen problems (rather than for all contract price variations to be made the application of a predetermined formula) would, it was felt, increase operator confidence in the tendering process.

4.9.4 Tendering Authority Views (Appendix 1)

Only one tendering authority offered views on this topic. Otago Regional Council considered that there needed to be flexibility in the procedures to allow for unexpected events outside the control of either the operator or the regional council control. Otago Regional Council cited the recent reduction in Transit New Zealand funding as one such example. In this case Otago Regional Council considered that the extent of possible

service reductions could have been minimised (in the absence of alternative funding sources) if it had been able to re-negotiate some contract prices.

4.9.5 International Experience (Appendices 4 and 5)

In both the UK and USA negotiation of tender price after contract award is generally prohibited. If at the time of tender evaluation the tendering authority considers the price to be too high it can choose not to award that contract and re-tender. Once contracts are in place any contract price variation is based on variable rates submitted by the tenderer at the time of tendering.

4.9.6 Discussion

The inability to negotiate after contract award raises two issues in respect of net cost contracts. These are:

- For service level changes, the operator must include a variable rate(s). While gross unit costs to apply to service changes can probably be calculated fairly accurately in advance, the operator cannot possibly predict the likely revenue change of an unspecified service change. If operators submit gross unit costs (and they cannot really predict net unit costs), then for any service increase they are likely to be overpaid. This is because they receive both the resultant increase in revenue plus full recovery of increased gross costs. Conversely for any service decrease they are penalised. This is because their total revenues fall by the gross cost of the service reduced, plus fare revenue foregone.
- Fare level changes should result in changes in contract payments so that contractors are neither advantaged nor disadvantaged by the changed fares. This calculation cannot normally be done by simply adjusting contract payment up or down by the change in revenue. This is because there is a general underlying patronage/revenue trend (downwards) for which the contractor should not be compensated, as it should have been allowed for when submitting the tender price. It seems most unlikely that the appropriate adjustment will be able to be made by mechanical application of a formula without any negotiation.

4.9.7 Conclusions

For net cost contracts, there appears to be a good case for permitting negotiation of contract price to allow for revenue changes in specific instances. These instances are where service levels or fare levels are received by the tendering authority.

No cases have been identified where the above issues have either impacted on the level of competition or on efficient contract pricing to date.

4.10 Tender Vetting and Non-Performance Penalties

4.10.1 The Issue

A large proportion of incumbent operators consider that one of the flaws of competitive tendering is that any tenderer can under-price. Their concern is that as a result that will put the incumbent out of business and that either:

- The new operator will then be able to increase their price when the service is next tendered because no competition will be left, or;
- The new operator will be unable to continue in business either and services will cease.

Tender price vetting and non-performance penalties have both been suggested to overcome this perceived problem of under-pricing. This section considers the competitive issues relating to tender price vetting and non-performance penalties.

4.10.2 New Zealand Procedures and Practice

The January 1991 CPPs suggested, in the guidance notes, that tendering authorities could specify either a performance bond or a statement of financial ability from each operator. That guidance note commented that performance bonds and financial ability are mutually exclusive and that if a performance bond is required then there is no need to judge financial ability.

Table 17. Performance bond requirements.

Tendering Authority	Performance Bond Requirements	
	Initial Contracts	Subsequent Contracts
Canterbury Regional Council	\$2,000/contract	c.\$8-9,000 per vehicle ⁽¹⁾
Wellington Regional Council	No bond	\$10,000/contract plus \$10,000 per vehicle
Otago Regional Council	3 months est. revenue/contract	\$39,000 ⁽²⁾
Auckland Regional Council	No bond	N/A ⁽³⁾

(1) For weekday "bus-type" contracts.

(2) For contract re-tendered because of Court of Appeal Judgement.

(3) No subsequent contracts let.

In the initial tender round, tendering authorities tended to require little or no performance bond, as shown in Table 17.

With such a low level of performance bond (particularly before 1 July 1992) operators would have been able to opt out of contracts with little financial penalty. Despite this "easy out" situation there have been few instances of operators seeking early contract termination. (In light of our earlier conclusion that operators in Wellington's Hutt

Valley had overestimated revenues on contracted services, this suggests a keen desire by operators to retain market share at the expense of profitability.)

4.10.3 Operator Views (Appendix 1)

Most operators expressed concerns that contracts could be won by operators based on unsustainably low tender prices, which would then result in:

- The operator not being able to fulfil the requirements of the contract;
- Meanwhile another tenderer who has submitted a sustainable tender price has been put out of business;
- The defaulting contractor being able to "walk away" from the contract with little or no penalty.

Operators considered that the increased risk associated with tendering against a competitor who was able to tender an unsustainably low price would be a disincentive to competition. While incumbent operators would have to "manage the best they could" (on the grounds that what else would they do for a living), it was considered that new entrants would be discouraged from competing.

Increased levels of performance bonds (or price vetting before contract award) were seen as possible solutions to this problem.

One operator (CTL) has noted that, contrary to the CPP guidance notes, performance bonds and financial ability are not mutually exclusive and that irrespective of financial ability the penalty for contractual non-performance is determined by the conditions of the performance bond.

4.10.4 Tendering Authority Views

As can be seen from Table 17 tendering authorities are tending to increase the level of performance bonds.

4.10.5 International Experience (Appendices 4 and 5)

In both the UK and USA successful tenderers are required to post performance bonds. These bonds are forfeited if a contract is terminated because of operator non-performance.

In London the tendering authority checks whether the tender is operationally viable, but tender prices are not vetted to identify whether the quoted price will cover costs. Also in the UK, performance bonds are not normally required for passenger transport contracts. In London at least, if the tendering authority thought they needed a performance bond they probably would not award a contract to such an operator. This implies that past track record is taken into account in tender evaluation.

In New Zealand, the CPPs do not suggest that track record be taken into account in tender evaluation. Tendering authorities could include track record as an evaluation

factor provided that it did not "unreasonably limit competition". We are unaware of any tendering authorities including track record in tender evaluation.

In the USA tender prices are not vetted as the view is that operators are welcome to donate or partially donate services to the tendering authority, but that any contract must be operated until scheduled expiry date, or the performance bond will be forfeited.

4.10.6 Discussion

To ensure stable reliable services for the benefit of passengers (and the achievement of tendering authority transportation policies), operators need to have incentives not to terminate contracts early. The main reason that operators would want to terminate contracts early is if their successful tender price is **unsustainably** low.

In our view, the emphasis on the sustainability issue is important. Tenderers should not be prohibited from donating/partially donating services provided the service can be sustained for the full contract duration.

There appear to be two options for ensuring service stability. These are:

- Vetting tender prices to exclude unreasonably low tenders. However this is unlikely to be an appropriate method since it implies that the tendering authority knows more about the costs of operation than the operator itself. Also it implies that operators should not be able to donate/partially donate services for their own reasons.
- Imposing performance bonds. The level of performance bond would need to be set at an appropriate level to encourage contract performance without unreasonably limiting competition.

4.10.7 Conclusions

- Tender price vetting is undesirable, for the reasons stated above (S4.10.6).
- Tendering authorities should specify performance bonds to encourage contract performance without unreasonably limiting competition. This may discourage some operators from submitting unsustainably low tender prices, and may therefore result in a small overall increase in tender price.
- Where there is already competition between operators submitting sustainable tender prices, performance bonds are unlikely to reduce competition. For the better resourced operators with good lines of credit, the performance bond will be fairly inexpensive and is therefore likely to have only a small impact on tender price.
- Where levels of competition are low, performance bonds may be a further deterrent to a potential new entrant; the risks associated with getting the tender price wrong are increased considerably; also, because the performance bond is

included for borrowing purposes as a sum already advanced, it reduces the amount of available credit. This will make it more difficult for a new entrant to raise sufficient capital to commence operations (particularly at a time when tendering authorities are tending to specify improved minimum vehicle quality standards).

- Where competition is increasing, then any impact on competition caused by performance bonds may be of secondary importance. Where performance bonds are required and where competition is not increasing this issue should be re-addressed. This would involve specifying maximum performance bonds in situations of low competition.

Because competition is tending to increase, it is recommended that this issue should be accorded a low priority in subsequent tasks.

4.11 Availability of Buses

4.11.1 The Issue

This issue deals with the availability of buses of suitable age and quality to meet the tendering authorities' requirements. The availability/unavailability of standard size buses is more important than is the availability of maxi-taxi type vans because:

- Standard buses provide, and are likely to continue to be the most cost-effective way of providing, the bulk of the contracted services.
- Standard buses have comparatively high unit capital costs.
- New standard buses cannot be readily bought "off the shelf".

Also, a large number of incumbent operators have received considerable public funding to buy their existing fleets. This puts them in a potentially advantageous position compared with a new entrant. This section discusses how the availability of suitable buses may impact on competition.

4.11.2 New Zealand Procedures and Practice

Before 1 July 1991 most existing urban bus operators (both municipally and privately owned) received considerable on-going financial assistance from public moneys for the specific purpose of fleet upgrading. As a direct consequence of this there was a fairly steady supply of good quality second-hand urban buses on the market. Often these were purchased for less intensive school bus operations or by "third-tier" urban bus operators.

With the advent of competitive tendering, almost all urban bus operators have postponed their fleet replacement programmes. This has had the immediate effect of all but eliminating the availability of good-quality second-hand urban buses. The shortage of these suitable low capital cost buses has been further exacerbated by some operators choosing to "hoard" surplus buses, rather than sell them. It is understood that this has been done by some operators to reduce the probability of competition.

In terms of vehicle availability two broad types of operator exist:

1. Those operators who have fleets of comparatively good quality buses purchased with considerable public assistance and who can, as a result, defer fleet replacement in the short term.
2. Those operators who have received no historic public funding who, in order to compete, have to procure vehicles. Because of deferred fleet replacement by other operators the available vehicles are likely to be old and/or unsuitable, or brand new.

Given the poor security of contract tenure and the need to be cost competitive, purchasing a new bus is most unlikely to be practicable. On the other hand, as tendering authorities tend to move towards improved minimum vehicle and fleet quality standards, the old and unsuitable vehicles are less likely to be a viable option.

Also, Local Authorities (District and Regional Councils) are prohibited from conducting passenger transport operations after 30 June 1991 (or such later date as the Minister of Transport may determine)⁸. This includes activities incidental to or connected with any activity carried on for the purposes carrying passengers and therefore prohibits tendering authorities from owning buses for lease.

4.11.3 Operator Views (Appendix 1)

Incumbent operators consider that suitable vehicles are readily available and that this has no detrimental impact on competition or tender pricing.

However aspirant operators consider that there is a shortage of good quality late model suitable vehicles available to purchase or lease, and consider that they have basically three choices:

- Purchase new buses but this is a high risk and will probably result in an uncompetitive tender price.
- Purchase old (unattractive and/or low quality) buses but this is undesirable from a company profile, image and quality viewpoint. Also, it is probable that a fleet comprising only vehicles of this type would fall below some regional council minimum vehicle quality standards.
- Purchase less suitable vehicles (e.g. secondhand Japanese imported Toyota Coaster type vehicles), but these vehicles are not designed for more intensive urban use and their repair and maintenance costs are likely to be too high.

4.11.4 International Experience (Appendix 5)

While most US tenders require the tenderer to provide the required buses, there are many instances in which the tendering authority provides the buses through a nominally priced lease to the operator awarded the contract. The overall US data suggest little difference between the number of tenders based upon bus provision: 4.2 tenders per

⁸ Local Government Amendment Act (No. 4) (1989) (S.594ZR).

RFT where the tendering authority provides the buses, compared to 3.9 where the tenderer provides the buses. However for large contracts competition is considerably greater where the tendering authority provides the buses.

In San Diego, it has been found that when the tendering authority provides the vehicles 1.3 to 2.5 times more tenders are received than when operators are required to provide the vehicles.

Table 18 shows, for the USA, the number of tenders by size of RFT when the tenderer or tendering authority provides the buses. Note also that the US market is much larger than the New Zealand market. It may be that increased competition where the tendering authority provides the buses would occur in New Zealand at lower contract size levels.

Table 18. Number of tenders by size of RFT and provision of buses in USA.

Number of Buses	Tenderers Provide Buses		Tendering Authorities Provide Buses	
	Tenders	Average Number of Tenderers	Tenders	Average Number of Tenderers
Over 75	3	0.3	4	3.3
50 to 74	1	3.0	6	3.8
30 to 49	12	4.2	12	4.8
15 to 29	14	4.7	10	4.0
Fewer than 15	15	3.7	1	5.0
All	45	3.9	33	4.2

Table 19. Vehicle provision practices in a number of countries.

Country	Vehicles Supplied By
New Zealand	Tenderer
UK	Tenderer
Sweden	Tenderer
Denmark	Usually tenderer, otherwise tendering authority
South Africa	Tenderer
Chile	Tenderer
Australia	Tenderer
US	Usually tenderer, otherwise tendering authority

4.11.5 Discussion

The inability of new operators to purchase or lease suitable buses may be a major disincentive to competition because aside from all other things, if an operator cannot procure the buses, that operator will simply not be able to compete. Also, the fact that most incumbent operators have benefited from historic public funding for fleet replacement programmes will place a new competitor at a serious disadvantage, even if that new operator were able to procure suitable vehicles at a competitive price.

It is clearly evident that some pre-existing operators have deliberately retained surplus vehicles (purchased with considerable public funds) to reduce competition.

The US experience strongly suggests that the barriers to new entrants are considerably increased by the capital requirements of large tenders in which the tenderer is responsible for providing vehicles. This is also likely to be true in New Zealand for even smaller contracts, because of the smaller and more delicate market.

This view appears to be supported by recent experience; new entrants into the urban passenger market are dominated by expanding taxi companies or new companies operating "off-the-shelf" passenger vans rather than buses.

4.11.6 Conclusions

- The availability of suitable buses to potential new operators at a competitive price is fundamental to actually encouraging new entrants to enter the bus market. Therefore this issue is important to achieving the competition objectives of the Transit New Zealand Act. Where there is already a high level of perceived competition, it is not clear that the emergence of new entrants will achieve more efficient pricing. It certainly will not result in less efficient pricing.

To achieve the competition objectives of the Transit New Zealand Act, options for making suitable vehicles available, and for ensuring that new operators are not penalised by past public funding to competitors, should therefore be accorded a high priority in subsequent tasks.

These options include:

- Requiring recipients of historic capital funding programs to "pay back" the sum previously advanced (or some lesser sum taking into account each vehicle's depreciation). The Local Government Amendment Act (No. 4) (1989) (S.594ZZH(1)(C)) requires such repayment, *"unless the Minister is satisfied that the money received will continue to be applied to public passenger transport services"*.

(Where the Minister is so satisfied, or where the passenger transport asset is not sold (e.g. a private bus company which having received capital funding assistance carries on in operation), the resulting ongoing bus operation will inevitably be in a strong competitive situation.)

- Permitting tendering authorities to own vehicles and to lease these to operators. This is done by a number of US tendering agencies and can be particularly helpful in encouraging competition, particularly for larger contracts. This model also allows the tendering authority to adopt a long-term view of plant replacement policies and allows bus operators to be more concerned with short-term tender pricing issues.
- Making "seeding grants" available to encourage the development of a private sector bus leasing industry in New Zealand. Truck leasing is a common and accepted practice in the competitively more mature road freight sector and bus leasing is common in Australia. The hastened development of a bus leasing industry may in turn result in increased levels of competition and lower contract prices earlier than would otherwise have been the case.

4.12 Barriers to New Entrants

4.12.1 The Issue

The Transit New Zealand Act specifically requires Transit New Zealand to have regard to the desirability of encouraging competition and the undesirability of discouraging competition (S.19(3)(d)). This implicitly requires that new entrants be encouraged and not discouraged from entering the market.

This section discusses most of the points previously discussed but from the perspective of their impact on encouraging or discouraging new entrants. In many instances these points will also apply to existing small operators, particularly those wishing to expand.

4.12.2 New Zealand Procedures and Practice

The CPPs include no specific provisions to positively discriminate in favour of new entrants. We are unaware of any tendering authorities adopting such procedures (and in any case such procedures are likely to be contrary to other CPP provisions).

Indeed, the Ministerial Directive A which was issued in November 1990 discriminated against new entrants by allowing tendering authorities to award contracts to incumbent operators where the incumbent's price was up to 20% higher than the otherwise preferred tender price!

4.12.3 Operator Views (Appendix 1)

Incumbent operators expressed diverse views on this topic. For example, the Yellow Bus Company Ltd (Auckland) states: *"the industry is starved of capital and new entrants would find difficulty in raising sufficient capital on the present type of contractual terms. This all acts as a significant barrier to the new entrants that could increase competition"*.

Other operators cite the uncertainty of future funding as being a major barrier. Given the uncertainty they wonder who would want to get involved in the industry even if they could raise sufficient capital on such low security of contract tenure.

In contrast Christchurch Transport Ltd considered that there are no barriers to new entrants.

Aspirant operators consider that barriers to new entrants are numerous and cite the following:

- Insufficient small RFTs, particularly RFTs offering good vehicle utilisation (this is seen as being particularly important for small fleets).
- Tendering authority acceptance and evaluation of group tenders which will "lock out" newer and almost invariably comparatively small operators.
- The general preference by tendering authorities for net tenders; this is considered to favour the incumbent operator, particularly when detailed and accurate patronage and revenue information is not published in the RFTs.
- The high capital cost of purchasing good quality late model vehicles and the general inability to lease suitable vehicles.
- Poor security of contract tenure, coupled with the threat of "on-the-road" competition from an unsuccessful tenderer (as has happened in Wellington).
- A perception that the tendering process is not fair, but is designed to favour a tendering authority-preferred operator(s) over other operators.
- The ability for incumbent operators to cross-subsidise those tenders where competition is expected.
- Ministerial Directive A to Transit New Zealand issued on 27 November 1990.

4.12.4 Tendering Authority Views

Tendering authorities offered no specific views on this topic.

4.12.5 International Experience (Appendices 4 and 5)

In the UK excessively large contract sizes and calling for net tenders without including detailed patronage and revenue information have both been identified as providing barriers to new entrants.

In the USA the following points have been identified as the most important barriers to increased competition from both new and existing operators:

- *Unfairness:* Private companies frequently cite unfairness (real or perceived) in the tendering process as a reason for not competing in competitive tenders. This may take various forms:
 - Unfair evaluation by public transport authorities, especially where the public transport authority administering the tender also competes for the tender.
 - "Low-ball" cost proposals, in which public transport authorities compete for tenders through cost proposals that are cross-subsidised by funds from services not subject to competitive tender.
 - Incumbent preference, which is perceived by competitors where the existing operator and the tendering authority have developed a long and presumably close relationship. Perceived incumbent preference is a problem especially where tender sizes are large⁹.
 - Operator preference, in which a consulting unit of a particular private company designs the competitive process, and is perceived as having a competitive advantage with the tendering authority as a result of the prior relationship and/or specifics of the process design that may give some advantage to the related operating company.
 - "Sham" processes, which are perceived by potential competitors where it is suspected that the tendering authority is not serious about proceeding to contract award.
 - Political interference, which has included threats by public transport labour unions, and feared political retribution by public officials supported by public transport labour unions. (These instances have been fairly rare.)
- *Excessive Tender Size:* Competition tends to be less for the largest tender packages, especially where vehicles must be provided by the tenderers. Further, indications are that the tendency to avoid multiple awards in group tender situations is deterring competition from smaller private companies.
- *Vehicles:* Competition tends to increase where revenue vehicles are provided under lease by the public transport authority.
- *Onerous Requirements:* Excessive performance bond requirements, excessive performance penalties, too prescriptive operational requirements (relating to inputs rather than to service outputs) deter competition.

⁹ Development of a tender can be very expensive. Larger companies have reported tender development costs as high as NZ\$30,000 to NZ\$60,000.

- *Capital Requirements:* Smaller companies are deterred from competing by the high costs of buses, especially where new or near-new buses are called for in the request for tenders. A particular problem is that the secondhand market for public transport buses is particularly weak, and that few if any public transport buses can be found on the secondhand market that are less than 12 years old.
- *Multiple Concurrent Tenders:* Responding to multiple tenders can be difficult for even the largest companies, given the substantial resources necessary to develop proposals. In some cases, competition has been reduced by the internal inability of companies to respond to multiple tenders¹⁰.

4.12.6 Discussion

Taking the USA experiences point by point, the New Zealand experience is:

- *Unfairness.* Some tendering authorities have been accused of acting unfairly, notably Auckland for the large group tenders accepted, Wellington for its protection of rail against bus services, and Otago for accepting large group tenders.
- *Excessive Tender Size.* The market strength that large group tenders afford a large operator is regarded by potential new operators as being anti-competitive.
- *Vehicles.* The unavailability of suitable modern vehicles at low "up front" capital cost is regarded as a barrier to competition. As tendering authorities impose higher minimum vehicle quality standards the barriers to new entrants will tend to increase.
- *Onerous Requirements.* This has not been a problem in New Zealand. If anything many operators would argue that penalties for non-performance are too low and there is little disincentive against operators submitting unsustainably low tender prices.
- *Capital Requirements.* As for Vehicles above.
- *Multiple Concurrent Tenders.* This was obviously a potential problem initially, when all services in New Zealand came for tender at much the same time. This is less likely to be a problem in future now that tendering authorities can, and are required to, introduce rolling contract expiry dates. In Auckland where all services in each large geographic area expire at once, this rolling contract

¹⁰ This is not to suggest that the private bus industry is incapable of handling the volume of tendering. The limited level of competitive tendering in the US justifies no more than a limited organisational response on the part of the largest companies, so that an undue concentration of tenders within a short period of time can exceed the capabilities of the resources they have committed to this line of business. If competitive tendering were to expand greatly, the commitment of the large companies would expand correspondingly.

expiry date requirement will not be fully implemented until the expiry of the second round of contracts.

4.12.7 Conclusions

- Currently in New Zealand the operator-perceived barriers to new entrants are high and this will tend to discourage competition.
- To encourage competition (or the threat of competition) it is essential that barriers (actual and perceived) to new entrants are minimised.
- Some of these barriers will reduce over time, such as the difficulty of responding to multiple concurrent tenders. Other barriers are likely to require more active measures if they are to be reduced. These barriers include:
 - Excessive tender size and evaluation of large group tenders with the sole objective of achieving lowest overall price.
 - The availability of suitable vehicles at low up-front capital cost and/or the unavailability of suitable vehicles on lease arrangements.
- Where in preceding sections further study has been identified as being necessary, this should also address ways to reduce barriers to new entrants. Options to reduce barriers include:
 - **RFT size** - ensuring there are sufficient small RFTs to attract new entrants.
 - **Group and Combined Tenders** - specifying evaluation procedures to overcome the inherent advantage to large tenderers.
 - **Gross and Net Tenders** - providing patronage and revenue information in RFTs for net contracts, a guaranteed minimum revenue figure, or issuing RFTs for gross contracts.
 - **Security of Tenure** - guaranteeing security of tenure, particularly for small contracts.
 - **Non-Performance Penalties** - limiting these so that an excessive burden is not placed on new entrants.
 - **Vehicle Availability** - encouraging a bus leasing industry and making vehicles available to new entrants at a price comparable to that paid by incumbent operators (excluding public funding received).

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APPENDICES

APPENDIX 1

**CONCLUSIONS FROM DISCUSSIONS WITH NEW ZEALAND
PASSENGER TRANSPORT SECTOR**

A1.1 Introduction

This appendix documents the conclusions of discussions with a number of passenger transport operators and regional councils on those factors which influence competition and price for the provision of contracted passenger transport services. The overall topic is divided into two broad headings: the market and the regulatory environment.

A1.2 The Market

A1.2.1 General

The key features of the New Zealand passenger transport market and their impact on competition and competitive pricing are identified.

Patronage has been steadily declining in the last 4 to 5 years, with in some cases reported patronage reductions of around 13-15 % pa. At the same time external funding has been reducing, with the inevitable result that fares have increased and services have tended to be reduced. Also, petrol prices have reduced in real terms, secondhand car prices have reduced dramatically, inner-city car-parking prices have reduced and unemployment has increased. These features have all combined to reduce public transport patronage levels.

The government appears to have no clear long-term public passenger transport strategy and consequently the market has no concrete evidence of what that may be. In more recent times the government actions appear to have been rather ad hoc. For example in the 1991/92 budget the government announced a c.\$20M reduction in central government funding for public passenger transport but then advocated that some regional councils could impose a regional petrol tax to offset this funding reduction.

At a recent meeting of operators and the Ministry of Transport (MOT), called to discuss the regional petrol tax legislation, one Ministry official stated that central government sees passenger transport not as a national but as a regional issue. However, the government's recent petrol tax initiative gives regional governments little scope for regional flexibility. For example, Transit New Zealand states that regional councils cannot fund reduced fares or increased service levels through higher than otherwise necessary regional petrol tax rates, but MOT officials consider that this is permitted! Given that central government funding is only determined on a year-to-year basis regional councils have been unable to formulate long-term passenger transport strategic plans. Recent legislation which requires regional councils to prepare 5-year transport strategy proposals is also unlikely to allow regional councils to undertake longer term planning, unless accompanied by longer term funding horizons. It is worth noting that the Minister of Transport has announced that he is seeking views on funding alternatives for Transit New Zealand and long-term horizons and possibly longer contract durations.

Deregulation / re-regulation of the passenger transport industry has obviously opened the opportunity for competition between passenger transport operators. However most passenger transport operators consider their main competition to be the private car and

can see few, if any, policies which enable or encourage public transport to compete with the private car. Indeed deregulation may have had a negative impact in this regard, for two reasons:

- (1) To be price competitive, older buses are now being used, thus reducing the attractiveness of the service. Fares have generally not reduced.
- (2) Investment in fixed infrastructure (busways, O-Bahn, etc.) appears extremely difficult and there is a lack of clear guidelines for capital investment in public passenger transport.

The perceived key features of the public passenger transport market then are:

- Lack of published long-term pro-public passenger transport strategies and funding.
- Declining service levels, qualitative standards and patronage.
- Deregulation which focuses on competition between passenger transport operators for a declining market.
- Inability of passenger transport operators to influence external factors to a sufficient extent to reverse declining patronage trends.
- Very real doubts about the future for the non-commercial services, particularly outside of Auckland and Wellington. (Note however that there are significant levels of commercial services in some smaller centres: Wanganui, Palmerston North and New Plymouth.)

A1.2.2 Other Market Issues

(1) Finance Availability

From discussions with one major trading bank, it appears that finance is unlikely to be a greater problem than for any other industry. The longer the contract and the more secure it is, obviously the easier it will be to get finance.

It appears that contracts of less than three years are unlikely to be attractive propositions to banks, particularly given the poor security of tenure.

(2) Vehicle Availability

The unavailability of good quality late model or new suitable buses at low initial capital outlay is not generally considered to be an issue by incumbent operators. We would comment that incumbent operators are almost bound to have such a view for the following reasons:

- The very fact that they are in business and have generally undertaken fleet replacement strongly suggests that historically, and in a more regulated environment, they have had little difficulty planning for and undertaking such fleet replacement programmes.

- The not unrelated issue that before deregulation a large number of operators received considerable financial assistance specifically for fleet renewal.

In Auckland private bus companies received capital funding from a dedicated "bus bank" fund and were, in the latter years, eligible for up to 90% funding for the purchase of an "average price bus" that permitted up to 1/15 of the fleet to be replaced each year.

In Wellington, pre-deregulation operator payments included a component for a return on capital.

In other areas operators also received specific capital funding to upgrade urban bus fleets as a consequence of the UTC's funding formula which differentiated between funding for operating and capital expenditure.

Incumbent bus operators who now have good quality fleets as a result of the pre-existing capital funding arrangements are obviously in a strong competitive position; their fleets have largely been paid for and because they are comparatively new, fleet replacement programmes can be postponed in the short term.

- As incumbent bus operators, they are more likely to benefit from favourable access to finance than would a potential new bus operator with no historic track record. Of course such comparative favourable treatment of incumbent operators by financial institutions may arise as a consequence of that operator being able to provide considerable security for loans. This security may be based on the value of buses already owned, and these vehicles may have been partly or largely paid for with public funding.

Despite the views of incumbent operators, it is our view that the unavailability of good quality late model or new suitable buses at low initial capital outlay is likely to be a disincentive to competition by potential new operators. For the reasons suggested above the odds are stacked in favour of incumbent operators, particularly where those operators have historically received external funding assistance for fleet replacement programmes.

The increasing shortage of suitable good quality late model buses (as a result of most operators cancelling their fleet replacement programmes) means that prospective new tenderers are forced into having to operate older buses (at least 12-15 years old, but possibly refurbished). However as regional councils tend to move towards increased minimum vehicle quality standards it will become increasingly unlikely that many of these older buses will be able to be used.

In our view then the unavailability of good quality new and late model buses at low initial capital cost, at a time of increasing minimum vehicle quality standards, is likely to further limit competition; new operators will no longer be

able to "get a foot in the door" by operating predominantly older lower capital cost vehicles.

A range of solutions may be available, such as:

- Requiring recipients of historic capital funding programs to "pay back" the sum previously advanced (or some lesser sum taking into account each vehicle's depreciation). The Local Government Amendment Act (No. 4) (S.594ZH(1)(C)) (1989) requires such repayment, "unless the Minister is satisfied that the money received will continue to be applied to public passenger transport services".

(Where the Minister is so satisfied, or where the passenger transport asset is not sold (e.g. private bus company having received assistance carries on in operation) the resulting ongoing bus operation will inevitably be in a strong competitive situation.)

- Permitting tendering authorities to own vehicles and to lease these to operators. This is done by a number of US tendering agencies and can be particularly helpful in encouraging competition, particularly for larger contracts. This model also allows the tendering authority to adopt a long-term view of plant replacement policies and allows bus operators to be more concerned with short term tender pricing issues.
- Making "seeding grants" available to encourage the development of a private sector bus leasing industry in New Zealand. Truck leasing is a common and accepted practice in the competitively more mature road freight sector and bus leasing is common in Australia. The hastened development of bus leasing may in turn result in increased levels of competition and lower contract prices earlier than would otherwise have been the case.

(3) **Competitive Behaviour**

The New Zealand bus industry is obviously small. Therefore most operators know each other fairly well, and within each region operators are generally well acquainted. In many instances existing privately owned bus companies have been operating "side by side" for generations and have historically assisted each other.

Given this background, it is possibly naive to think that each will attempt to compete with the other to take over a part or all of the other's "home patch". The natural inclination is to consider competing against the ex-municipal operators who have generally been perceived by private operators as being inefficient and not part of the private operator "clan".

Why then has there been little competition from "efficient" private operators against the believed-to-be "inefficient" municipal operators? Based on

discussions with operators it appears that the most probable causes of this reluctance to compete with ex-municipal operators are:

- Initial concern primarily to retain existing operations against unknown competitors.
- Operators are generally comfortable with their current size of operation; depot size, fleet size, management structure, etc. Any significant increase in size would require significant changes to most private companies.
- Fear of retaliation. What might a large ex-municipal operator do in subsequent tender rounds to retaliate against a vulnerable smaller operator?

These factors are unlikely to change in the short to medium term, and competition against larger dominant operators may depend on the emergence of new operators.

This emergence will be encouraged by increased certainty of contract tenure, sufficient small enough RFTs, ready availability of suitable quality vehicles, and contracts of sufficient duration to make the "effort" worth the risk.

A1.3 The Regulatory Environment

This topic of regulation can logically be further subdivided into two topics: the Competitive Pricing Procedures (CPPs) themselves and their implementation by regional councils.

A1.3.1 The CPPs

The strong general view from operators and tenderers is that the CPPs themselves both permit and encourage competition. Commonly, in discussion, operators referred to the CPPs to contrast the competition-encouraging "right way" defined in the CPPs against a tendering authority's "wrong way" procedures or actions.

Smaller operators were in general strongly supportive of the "prescriptive" nature of the CPPs and the effect such procedures would (if followed) have on encouraging competition. Particular points commented on by operators were that:

- (i) sufficient small RFTs;
- (ii) contracts of 3-5 years duration;
- (iii) contract lead time of c.4 months; and
- (iv) good certainty of contract tenure,

would all tend to encourage competition for passenger transport contracts. Items (i) to (iii) above are all explicitly covered in the CPPs. Item (iv) is handled less prescriptively in the CPPs, allowing tendering authorities to develop their own "out" clauses and compensation payment policies.

Larger (ex-municipal) operators were critical of the contract size limitations imposed by the January 1991 CPPs on the grounds that large operators need access to large single parcels of work if they are to be encouraged to enter or stay in the competitive market. The January 1992 CPPs legitimise the group tender concept employed by a number of operators in the initial tender round (but not envisaged or provided for in the original CPPs). Large operators were strongly supportive of the need for and retention of this group tender concept.

In contrast to operators, tendering authorities are generally more critical of the CPPs (though more critical of the original rather than subsequent version). These criticisms are that the CPPs are too prescriptive, and therefore:

- Do not give tendering authorities sufficient flexibility (e.g. prohibiting contract negotiation after contract award);
- Are impracticable (e.g. the January 1991 CPPs required revenue data to be provided for net contracts);
- Are becoming increasingly irrelevant (central government imposed rules at a time of declining central government financial involvement).

In these regards, tendering authority criticism of the CPPs concentrates mainly on the imposition they pose on tendering authorities, and generally not on any negative influence the CPPs will have on competition or tender prices.

The one exception to this is the CPP requirement that tendering authorities should not specify vehicle or other criteria which unreasonably limit competition. Some tendering authorities (Auckland, Canterbury) have interpreted this to mean that they cannot specify vehicle age and quality or size features (Auckland) or cannot specify them to higher quality level than that currently provided or able to be provided by an existing or probable potential tenderer (Canterbury). This interpretation maximises the scope for lower quality competition against competition by higher quality operators.

To conclude:

- Smaller and/or potential operators consider that the January 1991 edition of the CPPs would tend to encourage competition (but that some tendering authorities had not complied to the requirements).
- Larger operators consider that the January 1992 edition of the CPPs will encourage competition by virtue of permitting more attractive (to them) larger contract sizes.
- Tendering authorities made little comment on the impact that the CPPs would have on competition, other than for supporting the January 1992 edition legitimising the group tender concept. Some minor clarification of the intent of some aspects of the CPPs, as guidelines, may assist in correct interpretation.

A1.4 Implementation of Competitive Tendering

Most (but not all) operators/potential operators expressed concerns about procedures adopted by tendering authorities with respect to the effect such procedures have or have had on competition. Essentially the viewpoint of those operators who were less successful in the tendering process was that the rules (CPPs) were right; that most tendering authorities had not acted in accordance with these rules or the spirit of those rules; competition had been discouraged but would not have been discouraged had the rules been adhered to; and, had competition been encouraged, lower prices would have been achieved.

The more successful tenderers tended to be less critical of their respective tendering authority actions.

Operator views on key issues are discussed in the following sections.

A1.4.1 RFT Size

The general view of small operators was that large RFTs would discourage competition since small operators would effectively be excluded from tendering.

In contrast, larger operators generally believed that large RFTs were necessary in order to offer "parcels" of work large enough to attract the large operator to enter or stay in the market.

Waikato Regional Council was quoted by one Auckland operator as a tendering authority which had got its RFT size right and had encouraged competition. There, RFT sizes ranged from 1 to 8 peak buses which, for a c.28 peak bus operation, gave a good range for various sized operators to select from.

To conclude:

- A predominance of unreasonably small or unreasonably large RFTs will be anti-competitive and would be likely to result in higher than otherwise necessary tender prices.
- A wide range of RFT sizes tailored to attract various size operators will attract the greatest number of tenders and achieve the keenest competition.

A1.4.2 Group Tenders and Combined Tenders

With the advent of group tenders, the concept of combined tenders has become largely irrelevant. This section therefore focuses on issues related to group tenders.

It seems obvious that the group tender concept has the ability to reduce the amount of competition, both in terms of:

- The likely success of an individual tender; and

- The desire of a smaller operator to tender if that small operator perceives that the "odds" are against him.

From discussions with operators there are clearly two opposing schools of thought. These are:

- That group tenders should be permitted, preferably without limitation (within regional boundaries). This will result in the lowest possible tender prices, since operators will be able to achieve, and pass on, significant economies of scale. This view is supported by the larger operators, the majority of whom have submitted and won contracts, based on group bids.
- That group tenders should not be allowed: the original CPPs stated that up to three tenders could be combined by a regional council and that this additional concept of large group tenders was contrary to those procedures. Large group tenders allowed large operators to "swamp" the process so that a low priced individual tender would lose out to a group bid. This view has been expressed by operators whose individual tenders were generally unsuccessful against larger operators' group bids.

In accepting and evaluating group tenders, the issue is that of reaching the right balance between achieving lowest overall price against lowest price for an individual tender, taking into account both short-term and long-term impacts on competition and tender pricing.

In both Auckland and Otago, where group tenders were permitted, the tender evaluation process sought to achieve the lowest **overall** price. This approach results in the lowest level of external funding required, in the short term. In the longer term however, the inability of smaller operators to win contracts, almost irrespective of price, may lead to higher than otherwise necessary group tender prices by the incumbent operator.

Table 12 (p. 55) shows a simplified example of how a group tender price can achieve lowest overall price for all constituent tenders, but in doing so can exclude a competitively priced individual tender from being successful. If Operator B's tender for RFT 1 were accepted, total contract price for the four RFTs would be 380; 30 units more expensive than Operator A's group bid price of 350.

Clearly the tendering authority would need to make an assessment of the merits of encouraging competition against the disbenefits of receiving a higher than otherwise necessary overall tender price.

Transit New Zealand hoped that the requirement in the January 1992 CPPs that "... contract expiry dates shall be:

- (i) *reasonably spaced over the years so that a similar number of contracts expire each year*
- (ii) *reasonably spaced throughout any given year ..."*

would limit the scope for very large group bids, thus making the trade-off between achieving the lowest individual and lowest overall price less critical.

In large centres the group tender topic is likely to remain an issue. For example, if the 285 RFTs issued in Auckland in 1991 ranged equally from 3 to 5 years in contract duration and an equal number expired at monthly intervals throughout the year, then in each month 8 RFTs would be issued. As can be seen from Table 12, the group tender debate can arise when there are only four (or even fewer) RFTs issued by a regional council at any given time.

New Zealand passenger transport tendering practices give insufficient evidence to suggest how group tenders will actually impact on price on the longer term, except to reiterate opposing operator views that either:

- Prices will decrease as economies of scale are achieved and passed on to the tendering authority; or
- Prices will increase as competition is stifled.

To assess the short term impact on price, an analysis was undertaken of tenders won in the Wellington region by group tenders. (Rail services are not included in this analysis because of the absence of comparable published data.)

The results of this analysis are shown in Table 13 (p. 57) and show that:

- Overall, group tenders achieved an apparent saving of c.\$3.4M pa, or 33% over the sum of the individual tenders.
- For separate group tenders, savings ranged from 1% to 48% (\$112 pa to c.\$3.2M pa).
- The largest saving in dollar terms arises from Wellington City Transport Ltd's (WCTL) group tender, representing a saving of 41% or c.\$3.2M pa over the sum of the comparable lowest price individual tenders.

However, these results do need to be interpreted with considerable caution, for the following reasons:

First, had operators not been permitted to submit group tenders, and had therefore been forced to rely upon their individual tenders to win contracts, then the individual tenders are likely to have been more keenly priced.

Second, it seems likely that those tenderers who favour group tenders (generally the larger incumbent operators) will have "overpriced" their individual bids to demonstrate the validity of the "economies of scale" argument they generally hold.

Third, it is not evident whether there was any overall difference in respect of qualitative features offered between individual and group tenders which might impact on price.

Fourth, and arguably most important, there is doubt whether the savings shown in respect of group tender C11 (WCTL) are strictly related to the group tender issue. It is understood that the successful group tender was submitted at the eleventh hour after Christchurch Transport Ltd's apparent lack of tendering success in Christchurch. If this

was indeed the case then part of the saving (unquantified) is obviously attributable to WCTL's perceived threats of competition.

This would support the view that the dominant force influencing tender price is the perceived threat of competition while factors such as discounting to allow for revenue risk, contract tenure, etc. are subordinate to this factor.

To conclude:

- New Zealand evidence is insufficient to suggest whether group tenders will achieve lower prices in the long term (through economies of scale) or higher prices in the long term (through reduced competition).
- In the short term, group tenders appear to have achieved lower prices than would otherwise have been received. This conclusion needs to be treated cautiously, since it is likely that operators, given the opportunity to submit group tenders, artificially inflated their individual tenders (or did not adjust the individual tenders in response to increased threat, but did adjust the group tenders).
- Group tenders, if evaluated so as to achieve lowest overall price, can effectively have a similar impact as large individual RFTs. With respect to RFT size, we had previously concluded that a wide range of RFT sizes will tend to maximise competition and achieve keenest tender prices. This being so, tendering authorities should develop group tender rules so that sufficient small contracts are available for competition from small operators.
- The requirement for contract expiry and commencement dates to be reasonably spaced over the years and within each year will reduce the maximum size of group tenders but not eliminate the opportunity for group tenders.
- Tendering authorities need to consider the implications of group tenders much more carefully than they have done in the past. Tendering authority group tender policies and evaluation methodologies need to be published at the time of publishing RFTs.

A1.4.3 Contract Duration

Table 14 (p. 60) summarises the duration of contracts entered into in the 1 July 1991 tendering round. Overall average duration is a little over 3.5 years and is on par with typical international practice.

Industry support was strong for 3-5 year contracts; shorter contracts were considered to unreasonably raise the element of risk and longer contracts were seen as being anti-competitive because they would lock out a potential operator for too long a period.

Additionally, the increased risk factor of attempting to estimate revenue for net contracts more than 5 years into the future was also seen as a potential problem.

The generally held view of short (1-2) year contracts is that they are impracticable because of the perceived need to depreciate vehicles over a short time frame. Logically then one would expect longer contracts to be more keenly priced than shorter contracts (given a constant level of competition). It appears that contract duration per se had little impact on pricing policies and was very much subordinate to that of perceived risk from competition.

It therefore seems reasonable to assume that contract duration is really only likely to affect price in that some contract lengths may attract (or be expected to attract) more bids than other contract lengths. Given operators' expressed preference for 3-5 year contracts, it seems likely that contracts of this length are likely to attract more competition, and will therefore be more keenly priced.

When prompted, most operators and regional councils favoured the concept of a contract rollover provision for a pre-defined duration in the event of the operator attaining pre-specified productivity or performance targets. Operators felt this would be a "carrot" for good service while tendering authorities felt it would enable them to concentrate the competitive forces on operators who were performing less well.

To conclude:

- Contracts of 3-5 years duration are likely to attract, and to be expected by other competitors to attract, more competition than shorter duration contracts. This increased perceived competition is likely to achieve keener contract prices.
- As initial short duration contracts come up for renewal, consideration should be given to extending contract duration to 3-5 years to attract keener tender prices.

A1.4.4 Gross v Net Contracts and Patronage Information

Table A1.1 shows the extent of gross and net contracts throughout New Zealand in the July 1991 tendering round: 94% of all contracts were on a net basis.

Our discussions with operators and tendering authorities revealed strong views on this gross v net topic. **Potential new operators** were generally in favour of gross contracts for the following reasons:

Table A1.1. Summary of contract revenue type by the nine New Zealand regions⁽¹⁾.

Item	Auck-land	BOP	Cant-bury	HBay	Man-Wang	Sth-land	Tara-naki (2)	Wai-kato	Well-ton	Total
Total no. of RFTs issued	285	4	50	8	16	12	1	7	132	515
Total service covered by RFTs:										
- 000 vk pa	34300	c180	8360	370	1100	363		591	8700	53964
- Peak Buses	666(3)	?	121	9	25	10		19	19	
% tendered services by revenue type:										
- Gross Cost	0	25	4	0	96	0		0	15	5
- Net Cost	100	75	96	100	4	100		0	85	94
- Other	0	0	0	0	0	0		100	0	1

(1) Otago service details not available; all 23 RFTs were for net revenue type contracts.

(2) No contracts awarded since all required services notified were commercial.

(3) As stated by tenderers (some peak vehicles could cover more than one RFT); excludes rail.

Gross Contracts

- Place existing and potential operators on equal footing when tendering.
- Make tendering more simple and speedy.
- Reduce risk, particularly since future revenue streams are considered to be largely outside their control (congestion, local authority mode split policies, price of petrol, etc.)
- Reduce the cost of tendering. This seems particularly important since the most attractive contracts to potential new operators are likely to be comparatively small, with comparatively small dollar value profit margins.

Incumbent operators were generally in favour of net contracts, except for new trial services, for the following reasons:

Net Contracts

- Encourage and require a good standard of service since poor service will lead to poor patronage which in turn will lead to poor returns.
- Mean an operator cannot afford to be disinterested in revenue, and therefore discourage the opportunist "fly-by-night" type operator.
- Reduce operator fraud, thus maximising available public funds to pay for contracted services.

However, most operators in favour of net contracts also believed that patronage and revenue details should not be published. The rationale for this view was that:

- Patronage and revenue figures are commercially sensitive, and that for a net contract such figures should remain the property of the contractor; and

- Any potential competitor should undertake their own analyses at their own cost and not use information collected by the incumbent operator at the incumbent's expense.

This raises two obvious issues:

- (1) If the patronage and revenue information is commercially sensitive, as claimed, there would appear to be a prima facie case that publication of such information would encourage competition. In addition the competition would be "informed" competition; possibly there would be less risk to an incumbent operator since it appears that (in Wellington) most successful non-incumbent tenderers have won contracts by grossly overestimated revenue.
- (2) Tendering authorities should specifically state, as part of the formal tendering process and contract documentation, whether patronage and revenue information provided to the tendering authority by the successful tenderer **will be made publicly available**. Then tenderers can consider the risks and benefits of this requirement when determining whether and at what price to tender.

Regional councils held various views. Auckland and Wellington are in favour of net contracts even when they are unable to publish reliable patronage and revenue estimates, Manawatu-Wanganui is in favour of gross contracts, and Waikato is in favour of net contracts where reliable patronage and revenue figures can be published. Views expressed were:

- Gross contracts are too open to operator fraud (Auckland, Wellington).
- Gross contracts will ultimately require tendering authorities becoming intimately involved in detailed scheduling decisions since operators will be disinterested in patronage and revenue. Such involvement by the tendering authority is undesirable (Wellington).
- Gross contracts encourage competition, resulting in significant savings to tendering authority (Manawatu-Wanganui).
- Where patronage and revenue information is unavailable, contracts should initially be let as gross cost contracts. They should then be converted to net cost contracts once patronage and revenue information is available (Waikato).

It seems clear that incumbent operators favour net contracts and potential new operators favour gross contracts. The arguments by existing-operators against gross contracts (as noted above) are not compelling; such problems could be resolved by other appropriate mechanisms. For example, opportunity for operator fraud could be reduced by:

- Requiring contracted operators to use approved electric ticketing machines. Operators could then also be required to provide raw patronage and revenue data files to the regional council before receiving any contract payment.
- Imposing severe penalties for non-recording of passengers (warning followed by contract termination).

The issues to be resolved between the gross v net options are:

- To what extent gross contracts will, in the longer term, result in lower costs to the public purse? (New Zealand operator views, that are generally in favour of net tenders as a means of ensuring efficient use of public funds, conflict with international experience which shows that gross contracts result in lower costs to the public purse.)
- If gross contracts will, in the longer term, result in lower costs to the public purse, to what extent will the contract savings be offset by increased contract administration costs incurred by the tendering authority?
- If net public cost savings are achievable through gross contracts, are these sufficient to outweigh any lower standards of service as a result of lack of operator fare revenue incentives and operator preferences for net cost contracts?

Further analysis of contract prices between gross and net contracts will be needed to resolve these issues.

A1.4.5 Manner of Service Specification

Many operators were, in the initial tender round, daunted by the amount of paper to sift through in order to:

- Identify likely opportunities,
- Understand what services were required, and
- Understand how to submit a tender.

This is unlikely to be such a problem in future when contract expiry dates become staggered and fewer RFTs will be released at any given time. Also tenderers will become more familiar and hence more comfortable with the technical requirements of tendering.

The general view of all parties was that RFTs should specify frequency, headway and capacity requirements, and **also** include a workable suggested timetable. This would then allow operators freedom to be innovative within prescribed limits, or simply to tender on the suggested timetable.

Once an operator has deciphered the requirements of an RFT, the complexity of the RFT document itself is unlikely to effect tender price.

To conclude:

- Service specifications should specify frequency, headway and capacity criteria as well as including a suggested workable timetable.
- Complex RFT documentation will tend to be a disincentive to competition.

A1.4.6 Security of Contract Tenure

Both existing and potential operators had serious concerns over the topic. All believe that low security (coupled with non-existent/inadequate contract termination compensation) is a serious impediment to competition. Most existing operators made comments to the effect that the security was so poor that, if they had not already been in the passenger transport industry, they would not have sought to become involved.

Illustrations of poor or low contract tenure were:

- (a) Contract funding vagaries: Future funding of contracts is by no means assured.
- (b) Service level changes: Some tendering authorities have already considered service level and/or fare level changes to offset funding reductions. This is seen as a further winding down of passenger transport services.
- (c) Commercial competition: Some contracted services are being subject to significant levels of commercial on-the-road competition (e.g. through non-registered taxi pick-ups at bus stops). This is particularly serious to operators of net contracts. Generally, affected contract operators perceive little action by appropriate authorities to curb such "opportunist" practices.
- (d) Contract cancellation. Wellington Regional Council has not been averse to cancelling contracts or declining to award a contract for which acceptable tenders have been received but where a competitor notifies a commercial registration for that service. In effect this opens contracted services up to on-the-road competition.

All these features increase the risk of tendering for passenger transport contracts (though (c) and (d) do give scope for increased commercial competition).

As noted above, this poor security of tenure is of major concern to existing operators and it seems reasonable to assume that it must also be a disincentive for new operators to compete for contracted services. In effect it raises the risk without raising the rewards.

In practice Wellington Regional Council's policy (d) will favour the larger operator in any area. In the event of being unsuccessful for a contract, that unsuccessful tenderer can notify those same services as being commercial. Experience in the UK suggests that the successful on-the-road competitor will be the operator which provides the more frequent service. This will almost invariably be the larger operator with the greater resources. For this reason, Wellington Regional Council's policy can be considered to be a disincentive to encouraging new generally smaller competitors to enter the market.

Of those operators who did tender, it is doubtful whether poor security of tenure did in fact affect tender prices. As with a number of other issues, risks associated with poor contract tenure were very much subordinate to concerns over potential competitor actions.

To conclude:

- The poor security of tenure increases the financial risk of operating contracted services without also offering a commensurate increase in returns.
- Poor contract security is a disincentive to new entrants, and will decrease competition for contracted services.
- In the short term, poor security of tenure is unlikely to be reflected in higher tender prices, since this threat is seen as being of much lesser concern (more manageable) than the threat from competition.
- In the longer term if poor security of tenure acts as a strong disincentive to new competitors, incumbents will recognise the decreased risk from competitors and will be able to increase tender prices to account for this reduced risk factor.

A1.4.7 Tender Evaluation Factors

Operator reactions generally concerned the absence or inappropriateness of optional factors in terms of whether they truly reflected the added value of given qualitative features (e.g. Wellington Regional Council's 2.5 % weighting for all new buses over all old buses).

Operator comments concerning the impact of optional features on competition include:

- While believing that high standards were important for the industry, it was accepted that these may reduce the number of potential competitors able to compete; good quality late model/new vehicles are expensive and are not presently readily attainable at short notice and at low initial capital costs.
- A phase-in period should be allowed during which operators have time to upgrade to appropriate quality vehicles.
- During the phase-in period, the optional evaluation factor would need to truly reflect the benefit of the newer vehicles.
- Higher than present minimal standards will result in higher tender prices, at a time of continuing funding constraints.

In general most regional councils considered that there was scope for improvement in this area, particularly in regard to the specification of minimum vehicle quality standards and recognition for tenders proposing an above-minimum qualitative standard.

Higher minimum standards are likely to result, at least in the short term, in decreased competition as some operators will be unwilling or unable to improve their vehicle quality.

Those operators who do improve vehicle quality up to the new minimum will obviously also face increased costs, which are likely to be reflected in increased tender prices.

The likely operator-perceived reduction in competition through increased quality standards is likely to allow remaining operators to increase tender price in recognition of these increased costs.

To conclude:

- Current minimum qualitative standards are so low that there is little or no investment in vehicles. Operators are deferring capital expenditure and in doing so are able to submit comparatively low priced tenders. This is not a sustainable long-term course of action. Part of the savings currently being attributed to deregulation are not related to improved efficiencies introduced as a result of deregulation but arise from the cancellation of fleet replacement programmes (though some might argue that deferred capital expenditure is a legitimate efficiency improvement).
- Increased minimum qualitative standards may be a disincentive to competition, particularly from small under-capitalised operators. Encouragement to invest in the industry may be an incentive to competition from operators committed to providing quality services.
- Increased minimum qualitative features will increase costs and increase tender prices.
- Despite the increase in tender prices, regional councils do need to specify higher minimum qualitative standards to ensure that there is sufficient investment in the industry to at least achieve an acceptable "steady state" fleet age profile.

A1.4.8 Contract Negotiation Procedures

Most operators considered the inability of tendering authorities to negotiate after contract award to have a positive effect on encouraging competition as it avoids the risk of subsequent "Dutch auctions" where one tenderer is played off against another to achieve a lower price. Interestingly some operators suggested that once a contract had been won, then there should be some scope for negotiation at a later stage, particularly in the case of tendering authority-imposed fare level changes for net contracts.

This suggests a strong preference for a tendering system which does not allow the tendering authority to play one operator off against another in the process of tender evaluation, but does allow post-contract award negotiation to:

- Stave off the need to re-tender for that service in the event of significant future service changes, or
- To get a better contract price at an appropriate later date.

Some tendering authorities are also in favour in principle of being able to negotiate with operators for specific events, such as the Government's recent 40% funding reduction. One tendering authority in particular thought that service reductions could be minimised if they were able to negotiate revised contract payment rates with existing operators.

To conclude:

- Given that competitive tendering is required, operators consider that the inability of tendering authorities to negotiate with tenderers before contract award will improve their confidence in the process. This will tend to result in increased competition.
- Having won a contract, some operators would then prefer to be able to negotiate changed contract payment rates in the case of service or fare or patronage level changes rather than for such payment variations to be made simply by rote application of an agreed formula.
- Any ability by tendering authorities to impose revised contract rates on contracted operators outside of those agreed at the time of contract award will tend to reduce operator perceptions of contract tenure. This will tend to reduce competition.

A1.4.9 Barriers to New Entrants

In general, the industry is seen as being difficult to enter, especially for new small operators wanting to provide high quality bus services, because of the high cost of quality vehicles, group tenders which favour large operators, etc. Also it is generally considered that there is little incentive for potential new operators to want to enter the industry; security of contract tenure is poor; and as competitive tendering drives prices down returns will also be poor.

Some of the barriers could be overcome. For example there may be ways to encourage the development of a bus leasing industry, and group tender evaluation procedures could be revised to ensure that dominant incumbent operators were not able to control the market.

On the other hand the perception that competitive tendering will, by driving prices down, result in poor returns is unlikely to be readily overcome. This (real or imaginary) perception may well be fundamental to competitive tendering itself.

A1.4.10 Contract Performance

It is obviously in the interests of the travelling public to receive stable services. It is also in the tendering authority's interests since stable services will encourage patronage, reduce contract payment costs and also minimise costs associated with premature re-tendering.

However a large number of operators expressed concern regarding competitors who might win contracts based on low tender prices, and then be unable to fulfil the contract for the full term. Those operators concerned with this possibility felt that safeguards were insufficient against such low priced unsustainable contracts being awarded, for the following reasons:

- No pre-contract award vetting of tenders is carried out by the tendering authority to ensure that prices were reasonable.
- Operators can exit the market very readily with short notice and with little or no financial penalty.
- No barrier to re-entry for operators with previous poor track records is apparent.

Implicit in the concept of vetting tender prices is the concern that operators should not under-price. However it seems reasonable that if an operator wishes to donate services to the tendering authority then the operator should be free to do so. However in donating services, it also seems reasonable that the operator should be required to provide the required services for the full contract duration. Also, it seems reasonable that operators should be made responsible for any under-pricing decisions. This suggests that tendering authorities:

- Should not vet contract price calculations before contract award, but should be pleased to receive donated services;
- Should require operators to post a performance bond which would be forfeited in the case of contract cancellation by the contractor;
- Should take into account an operator's previous track record when evaluating tenders.

A1.4.11 Operator Accreditation

Two operators proposed that all operators should be required to have gained a Certificate of Proficiency before operating services commercially or under contract.

The purpose of this would be to:

- Ensure operators knew what they were doing, and the implications of their decisions, prior to getting into the market;
- Strongly discourage unsustainable pricing policies.

While there is undoubtedly merit in increasing the degree of managerial professionalism in the industry it is doubtful whether this would achieve the above two stated desires because individual managers would still be able to make their own management decisions.

The suggested requirement (A1.4.10) that contractors be required to fulfil the conditions of the contract for the full contract duration or forfeit their performance bond would seem to negate the need, from a purely competitive pricing viewpoint, for such accreditation requirements.

LIST OF PASSENGER TRANSPORT OPERATORS CONTACTED

Birkenhead Transport Ltd
Cesta Travel Ltd
Christchurch Transport Ltd
Citibus
Cityline (Lower Hutt)
Commercial Buses Ltd
Hanhams Buses Ltd
Mana Coach Service Ltd
Newlands Coach Service Ltd
Newmans Coach Lines Ltd
Red Bus Ltd
Shaws Transport Ltd
Simpson's Buses
The Yellow Bus Company Ltd
Wellington City Transport Ltd

(As well an advertisement was placed in one issue of the NZ Bus and Coach newsletter seeking input/comments from any operators, particularly those who had considered tendering but had decided not to for various reasons)

LIST OF REGIONAL COUNCILS CONTACTED

Auckland Regional Council
Canterbury Regional Council
Manawatu-Wanganui Regional Council
Waikato Regional Council
Wellington Regional Council

OTHER PARTIES CONTACTED

NZ Bus and Coach Association

One major Trading Bank (regarding impact of contract duration on bank's willingness to loan money; bank's name to remain confidential)

Various vehicle hire/leasing organisations regarding their ability/willingness to own larger buses for lease to operators.

APPENDIX 2

OPERATOR TENDER PRICING POLICIES

A2.1 Introduction

This appendix describes operator tender pricing policies and is based on the views that have emerged from discussions with operators. Reference to policies relating to commercial services is also included since in effect these are services priced at zero cost to regional councils. The various issues are arranged in chronological order, from c. January 1991 to April 1992.

A2.2 Initial Commercial Registration Strategies

Before initial tendering, operators were (and still are) able to notify commercial services that they were prepared to operate without any regional council funding.¹

This caused operators to consider not only the net costs of the most promising commercial services but also the strategic advantages of notifying some services which were not truly "profitable" as being commercial.

The "over-contracting" policies of some regional councils had an impact on an operator's ability to convert a previously loss-making service to a commercial service. For example, one regional council (Canterbury) advised that it would consider contracting over a commercial service if that commercial service were to result in a fare increase in excess of 20%. Given that pre-existing overall cost recovery in this case was in the order of 35-40%, it is hardly surprising that no commercial services were notified, either on strategic or true commercial grounds.

Other operators, with either higher cost recoveries and in regions where regional councils were less inclined to over-contract, did in some cases notify services as being commercial.

From discussions and from operator actions, it seems clear that the strategic implications of notifying services as being commercial were also taken into account by most operators. Incumbent operators generally considered that a potential new entrant would be reluctant to engage in on-the-street competition against an incumbent commercial operator, and would prefer to compete for the contract. Prudent notification of selected key services as being commercial therefore gave an incumbent operator some certainty of post-tendering work-load, with the possibility of this being "topped-up" with contracted work.

In one case (Auckland), a large number of well patronised services were notified by the incumbent operator as being commercial, but withdrawn immediately before a critical pre-tender date. If they had not been withdrawn they would have had to be operated without change until November 1992. This can be seen as a strategic move by the incumbent operator as it successfully scared off any other (real or imaginary) commercial operators.

¹ Ignoring the possibility of concession fare reimbursements.

In this case, the risk to the incumbent operator from competition in the tendering process was also minimised, because of:

- (i) Market share: it was unlikely that any competitor could "gear up" in sufficient time to compete for the subsequent contract; and
- (ii) Even if a competitor could "gear up" in time then that competitor was unlikely to win anyway, irrespective of price, because of the "group tender" concept.

Some operators such as Mana Coach Service Ltd, Newlands Coach Service Ltd and Wellington City Transport Ltd in Wellington did identify services which could be operated without financial assistance and notified these as being commercial.

In Auckland one urban operator, Birkenhead Transport Ltd, notified virtually all weekday 6am - 6pm services as being commercial and subsequently was largely unsuccessful in tendering to retain the non-commercial services.

A number of new entrants into the sector have notified significant portions of existing services as being commercial. Given the scale of these commercial undertakings compared with the total amount of passenger transport services in the same region, it seems reasonable to assume that such operators truly believed these services to be commercial.

Main examples of this are:

Hamilton: Goldstar Buses Ltd commercially notified an increase in the level of bus service at lower fares. This operator has since ceased trading and pre-existing service levels are now operated under contract.

New Plymouth: Goldstar Buses Ltd notified c.90% of the pre-existing bus service as being commercial. This operator has since ceased trading and a somewhat lesser level of service is now being operated commercially by other operators.

Palmerston North: Before tender closing date, the existing taxi operator notified all services as being commercial and is still continuing in operation. Other than for very minor services and a paratransit service, no services are operated under contract.

Wanganui: As in Palmerston North, pre-existing "subsidised" bus services have now been replaced with a commercially operated "shared" taxi service.

A2.3 Initial Tender Pricing Policies

The two main issues are:

- Service costing and revenue estimating methodologies
- Adjustments to initial prices to account for risk and market factors.

A2.3.1 Service Costing and Revenue Estimating Methodologies

Services have been costed by operators to varying degrees of sophistication. Some operators used a "rule of thumb" cost per bus kilometre or per bus hour to estimate contract costs, using either marginal or average costs. Some other operators, generally the larger operators, developed a set of unit costs (\$X per bus kilometre, \$Y per bus hour, \$Z peak bus), and a diverse allocation basis: marginal, long run or fully allocated. Naturally operators were reluctant to discuss their allowance for profit margins in their tender prices and no comments are included on this topic.

For net tenders, revenues were also estimated. From our experience and discussions, most operators revenue estimates were based on:

- Experience (incumbent operators);
- Surveys (generally of very short duration); or
- Guesswork (e.g. allow 5 passengers per one way trip at say \$1.20 per passenger, etc.).

At this stage little or no allowance was made for the continuation of the downturn in patronage and revenue over the last few years. This then gave a "datum" point about which to adjust tender price to account for risk.

A2.3.2 Adjustments for Risk and Market Factors

Ideally one might reasonably expect operators to have adjusted tender prices to allow for varying degrees of financial risk associated with:

- contract duration (short or long)
- security of tenure (bad or good)
- contract termination (likely or unlikely)
- revenue risk (high or low)
- competition (unlikely or likely).

From discussions with operators it appears that the perceived impact of competition or lack of competition has tended to outweigh all other market factors, almost to the point of those other factors becoming irrelevant. For example while operators may state that they will price longer term contracts more keenly than shorter term contracts, whether they do **in fact** will not depend so much on the contract duration but on the amount of competition each tenderer perceives that a request for tender will attract.

The same comment applies in respect to security of tenure and contract termination clauses. While incumbent operators certainly are concerned about the vagaries of government funding, competitive pressures (where competition is perceived as a real threat) have in some instances restricted an operator from increasing price in recognition of the contract insecurity.

In essence then for incumbent operators, the risk from competition outweighs the risk from all other factors where competition or the threat of competition is perceived to exist.

In the initial round, while all operators were mindful of the risks of competition, many considered the risks to their core businesses to be small for the following reasons:

- The absence of obvious competitors: most incumbent bus operators in each area were on good terms, and were considered unlikely to compete aggressively with their neighbouring operators.
- Each incumbent bus operator was primarily keen to retain its "home patch" and considered that other incumbent bus operators were likely to have the same priority.
- The speed at which the whole process was developing gave little time for existing or potential operators to assess new opportunities.
- The comparatively short lead times between release of tendering authority policy statements and RFTs were considered by many incumbent operators to provide very little time for a competitor to make necessary depot, driver and vehicle arrangements.
- The industry is small and has well developed informal lines of communication: this makes it difficult for a new or expanding existing operator to act without signalling those intentions to the market.
- The size advantage of incumbent operators, particularly given the added strategic advantage of large group bids.

However in some areas, operators obviously underestimated the risks from competition, examples of which are as follows:

In **Palmerston North** the commercial registration of all services by the existing taxi company came as a complete shock to the incumbent bus operator.

In **Christchurch** the incumbent operator (Christchurch Transport Ltd) was initially successful in retaining only c.30% of pre-existing services. It should be noted however that the new competitor (Ritchies Transport Holdings Ltd) chose not to accept all contracts offered because of the difficulties of organising such a large expansion in such a short time. Ultimately the incumbent operator ended up retaining c. 70% of pre-existing services.

In **Dunedin** there was competition against all incumbent operators, although in the case of the main competitor, Ritchies Transport Holdings Ltd, even had it been offered a large number of contracts, it possibly would not have been able to accept them as it had insufficient resources to accept all contracts won in Christchurch.

In our view, incumbent operators in **Wellington** were the most concerned about the risks from competition. For example, it has been suggested that one incumbent operator, on hearing about Christchurch Transport Ltd's initial poor result, then re-submitted tenders (before tender closing date though) at much lower prices. It is not

clear whether that operator would have been successful at the original higher price and was effectively scared into submitting lower prices based on the perceived, rather than actual, threat of competition.

Operators in Wellington's Hutt Valley were also very concerned about competition. There, the tendering authority initially declined to accept a large number of tenders and published revised request for tender documents. This delay meant that Hutt Valley tenders closed after all other tenders in the region. Consequently increased competition was expected, caused by the publicity surrounding the initial withdrawal of request for tender documents and the fact that all other operators could assess their tendering success in other parts of the region and might choose to "have another go" in the Hutt Valley.

A2.4 Subsequent Tender Pricing Policies

In April 1992 the initial 12 month contracts in Wellington came up for re-tender. The differences between this and the initial tender round were:

- The April 1992 RFTs included a 1-2 day survey of patronage. From discussions with incumbent operators we understand that in some cases this patronage data, if simply multiplied up to an annual figure, over-represented historic levels by as much as 60%. It seems reasonable to assume that some tenderers will have taken this figure as being fairly accurate and, even given some considerable discounting, will have under-priced tenders. Other operators, particularly incumbent operators who could determine the accuracy of the 1-2 day survey data in respect of their services, are likely to have heavily discounted revenue estimates from this source when submitting tenders for other contracts.
- Some RFTs previously published as gross contracts were converted to net contracts. These previous gross contracts tended to be small or new services. Given the comparatively small amount of revenue (compared to both the costs of independently assessing revenue and the proportion of total operating costs for that service), some operators chose to very heavily discount their revenue estimates. We are aware of one operator who submitted a successful net tender on the assumption that there would be no revenue (i.e. priced as a gross contract) so that any revenue at all is a bonus! In simple dollar terms, the tender price appears to have fallen in the conversion from gross to net. However, because the successful tenderer submitted a net price only a little below the previous gross contract price, the net cost to the tendering authority of funding this gross contract has increased considerably.
- From previously published information, operators were able to assess previous levels of competition (bids per RFT), successful tender prices, and range of tender prices. Since input costs had not altered appreciably in the preceding 12 months, it gave operators a good indication of the price that was likely to be successful. Therefore, for some operators, the emphasis changed from

"What will it cost us to do this job, and what are potential competitors likely to price?" to "Can we better the previously successful tenderer's price?"

A2.5 Emerging Commercial Strategies

In Wellington, the region where the greatest number of contracts has already come up for renewal, an interesting commercial strategy is emerging. On six occasions now, where a tenderer has been advised that its tender has been unsuccessful but before award of the contract to the preferred tenderer, one of the unsuccessful tenderers (incumbent or otherwise) has notified all or most of that service as being commercial.

There are three possible explanations for this strategy:

- The service can be operated profitably on a commercial basis, but operators were hoping to further increase their revenues (profits) by tendering. If unsuccessful in the tendering process, the operator reverts to the fall-back, but still profitable, commercial service option.

In this situation, competition prohibits operators from taking "excess" profits and services of a given quality are provided without external funding support.

- The service can be operated profitably on a commercial basis but only by reducing quality standards below those proposed in the operators' tenders. This can be seen as an operator attempting to successfully tender for a service by providing quality levels higher than the minimum requirements. When the tender proves not to be cost-competitive because of the higher-than-required quality standards, the operator reverts to the fall-back position of operating the service commercially. In these instances it will be particularly interesting to note whether the commercial service is actually operated at the high cost and high quality level (as tendered) or the lower cost and lower quality level. In our view, this quality issue will largely depend on two factors:
 - Whether the now-commercial operator has already purchased (or has a commitment to purchase) the higher quality vehicles; and
 - Whether the operator hopes to persuade the tendering authority that the minimum quality levels specified in the RFTs are too low, and in due course re-tender for the service when and if the regional council specifies higher minimum quality levels in its RFTs.

In this situation, competition eliminates the need for external funding for the service in question provided that the tendering authority is prepared to accept lower service qualitative features.

- The service cannot be operated profitably on a commercial basis, but in notifying it as being commercial:
 - An incumbent operator who has been unsuccessful in tendering stops an otherwise contracted competitor from establishing a "foothold" in the incumbent's "home patch".

- A new operator, having unsuccessfully tried to enter the market by tendering, now sees no alternative way of entering the market other than by commercial notifications.

While the above strategy eliminates the need for external funding for the service in question in the short term, it is not considered to be sustainable in the long term. The incumbent will have to increase prices or reduce profits elsewhere in order to cross-subsidise the loss-making commercial service, thus increasing the risk of competition. The new operator will have to do likewise but, because in Wellington the new operators have tended to be comparatively small, their ability to cross-subsidise is also likely to be small. Business failure seems inevitable. If loss-making commercial services are withdrawn, as seems likely, then regional councils will probably have to call for tenders at which time the same strategy could be repeated, this time with another new aspirant notifying its services as being commercial.

The latest development to have occurred in this commercial strategy is for the preferred tenderer (who was not awarded a contract because of a non-preferred tenderer's commercial notification) to also notify services as being commercial. Typically these services are timed to operate a little ahead of the other commercial operator's services, to maximise its own and to minimise its competitor's patronage and revenue. Even if the service could indeed be operated profitably by one operator, it seems extremely unlikely that it will be able to be operated profitably by two operators. In all probability the smaller less well resourced, generally new, operator will be forced to withdraw.

APPENDIX 3

ANALYSIS OF WELLINGTON REGIONAL COUNCIL TENDERS

A3.1 Introduction

Part of this project required analysis of tender bids. The purpose of this was to assess the accuracy of operator revenue estimates in order to identify whether incumbent operators were more capable of accurately estimating revenue than new operators and to identify whether revenue tended to be over- or underestimated. This would then suggest whether current tendering procedures tended to favour one category of operator over another and, in turn, suggest possible changes to tendering procedures to more fairly encourage competition.

For this analysis Wellington Regional Council (WRC) tenders were chosen for the following reasons:

- Benchmark gross cost, revenue and net price estimates were available from WRC for all RFTs in the region published before 1 July 1991.
- The sample size would, it was hoped, permit robust conclusions since there had been a comparatively high number of bids per RFT (compared with other regions) and a fairly large number of RFTs.
- Some contracts were about to expire and had recently been re-tendered. It was hoped that these tender results could be compared with earlier tender results to assess whether any trends were emerging.

A3.2 Methodology

With WRC's assistance, all relevant bid details (operator name, gross cost, revenue estimate, net cost and previously derived benchmark figures) were input into a spreadsheet package according to RFT number.

Actual annual revenue was estimated from the operator-supplied key factor reports and also input into this spreadsheet, according to RFT number. In calculating annual revenue from the year-to-date key factor reports, the following process was adopted.

- (1) Revenue estimated for those months for the year-to-date for each RFT that the operator had not supplied a key factor report. This estimate was determined by the average ratio of revenue earned in one month compared to the previous month for all RFTs where both figures were available, and then applying that ratio to determine the probable actual revenue where an operator had not completed a key factor report for that month for that RFT.
- (2) Spurious ex-key factor monthly figures were then deleted; in some instances the variance between typical monthly revenue figures and doubtful figures was as much as 50%.
- (3) Where only two or less actual key factor report revenue figures had been provided by operators for any RFT, all revenue figures were discarded. This

was done because it was considered inappropriate to extrapolate to an annual figure on so few data.

- (4) The resultant 10 months year-to-date (July-April) revenue was increased to an estimated annual figure by multiplying by 12/10. Inaccuracies by using this multiplication factor will be of second-order importance.

A3.3 Discussion

A3.3.1 Revenue Analysis

For this analysis, a subset of the database was produced to include only those net contract RFTs for which acceptably robust actual revenue figures were available. This eliminated 95 of the 132 total RFTs, to leave a sample of 37 RFTs (94 bidders) for further analysis. (Allowing for the fact that 15 of the 95 eliminated RFTs are for gross contracts, it follows that adequate key factor reports are not being provided by operators for 80 (c.68%) of all net contracts.)

The resulting subset of tenders for further evaluation has the following characteristics:

- All services operate in the Hutt Valley.
- All services are for 19 months duration (expire February 1993).
- As a result of the initial tender process 70% (26 out of 37) services changed hands. This shows that the most successful tenderers were those who were bidding for services not currently operated by them.
- Detailed patronage and revenue data had not been published with these net cost RFTs. Therefore operators had to make their own assessments in comparatively little time (though one incumbent operator, Cityline, had recently installed electronic ticketing equipment on all buses and was therefore better placed to make accurate revenue estimates).

To analyse tender bids, estimated actual annual revenue (based on actual monthly key factor report revenue figures provided by operators) for each RFT was set at 100 with all other revenue figures (benchmark, successful bid, unsuccessful bids) for each RFT expressed as a percentage of that figure.

Also, for this sample set of RFTs, weighted average revenue figures were calculated:

- For the total sample: to show the overall comparison between actual, benchmark, successful tenderer estimate and unsuccessful tenderer estimate revenue figures.
- By operator: to show how each operator's overall revenue estimates at the time of tendering compares with both the actual, benchmark and successful tenderer revenue figures.
- To differentiate between incumbent operators tendering for their own services, and aspirant operators tendering for services "belonging" to other operators.

A3.3.2 Actual v Benchmark Revenues

Overall, the benchmark figures exceeds the actual revenue by 51%. This is of considerable surprise to us, given that the benchmark revenue figure was a dispassionate assessment, based on historic patronage and revenue data. While some reduction in actual revenue (10-20%) to allow for patronage decline and/or margins of error might have been expected, this analysis shows an excessive variance.

Three possible explanations for this variance are:

- Despite rigorous and dispassionate analysis, the benchmark estimates are unreasonably high, or
- Annual revenue has reduced by c.30% in the past 12-18 months, or
- Operator key factor reports are under-reporting revenue.

There may have been some degree of revenue overestimation in preparing benchmark revenue figures, and there has been some actual patronage and revenue decline. However we believe that the accuracy of the actual revenue figures, derived from operator supplied key factor reports, is also open to question.

In drawing subsequent conclusions, we have taken a figure midway between the benchmark revenue estimate and the key factor revenue figure as representing the true actual revenue figure.

A3.3.2.1 Successful tender revenue estimate v actual revenue (assumed)

Overall, successful tenderers have considerably overestimated revenue by c.47%! The fact that successful tenderers have overestimated revenue is probably not surprising given that the tender with the highest revenue estimate is most likely to offer the lowest net cost and is therefore likely to be successful. Also, as stated elsewhere, while ideally operators may have wished to discount revenues on account of the revenue risk and other market factors, it would appear from this revenue analysis that such discounting would lead almost invariably to tender failure. (Though of course this overestimation of revenue may possibly have occurred **after** discounting initial revenue estimates.)

It is notable that the degree by which revenue was overestimated varied, depending on whether the successful tenderer was the incumbent operator. Overall, successful tenderers overestimated revenue for their existing services by c.14%, compared with aspirant successful tenderers who overestimated revenue by c.63%. For many tenderers, the "grass is greener over the fence" syndrome appears to have been applied. While existing operation revenues were overestimated, revenues for operations in areas new to them were overestimated by an even greater amount.

A3.3.2.2 Unsuccessful tender revenue estimate v actual revenue (assumed)

It is no surprise that unsuccessful tenderers almost universally estimated lower revenues than did successful tenderers overall by 41%. These conservative revenue estimates by unsuccessful tenderers are c.13% below actual assumed revenues.

Overall, where the incumbent operator was unsuccessful, revenue estimates appear to have been heavily discounted, falling short of actual assumed revenue by c.37%. Given

this conservative revenue estimate by the incumbent operator, together with the highly inflated revenue estimate by aspirant operators, it is of no surprise that such a large percentage (c.70%) of all services changed hands. This analysis tends to confirm the view that making conservative revenue estimates is an almost sure formula for tender failure.

Overall, where aspirant operators were unsuccessful, revenue was still overestimated (c.6%) but not as much as:

- When the incumbent was successful (c.15% revenue overestimate); or
- When the aspirant was successful (c.63% revenue overestimate).

A3.3.2.3 Accuracy of revenue estimates by operator

A total of seven operators tendered for this group of RFTs, two of whom were, at the time of tendering, operating all affected services. One of the incumbent operators and two of the aspirant operators were completely unsuccessful in tendering, with the resulting services being provided by four operators (one incumbent, three aspirants).

A3.3.3 Revenue Analysis Conclusions

Because of the absence of complete key factor reports for so many of the net contracts, this analysis had to be limited to only 37 RFTs. These are all for 19 month contracts in the Hutt Valley, and were tendered for by seven operators.

Because of this comparatively small sample size, considerable caution needs to be exercised in attempting to draw "universal" conclusions. With this caveat in mind, the following conclusions are drawn:

- Overall, tenderers have generally overestimated revenues.
- Where tenderers have made more conservative revenue estimates they have been less successful in the tendering process.
- The "grass is greener" syndrome is evident as operators tended to overestimate revenue to a greater degree when tendering outside their "home patch".
- The two pre-existing incumbent operators show a wide divergence of revenue estimation accuracy. One operator was somewhat optimistic for existing services and even more so when tendering for another operator's services. The other operator is very conservative and as a result was completely unsuccessful in tendering for these services.
- In this first round, there would seem to have been a strong drive to retain or gain market share, even at the expense of losing profitability. This could explain the general overestimation of revenue and the greater degree of revenue overestimation by aspirant tenderers.
- Conventional wisdom might suggest that operators would or should discount revenue when tendering for net contracts (to allow for the revenue risk of poor

estimates). The analysis shows that this is a luxury that tenderers cannot afford if they are to win tenders as the short term risk of or from competition is greater than the risks associated with inaccurate revenue estimates.

- On the available evidence, it would seem that WRC is receiving services at an artificially low price, with contracted operators receiving lower than necessary revenues. Such prices are unlikely to be sustainable in the medium term unless they are also being accompanied by generous estimates of costs and profit margins. This conclusion would seem to be supported by operator comment and actions, such as:
 - Antipathy between operators "poaching" passengers and allegedly operating services illegally.
 - Some operator calls for service rationalisations to reduce duplication of services.
 - One operator withdrawing from one contract.
 - One operator was generally known to be having financial difficulties some time before the regional council cancelled the contract on the grounds of its poor performance.
 - The declining quality of vehicles over time.

A3.3.4 Implications for Gross v Net Contracts

From the sample data, it is clear that operators have won contracts as a result of overestimating revenues (or have overestimated revenues in order to win contracts and market share).

If these contracts had been let as gross contracts (and assuming the same gross costs for each contract) then the level of public funding would have been greater. This increase in required public funding would have been in the order of c.25%-90%, depending on cost recovery through fare revenue (Table A3.1).

Obviously, the results in Table A3.1 assume that the same gross costs apply, for both gross cost and net cost contracts for each RFT. To be competitive and retain market share in the case of gross contracts, operators may choose to discount gross costs.

Table A3.2 shows the extent to which gross costs would have to be discounted to achieve the same level of net public funding as for equivalent net contracts.

Table A3.1. Possible funding impacts of gross v net contracts.

Item	Contract Type		% Change
	Net	Gross	
50% Cost Recovery Through Fares			
Gross cost to operator	250	250	0
Fare revenue	184(1)	125(2)	-32
Net public funding	66	125	+89
30% Cost Recovery Through Fares			
Gross cost to operator	250	250	0
Fare revenue(3)	110	75	-32
Net public funding	140	175	+25

- (1) Using weighted average revenue estimate for successful tenderers from tender analyses.
- (2) Using actual revenue-assumed from tender analyses.
- (3) Fare revenue from 50% cost recovery option factored by 0.6 to derive 30% cost recovery option.

Table A3.2. Gross cost reductions necessary to achieve same level of net public funding for net v gross contracts⁽¹⁾.

Item	Contract Type		% Change
	Net (2)	Gross	
50% Cost Recovery Through Fares(3)			
Gross Cost	250	191	-24
Fare Revenue	184	125	-32
Net Public Funding	66	66	0
30% Cost Recovery Through Fares(3)			
Gross cost	250	215	-14
Fare Revenue	110	75	-32
Net Public Funding	140	140	0

- (1) Based on Table A3.3 figures.
- (2) From Table A3.3.
- (3) Prior to required reductions in gross costs.

A3.3.5 Second Round Tender Prices

For this task the intention was to compare prices received for the second round of tenders with prices received for those same tenders in the first round, but this was complicated because some of the second round RFTs are not strictly comparable with their predecessors. For example, some second round tenders are an amalgam of two first round tender and some initially gross contracts have been converted to net contracts. Also, only a few of the second round tenders are for services that operators had provided key factor revenue data for the first round.

Therefore only two second round tender results can be compared with first round tender results, and this represents too small a sample from which to draw any conclusions as to operator tender pricing policies.

However Table A3.3 does provide a comparison of the number of bids received for the initial 12 month contracts, when first and subsequently tendered. From this table it is apparent that:

- Competition has increased, from an average of 2.3 to 3.1 bids per tender.
- The number of services being operated commercially has increased.
- Whereas initially a number of contracts received only one tender, now all contracts received at least two tenders.
- The greatest competition occurred for those three 12-month contracts which were re-tendered after only seven months operation. This suggests that calling for fewer tenders more frequently is more likely to encourage competition than calling for a greater number of tenders less frequently.
- The sample size is too small to draw definitive conclusions as to the tender price impacts of longer/shorter or gross/net tenders.

Table A3.3. Number of tenderers by RFT, for RFTs re-tendered since 1 July 1991.

RFT No.	May 1991			Nov 1991			April 1992		
	Duration (months)	Type	Bids	Duration (months)	Type	Bids	Duration (months)	Type	Bids
HV 371/2 Lower Valley Circuit	19	Net	2	5	Net	7	7	Net	4
HV 331/2 Naenae Evenings & Saturdays	19	Net	4(1)	5	Net	6(2)	7	Net	5
HV 261 Wainuiomata Weekends	19	Net	3	5	Net	5(3)	7	Net	5
Hutt Valley Average			3.0						4.7
WN 628 Miramar Heights, Saturdays	12	Gross	3				12	Net	3
WN 529 Southern Shopper	12	Gross	2				12	Net	3
WN 520 Mt Victoria-Highbury, Weekdays	12	Net	2				24	Net	0(4)
WN 226 Strathmore, Sunday	12	Gross	3				12	Net	3
WN 519 Western Wanderer	12	Net	1				24	Net	0(4)
WN 329 Breaker Bay/Scorching Bay	12	Gross	4				6	Gross	0(4)
Wellington Average			2.5						3.0
PK 436/2 Whitby/Paremata School	12	Net	2				24	Net	2
PK 531/2 Whitby Shoppers'	12	Gross	3				19	Net	2
PK 536/2 Whitby Peak	12	Net	1				27	Net	2
Porirua Average			2.0						2.0
NS 222 Tawa shoppers			0(5)				19	Net	4
NS 349 Johnsonville Evenings	12	Gross	5				12	Net	0(4)
NS 351/2 Churton Park, Interpeak	12	Gross	1				12	Net	2
NS 452/2 Churton Park, Schools	12	Net	1				12	Net	2
NS 479/2 Grenada Village, Schools	12	Gross	1				12	Net	2
NS 578/2 Grenada Village, Peak	12	Gross	1				12	Net	3
NS 771/2 Newlands Sunday	12	Net	2				12	Net	2
Northern Suburbs Average			1.8						2.5
OVERALL AVERAGE			2.3			6.0			3.1

- (1) Previously 3 tenderers for one part, 4 tenderers for the other.
- (2) Previously let as two contracts, 6 bids received for each part.
- (3) Previously let as two contracts, 5 bids received for each part.
- (4) Notified as being commercial.
- (5) Previously operated commercially.

APPENDIX 4

COMPETITIVE TENDERING FOR BUS SERVICES IN BRITAIN

COMPETITIVE TENDERING FOR BUS SERVICES IN BRITAIN

*Prepared by J.Dodgson,
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1992*

Outside London

Competitive tendering has been in operation outside London since deregulation of local bus services in October 1986.

Major features are:

- (1) Local authorities (Passenger Transport Executives (PTEs)) in the former Metropolitan Counties; Counties and Shire Districts in England and Wales; Regions and Island Councils in Scotland) are required by law to put all services out to competitive tender, with the exception of some de minimus exemptions.
- (2) Any firm can tender, and the local authority is not permitted to restrict any firm from bidding. The tendering authority is required to publicise the tenders, and to send tender documents to anyone who requests them in writing. However, contracts can only be awarded to firms with Passenger Service Vehicle Operators' licences.
- (3) Contracts may not be for a period of longer than five years.
- (4) Results must be published in the form of:
 - (i) the name of the successful tenderer (if any),
 - (ii) the annual value of the contract payment,
 - (iii) the number of tenders received,
 - (iv) the highest and lowest bids,
 - (v) separate information where the bids are invited on different bases.

Brief reasons must be given if the lowest bid is not accepted. A copy of the most recent results for Lancashire County Council, one of the largest Shire counties, is attached. Authorities do have the right to reject all tenders and negotiate with anyone they choose. In Tyne and Wear the PTE refused to award a few well-chosen contracts in the first round because it believed the companies were overcharging.

Practices in making public the results of the tendering process in the required form do vary between authorities.

The almost universal approach is for tenders to be sought on the basis of a firm specification. Variations can then be accommodated by the tenderer also submitting an alternative, or non-conforming, tender so that the authority can see the extra costs involved in accepting the variation from the original specification. Many authorities do only accept alternative tenders if a straight tender is also submitted, so that this comparison can be made.

The two main types of contract are for:

- (1) Gross (minimum cost, MC) subsidies: the operator receives payment for operating the service, and remits all the revenue to the authority.
- (2) Net (minimum subsidy, MS) subsidies: the operator keeps the revenue, and is therefore paid for the (expected) loss on the service.

With the MC system, the authority bears the revenue risk, whereas with the MS system the operator bears the risk. Although the MC system reduces the incentive for the operator to maximise revenue, it is possible to add a revenue bonus provision to an MC contract. It is also possible to reduce the risk for the operator involved with an MS contract by adding a minimum revenue guarantee. However, neither of these is common.

Within London

As a consequence of the 1984 London Regional Transport Act, London Regional Transport (LRT) started tendering of bus services in November 1984, with the first tendered operations starting in July/August 1985. Route licensing remains in operation in London and the market is not deregulated. Following the 1992 Conservative election victory, bus services are to be deregulated in London, but not until 1995 at the earliest.

In London an initial pre-qualification, or vetting, procedure for applicants was soon abandoned. LRT invites bids from any operator who may be interested. The tendering programme for each fiscal year is established in the previous autumn, and an annual programme with routes and dates for tenders and starts of operation is publicised for operators. This means that potential operators in London generally get more advance notice than elsewhere in the country.

Participation by private sector operators is a policy objective. By April 1992 there were twelve London Buses subsidiaries and 16 independent operators operating over 250 separate tendered services (Jones 1992). By April 1993 the plan is to have 43 percent of the network (78 million bus miles) operated under contract.

Nearly all contracts are let on an MC basis (the few exceptions were where the revenue was expected to be so low that it was not worth the cost of monitoring it), and the system of route regulation means that successful tenderers know they will be protected from competition (though since they remit all revenue earned to LRT, they would not have to worry about the effects of competition on this score anyway).

Most contracts have been for three years, but the Tendered Bus Division has recently started inviting bids for both 3 and 5 year terms.¹

LRT does try to assess whether a bid is realistic. For example, are the schedules and bus requirements feasible in London traffic conditions, and could the contractor attract labour at the earnings implied? If not, bids might be rejected. LRT are not bound to accept the lowest bid. In the rest of the country, the tendering authority is also not bound to do so, but (unlike in London) must publish their reasons. This may make it easier for LRT to reject a lower bid.

LRT's published criteria for judging bids (London Transport Tendered Bus Division, 1991) are:

- (i) level of quoted price,
- (ii) adequacy of proposed level of resources,
- (iii) competitiveness of wages and conditions proposals vis-à-vis recruitment and retention,
- (iv) operational feasibility (remoteness from depot),
- (v) control and supervision proposals,
- (vi) suitability of vehicles,
- (vii) track record and experience.

Glaister, a member of LRT's Board, notes (in 1990):

"I believe that tendering in London can be considered a success. The results have been good, the administration has run smoothly and the sensitive situation created by an in-house supplier competing against outside competition has generally been handled satisfactorily."

Contestability and Competition

If the tendered market were **perfectly** contestable, then the number of bids per contract would not matter. Any firm would know that if it did not keep its costs to a minimum, charge a price equal to average costs, and only bid for contracts where it was operating at its most efficient scale (i.e. where average costs were at a minimum), would it win a bid.

In practice, we would not expect perfect contestability, and would be interested in both actual competition, as evidenced by the number of firms entering bids, and potential competition, in the sense of the existence of firms who would be in a position to bid even though they do not actually do so.

¹ They expected that operators would bid a lower (unit) price for 5 year bids than 3 year bids, but apparently this has not happened – operators are prepared to take the risk that contracts on a 3 year basis would be extended.

Tyson has looked at bidding in the seven main conurbations, the former Metropolitan Counties. Table 1 shows the number of operators, and bids per tender, in the initial phase of tendering (1986), in the first year of deregulation (1987), and the second full year (1988).

In the initial phase, the (unweighted) average of bids per tender was 1.72. This rose to 2.69 in 1987, and to 3.22 in 1988.

Table 1. Bids per tender in the seven main conurbations.

Conurbation	1986	1987	1988
Greater Manchester (GM)	2.53	2.45	4.00
Merseyside (M)	1.70	2.77	3.10
South Yorkshire (SY)	1.32	2.43	2.87
Strathclyde (S)	2.36	3.20	3.40
Tyne & Wear (TW)	1.30	2.75	3.16
West Midlands (WM)	1.49	3.22	3.01
West Yorkshire (WY)	1.36	2.00	3.01
Average	1.72	2.69	3.22

Sources: Tyson (1987, 1988, 1989)

It is worth noting that in the initial phase five of the British areas had fewer bids per tender than Wellington and two had more. Four British areas had **more** bids per tender than Auckland and two had fewer (West Yorkshire had exactly the same number). All seven British conurbations generated more bids per tender than Canterbury.

In a study of the first, 1986, round of tendering, Tyson (1987) noted that most contracts were of relatively short duration, reflecting both the desire to stagger the task of renewals and uncertainty about future finance. This was likely to have been a factor in inhibiting initial entry. Nine and a half percent of contracts (mainly in Manchester and Strathclyde) were won by independent operators new to the local bus market (most of these were established coach operators). Tables 2 and 3 show the distribution of bidders per tender in each area, and the types of operator winning tenders.

Analysis of Operators Bidding for Tenders

This analysis is summarised in Tables 2 and 3 below.

Table 2. Analysis of number of bidders per contract.

Source: Tyson (1987, p.16)

Number of Bidders	Percentage of Contracts in*						
	GM	M	SY	S	TW	WM	WY
1	19	43	73	27	80	58	70
2	35	46	22	35	—	36	25
3	27	9	—	22	—	5	4
4	14	2	—	11	20	1	1
5	4	—	5	3	—	—	—
6-10	1	—	—	2	—	—	—
10+	—	—	—	—	—	—	—
Ratio of bidders/ contract	2.53	1.70	1.32	2.36	1.30	1.49	1.36

* GM = Greater Manchester; M = Merseyside; SY = South Yorkshire; S = Strathclyde;
TW = Tyne & Wear; WM = West Midlands; WY = West Yorkshire

Table 3. Number of tenders won by each type of operator.

Source: Tyson (1987, p.17)

Operator Type	Area*						
	GM	M	SY	S	TW	WM	WY
Own PTC	240	347	600	233	32	330	181
Other PTCs	7	nil	nil	nil	nil	nil	nil
NBC (S 24)	73	100	300	277 ⁽²⁾	76	60	349
Other NBC	nil	nil	nil	na	nil	nil	nil
Independent (stage)	9	1	70	134	14	6	2
Independent (other)	57	5	30	232	nil	7	23
Taxis	nil	nil	1	nil	nil	nil	nil
Total⁽¹⁾	386	453	1001	876	122	403	555

Notes

- (1) The total number of tenders may disagree with that given earlier as not all tender results are available for this analysis and in many cases grouping of tenders has taken place.
- (2) Scottish Bus Group. PTC Public Transport Company
NBC National Bus Company *See Table 2 for name of conurbation

All the conurbations used MS contracts, except Tyne and Wear (where there was a mixture of MS and MC contracts).

Tyson concluded at the end of the first full year of deregulation:

"Overall, it is fair to conclude that there has been a reasonably high level of competition in providing services from all types of operator."

(Tyson, 1988, p.7)

At the end of the second year, he concluded:

"Competition has been on a much larger scale than anticipated by many people, with at least thirty operators in the market in each area and an average of three bids for each tender for subsidised services."

(Tyson, 1989, p.4)

He also noted that the increase in competition has come primarily from existing firms, but that there has been a small but steady flow of entrants. The figure of three bids per tender was becoming the norm.

Competition outside the main conurbations has also increased. In Avon (Bristol) there were 2.5 bidders per contract in the first round, 4.0 bids per contract in the first annual review, and 3.8 bids per contract in the 1988 round. In Warwickshire bids per contract were 3.8 in 1986, 5.0 in 1989, and 6.8 for the first two tender rounds of 1990. Bids per tender in the Portsmouth area went from 2.0 in July 1986 to 3.8 by April 1990.

Contract entry is a relatively risk-free way of entering the market, and many operators have entered the market, and then diversified into commercial operations once they have become established. (Others have adopted the alternative approach, of identifying a commercial gap, and then tendering once established where they saw an opportunity to use spare resources: good examples of this strategy are Fareways, Liverline and Liverbus in Liverpool.) Huntley, publishing in 1989, noted there were over 200 recorded cases of former territorial operators starting operations outside their home base, and over three-quarters of these operations were wholly or partly based on tendered operations. This cross-competition between operators from different areas (see also Tyson, 1989, p.6) has been an important feature of UK bus competition, and might not be the case in New Zealand because of the lower number of operators and the much higher density of operations in Britain – any operator in the more urbanised areas of Britain knows that there are many other quite sizeable operators located not too far away eyeing their market.

In London, Higginson (1989) notes that up to the end of 1988 there has been an average of 3.75 bids per route. Every contract had attracted at least two bids. This has now increased to around 4 to 5 bids per contract, primarily because different London Buses Limited (LBL) subsidiaries are now allowed to bid against each other. London Buses apparently limit these bids to three subsidiaries. The typical pattern may be that the "home" operator and the two with the nearest operating areas will bid. Routes have changed hands between LBL subsidiaries as a result.

By March 1991 just over 200 routes, representing 34 percent of the network, had been contracted. There were 150 contracts, covering 60 million vehicle-miles per year. The successful operators were 12 LBL subsidiaries, plus 16 independent or municipal forms who operated a little under 45 percent of the tendered service (Wren 1991).

There are two main types of independent. The first are ex-NBC companies whose operating area was near London. The former London and Country bus company as transferred to the NBC, so that when NBC was privatised (London and Country as four units) there were a number of large operators around London. Ex-NBC independents include Eastern National, Kentish Bus, Country Bus, London and Country, Luton and District, Thamesway, other independents, most of whom had previous experience in coaching. They include Grey Green, Capital/Ensign Citybus, Armchair, BTS, R & I Metrobus, London Buslines and Atlas Bus. The most recent independent is Javelin Coaches, a company owned by Tyler Waste Management. The situation in London has therefore been similar to that of other conurbations in that the established company has faced competition both from quite large companies well-established nearby, and from the smaller and dynamic ex-coaching firm. Recently a large operator from the north of England, Yorkshire Rider, tendered (unsuccessfully) in London. The only municipal company to win contracts in London, Boro'Line, no longer does so.

Competition, Bids Per Tender and Contract Price

Does the number of bids influence contract price? If competition is important one would expect that the more bids per contract, the lower the cost of the winning bid.

Pickup et al. (1991) use data from the West Midlands to regress contract price on size of contract (annual vehicle miles), length of route, type of service, type of vehicle used, time span of contract, and the number of bidders per contract. Other things equal, contract price was 17 percent lower when there were two bidders rather than one, and 30 percent lower when there were three or more bidders rather than one.

Two factors seemed important in the West Midlands study in increasing competition, namely the size of contract (with greatest competition for smaller contracts), and contract duration (with greater competition for contracts of three or more years duration). However, what may also be very important is getting serious competition for big contracts. In October 1986 the ex-PTE operator West Midlands Travel held 82 percent of contracts and operated 77 percent of tendered vehicle miles. However, the latter figure was reduced to 67 percent by May 1988 mainly because of the success of Midland Red West and other ex-NBC companies in winning tenders. Thus, you could have quite a lot of competition from small operators for small contracts, but the incumbent may not be seriously challenged without another big operator entering the market and mounting a serious challenge for the bigger contracts.

Tough (1992) also suggests that increasing the number of bidders reduces costs. Analysis of the relationship between bids per tender (grouped into 1-3, and 4+) and cost per bus-mile for a sample of 100 tenders for each of four authorities (Oxfordshire, Wiltshire, East Sussex and Essex) shows that this is so where the authorities use MC

or dual contracts, but not so with MS contracts. His explanation is that MC contracts attract small operators, and the more such operators, the lower is likely to be the winning bid. (All the bus operators he surveyed also said they would reduce profit margins as a result of competition.)

On the other hand, MS contracts are usually bid for by the larger operators, who are likely to bid for all contracts in their area. In so far as such MS contracts do attract additional bids from small firms, these forms are not likely to be successful because they are likely to be at a disadvantage in predicting revenue in comparison with the larger experienced firms, and therefore less likely to win because they will need to include a larger revenue-risk premium. In other words, increases in bids per tender for MS contracts will not lead to a reduction in expected price per tender because the additional bidders are unlikely to be potential winners.

Consequently, adopting MC rather than MS contracts is a way to increase bids per tender, and reduce contract prices.

Beesley and Glaister (1989) have an alternative hypothesis about the relationship between the number of bids and the cost per bid. This is that bid values will rise with the number of bidders because bidders will be worried about the "winner's curse". However, their statistical analysis of 473 bids for 122 routes indicates that bid values declined (though not in a statistically significant manner) as the number of bidders for a contract increases.

The author asked in London if they thought that bids were lower if there were more bidders, and the answer I got was "probably not," but it might improve quality (which does seem to be a more important factor in assessing bids than elsewhere). Some areas of London are more competitive than others because of the location of operators. Prices have come down with the recession as operators have faced more pressure on costs and as some have tried to compensate for losses of other business.

Divergences Between Tender Bids

The divergence between lowest and highest cost tenders has often been high. For example, in Lancashire County Council's results for 28 contracts let between February and October 1992, the ratio between maximum and minimum bid was 3.2.

Huntley (1989) suggested five reasons for variation:

- (1) Operators sometimes miscalculate, or do not submit serious tenders. One reason for the latter is where an operator is required to submit both MC and MS bids, but only wants one to be considered. (Another would be where operators were not competing seriously with each other. I have not seen any evidence that this occurs, Since collusion is illegal, and would be fairly transparent from inspection of tender documents – though not from published results – it may well not be common.)

- (2) Actual differences in operating costs.
- (3) Differences in the availability of resources, and hence their opportunity cost. For example, an operator with an all-day weekday service may be able to put in a much lower bid for a Sunday contract than another firm which would have to acquire new vehicles.
- (4) Revenue prediction appears to account for the greatest degree of uncertainty and price difference between contracts.
- (5) Analysis of tender results shows that operators who run a significant number of commercial services tend to have different tender policies for "home" and "foreign" contracts. He suggests that there have been numerous instances of pricing of contracts below cost as a short term tactic to prevent competition. (This seems to be an example of a predatory, i.e. anti-competitive, practice that would fall foul of the Office of Fair Trading's guidelines.) Tough (1992) also quotes examples of operators who said that they would tender below marginal cost to stop other operators entering their market.

Variation was likely to be greatest in the initial phases of deregulation when operators were more uncertain about the costing and tendering process and the strategies of their rivals, and when operators were less likely to have adjusted to equilibrium in terms of utilising spare resources. Indeed, Pickup et al.'s (1991) analysis of the West Midlands showed that the ratio of highest to lowest bid averaged 5.28 in the initial, pre-October 1986, phase, but has fallen to an average of 2.28 in the February to May 1988 period.

Gross v Net Contracts

Huntley (1989) provides Table 4 (p.148) to compare the MC and MS bases. It is generally agreed that MS tenders favour larger operators with experience of revenue measurement, either because they themselves have operated the routes out to tender in the recent past, or because they are just more skilled in assessing the revenue prospects of different types of service. Larger operators might, however, favour MS tenders on their own patch, but might bid on an MC basis elsewhere. On the other hand, smaller less experienced operators generally prefer MC tenders.

Some tendering authorities use both methods, either seeking some contracts under one method, and some under another, or seeking bids on either (or both) bases. For example, Lancashire invite bids on either or both bases. To reduce the advantage of incumbents who will have a better idea of revenue prospects in the MS approach, they include recent revenue figures for the services under bidding. Some (generally the smaller) operators put in alternative bids in which their MC and MS bids just differ by the authority's revenue figure – in such cases the MC bid is accepted, i.e. the authority bears the revenue risk. Many other authorities also provide revenue/passenger figures with the tender documents to aid bidding and increase competition – this is something that they can do now they have had six years of experience, but which they could obviously not do in the early days.

Table 4. Comparison of cost and subsidy based tenders.

COST CONTRACTS also called FIXED COST CONTRACTS or MINIMUM COST (MC) CONTRACTS	SUBSIDY CONTRACTS also called BOTTOM LINE CONTRACTS or MINIMUM SUBSIDY (MS) CONTRACTS
<i>Advantages</i>	
<ol style="list-style-type: none"> 1. Reduced risk for operator 2. Greater stability may result 3. Attractive to small operators 4. Simpler administration of network ticketing schemes 5. Greater control for authority 6. Easier to retain authority marketing schemes, return fares 	<ol style="list-style-type: none"> 1. Greater incentive for operator 2. Reduced risk for authority 3. Maximum commercial freedom 4. Simpler administration of operator based ticketing schemes 5. Minimum "interference" with commercial market 6. Easier marketing of network
<i>Disadvantages</i>	
<ol style="list-style-type: none"> 1. Increased monitoring costs and manpower for authority 2. Need for detailed audit 3. Reduced incentive for operator 4. Authority must budget to cope with trading risks 	<ol style="list-style-type: none"> 1. Difficulty in retaining authority based ticketing schemes 2. High risks for operators may result in high tender prices 3. Potential conflict of operator and authority fare objectives 4. Risk may deter competition

Tough's (1992) view of the advantages is that MC subsidies are to be preferred because they reduce the costs to the tendering authority both because operators do not include a risk premium to allow for revenue uncertainty, and because MC tenders encourage more bids per tender and these extra bids will come from small firms who may be effective competitors. Although there are disadvantages of MC as opposed to MS subsidies, in the form of extra monitoring costs and the possibility that older, lower quality, vehicles will be operated, they are not likely to outweigh the benefits. In any case, experience suggests that, in general, operators with MC contracts do have sufficient internal and external incentives to perform to contract. It is worth noting, however, that all of Tough's data are for Shire counties.

Evidence from London (Beesley and Glaister (1989), Jones (1992)) also suggests reliability is not a problem with MC contracts.

Composite Tenders

In its initial advice to authorities, the Department of Transport (DoT) warned of the dangers of inhibiting competition if tender packages were too large, and thus beyond the resource capabilities of smaller firms. The DoT suggested that tenders be invited for the smallest economic units, and that operators be given the opportunity to combine bids into composite bids where economies could be achieved. This is standard practice. Combined bids can result in lower overall tender prices where cost savings can be achieved by "inter-working" or by savings in overhead or administration/supervision costs. Obviously this helps the larger operators. But authorities might also in some instances reject a composite bid in favour of slightly higher individual bids in order to encourage competition (e.g. Hampshire County Council).

Composite tenders did create problems in London. Beesley and Glaister note that initially in competitive tendering LRT were adopting a policy of offering larger and larger local networks. LBL were successful in winning these networks, and there were no other tenderers large enough to compete. LBL were also offering a price to operate a network, and individual prices for separate routes which appeared to have much higher mark-ups over costs. In effect, LRT were faced with the choice of accepting the network bid from LBL, or a combination of route bids from LBL and independents which would have cost more. Beesley and Glaister concluded that there was a problem because there was no effective comprehensive alternative bidder. Two lessons implemented as a result of this were that packages of routes offered should not be too big, and that some of the packages should be for routes that could not be combined as a unitary network. There were also concerns as to whether LBL's bids reflected a fair allocation of their overhead costs given that some of their (subsidised) network was not subject to tendering.

London Transport now require that any operator who bids for sections of the network on offer must also submit bids for all the parts in the total he bids for. Combination bids from bigger operators generally do include a discount for the whole package, but it still has been possible to save on these costs by accepting lower route bids from smaller firms for parts of the total. Smaller firms are also allowed to indicate the total resources they will be able to commit (e.g. they could bid for eight routes but indicate they could only operate four as a maximum). London Transport say they do like area networks to be split up because there is then some form of (service performance) competition between operators (and also someone to takeover if a contract has to be cancelled).

Inflation Adjustment

Bus subsidy contracts generally allow for adjustment to take account of inflation in costs. Huntley (1989) quotes a 1987 survey by Dodd, which showed that 53 percent of authorities had automatic annual price adjustments, 28 percent allowed for adjustment on application by the operator, and 9 percent only at the authority's discretion. Of the other 10 percent, half had no contractual provision for increases, and half only let short contracts where this problem would not arise.

Methods of price adjustment are normally related to operators' costs, or to published cost indices such as the Retail Price Index (RPI) or the Index of Producer Prices. For example, Lancashire uses an index which is based on a combination of the RPI, diesel costs and bus industry wages. Contracts are adjusted up automatically every 12 months.

London Transport used to index on the basis of 95 percent of the RPI, plus one percent, but recently moved to indexation on the full value of the RPI. There is automatic adjustment one year after the date of contract submission.

Insufficient allowance for price adjustment would obviously increase the risk in bidding, since operators would need to predict the expected increase in their costs over the period of the contract and include an element to allow for this in their bid. The most important item is how earnings are expected to rise in relation to the anticipated increase in retail prices. Operators will also have to predict increases in fuel prices. The risk increases with contract length, with the anticipated level of inflation, and with variability of inflation.

Tendering and Profitability

There is no clear evidence that operation of tendered services increases or decreases an operator's profitability. Price Waterhouse (1990) undertook a profitability study of the bus industry in which profits per seat for 109 operators were regressed on variables such as company size, market concentration, type of organisation, and the percentage of the operator's bus-miles that were subsidised (the mean value of this in the sample was 11 percent). Price Waterhouse thought that on balance the sign of this last variable should be positive, since companies could use tenders to secure better use of assets, even though they noted that companies might be prepared to operate subsidised services at a loss to preserve area monopolies. In practice, the variable was not statistically significant.

There is some belief that in the early days some operators may have operated some tendered routes at a loss to preserve territory, but it appears that this practice has died out as operators realise it is counterproductive. Also firms are now more likely to be adjusted to long run equilibrium and less tempted to use spare resources to bid for contracts that do not properly cover long run costs.

Tendering and Competition Policy

The deregulated bus industry has been subject to detailed investigation by UK competition policy agencies, the Monopolies and Mergers Commission (MMC) (on mergers), and the Office of Fair Trading (on predatory behaviour and restrictive practices). Most of the subject of such investigations has been in regard to commercial services, though there was some concern at the practice of some operators who abandoned commercial services and then re-registered them if they were unsuccessful in winning a tender competition. This would force the authority to cancel the contract,

and so the successful bidder would face a risk even with an MC contract. The commercial operator acting in this way might be making a loss to discourage competition on its patch, or it might be trying to gain some extra revenue from a service that was barely commercial. This practice is now rather frowned upon by competition agencies, and is probably less common than in the past (though it is something that may only have happened in a few instances in each area anyway).

Of the six merger investigations, only one concluded that the merger would adversely affect competition in the **tendered** market. This was the Badgerline/Midland Red West merger in the Bristol area. Here restrictions were agreed by the partners, so that both subsidiaries would submit independent bids, and would not re-register commercial services. Elsewhere the MMC generally found that there was enough actual and potential competition, both from small independents and from larger forms located close by, to deter merged firms from putting in above-cost bids. The conclusion with regard to the Western Travel/ G & G Travel case is typical:

"6.36. On the evidence we have seen, however, there would seem to be fairly active competition for contract services in Warwick and Leamington, with on average some four bidders per contract. Of the individual tenders we have examined, there were only two since 1986 in which MRS and G & G were the only bidders (see paragraph 3.40). Competitors include companies based outside Warwick such as Lloyds of Nuneaton, WMT and Midland Fox, although they are less successful partly because of the cost penalty of operating at a distance from their depot. There are, however, some half dozen smaller competitors who have won contracts in the Warwick area. On the majority of contracts won by MRS and G & G, companies independent of the Western group provided the second lowest bid and the most effective competition to MRS or G & G."

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APPENDIX 5

COMPETITION IN OVERSEAS PUBLIC TRANSPORT COMPETITIVE TENDERING: Africa, the Americas, Australia, and Continental Europe

**COMPETITION IN OVERSEAS PUBLIC TRANSPORT
COMPETITIVE TENDERING:
Africa, the Americas, Australia, and Continental Europe**

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1. INTRODUCTION

This report outlines structures of the most significant overseas markets for competitively tendered public transport service (outside the United Kingdom). Recommendations are offered that the authors believe would enhance the development of a sufficiently competitive supplier market to achieve public objectives in New Zealand.

2. UNITED STATES

2.1 Situation

Public transport competitive tendering is a highly charged political issue in the US. Most public transport bus services are operated directly by public transport authorities. A substantial portion of public transport subsidies are directly collected by or funnelled directly to public transport authorities, through earmarked (dedicated) taxes. As a result, the political decision making process does not regularly prioritize public transport subsidies in relation to other public funding needs.^{1*} Further, public transport trade unions are adamantly opposed to competitive tendering and contribute considerable sums of money to prevent its implementation.² In this environment public transport authorities have little incentive to implement cost-effective strategies, such as competitive tendering. Private companies claim that some public transport authorities have deliberately designed competitive tendering programmes to fail.

Nonetheless, competitive tendering is expanding in the US. Typically, competitive tendering has been implemented where there is a separation of policy from operations (where the public agency planning the public transport system and administering contracts is not permitted to directly operate service),³ where new public transport authorities have been created⁴ or, in rare cases by a public transport authority.⁵

The competitive tendering market: Approximately 3,500 public transport buses are now competitively tendered in the US, representing 8 percent of public transport bus service.

The private bus industry operates more than 135,000 buses. The private bus industry includes three primary components:

- Private companies whose primary passenger transport product line is dedicated school bus service. These private school bus companies provide services under contract to local educational authorities.⁶ The private school bus industry includes hundreds of private companies that operate a total of more than 110,000 buses. The smallest companies operate a single bus, while the largest company⁷ operates approximately 18,000 buses (nearly half the number of publicly operated public transport buses). The six largest school bus companies⁸ operate

* 1, 2, ... 25

See Endnotes (pp. 173-175).

approximately 40,000 buses and provide nearly 4.5 million passenger journeys daily.

- Highway coach companies, which operate scheduled inter-city coach services, charter services and tours. The highway coach industry operates approximately 25,000 buses. Locally owned charter and tour companies are located in virtually all metropolitan areas with more than 500,000 population.
- A few smaller regional and national tendering firms specializing in competitively tendered services. Most of the specialized companies are major competitors in tendered paratransit⁹ services. Other companies specialize in providing specialized bus services for corporate customers, such as airlines (employee shuttles) and airports (parking shuttles).

Competitively tendered public transport bus service is supplied by companies from all three components of the competitive tendering supplier market. The most frequent competitors are the larger school bus companies, which tend to compete throughout the nation, even where they do not already operate.¹⁰ Other companies compete in their service areas. At one time, two national highway coach companies were major competitors, however the merged firm's competitive tendering services unit was later purchased by a school bus company.¹¹

2.2 Competitive Tendering Issues

In the US system of federal governance, the amount and design of competitively tendered service is normally decided by local or regional governments. As a result there tends to be considerable variation in approaches to competitive tendering.

Size of Tender: Tenders range in size from a single vehicle to 350 vehicles. However, the largest contract award was for approximately 200 vehicles. Few tenders are larger than 50 vehicles, with most in the range of 15 to 49 vehicles. The US concern with keeping tenders smaller rather than larger is illustrated by the nation's only mandatory competitive tendering legislation, which required that tender sizes be kept as "small as practicable" (Colorado), and by proposed state legislation with maximum tender sizes expressed in number of vehicles (New Jersey, California, Washington, Pennsylvania, Illinois, Arizona, Minnesota, and Michigan).

Contract Duration: The average is 3 to 5 years. Contract durations of more than 5 years are nearly non-existent, though a small number of contracts permit renewal options beyond 5 years.

Provision of Vehicles: Revenue vehicles may be either supplied by tendering authorities or the tenderers as specified in the request for tenders. Vehicles tend to be supplied by tendering authorities in larger tenders.

Price Adjustment during Contract Term: Most US contracts require a single tender price for the term of the contract (total price or unit price, such as per kilometer or hour price). In some cases the fuel component of the contract price is indexed. Finally, in some cases contract prices are indexed annually, using a percentage of the change in the retail price index (Consumer Price Index). Negotiation is not permitted.

Gross v. Net: Almost all US cases rely on gross revenue tenders. A notable exception is Denver, where the state law mandating competitive tenders requires a net revenue approach. Two characteristics of the US market appear to support the preference for gross revenue tenders. First, the supplier market is composed primarily of private companies accustomed that hire vehicles out on a contract basis to a single purchaser. As a result, the private companies are uncomfortable with taking any risk for passenger fares, and may inflate their tender prices to compensate for their high degree of uncertainty. Second, there is a perception that, in the decentralized and automobile-dependent US, there is little potential for improving ridership through better service.¹²

Public Information: Virtually all US states have laws that require full disclosure of tender award information.

Group tenders: Most US tenders are not group tenders, though group tenders have been used in some large procurements (Dallas, Denver and Houston). Where group tenders are permitted, contract award is usually at the group level. Large company pricing strategies have favored group, rather than individual, awards. Further, public administrators tend to express a preference for group tenders due to perceived economies of administrative scale.

Separation of Policy from Operations: Generally policy and operations are combined in a public transport authority, but there are exceptions.

"Hit and Run" Entry: "Hit and run" entry occurs, even in relatively large competitive tenders.¹³ Usually "hit and run" entry involves a local or regional company that has been previously absent from competitive tendering in a local area.

Conformity Requirement: Tenders that do not comply with the scope of work or any other requirement as specified in the RFT are routinely disqualified.

2.3 Competitiveness of the Market

Competitive tendering was relatively rare in public transport before 1985. Starting in late 1984, federal policies encouraged competitive tendering. Further, the continuing escalation of public transport unit costs provided some authorities with an incentive to competitively tender for service.

Historical Trend: According to a sample of 78 requests for tender, the average number of tenders submitted per request for tender was less than two before 1985, reflecting the sporadic nature of competitive tendering at that time. With increased public policy attention, the competitive tendering market matured quickly, increasing to an average of between four and five tenders per RFT. This maturing occurred because of the pre-existing strength of the US private bus industry.

NUMBER OF TENDERERS PER TENDER PACKAGE PER YEAR		
Years	Requests for Tenders	Average Number of Tenderers
1984 and Before	8	1.8
1985-1986	14	4.1
1987-1988	17	4.2
1989-1990	20	4.0
1991-1992	19	4.7
All	78	4.0

Size of Tender: At the same time, except in the smallest RFTs, the number of tenders submitted appears to be negatively related to the size of the tender package (in number of buses). For tenders requiring more than 75 buses, the average number was 2.0 tenderers. For packages requiring from 15 to 49 buses, the average number was c.4.5 tenderers.

NUMBER OF TENDERS BY SIZE OF TENDER PACKAGE		
Number of Buses	Tenders	Average Number of Tenderers
Over 75	7	2.0
50 to 74	7	3.7
30 to 49	24	4.5
15 to 29	24	4.4
Fewer than 15	16	3.8
All	8	4.0

This finding is consistent with the structure of the US private bus industry, whose most frequent participants in the public transport tendering process are large national school bus companies. These companies are unlikely to enter new markets in response to the smallest tender packages, while they are sometimes deterred by the barriers to entry for large tender packages (such as the perception of incumbent preference and the high cost of preparing large tenders).

Despite the lower level of competition reported for smaller tenders, additional US experience suggests that it is better to err on the side of tenders that are too small than tenders that are too large. Some large local education authorities competitively tender on an *single bus basis*, and one (St Paul, Minnesota) does so *annually*. Healthy competition occurs, though some larger national firms refuse to participate. Their place, however, is taken by smaller, local operators (of a type that no longer operates in many larger US urban areas). This would seem to suggest that the supplier market will accommodate itself to any tender size determined by tendering authorities, so long as the tender size is not so large that capital barriers restrict competition.

Re-tendering Where Competition is Insufficient: Failure to attract a sufficient number of tenders often causes substantial concern among US tendering authorities. In many cases, such tendering authorities will reject the one or two tenders received, consult with operator organizations to determine why competition was so limited, and issue a new RFT with revisions intended to encourage a greater degree of competition.

Provision of Buses: While most US tenders require the tenderer to provide the required buses, there are many instances in which the tendering authority leases publicly owned buses to the operator awarded the contract.¹⁴ The overall data suggests little difference between the number of tenders based upon bus provision: 4.2 tenders where the tendering authority provides the buses, compared to 3.9 where the tenderer provides the buses. However, considerable differences are found as the number of buses required for the tender increases. There is noticeably greater competition for tenders of more than 30 buses, while competition is approximately the same in smaller tenders, regardless of vehicle provision.

2.4 Examples

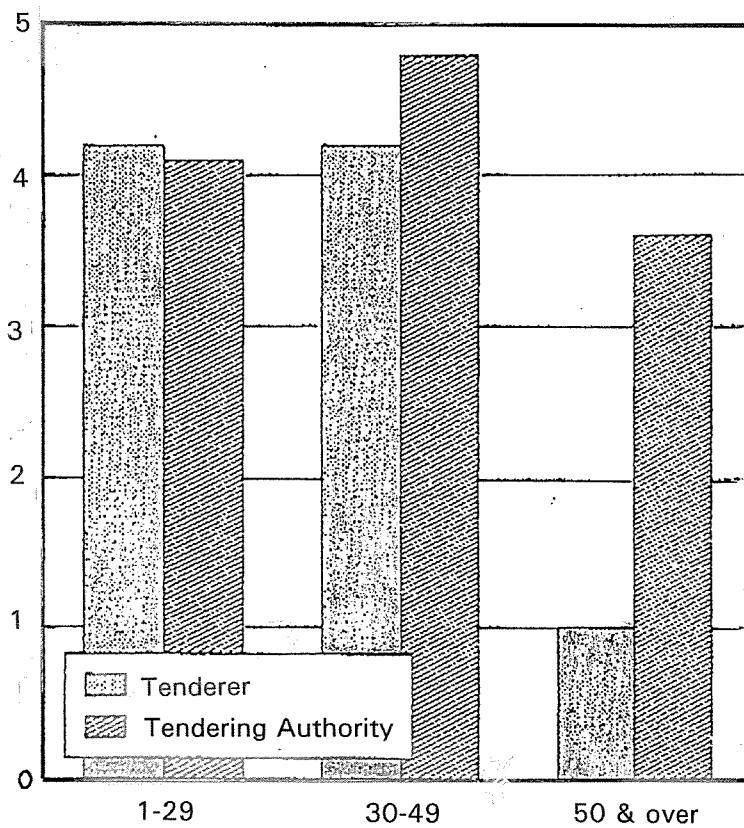
Descriptions of competitive tendering competition follow:

San Diego, California: San Diego has separation of policy from operations and has developed a reputation for unquestioned integrity with respect to the tendering process and selection of operators. When buses are provided by public authorities, the number of tenders averages from 8 to 10. When buses are provided by the tenderers, four to six tenders are typical. The typical tenderers include at least four national school bus companies, two specialized companies, and various local and regional companies.

NUMBER OF TENDERS BY SIZE OF TENDER PACKAGE AND PROVISION OF BUSES				
Number of Buses	Tenderers Provide Buses		Tendering Authorities Provide Buses	
	Tenders	Average Number of Tenderers	Tenders	Average Number of Tenderers
Over 75	3	0.3	4	3.3
50 to 74	1	3.0	6	3.8
30 to 49	12	4.2	12	4.8
15 to 29	14	4.7	10	4.0
Fewer than 15	15	3.7	1	5.0
All	45	3.9	33	4.2

Figure 1. Average number of companies submitting tenders. By provider of buses.

From sample of 78 US tenders



Detroit, Michigan: Detroit's suburban public transport authority handles both policy and operations. In 1991, it oversaw a competitive tendering process that was strongly opposed by public transport trade unions. Various potential competitors were concerned that the process would not be fair, and that the public transport agency had no serious intention of awarding a contract. Special efforts were taken by the public transport authority to convince potential tenderers that the process was genuine. The public transport agency was committed to submitting its own tender consistent with the requirements placed on private tenderers. It further announced that its price proposal would be developed using generally accepted accounting principles, so that all attributable costs would be included. Finally, it promised to publicly announce its tender price concurrent with the submittal deadline, so that there would be no suspicion of unfair price manipulation. This strategy was successful, in that five tenders were received, two from national school bus companies, one from a small national company specializing in tendered public transport service, one from a new entrant, a national company specializing in airport services (this was a case of "hit and run" entry), and one from the public transport authority itself. Two national school bus companies that had been expected to tender did not; one due to what it deemed to be too costly short term capital requirements and the other because it simply failed to complete its tender on time. The contract was awarded to a national school bus company.

Las Vegas, Nevada: In 1992, Las Vegas sought tenders for its new public transport system to replace the private monopoly system that continued to be profitable to the end. Local public authorities decided to replace the private monopoly system because its services were too limited. The tender required approximately 60 vehicles, which will be provided by the tendering authority. Seven tenders were received, including 4 from national school bus companies, 2 from specialized national companies and one from the former public transport monopoly. The contract was awarded to a national school bus company.

2.5 Obstacles to Competition

According to private operators, the most important barriers to heightened competition for competitive tenders are:

Unfairness: Private companies frequently cite unfairness (real or perceived) in the tendering process as a reason for not competing in competitive tenders. This may take various forms:

Unfair evaluation by public transport authorities, especially where the public transport authority administering the tender also competes for the tender.

"Low-ball" cost proposals, in which public transport authorities compete for tenders through cost proposals that are "cross-subsidized" by funds from services not subject to competitive tender.

Incumbent preference, which may be real or merely perceived by competitors where the existing operator and the tendering authority have developed a long and presumably close relationship. Perceived incumbent preference is a problem especially where tender sizes are large.¹⁵

Operator preference, in which a consulting division of a competitor is retained by a tendering authority to design the tendering process. This can result in a real or perceived preference for the competitor.

Sham processes, which are perceived by potential competitors where it is suspected that the tendering authority is not serious about proceeding to contract award. (The largest US tender was such a case.)

Political interference, which has included threats by public transport trade unions, and feared political retribution by public officials supported by public transport trade unions (this has been infrequent).

Excessive Tender Size: There tends to be less competition for the largest tender packages, especially where vehicles must be provided by the tenderers. Further, there are indications that the tendency to avoid multiple awards in group tender situations is deterring competition from smaller private companies.

Vehicles: Competition tends to increase where revenue vehicles are provided under lease by the public transport authority.

Onerous Requirements: Excessive performance bond requirements, excessive performance penalties, too prescriptive operational requirements (relating to inputs rather than to service outputs) deter competition.

Capital Requirements: Smaller companies are deterred from competing by the high costs of buses, especially where new or near-new buses are called for in the request for tenders. A particular problem is that the secondary market for public transport buses is particularly weak, and that few if any public transport buses can be found on the secondary market that are less than 12 years old.¹⁶

Multiple Concurrent Tenders: Responding to multiple tenders can be difficult for even the largest companies, given the substantial resources necessary to develop proposals. In some cases, competition has been reduced by the internal inability of companies to respond to multiple tenders.¹⁷

Lack of Familiarity: Most competitive tendering tends to be centered in a few areas, particularly California, Texas, Minnesota, the Washington DC area, and the Chicago area. As a result, smaller local private companies in other areas are often unfamiliar with competitive tendering.

2.6 US Conclusions

US Competitive tendering has routinely resulted in cost savings averaging 30 percent compared to non-competitively tendered services provided by public agencies.¹⁸ In addition, subsequent tender prices have been inclined to rise at a lower rate both general inflation and non-competitively tendered public transport costs. In addition, the private bus industry is strong enough to supply considerably larger amounts of competitively contracted bus service than are required at this time. The geographical dispersion of local charter and tour companies and the existence of the small specialized national companies makes "hit and run" entry a genuine possibility in virtually all but the largest tender packages. The size of the competitive supplier market, the lower cost of competitively tendered services and the more moderate cost increases indicates that the US supplier market is competitive – that there is a sufficient supply of private firms prepared to provide public transport service at competitive market prices.

3. SWEDEN

Sweden is implementing a gradual conversion of its public transport bus systems to competitive tendering. Most of Sweden's 24 counties have implemented competitive tendering, and conversion has recently begun in the Stockholm area, where 20 percent of bus services were competitively tendered. To enhance competition, the bus operations of SL (the Stockholm public transport agency) will be divided and corporatized.

There are approximately 13,300 buses in Sweden, of which approximately 5,600 are privately owned (42 percent).

Contract Duration: 3 to 5 years.

Provision of Vehicles: Tenderers provide.

Price Adjustment during Contract Term: Indexed – negotiation not permitted.

Gross v. Net: Gross, except in one county.

Public Information: Tender award details are public.

Separation of Policy from Operations: Yes.

Hit and Run Entry: Many new entrants have competed for tenders.

Conformity Requirement: Tenders that do not comply with the scope of work or any other requirement as specified in the RFT are routinely disqualified.

Average cost savings of 5 to 15 percent have been reported, with some cases in the 20 to 30 percent range. *Ministry of Transport officials indicate satisfaction with the extent of competition in Sweden.*

4. DENMARK

The Danish parliament has mandated competitive tendering of public transport services, with a 45 percent requirement placed upon Copenhagen for 1994. At this point Copenhagen competitively tenders more than 30 percent of its service (300 buses), and the public transport authority (HT) does not compete for tenders.¹⁹

Before service was competitively tendered in Copenhagen, 18 percent of the bus service was provided by private carriers under licences.

Size of Tender: 5 to 15 buses

Contract Duration: 4 years.²⁰

Provision of Vehicles: Usually the tenderer, but sometimes the tendering authority.

Price Adjustment during Contract Term: Indexed – negotiation not permitted.

Gross v Net: Gross.

Group Tenders: Limited in size and geographical scope.

Public Information: Tender award details are public.

Separation of Policy from Operations: No, but the public transport authority does not compete for tenders. There are plans to create such a separation when the public transport authority begins to compete.

Hit and Run Entry: New entrants have competed for tenders, including a Swedish company that has won tenders.

Conformity Requirement: Tenders that do not comply with the scope of work or any other requirement as specified in the RFT are routinely disqualified.

As of March 1992, five packages of tenders had been awarded. The average number of tenders has been 20. There was some reluctance on the part of private operators to tender on services that had been historically operated under licence by competitors. Privately licensed services were competitively tendered first, followed by publicly operated services. HT has gone to extraordinary steps to ensure the objectivity of the tendering process and contract award. It attributes both improved service quality and stabilization of declining ridership to competitive tendering. Cost savings have averaged 10 percent and *HT considers a sufficient level of competition has occurred for competitively tendered services.*

5. SOUTH AFRICA

Approximately 60 percent of conventional commuter express bus services are provided by private companies holding route licences. The government has begun an experimental programme to replace licensed services with competitively tendered services.

Size of Tender: Average 33 buses (range 3 to 250).

Contract Duration: 4 years.

Provision of Vehicles: Tenderers.

Price Adjustment during Contract Term: Indexed (because of the high inflation rate, prices are adjusted quarterly). Negotiation is not permitted.

Gross v Net: Net.

Group Tenders: Limited in size.

Public Information: Tender award details are public.

Separation of Policy from Operations: Yes.

Conformity Requirement: Tenders that do not comply with the scope of work or any other requirement as specified in the RFT are routinely disqualified.

The lowest number of tenders was 2 and the highest 18. The average was 8, and larger RFTs generally attracted fewer tenders. The relatively larger tender size works well in South Africa, due to the strength of the private bus industry relative to the tendering market. Further, the use of group tenders permits smaller operators to compete. Even so, the Ministry of Transport has expressed concern that tender sizes are so large that competition is deterred. Nonetheless, *the Ministry of Transport considers the tendering programme a success and notes that savings have been achieved.*

6. CHILE

In the 1970s, Santiago's publicly owned bus system was abandoned, due to management difficulties and escalating costs. It was replaced by a deregulated system of 11,000 private buses, dominated by minibuses.²¹ The large number of buses created serious traffic congestion in the busiest corridors, which induced the government to implement a competitive tendering programme in such corridors.

Contract Duration: 1.5 years, with 1.5 year renewal option.

Provision of Vehicles: Tenderers.

Price Adjustment during Contract Term: Indexation.

Gross v Net: Net.

Group Tenders: No.

Public Information: Tender award details are public.

Separation of Policy from Operations: Yes.

Requests for tenders for 6,000 buses were issued in 1992, and 300 tenders were received. *Ministry of Transport officials are satisfied with the level of competition and anticipate that the lower fares will result.*

7. AUSTRALIA

In 1989 New South Wales began competitively tendering late night rail substitution service ("Night Ride") in the Sydney area and rural rail substitution service ("Country Link"). The private bus industry in New South Wales is particularly strong, composed of large companies providing virtually all of the suburban Sydney bus service (under non-competitive contracts) and many other companies providing charter, inter-city and school bus services.

Contract Duration: Up to 3 years, with a 2 year renewal option.

Provision of Vehicles: Tenderers.

Price Adjustment during Contract Term: Indexation.

Gross v Net: Net.

Group Tenders: No.

Public Information: No.

Separation of Policy from Operations: Yes.

Conformity Requirement: Tenders that do not comply with the scope of work or any other requirement as specified in the RFT are routinely disqualified.

Seven "Night Ride" RFT's were issued, with an average of four tenders per RFT. Earlier in 1992 RFTs were issued for 41 "Country Link" services, with an average of more than 12 tenders submitted per RFT. In addition, a "commercial service" RFT attracted six tenders (the basis of contract award was the quality of proposed services – no public subsidies would be applied to the service). The amount of competitive tendering is small in relation to the size of the private bus industry, and as a result there has been brisk competition. *Department of Transport officials are satisfied with the extent of competition and the resulting cost savings.*

8. NORWAY

A national conversion to competitive tendering is beginning. It will be phased in over 10 years. Maximum contract length will be three years (with a two year renewal option) and there will be separation of policy from operations (except possibly in Oslo). Contracts will be gross. Norway's strong private bus industry, which still provides a large percentage of the public transport service, *is expected to be sufficiently competitive to achieve market prices on tendered services.*

9. FINLAND

Finland has a strong private bus industry. A phased national conversion to competitive tendering will begin in 1993. Policy will be separated from operations and contracts will be gross. *It is expected that the phased implementation will result in brisk competition.*

10. CANADA

The private bus industry in Canada is structured similarly to that of the US, with the exception that a higher percentage of school bus service is provided by private carriers (estimated at 50 percent). However, competitive tendering is limited to systems in smaller urban areas (Alberta, British Columbia, Northwest Territories, Ontario, Quebec and Saskatchewan) and to suburban systems in metropolitan Toronto. Contract duration tends to be five years or less and contracts are gross. Even so, contracts change hands from time to time in the smaller urban areas. *There is strong competition for the metropolitan Toronto contracts.*²²

11. NURSING A MARKET TO COMPETITIVENESS

All of the situations above involve nations in which the amount of competitive tendering is well within the capacity of the private bus industry to provide. Further, in each nation excluding Chile, competitive tendering has been phased in, so that the private bus industry was not faced with a large number of tenders at the same time. As a result, there has generally been a healthy level of competition, and public cost control objectives are being achieved. These two factors would seem to be prerequisites to a healthy degree of competition for competitively tendered services, and in each nation such healthy competition is occurring or is expected to occur once competitive tendering is implemented.

OVERSEAS EXPERIENCE IN COMPETITIVE TENDERING			
Country	Average Number of Tenders per RFT	Implementation of Competitive Tendering	Private Bus Industry of Sufficient Strength to Supply all Tendered Services?
Australia (NSW)	4 to 12	Phased	Yes
Canada	Not Available	Phased	Yes
Chile	Not Available	All at Once	Yes
Denmark	20	Phased	Yes
Finland	Planned	Phased	Yes
Norway	Planned	Phased	Yes
Sweden	Not Available	Phased	Yes
United States	4 to 5	Phased	Yes
South Africa	8	Phased	Yes

Excludes the United Kingdom (see Appendix 4)

These important prerequisite conditions to healthy competition were reversed in New Zealand. The private bus industry was far smaller than the competitive tendering market, and virtually all of the nation's subsidized public transport was tendered at the same time.²³ In considering strategies to make the New Zealand tendering market more competitive, fundamental principles should be considered.

11.1 The Purpose of Public Funding

The principal purpose of public financial involvement in public transport is to serve societal needs, such as controlling air pollution, traffic congestion, and energy consumption by encouraging the highest possible level of public transport ridership within the public funding constraints (assuming appropriate service and safety standards). This requires that, on any given service, public expenditure be minimized, so as to support the highest level of other public transport services. Moreover, a larger number of consumers will be attracted to public transport service if passenger fares are lower, rather than higher. Thus, cost minimization is a fundamental requirement for the achievement of public transport objectives.

11.2 Competition: The Most Reliable Cost Minimizing Mechanism

It is a well known fact that competitive discipline is the most reliable mechanism for cost minimization. It is sometimes suggested that "economies of scale" have a cost minimizing impact, but in the absence of competition there is no incentive for a producer to pass economies of scale on to consumers, much less to public agencies that fund consumer services. Examples abound of non-competitive enterprises, which should theoretically enjoy economies of scale, being extremely inefficient – exhibiting "diseconomies of scale."²⁴ If economies of scale, rather than competitive incentives, were the most reliable controller of costs, then the world would be rushing to create larger business organizations and new state owned enterprises, rather than the reverse. Two US examples further illustrate the point:

- The break-up of the American Telephone and Telegraph monopoly in the early 1980s opened the long distance (STD) telephone market to other competitors. The result has been far lower telephone rates, not to mention considerable product innovation.
- The majority of new job creation in the competitive US economy can be traced to the activity of *small, not large, business firms*. Indeed, the percentage of US employment attributable to the largest firms is declining.

11.3 The Complex Task of Market Development

It requires more than a recognition of the cost controlling nature of competition to develop a competitive supplier market. The difficulties of formerly communist nations in transitioning to competitive markets well illustrates the complexity of this task. It takes both time and enlightened public policy to nurse a non-competitive market to competitiveness. A sufficiently competitive market emerges only when a healthy number of suppliers is prepared to offer a particular product or service. A market, such as public transport, that relies on public subsidies must especially rely on public policies that encourage development of an appropriate market structure. The preceding review of the international experience suggests some important considerations and related recommendations. The order of their presentation represents their priority in the opinion of the authors.

A Competitive Market Requires Business Confidence: There must be a reputation on the part of tendering authorities for uncompromising objectivity. There must be no perception that some operators are favored over others in evaluation or that the tendering process has been designed to advantage particular operators. There is no size of supplier market that will overcome the perception that the tendering authorities are not acting in good faith. In a commercial market, voluntary private investment occurs only if there is business confidence. Two of the most important elements of business confidence are a predictable property rights system and faith in the business climate. Predictable property rights are a prerequisite because no one will invest, for example, if there is a perception that government might expropriate property or title to property

is unclear. The second issue, faith in the business climate, refers to the rules of the economy supporting the hope that investors will be able to make reasonable after tax returns on investment. In competitive tendering, competition will occur only if competitors have confidence in the market; confidence that their investment in the tendering process cannot be "expropriated" by a sham process and confidence that the "rules of the game" do not advantage particular competitors.

Recommendation #1:

Tendering authorities and all governmental agencies should "go out of their way" to guarantee the integrity and equity of the competitive tendering process, so that the desired additional investment in public transport is obtained.

Tender Sizes must not Exceed Competitive Market Capability: For a competitive tendering market to sufficiently develop, the maximum size of tender (whether a single tender, combined, composite, or group) must be limited to a size appropriate for the supplier market as it exists in the local community. In determining the maximum tender size, the number of probable competitors should be considered. In the United States, the supplier market is sufficiently strong that virtually any reasonably sized RFT is likely to seriously interest at least six potential tenderers (the average number of tenders actually submitted tends to be smaller). In Denmark, Australia, Chile, and South Africa an even larger number of tenders is routinely attracted. Even in London's model competitive tendering environment, the average of four to five tenders was achieved only after the former public bus monopoly was corporatised and divided into 11 separate entities, creating additional competitors (see Appendix 4). ***The competitive market is capable of adapting to tender sizes that are too small, but not capable of adapting to tender sizes that are too large*** (because of the overwhelming barriers to entry).

Recommendation #2:

A strict limit should be placed on the maximum size of tenders (whether single, combined, or group tenders), so that competition can be maximized and costs minimized. In larger urban regions, each individual tender should be small enough that it is within the reasonable capability at least five local operators. Such a guideline is likely to result in the level of competition similar to that being achieved in London and in the United States.

A Competitive Market Requires Competitors: For a market to be sufficiently competitive to supply enough service at truly competitive prices, there must be a sufficient number of competitors. Where a market structure is dominated by a single regional operator, and especially where such a dominant operator is publicly owned, development of a sufficiently competitive market is likely to be even further impeded.

In both London and Stockholm, the former public bus monopolies have or are being divided and corporatised.

Recommendation #3:

Each publicly owned public transport operator operating more than one transport operating facility should be divided and corporatised into separately owned entities, each with no more than one transport operating facility, to dilute excessive market power and maximize competition.

Vehicles: A Serious Barrier to Entry in a Developing Market: Acquisition of suitable vehicles can be a serious barrier to entry for companies whose size is small relative to the size of tenders. This is especially true in the present early stages of supplier market development. Moreover, the exclusive use by publicly owned operators of publicly purchased vehicles further disadvantages private competitors, making the achievement of a healthy supplier market even more remote.

Recommendation #4:

As a transitional strategy, consideration should be given to legislative and/or regulatory mechanisms that would permit vehicles previously purchased with public funding assistance to be leased to tenderers awarded contracts, so that new entrants and smaller operators are encouraged to become larger and more significant competitors.²⁵

END NOTES

1. The difficult fiscal situations faced by state and local governments in the United States has recently given rise to proposals to eliminate "earmarked taxes," making such funding available for a wider variety of public needs.
2. This occurs at virtually all levels of government involved in funding or overseeing public transport (federal, state and local). Analysts are increasingly characterizing America's political system as government by special interests with well financed groups (for example, labor unions, industry associations and environmental groups) obtaining legislation to their liking, or preventing that which is not to their liking through contributions to individual political campaigns. This type of political manipulation arises primarily from the decentralized and non-Parliamentary form of US governance. With no requirement to form and maintain "government" in the Parliamentary sense, political parties tend to be less unified, both in terms of philosophy and voting behavior. As a result, a political interest on the "left" may obtain political support from a legislator perceived to be on the "right," and vice versa (in both cases violating the wishes of their respective party leaderships).
3. For example, San Diego, Los Angeles, Chicago, Dallas, and Minneapolis-St Paul.
4. For example, Seattle (Snohomish County), Kansas City (Johnson County, Kansas), Sacramento (Yolo County), Atlanta (Cobb County), and Washington (Montgomery County, Maryland, Fairfax and Prince William Counties, Virginia).
5. For example, Denver (legislative mandate), Houston, Cincinnati, New Orleans and Miami. In the latter two cases, competitive tendering programs were financed by federal demonstration grants, in which the public transport authorities received discretionary capital funding for other projects as a inducement to try competitive tendering. In both cases the public transport authorities sought to take the inducement money and cancel competitive tendering. Both competitive tendering programs were later canceled, with a primary factor being the transit labor union opposition and their ability to influence the local political process.
6. The school bus industry is the largest surface passenger transport industry in the US. The school bus fleet is nearly 400,000 buses (public and private), compared to public transport's peak bus requirement of 43,000. On a daily basis, school buses carry 45 million passenger journeys, compared to 20 million for *all* public transport modes combined (public transport ridership also includes a large number of students who are transported to and from schools). Daily passenger kilometers are estimated at 750 million for school buses and 160 million for public transport. It is estimated that contracted school buses carry approximately the same number of daily passengers as public transport bus services and double the passenger miles.
7. Laidlaw Transit, which is headquartered in Canada.
8. Laidlaw Transit, Mayflower Contract Services, Ryder Transportation Services, National School Bus Company, Vancom, and Durham Transportation.

9. Generally door-to-door service for the transport disadvantaged, and senior citizens.
10. School bus companies have entered new metropolitan markets to submit tenders for fewer than 20.
11. Greyhound and Trailways. Trailways was acquired by Greyhound, whose tendered bus unit was purchased by Ryder.
12. The difficulty of attracting higher levels of public transport ridership is underscored by recent findings of the 1990 census. Despite an increase in public transport subsidies of more than 60 percent (inflation adjusted), public transport's work trip market share continued to decline. The percentage of Americans using public transport for the work trip declined 17 percent between 1980 and 1990. Among the nation's nearly 40 metropolitan areas of more than one million residents, public transport work trip market share declined by more than 30 percent in nearly half, and increased in less than 10 percent. The trend was no different with respect to metropolitan areas that built or expanded urban rail systems – *no metropolitan area building or expanding rail experienced an increase in public transport market share*. Particularly discouraging are the findings that work trip market share declined by 35 percent in Atlanta, despite expansion of its heavy rail system from 10 to 55 route kilometers, and by 33 percent in Portland (Oregon), despite opening a highly acclaimed light rail line in 1986.
13. A notable example is the case of the San Mateo County Transit District in suburban San Francisco, where a local charter and tour company that had not previously competed for tenders won a 60 bus contract. In this case, the buses were supplied by the public transport authority.
14. Usually through a nominally priced lease, such as US\$1.00 per year. Some tendering authorities charge a market rate for leased buses. The public policy effect of either practice is, however, the same, since the contract rate paid by the tendering authority to the operator will include reimbursement for the bus lease cost.
15. Development of a tender can be very expensive. Larger companies have reported tender development costs as high as NZ\$30,000 to NZ\$60,000.
16. Most US public transport buses are purchased with federal subsidy support. Federal guidelines require that buses be kept in use for 12 years.
17. This is not to suggest that the private bus industry is incapable of handling the volume of tendering. The limited level of competitive tendering in the US justifies no more than a concomitant organizational response on the part of the largest companies, so that an undue concentration of tenders within a short period of time can exceed the capabilities of the resources they have committed to this line of business. If competitive tendering were to expand greatly, the commitment of the large companies would expand correspondingly.
18. Price Waterhouse recently reported 60 percent savings in a large Los Angeles competitive tendering project. KPMG Peat Marwick has reported savings of 31 percent in the legislatively mandated competitively tendered Denver services. US cost savings

tend to be considerably higher than that in other nations (except Canada), because public transport cost escalation has been greater in the US.

19. There are proposals to increased competitive tendering to 100 percent of service and to permit HT to compete.

20. The law permitted contracts of up to 8 years, but HT chose to limit contract duration to 4 years, to maximize competition.

21. Unlike New Zealand and the UK, Santiago's deregulated environment did not permit public authorities to competitively tender for services not provided by the private operators. This was politically possible at least in part because of the high public transport demand, which results from the low automobile ownership percentage (60 percent of the trips within metropolitan Santiago are on public transport).

22. For example, a recent new contract attracted 5 tenderers.

23. It is important to contrast the New Zealand situation with that of the UK outside London. There, as in New Zealand, all subsidized services at once were competitively tendered at the same time. However the structure of competitive tendering was much different, largely because of the essential commercial nature of the UK public transport market. More than 70 percent of public transport services were registered for commercial operation, a substantially higher percentage than in New Zealand. The services that remained to be competitively tendered tended to be small in size, with a commercial market of more than sufficient size to handle the tendered services.

24. For example, diseconomies of scale are typical of the non-competitive portion (90 percent) of the US public transport industry. On average, public transport agencies operating more than 500 buses have 40 percent higher hourly costs than agencies operating 100 to 250 buses, and 75 percent higher hourly costs than agencies operating 25 to 50 buses.

25. While there may be insufficient publicly purchased vehicles to operate all competitively tendered services, tendering authorities could ration the publicly purchased vehicles to specific services, noting the availability of such vehicles in the corresponding RFTs.