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A study of a trusting partnership between government and industry

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ABSTRACT:

This paper is about reform to rural and regional bus services. The Stage 1 and 2 reforms were not done in true partnership with Industry and those experiences were published for T10. The Stage 3, Rural and Regional Reforms, were much closer to achieving trusting partnerships. The Stage 3 reforms also provide important examples and experiences in the way social exclusion can be addressed and how different funding options can be applied. The Government's School Student Travel Scheme (SSTS) is the framework for services in rural and regional areas. This paper covers all of the conference themes and contrasts the different approaches in Stage 3 to the earlier stages. The political environment has been changing in the NSW jurisdiction and this has had a big impact on the reform and partnership debate. Competition in rural and regional areas presents a different challenge than in urban areas and value for money and service planning have different dynamics. In most rural and regional areas cost recovery is very low and service design has been based on population rather than travel demand.

The Rural and Regional Reforms allowed Government to ensure greater community consultation in the planning of bus services and included performance reporting, which was previously lacking as a mechanism to determine renewal. The rollout of new contracts with accompanying explanatory notes was the work of a joint BusNSW/Government Taskforce and are key features of the Stage 3 reforms.

KEY WORDS: ***Contracting, planning, reforms, trusting partnerships and social exclusion.***

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1. Executive summary

Contract reform for bus services in rural and regional New South Wales, (NSW) was the final stage in a bus reform process commenced by the NSW Government in 2004 with the release of the Final Report of the Review of Bus Services in NSW, prepared by Barrie Unsworth (2004). The approach to the negotiations for new contracts, for a new funding model and for new planning guidelines was in stark contrast to the negotiations in the metropolitan and outer metropolitan areas of NSW. The experiences of those negotiations were outlined in "A journey from adversary to partnership bus reform in NSW 2008" written by Mellish, MacDonald, Dwyer, (2008).

The establishment, for rural and regional bus reform, of a joint, Ministry of Transport and Bus Industry Task Force and the use of expert advisors were the catalysts that created a partnership between Government and the Industry in the development of outcomes that would provide a lasting basis for rural and regional bus services.

The process allowed the Government's objectives of continuity of service, viability for operators and transparency in reporting to be achieved, whilst allowing the security of tenure and certainty of definition sought by the industry.

The outcomes included two new rural and regional bus service contracts (Type A contract and Type B contract), a standard set of terms and conditions applicable to both contracts and new and more equitable funding models for both contract types, based on agreed, actual costs, associated with the running of the bus services. Other innovations to come out of the partnership approach included the development of planning guidelines that gave certainty to school bus operators and country town operators in the planning of future services and the opportunity for the conversion and amalgamation of school bus services into a country town service.

The NSW Government, in support of the reform process, increased funding for bus operators to provide wages parity for rural bus drivers with their metropolitan bus drivers, retrospectively provided support funding for operators to meet new accreditation standards and agreed to fund new buses based on their age, which included air conditioning in all new buses.

The Taskforce, having settled on the format of the new contracts then embarked on the onerous task of rolling out seven hundred and sixty five (765) contracts to rural and regional operators throughout the width and breadth of NSW, within a six months period. The fact that this task was achieved with the Ministry of Transport and the Bus and Coach Association of NSW (BusNSW), representing the industry, providing some thirty three (33) seminars over this time to support the process is a testament to the success of the trusting partnership between Government and Industry.

2. Background

In 2003 the Minister for Transport Services, the Hon. Michael Costa, MLC, initiated a review of bus services in NSW, chaired by the Hon Barrie Unsworth (former Premier of NSW), with a view to improving the efficiency and reliability of bus services to better meet community needs and ensure value for money. There was a particular need to review arrangements for metropolitan operators, a number of whom were experiencing financial viability issues, which were threatening continuity of essential public services. The Review's focus also included bus services in outer metropolitan and rural and regional areas of NSW.

The Final Report of the Review of Bus Services in NSW prepared by Barrie Unsworth (2004) identified a number of deficiencies in the way bus services were contracted, planned and funded across the state. A joint BusNSW/Ministry of Transport Consultative Taskforce provided advice to the Government on a preferred way forward for metropolitan bus services, following which, Government endorsed the progressive roll-out of new contracts, funding and service planning arrangements in the Sydney metropolitan area from January 2005. This was followed by the introduction of similar, new arrangements in the outer-metropolitan areas of Newcastle, Wollongong, Central Coast, Lower Hunter and Blue Mountains. BusNSW maintains this process was not a "trusting partnership" and this was the subject of "A journey from adversary to partnership bus reform in NSW 2008" written by Mellish, MacDonald, Dwyer (2008).

In January 2006, the Minister for Transport and Deputy Premier, the Hon. John Watkins MP, established a joint Ministry of Transport/BCA Rural and Regional Bus Reform Consultative Taskforce (the Taskforce) to develop options, for Government's consideration, for improving bus service provision in rural and regional NSW. These were encapsulated in the Terms of Reference for the Rural and Regional Taskforce prepared by the NSW Ministry of Transport (2006).

The Minister also sought advice from the Taskforce on any interim measures that could be introduced prior to implementing reforms to assist the sustainability of the bus industry and help maintain essential public transport services in regional and rural areas.

2.1 The results of the NSW rural and regional reforms

Seven Hundred and sixty five (765) new contracts were issued to both school bus operators and route and school bus operators, between 1/7/2008 and 6/2/2009, which included a new funding model and changed service planning guidelines. This is a significant reduction in the number of contracts and more manageable for Government, who along with BusNSW are happy with the results, so far. The next phase, with all contracts now signed, is to ensure the contracts are functional and well understood by the industry, which will take some time, and on-going education and training.

To get the best value out of this paper, readers need to understand the two contract environments that emerged and how operators can have two different types of contracts in different parts of the state.

One contract type was previously known as a "non commercial" contract, which applied to single line of route school only services and which provided a gross cost model, based on the principle that one contract applied to each individual bus and the line of bus service undertaken. This type of contract became a Type A contract after the reforms, but was still based on the previous principle that individual bus categories (size of bus) are attached to individual contracted run (line of route). After Bus Reform it is now possible for an Operator to incorporate multiple Contract A line of route into one Type A contract. The funding model for Type A contracts is still based on each individual bus for a determined school service but the payments are aggregated for the purposes of the contract.

There are four categories of buses in the Type A contract. The categories are determined by the Authorised Adult Seating Capacity.

The second contract was previously called a "commercial contract" and its characteristics were different to the Type A contract. These contracts are now called Type B contracts and cover route and school services in accordance with agreed service planning guidelines, rather than specific routes designated by the Government. Type B contract operators are not paid as a gross costs model but based upon patronage and agreed fares for school children and agreed fares for adult and concessional passengers.

How these new contracts emerged out of the previous system and how many of the old principles have continued is a fascinating study in itself. One of the key features of the Type B contract systems is the operation of the SSTS explained below, and how funding for the Operator under SSTS helps to cross subsidize lowly patronized route services.

3. Bus services in country NSW

Bus services in rural and regional areas were previously provided for by some one thousand eight hundred and seventy nine (1,879) contracts for which, in 2006/07, Government payments totalled $287,000,000. The seven hundred and thirty seven (737) private operators, who hold these contracts, range from single bus/single contract holders operating in isolated areas, to companies with multiple contracts and large bus fleets operating in and between regional NSW towns and villages.

Under previous arrangements, school only services were provided under "non commercial" contracts, which required Operators to transport school students (free of charge) to school from more isolated areas where there are no other public transport services. Services in larger populated areas, such as regional centres, country towns and villages were operated under commercial contracts, which included integrated route services and school services. Operators were able to hold multiple contracts, which included a mixture of commercial and non commercial contracts.

The following table indicated the distribution of contracts across operators, prior to bus reform:

Contract type and Configuration	No. of operators
Single non commercial	392
Multiple non commercial contracts (2-16)	267
Single commercial contract	17
Multiple commercial contracts (2-4)	6
Commercial and non commercial contracts (ranging from 1+1 to 26 commercial and 54 non commercial)	55

Payments under previous non commercial contracts was made on the basis of a cost plus model (linked to the size of the bus, the number of days operated and an agreed number of kilometres travelled). Operators with previous commercial contracts were reimbursed through the fare-box and via Government payments for SSTS and half fare concession reimbursement.

Previous work, in particular the Review of Bus Services in NSW prepared by Barrie Unsworth (2004), had identified perceived problems for the commercial contracts with this method of payment and which needed to be addressed in the reforms.

It was relatively clear from the start of the reform process that the gross cost contract model for non commercial contracts was still the most appropriate for the dedicated school bus services, ie. the Government pays the cost of operating a service and includes a margin for the operators' effort and investment.

However, for the commercial contract reforms there were considerable differences between Government and BusNSW on the best funding model. There were also differences within Government as well as within the Industry as to the best method of achieving viable contracts. Sections of Treasury favoured a gross cost style funding model wherein the Government controlled the service planning and reimbursed efficient costs and controlled the operators' margins.

4. Free school travel is backbone of NSW country bus services

The NSW Government is committed to providing support for students to access education. The SSTS is a key component of this.

The SSTS provides subsidised travel for eligible school students on rail, bus, ferry and long distance coaches. A subsidy is also available for transport to and from school in private vehicles in areas where there is no public transport. The Private Vehicle Conveyance Scheme (PVC) subsidises parents, who do not have access to school bus services in remote rural areas.

The Ministry of Transport manages the SSTS through its regional offices located in Newcastle and Wollongong. Transport operators issue passes to eligible students, and schools also play an important role in verifying students' eligibility and liaising with transport providers.

The payments to operators for providing school services in rural and regional areas cross subsidize scheduled route services to the public. This has a major influence on service design and funding models discussed later, as most non school services (scheduled route services) are poorly patronized because of low densities and traditional car use supported by the availability of free parking etc.

The social benefit of using school bus funding to underwrite minimum service levels is discussed later.

Despite reassuring the community and bus operators that there would be no change to the Government's policy on free school travel, the Government made an announcement in December 2008 proposing changes to the SSTS.

Prior to December 2008 there was a lot of political unrest in NSW resulting in the Premier being deposed by his own Party, and the Treasurer and Transport Minister retiring from politics. With a new Premier, a new Transport Minister and a new Director General in charge of the Premier's Department the failure to franchise sections of the State's electricity assets caused a major budget shortfall.

To offset this problem and at the height of the political unrest the NSW Government turned to save money on the cost of providing free school travel. Various options were proposed, including asking the parents for a co-contribution.

The Taskforce and other Ministry of Transport staff, involved in the reform process, were not involved in this political announcement, but had to hastily try to negotiate and cobble together side letters to give effect to the Government's new decision, while at the same time protect operators with transition arrangements to avoid significant impacts for Operators' revenue, which may have resulted from dramatic reductions in eligible school students and hence reduced services. Many parents, experiencing hard financial times in the rural areas from drought were determined not to pay the contribution which would have significantly reduced the transport task for Operators and affect their ability to run other cross subsidized services.

Because of the groundswell of opposition to the changes to the SSTS, the Government reversed its decision and the work on the side letters scrapped.

The uncertainty created by the Government's decision to seek a parent contribution for the SSTS destabilised the trusting relationship that had been developed during the reform process and threatened the roll-out of new contracts which was ongoing at the time.

5. Central agency – political climate and regulatory environment

The Minister, who initiated the Bus Reform process in 2004 was no longer the Minister when the rural and regional reform stage was due to be addressed. The role of the Director General of the Ministry of Transport had also changed a number of times since the reform legislation. The role of the Director General was critical to the creation of the trusting partnership for which an understanding of the benefits of partnership with industry is an essential requirement.

BusNSW spent a lot of energy identifying the benefits of a partnership approach and contrasting this with the experience from the metropolitan and outer metropolitan reforms.

One of the first tasks of the Director General was to outline at an industry conference the broad timelines and approach of the Government to regional and rural reforms.

Because of the Government's preferred bus reform funding model for metropolitan bus services was considerably different to the arrangements existing in country NSW, it was essential for the Taskforce to agree to go through a risk analysis and assessment of the planning, funding and contracting options that best met with the Government's objectives.

There was a lot of pressure and left over sentiment from the metropolitan reforms to introduce a cost plus style contract environment in regional NSW with the Ministry of Transport undertaking the planning of services in country towns as they now do with metropolitan services.

It took some time and a lot of meetings for the Ministry to realise that they did not have the resources or the expertise to plan services in the 70 plus country towns, nor the ability to efficiently utilise/integrate the school bus services that are required under the SSTS.

Considerable effort was put into analysing service levels, patronage and revenue in country towns. A study was also conducted in the Tamworth (NSW country town population approx. 32,000) district to compare a theoretical new timetable bus network with what existed prior to the reforms. In metropolitan areas travel demand analysis was undertaken to assist with developing strategic corridors and to design services. This approach was not suitable for rural and regional areas. The results of the Tamworth trial showed that if you started a planning exercise with a fresh sheet of paper some initial savings and service improvements could be made, however the cost savings were small and the transition requirements long. The Ministry also realised that maintaining and improving networks was better left to the local operator.

The Ministry eventually accepted that there needed to be sufficient financial flexibility and incentives built into the funding model to enable the rural and regional operator to plan services which utilized the SSTS funding to subsidize the route service system.

The Consultants appointed to assist the Taskforce then focused on how to ensure value for money, a Government objective, if the funding for country town services was to be fare box driven (form of net cost contract) and that the existing fare schedules and SSTS payment tables were not delivering abnormal returns to operators.

To overcome this issue the country town operators provided accounts to the Government to demonstrate that they were not making excessive profits and that they needed the flexibility of planning (within Government guidelines) to be able to efficiently integrate school and non school services. The Government's adviser, Ernst and Young, were particularly important in this regard, and were able to explain to Government the risks and benefits of the proposed net cost funding model, even though it was basically against the principles followed in the metropolitan reforms.

Extensive work was needed to analyse the differences between the two "commercial" funding models, which eventually showed the net cost model was more efficient than the gross cost model in the NSW country town environment. The two reasons for this were the better utilisation of the fleet and the benefits of allowing the Operator and not the Government to undertake the service planning tasks (within guidelines). The incentive is with the country operators to minimise costs and attract more passengers, rather than simply run extra kilometres.

A critical factor in the partnership and negotiation was the industry associations willingness to make available the advice and workings of its key financial and legal advisers. BusNSW was confident that industry benchmarks were more appropriate and then negotiating on individual costs and margins. BusNSW put a proposition to the Director General that if the Government contributed towards the Industry's legal and accounting costs then the advices and reports generated would be made available to the Industry as a whole, not just BusNSW members. This approach helped save Government considerable resources. In contrast the metropolitan reforms saw the Government remunerate individual operators for large legal and accounting costs incurred by individual operators rather than through an industry wide approach.

6. Negotiated contracts rather than tendering

Dedicated school bus services that did not form as part of a school and route network were generally owned by many small business people who had acquired the business on the expectation of ongoing contract renewal rights. Even though this was technically not the case the Government's behaviour over the past fifteen (15) years had created the market expectation for 'grandfather rights'. Under the old contracts continuing rights were very important as an operator had to hold a contract at least two terms to be able to get an adequate return on investment.

The Government did not have an appetite to require these operators compete for their contracts as they were operating in drought affected remote communities and their existing rates of revenue which were developed by the Government were based on estimated industry efficient costs for service.

The decision to negotiate new contracts rather than going to tender was therefore not a difficult one for the Government, because of the diverse nature of the services provided in country towns and remote locations and the political damage tendering could do by disadvantaging small businesses and remote communities.

The Government was not looking for a dispute with operators who could lose their businesses if tendering was introduced. The operation of the existing contract and funding model meant some operators would have not received an adequate return on investment if tendering was introduced. This factor was recognised later in the provision of transition funding to cover inadequacies of the previous funding system.

Government was not prepared to be confronted with political pressure from small business, school, bus operators, who despite being efficient and meeting all the contractual requirements would have lost their businesses.

At the public meetings this became evident to the Government who moved very quickly to reassure operators that everyone who wanted to stay in the Industry was able to do so. Basically this meant that there was no forced rationalisation or tendering, and therefore the value for money and efficiency (competition principles) objectives needed to be built into the contract and next round contract negotiations.

It was, in fact, BusNSW who was more proactive in promoting rationalisation, so that further reforms would not be needed in a relatively short time if new contracts did not deliver efficiencies.

7. The taskforce approach

The Taskforce established working groups, comprising nominated representatives from the Ministry of Transport and the Bus Industry, to progress consideration of funding, contracting and service planning issues and options. The Ministry of Transport assisted with the provision of legal, financial and service planning advisers to supplement expertise available on the Taskforce.

The Taskforce, through the working groups and with the help of its expert advisers, drew on a range of information to inform its deliberations including:

- a confidential survey of all non commercial operators (with a survey return rate of 30%) to better understand operating and capital costs and revenues;
- a confidential financial survey of 15 commercial operators to better understand their financial position and annual financial results**;**
- detailed analysis of daily diaries, recording operating information over a 9 month period, kept by 14 operators in the Tamworth area;
- a telephone survey involving 1,000 randomly selected residents over a two week period to ascertain community travel patterns and needs in the Tamworth area;
- analysis of existing policies and procedures governing bus service provision in rural and regional areas;
- other relevant information including Australian Bureau of Statistics (ABS) census data, patronage data across a broad selection of towns, information from relevant industry suppliers and regional fuel pricing data; and
- forums with bus operators and community groups at Tamworth, Mudgee, Nowra and Sydney, as well as involvement in conference sessions at BusNSW conferences and other operator meetings during 2006 and 2007.

A key input to the deliberations of the Taskforce was the financial analysis undertaken by Ernst and Young, in conjunction with Pitcher Partners, who were both retained as financial advisers to the project.

The Taskforce presented an interim report to the Minister in August 2007. As well as identifying a range of measures to ensure sustainability of the rural and regional bus industry in the short term, the report recommended that any proposed new arrangements, including transition strategies, should be finalised and submitted for Government consideration by November 2007, ready for progressive roll-out, subject to Government approval, from the first half of 2008.

The consultative process of the Working Groups resulted in a very high level of agreement between the Ministry of Transport and the Bus Industry on preferred options for the future contracting, funding and planning of bus services in rural and regional NSW. The Report, Rural and Regional Bus Reform, Ministry/BCA Consultative Taskforce Report prepared by the Ministry of Transport (2006) presented the Taskforce's key findings/observations and recommendations to Government for implementation.

The issue of the cost for operators of increasing safety and other compliance obligations was also raised. While this was not a direct consequence of the proposed reforms, it was an issue that nevertheless had to be addressed. New Accreditation standards and external audit regime had been rolled out within the 12 months prior to the commencement of proposed new contracts.

Those issues on which the Taskforce was not able to reach agreement were also highlighted and funding impacts of the reform package were presented.

Taskforce work recommendations presented to the Minister in 2007 included:

- trial three funding model options;
- review existing Minimum Service Level Policy;
- develop a revised contract, incorporating the preferred funding and service planning approaches;
- a simplified revised contract to be adopted for single, isolated bus operators;
- a service planning trial to be undertaken in the Tamworth region;
- relief from increasing fuel prices to be made available to commercial operators through indexation payments;
- the Minister to consider interim relief for non commercial operators for increased fuel consumption provided the industry is able to quantify the impact of additional consumption;
- relief from average age provisions to be provided for a period of up to 3 years for smaller operators who can average bus age over no more than 2 vehicles; and
- relief from decreased contract payments arising from a decrease in contract category of non commercial contract holders.

8. Key issues/outcomes

8.1 New contract, schedules and explanatory notes

The contracting arrangements governing the provision of school only and school/regular scheduled route services in rural and regional NSW have been in place since the early 1990s following the introduction of the Passenger Transport Act 1990. School only services were contracted as non commercial contracts and the scheduled route and school services were badged as commercial contracts.

As was the case with contracts previously in place in metropolitan and outer metropolitan areas, there was recognition that these arrangements needed to be revisited and updated.

Key issues for both types of contracts include: few measurable and enforceable performance standards; no graduated approach to contract breaches; limited reporting requirements; and very limited means of ensuring continuity of service.

A particular concern with non commercial contracting arrangements was the approach to categorizing buses (which determines what size bus an operator was required to purchase which in turn was linked to payments) was outdated – the categories used under the contract no longer reflected the actual sizes of buses being manufactured and in use. An additional problem was that an operator could purchase a twelve (12) seat bus (the lower end of the range for category 2) but would be paid as if a 25 seat bus was being operated (the upper end of the range for a category 2). This meant that Government was, in some cases, paying for, but not getting, maximum capacity for that category of bus.

Non commercial operators also had the uncertainty of a contract which was only for five years despite the considerable upfront investment they had to make to run their businesses. Additionally, to assist in the implementation of an anticipated new contractual regime, interim contracts were in place in many parts of NSW, creating considerable uncertainty for smaller operators. These interim contracts allowed for termination after twelve (12) months by the Director General giving three (3) months notice.

Under commercial contracts there were limitations arising from unclear renewal provisions, no requirements for neighbouring operators to work cooperatively, rigid minimum service levels which had not been updated and which restricted a more flexible approach to service planning and delivery, and a lack of community input to service reviews and changes.

A further anomaly was the lack of consistency between Government reimbursements for concessions available on metropolitan and outer metropolitan regular route bus services and the much more limited range of reimbursements that could be accessed on similar services in rural and regional areas. In this regard, it should be noted that in response to the Review of Bus Services in NSW prepared by Barrie Unsworth (2004), Government gave in principle support to the provision of a form of Pensioner Excursion Ticket (PET) to rural and regional communities provided it could be rolled out on a cost neutral basis.

Maximum fare scales applicable to regular passengers needed to be de-linked from shadow fares payable for school student transport to minimize the impact on operator viability of any future decisions that may be made by the Independent Pricing and Regulatory Tribunal (IPART) to harmonies fares in rural and regional areas.

A key concern for Government was the need to be able to ensure continuity of services in the event of an emergency or other occurrence which might prevent an operator from providing the contracted services. This was particularly important in rural and regional NSW where many families were dependent on the school bus transporting their children, often over long distances, to school each week day. But under current contracting arrangements the Director General was not able to ensure continuity of service should an emergency situation cause services to stop. It was acknowledged that such occurrences would be rare and that in most instances other rural and regional operators would be able to assist by providing spare buses. However the Government was keen to ensure greater certainty on this issue.

A final problem with the previous contracting arrangements was the sheer number of contracts – primarily as a result of each school bus route being the subject of a separate contract under the existing non commercial model – and the administrative inefficiencies created for both operators and the Ministry of Transport.

The Taskforce recommended the introduction of three contract types. A standard set of provisions that apply to all operators, a contract for operators under the gross cost model, and a contract for operators under the net cost model. These were written with the plain English objectives in mind. The main features are:

8.1.1 Standard terms and conditions

7 year term;

Provision of regular bus services;

Change events and changes to services;

Cure regime for breach notice;

Emergencies services;

Financial Viability Review;

Regular review of services;

Reporting and performance requirements;

Contract Management Plan to achieve KPIs and meet contract obligations; and

Dispute resolution.

8.1.2 Contract "A" terms

Changes to services initiated by the Operator;

Service review every 12 months to test category shift;

Replacement of buses for age or change in category provided maximum seating capacity for the relevant category, in line with funding provided;

Right of first refusal for seven (7) years;

Assignment of contracts;

Schedule 4 Funding Model – based on the category of bus, the age of the bus and kilometres travelled;

Service Planning Guidelines setting out criteria for establishing new services and service design principles and conversion to Type B;

Fleet procurement guidelines;

Reporting;

KPIs;

Cooperation with neighbouring operators;

Multiple lines of route under a single contract;

Recognise economies of scale/reduce administrative payments for contracts >10 lines of route; and

Bus categories updated to reflect bus models available and in use.

8.1.3 Contract "B" terms

New planning requirements:

Greater flexibility with processes for service design and implementation that safeguard the community, including community consultation;

Ability to change services at Director General's request;

Three year service reviews;

Network review initiated by the Director General;

Bus age and bus replacement requirements;

Amalgamation of services and conversions linking Type A with Type B contracts;

Right of first refusal;

KPIs;

Service Planning Guidelines which identify country town services, village to town services, town to town services and school services;

Planning principles which set out service design and coverage, service frequency and span of hours and allocation of new school students;

Reporting;

Coordination of services with neighbouring operators;

Concessions consistent with metropolitan and outer metropolitan areas – including Pensioner Excursion Ticket (called a RED ticket);

Continuity of service: assured by gaining access to Emergency Bus Fleet;

Profit sharing arrangements above a certain threshold; and

Contract management plan.

8.2 Funding

Before bus reform, non commercial contract holders were funded on the basis of the gross costs associated with carrying an identified number of students over a pre-defined route/set of kilometres in a suitably sized bus. This model was developed by PriceWaterhouseCoopers (PWC) when non commercial contracts were first introduced and is known as the 'PWC model'.

The PWC model's limitations, included:

- it applied to owner/operators who used one bus to service a particular school route and also applied to large operators who held multiple non commercial contracts (and commercial contracts) and operate large fleets;
- it did not accurately estimate the user cost of capital. The amount of the depreciation allowance and the return on investment was calculated on a multiple, year moving, average of value of the bus fleet, rather than on the original cost of the bus. Since the market prices of buses had been increasing significantly over time, operators of newer buses had been significantly under-funded for their capital costs and operators of older buses had been significantly over-funded for their capital costs;
- it did not adequately compensate operators for costs incurred and operators have had to use capital and margin payments to cover actual operating and compliance costs;
- it did not provide for a minimum of driver hours for which operators will be funded which was exacerbating the problem of attracting and retaining drivers in a tight employment market for what can be less than an hour's work in the morning and similar in the afternoon;
- there was no recognition of economies of scale for those larger operators with multiple non commercial contracts; and
- the annual indexation process applied generalized, rather than industry specific inflators, which did not necessarily reflect actual cost movements and operator returns on investment, were interrelated to the capital payment and nominal return calculations.

The Commercial contract had limitations, which included:

- operators were mainly funded through the Scheme on the basis of a capacity payment, set up originally and attributed to an estimate of the numbers of school children carried, (ie. 79% of passes on issue). This was the main source of income;
- out of this funding operators were expected to, not only transport school children within their contract areas, but also required to provide minimum levels of route services for the general population and to plan their services to meet the requirements of the Minimum Service Level Policy, which stipulated service frequency and network coverage based on population and walking distance criteria;
- fare increases were linked to an annual review of the Bus Industry Cost Index by IPART which applied generalized inflators to cost categories associated with rural and regional bus service provision.

Further problems associated with type of funding model included:

- it was designed originally to deal with commercial operators without any special consideration for the rural and regional environment and only applied to rural and regional 'commercial' operators;

- it funded commercial operators on the basis of a proxy for the number of passengers they carried;
- it required commercial operators to use funding to cross subsidize their provision of minimum service levels to the general public in their contract area, but the extent of this cross subsidy and its adequacy or otherwise was unknown; and
- it determines fare increases on the basis of generalized inflators which were not necessarily a good proxy for the real cost increases experienced by rural and regional bus operators.

8.3 There are two types of funding models agreed and now in place

Type A contract funding (gross cost) is calculated based on the age and category of the bus, the kilometres and hours and number of days an operator runs the services. Operators' margins are based on a return on investment and a percentage of agreed costs.

Because of the transition from one funding model to another a number of safety net and transitional provisions have also been implemented. These transition provisions relate to changing the rules and categories of the bus and changing the method of calculating the capital component. There are efficiency savings deducted from operator payments where operators get economies of scale from holding 10 or more type runs. There is a five per centum (5%) efficiency savings adjustment in this circumstance.

The Taskforce proposes that, under new funding arrangements for Contract A's, Government should continue to wear most of the planning risk, reimbursing operators for most of the costs of providing the services (as currently happens) but using a funding formula that:

- includes more up to date estimates of the major costs of service delivery;
- uses a more accurate method to estimate capital costs;
- uses more appropriate indexes to estimate costs in future years; and
- provides reasonable returns to the service providers.

Under this approach, operators would still bear the risks of declining student numbers which could mean a reduction in payments or in the worst case, loss of contract or no second contract.

Key aspects of this proposed approach to funding services under Type A contracts are discussed below:

Depreciation:

The PWC model determined depreciation on the basis of a rolling average bus price for each bus category. All buses in a particular category received the same amount of depreciation, regardless of bus age. This approach also meant that over time capital payments increased as new vehicle prices increased (despite the value of the bus decreasing). In the early years or when a bus was first purchased, operators were under funded.

Under the existing non commercial contract, buses had to be replaced before they exceeded the allowable average age. Larger operators were able to retain buses for a longer period of time as a result of allowable bus age being averaged over the fleet. However, single bus operators who had to replace their bus at a younger age could fail to recoup the full bus cost.

Under the proposed arrangements under Type A contracts, bus reform contracts operators will be funded in line with accepted practice in relation to depreciation - on a straight line basis, based on bus price in the year of purchase, with remuneration of capital costs ceasing once the bus has been fully depreciated.

Other proposed features:

i) revised operating costs, recognising increases in expenses incurred in tyres; repairs and maintenance (including repairs and maintenance of air-conditioning on buses); vehicle registration and insurance; cleaning costs; contract administration and compliance;
ii) revised capital costs, with both depreciation and Weighted Average Cost of Capital paid in line with actual costs incurred by the operator;
iii) improved method of calculating returns/margins to operators;
iv) minimum payment for 2 hours driving /day;
v) resetting of contract kilometres where appropriate, but in limited circumstances;
vi) reduction in administration payments for those operators with > 10 lines of route, recognising economies of scale;
vii) provision of air-conditioning in all new buses and seat belts in all new Category 1 buses;
viii) transition arrangement to act as a safety net and to reflect inadequate finding for buses under the previous model; and
ix) revised indexation approach for future cost increases – applying industry specific rather than generalised inflators.

Type B contract funding (net cost/fare box retained) is based on the operator receiving a payment from the Government for each school student for which services have to be provided. The student payment is based on the distance the student travels as reflected by the bus pass issued to the student upon application. The Type B contract operator also retains any fare box revenue from scheduled route services and receives a reimbursement of the revenue foregone for issuing concession fares determined by the Government. The concession re-imbursement has been complicated because of the introduction of a new excursion ticket [the Regional Excursion Daily (RED)], and the need to establish safety nets for operators' revenue because of the free travel available for subsequent trips within the defined excursion ticket valid period.

The number of eligible students for which an operator is paid is therefore an important consideration particularly when students come and go part way through a year. Systems have been developed to determine what proportion of a semester the student needs to be available for travel in order for the operator to receive payment. This is based on the operator's commitment to provide adequate capacity for the peak student load at any one time and the acknowledgement it takes time to add/delete services.

There have been a number of other changes relating to the operator payments. These include migrating from payment in advance to payment in arrears, and converting to 12 monthly payments per annum. Previously non commercial operators received 11 p.a. and commercial operators 10 p.a.

The Taskforce proposed that under revised funding arrangements for Type B contract operators would continue to be responsible for service planning/network design to meet the agreed Service Planning Guidelines, and so would accept any patronage, revenue and cost risks associated with inefficient timetables and routes.

Under this model, Government would provide Type B contract operators with a level of funding sufficient for them to be able to cover the costs of providing the required transport services in their contract areas and earn an acceptable rate of return on their investment.

A key consideration in arriving at this position was analysis of results from a financial survey of 13 commercial operators (45% of all rural and regional commercial operators, holding 66% of rural and regional commercial contracts and 54% of non commercial contracts held by rural and regional commercial operators). Another key consideration was the cost to Government of planning all rural and regional bus services, and identifying the appropriate kilometres to run.

This commercial operator survey identified a wide range of earnings, profitability and returns across the regional operations surveyed. Because the provision of rural and regional bus services is a highly capital intensive business, operators' investment in fleets, land, buildings and other equipment was considered alongside earnings. Based on this analysis, it was concluded that the profitability of rural and regional operators varies significantly across regions and most operators, but not all operators, generating reasonable and not excessive rates of return. It was evidenced from the survey that there were some inconsistencies in the application of fares used to determine school student subsidy payable and that this may have had an impact. The Taskforce supported further analysis of this to ensure there was no impact on operators' viability.

It was also agreed by the Taskforce that rural and regional operators were best placed to undertake the planning and design of their service networks, incorporating both school and route services, and to derive efficiencies from this process.

On this basis and given the lack of 'super profits' identified, it was agreed that the existing 'commercial' funding model (with payments to operators derived from the fare-box, SSTS and concession reimbursement) updated as necessary, factoring in the provision of PET and other concession arrangements, and with the addition of some key safeguards - provided the most suitable model for moving forward.

It was also acknowledged that in some situations where a Type B contract holder held a number of Type A contracts, there might be synergies and economies of scale for both the operator and the Government, if the Type A contracts were amalgamated into, and paid on the same basis as, the Type B contract. This approach was suggested only on the basis it could be demonstrated that there were cost savings to Government or only a marginal increase in payments to an individual operator (recognising that there was a greater risk to the operator in providing these services under the Type B contract funding model).

BusNSW has throughout the Taskforce process indicated the need to agree on set criteria to be used for determining the appropriate shadow fare applicable to each student. During the process the existing fare inconsistencies were highlighted. These anomalies would then be addressed with the roll-out of new contracts and in conjunction with the conversion of Type A contracts.

Consolidation of contracts would have administrative benefits as it would result in less contracts and it would enable the operator to incorporate the school only services into the rest of the service network and maximise efficiencies.

To assist operators to convert Type A contracts in this way, it was agreed that there would be a three year transitional funding arrangement under the initial contract. This transitional arrangement provided funding as calculated under Type A contract for the first twelve months, then 50% of the funding difference between the Type A contract funding and Type B contract funding for the next two years, then moving to 100% of Type B contract funding in the next year. The Government would benefit by 100% of the savings on an ongoing basis after the 3 year phase for conversions.

To encourage operators to convert any Type A contract purchased in the future it was agreed that for the first three years, operators would be paid under the Type A contract funding model (retaining any efficiency savings for this period of time), after which the new funding arrangements would commence and efficiencies would flow to Government.

In summary, key features of the proposed approach to funding Type B contracts include:

i) updated shadow fares and indexation model that includes provision for air-conditioning in buses and costs of compliance arising from the Bus Operator Accreditation Scheme and other Government mandated requirements (such as drug and alcohol testing). *Note: The cost of compliance issue is discussed further in sections in 7 (Other Initiatives);*

ii) RED reimbursement on the basis that total concession revenue received through the fare-box and via Government subsidies prior to the introduction of RED remains the same, indexed annually in line with cost increases determined through the updated indexation model. To provide incentives for Operators to grow RED patronage it has been agreed that Government reimbursement will increase by half the demonstrated patronage increase. For example, if an operator increases RED patronage by 2% in a given year, concession reimbursement payments for that year would increase by 1%;

iii) provision of detailed financial information of the operator on an annual basis;

iv) clear set of rules on contract conversion and/or acquisitions to consolidate services to gain efficiencies, including fares to apply for these services; and

v) profit sharing arrangements when operators earn excessive profits. Under the profit sharing arrangement the operator returns to the Government 50% of any "super" profits earned during a financial year.

The profit sharing calculation is calculated by reference to the operator's Earnings Before Income Tax Depreciation and Amortisation (EBITDA) in the 2007/2008 year. This income base is to be indexed each year and then compared to the actual earnings of the operator.

The calculation of profit share is as follows:
[Actual Earnings – (2007/2008 earnings (indexed) x 1.5)] x .5

8.4 Fleet replacement

A major consideration for the Government during the bus reform process was to determine whether the average age for buses should be lower than the existing average age. Work was done to establish if the fleet was suitable for the purpose and if it was generally in compliance with the age parameters under the previous contract regime.

It was eventually agreed that the bus replacement program would not extend or reduce the overall state average fleet age (eight (8) years for category one and two and twelve (12) years for category three and four). However some changes were needed to accommodate effective fleet replacement strategies for operators that have both Type A contract and Type B contract fleets. The method of calculation of the average age limits for the A fleet and the B fleet are different. This is an anomaly yet to be corrected. The inequity means that theoretically the same bus doing the same job but with different Type A contract or B contract operators would have to be replaced at different times.

Because of operators having mixed Type A and Type B contract fleets a maximum age had to be introduced for the Type A contract fleet.

For Type A contracts, one of the concerns emerging after the reforms is the process of replacing a bus if it has not reached the Ministry's expected useful life. The Government's funding is based on robust bus specifications guaranteeing the bus would have a useful life of 20 years (13 years for mini buses). Business rules are developed where an operator can seek early replacement otherwise they have to wait until the maximum or average age is triggered.

Replacing a bus is also complicated if your student numbers increase or decrease affecting the contracted bus category.

Type B contract buses can be bought and sold at any time as long as the operator meets the contract average age requirements (12 years for large buses and 8 years for small buses).

8.5 Category shift Type A contract

There are strengths and also weaknesses in adopting the standard four bus categories when determining capital payments under the Type A contract funding model. On the one hand it avoids the administration of attracting a capital value/payment to an individual bus (1,800 of them in all various sizes) but on the other hand it requires working business rules on how to accommodate:

- changes to student numbers; and
- determining the most suitable replacement bus.

This is an area of bus reform that was less developed at the time of contract rollout – despite BusNSW putting forward business rules, before the roll-out was completed.

The concept of a contract bus category being different to a payment bus category is proving difficult for the Ministry to administer.

If student numbers decrease it may be cheaper for the Government to keep paying for the existing larger bus, than pay for a replacement smaller bus.

If student numbers go up and exceed the bus capacity another set of procedures need to be followed to determine how best to carry the students.

Despite these problems the decision to group buses into categories and standardise the capital funding is considered worthwhile.

These factors together with the varying methods of average age calculation are altering market behaviour, including:

- less incentive to buy a second hand bus;
- greater incentive to replace the bus as soon as possible; and
- valuation and negotiation methods when buying and selling bus contracts/licences.

8.6 Asset ownership

At the start of the reform process the Government was keen to ensure that they had control over the new buses they funded. Under new metropolitan/outer metropolitan bus contracts, the Director General has security over new bus assets acquired under the contract. This ensures that in the event of an operator being unable to provide the contracted services, a replacement operator is able to step in and is assured access to (at least some of) the fleet to ensure continuity of service.

The Taskforce agreed that there was less risk of service disruptions in rural and regional areas due to the generally smaller fleet sizes and the benefits of Government contracts. In these circumstances, where an operator is unable to provide the services, access to the fleet is less of an issue, as other operators will generally be able to assist with spare buses.

In this regard, the emergency service provisions of the Type B contract - which require operators to use their best endeavours to make buses available at the Director General’s request in the event of an emergency affecting other operators – provide further assurances that operators will cooperate and assist in this way.

However the Ministry’s view is that this mechanism may not be sufficient to guarantee continuity of service where larger fleets are concerned. BusNSW disagreed and pointed to the dramatically different funding model and risk allocation, ie. the Type B contract requires the operator to replace and maintain the fleet, where in the metropolitan contracts the Government funds are applied to each individual bus replacement.

The Ministry therefore proposed that, for any operator operating 60 or more buses for the purpose of a rural and regional bus service contract, a range of security documents (general financier direct agreement; deed of charge; and/or a bus lease direct agreement) should be required as part of the contract. BusNSW’s view was that such requirements did not provide the continuity of service sought by the Ministry of Transport.

BusNSW contended that there were a comprehensive range of safeguards built in to the contract to address the continuity of service risk. These included:

- extensive reporting financial and operational with KPIs;
- contract management plans;
- regular service reviews;
- financial viability provisions;

- emergency bus fleet provisions;
- complaints mechanisms; and
- cure regimes.

Furthermore, the metropolitan and outer metropolitan funding model identifies and funds every individual bus, which makes procurement of security more administratively feasible with the Ministry determining the appropriate size of fleet. In rural and regional areas Type B contract operators have to provide the appropriate fleet with no specific bus capital funding provided for the Type B contract operators.

The BusNSW views were finally accepted.

8.7 New service planning guidelines

The Service Planning Guidelines for rural and regional bus services are intended to provide guidance in the design and operation of bus services in rural and regional NSW.

These Service Planning Guidelines updated the previous Minimum Service Level Policy for non-Urban Regions and need to be read in conjunction with the body of the contract to which they are attached as a schedule.

In recognition of changes that occur in the population of the community serviced, or other circumstances specific to rural and regional NSW, the Service Planning Guidelines will be reviewed annually by a joint Ministry of Transport/BusNSW Working Group.

In rural and regional NSW, the Government is committed to the provision of safe and reliable bus services that:

- are organised with passenger need as a key consideration;
- reflect and are responsive to local patterns of travel demand, taking into account the needs of those who are most reliant on public transport; and
- are co-ordinated with other services in the area to best meet demand within available resources.

Service levels are based around the concept of a country town defined by the Director General of Transport based upon population data determined by ABS Census Data in relation to the urban centre's/locality's boundaries and populations. Where the data reveals a change of population that affects the service level for the Contract Service Region or village to town services, a review of service levels must occur within 12 months after the data from the Census is released.

The Service Planning Guidelines cover rural and regional bus services including:

- town services;
- village to town services;
- town to town services; and
- school service

8.8 Drivers wage parity

Under new contracting arrangements, drivers employed by private operators in metropolitan and outer metropolitan areas were granted a pay increase of 7% through the bus reform allowance, giving them improved parity with drivers employed by State Transit Authority. The allowance was seen as a means of assisting private operators to overcome the difficulties they were experiencing in attracting and retaining drivers.

It also recognised the additional tasks to be performed by drivers arising from:

- trialling Tcard for school students;
- fare harmonisation (ie. new fares);

- introduction of PET to private buses; and
- the roll-out of integrated networks resulting in changes to bus services.

There was a parity issue with drivers in rural and regional areas. Combined with other features of driving buses in rural and regional areas – such as the increased incidence of split shifts (to meet school peaks) and absence of casual work in school holidays – this was exacerbating the driver shortage problem.

The Government approved a seven per centum (7%) wage increase by extending the bus industry allowance into a wage increase for rural and regional bus drivers, who now have parity with the metropolitan bus drivers.

8.9 New accreditation standards

Since the introduction of contracting arrangements in the early 1990s the obligations on operators to comply with a range of safety related and other requirements has increased. These obligations include:

- compliance with the Road Transport Authorities heavy vehicle legislation and related standards;
- Occupational Health and Safety legislation requirements;
- administration of SSTS policy and procedures such as the Guidelines for Managing School Student Behaviour;
- undertaking working with children checks as required by prohibitive employment legislation;
- drug and alcohol testing; and
- increased responsibilities under the new Bus Operator Accreditation Scheme (BOAS) such as establishing a Safety Management System, conducting daily safety checks and undertaking annual self audits, and three yearly external audits.

While these additional requirements imposed additional costs and financial penalties/fines for non compliance on operators, funding models had not been adjusted accordingly.

The Taskforce therefore recommended that going forward, new funding arrangements for both Type A's and Type B's need to factor in any one-off set up costs for these compliance activities as well as recurrent costs.

It was noted that NSW had the highest standards of accreditation in Australia (operators, drivers, vehicles) with the same standards that apply to the largest bus operators that have in excess of 1,000 buses also applying to single bus operators in remote areas.

8.10 Community consultation

The contract negotiations included the development of improved community consultation. In designing and reviewing bus services the operator must involve the local community as a means of ensuring local transport demands are taken into account. As a general rule:

- community consultation, in the form of a community forum, must be held as part of the three yearly service reviews;
- consultation is required in the event of a material change to services being proposed, which includes consulting with the local council, schools and other key stakeholders in the local community likely to be affected by the change;
- operators are to consult with the community and other transport providers (eg. other bus operators, taxi operators, community transport) in determining the demand for services in the Contract Service Region;
- operators are to participate in Regional Transport Forums where a forum exists in their area;

- material changes require a minimum of two weeks' notice to be given to the public prior to implementing the change;
- minor changes require a minimum 2 business days notice to be given to the public prior to implementing the change; and
- the process for communicating service changes are specified in the Contract.

8.11 Social exclusion

Addressing social exclusion did not appear to be a particular Government's objective in these reforms. However it is clear that the system of using SSTS payments to cross subsidise non school travel has a major benefit on remote communities. When the Taskforce was working on the service planning guidelines and specifying what were the minimum or appropriate service levels the industry pointed to a number of studies showing the benefit to the community of rural and regional areas having adequate services.

It has been BusNSW rather than the Government that has been promoting the benefits of the service planning guidelines for social exclusion minimisation.

The service planning guidelines mean that country towns receive services regardless of how well they are patronised and villages are linked with towns to ensure that people outside the town centre have a regular service.

9. Roll out plan

Because of political instability BusNSW took the decision to push ahead with the early roll-out of new contracts, even though some of the work of the Taskforce was still in progress in the first half of 2008. It was originally estimated that the roll-out of the new contracts could take up to 12 months because of the work involved and the need to co-ordinate schedules, explanatory notes and mapping technology.

It was agreed to try and roll-out the contracts within a six month period from July 2008, and this was substantially achieved. Once BusNSW assessed the contracts were good news, sustainable and reasonable, operators were eager to sign. Thirty three (33) joint seminars were conducted throughout the State by Government and BusNSW representatives. Ahead of each seminar, contracts, explanatory notes and payment schedules were forwarded to the operators in the seminar areas. A BusNSW funding model calculator and average age calculator were major factors in operators understanding and agreeing to enter new contracts.

The Government's acceptance to backdate funding arrangements took the pressure off operators concerned that they were going to be left behind if the reform team could not get to their location as early as they would like.

The Government's resources and ability to keep up with the introduction of the various changes is of concern to BusNSW but the decision to proceed with a short roll-out has been considered worthwhile by both Government and BusNSW.

10. Relationships

The professional relationships established within the Taskforce proved to be very important for the successful implementation of the reforms.

The process driven by a trusting partnership, whereby Government and BusNSW worked towards a single goal, achieved the outcome of bus reform.

The outcome was based on hard work and mutual respect with agreed common purposes. The structures of Government departments were sometimes convoluted and complicated and BusNSW also relied on bus operators to work on each of the working groups within the Taskforce areas.

BusNSW acknowledges the Ministry of Transport's achievement in supporting the development of an effective partnership that has been successful in delivering new transport contracts to rural and regional NSW.

11. Lessons learned

From BusNSW's perspective the most important lessons learned about such Industry Reforms have been:

- the political climate has to be stable and conducive for partnership. The relevant Minister has to have influence and credibility with Cabinet and the Budget Committee;
- early decisions have to be taken on how to demonstrate value for money factoring in the history and status of the existing financial structures;
- reform objectives have to be openly debated and agreed up front;
- the Government department has to allocate quality staff and demonstrate leadership;
- quality independent external advisers are needed, and there needs to be transparency and probity in their deliberations;
- industry representatives have to be duly authorised to bind and be committed to the agreed objectives and outcomes;
- joint BusNSW/Government roll out seminars provided the best implementation strategy; and
- the core members of the Taskforce need to continue to meet together beyond rollout.

12. Benefits of reform

a) Reduction in the number of contracts by >50% with potential for further reductions over time;

b) Graduated cure regime;

c) Clearer contract provisions and performance requirements;

d) Continuity of service; more equitable funding;

e) Improved operator viability; increased bus capacity in rural and regional areas. improved flexibility of services;

f) Community input into service planning; service continuity provided for the; increased capacity on school bus services; and

g) Improved and consistent concession rules; seat belts in all new small buses (Category 1 up to 13 seats); and air conditioning in all new buses.

The costs of the reforms have not been made public, however BusNSW estimates that increased revenue includes updated costs items, wages parity and acceptance of costs associated with new accreditation.

The outcome, achieved through a trusting partnership between Government and BusNSW is considered a very good investment for rural and regional transport in NSW, a real benefit for the community.

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