

# 9<sup>th</sup> Conference on Competition and Ownership in Land Transport

## Competitive tendering contracts: Why is Norway lagging behind?

*Research Sociologist Trine Hagen, Institute of Transport Economics, Norway*

*Research Sociologist Frode Longva, Institute of Transport Economics, Norway*

### Approach

The validity period of contracts regulating production of public transport in Scandinavia varies greatly, from one-year agreements to ten years plus options. For contracts of a certain duration there will – in most cases, at one time or another – occur a need to deviate from the original agreed-upon production contract. Many circumstances may cause a need for change in a contract to occur, for example budget changes, changes in political priorities or demographical issues causing traffic streams to change more or less permanently.

The key question in this paper is as follows:

How is the need for change in a signed contract for production of public transport services handled, in contracts entered into as a result of competitive tenders?

Further;

1. What are the most common guidelines for contract amendments in public transport production?
2. What is common practice when a need for a contract amendment rises?
3. What are the usual results of negotiations concerning contract amendments in public transport?

In order to answer these questions, we have examined competitive tendering contracts and the handling of contract amendments in 8 Scandinavian cases.

## **Introduction**

### **A brief introduction to Norway**

Norway has a population of approximately 4.5 million inhabitants. The country consists of 19 counties, most of them including large sparsely populated areas and some small towns. There are a few major cities: Oslo, Bergen and Trondheim are the largest. Public transport in Norway reflects the demographical structure of the country. Public transport in the countryside differs greatly from urban public transport. The largest segment of the public transport market is operated by local bus, coach, train, ferries and high speed passenger boats. In Oslo there is also an underground system and a separate tram system.

### **Competitive tendering of bus services in Norway**

The provision of the Norwegian public transport has changed the last fifteen years. Competition in the market has increased as competitive tendering has been introduced. Subsidies declined by 42 % from 1986 to 1999 (Fearnley and Carlquist 2001). Changes in the Transport Act, which allowed for competitive tendering of public transport operations were approved by the Government in 1991 and gradually set in force from April 1994. In April 2002 full scale competitive tendering was allowed in Norwegian public transport operations. Most counties have introduced tendering to some extent, but only two so far (Vestfold and Akershus<sup>1</sup> counties) in full scale involving all public transport operations by bus. A projection of tendering in the bus market in Norway shows that 28 % of the public transport market will be subject to competitive tendering in 2005, and the number will increase in the years to come (Bekken 2004). About half of all Norwegian counties have experiences with competitive tendering of bus operations. Compared to Sweden and Denmark, Norway was late introducing competitive tendering, and has not yet caught up with the neighbouring countries in the extent of competition in public transport.

It is the county councils who purchase public transport in Norway.

## **Methodology**

The contracts that are studied here are gathered from the counties of Oppland, Oslo, Akershus, Vestfold and Rogaland in Norway, Västernorrland and Halland in Sweden, and Copenhagen in Denmark. The contracts have been made available to us by the county councils, except from the Vestfold contracts, where we were not allowed access to the actual document but were told what was in it.

The conclusions are partly based on readings of the contents of the formal contracts, and partly on interviews with representatives of the authorities. It is important to emphasise that we have not interviewed representatives of the bus operators in these counties, so the counties counterparts have not been heard. This might have given us a potentially skewed picture of how the contracts function, but informal talks with operators conducted posterior to the data collection among authorities confirm our conclusions.

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<sup>1</sup> The SL (Greater Oslo) area.

We have examined eight cases only. These cases were chosen because they had their origin in competitive tenders, but also because we believe they give a representative picture of this kind of contract and the practice of them in Scandinavia. However, the low number of cases makes it difficult to generalize our conclusions further than to the contracts we have actually studied. This paper has its origin in research commissioned by the Norwegian branch of multinational bus operating company Connex.

## **Cases**

We will now give a description of contracts and contractual practice in each of the eight cases. We will focus on how issues of dynamic adaptation are handled through economic incentives, contractual clauses on negotiations and informal conduct.

### **Oslo**

The better part of bus operations in Oslo have at one time or another been tendered since public transport tendering was allowed by law in 1994. In 2006-2007 all bus operations in the capital will be tendered. AS Oslo Sporveier, a public limited co., handles all public purchases of bus operations. The company does not have any in-house transport operations, but the community of Oslo owns the subway operator, tram operator and the largest bus operator in town, all public limited cos. Subway and tram operations have so far not been tendered.

The contracts in Oslo are gross cost contracts, and contain opportunities for bonuses as well as sanctions. However, the levels of incentives are relatively low seen as part of the total contract sum.

The Oslo contract does contain a clause saying that there might be a need for adjustments in the contract, and levels of financial compensations for such changes are stated. A 1 % change in production is allowed without economical compensation for the operator. The authorities are granted the formal right to initiate changes.

In practice, the parties in the Oslo contract do negotiate, even if the contract does not state any formal rights for the operator to re-negotiate if the authorities request that the production volumes will change. Changes are usually compensated financially, but the level of compensation varies according to reason.

### **Akershus**

A large part of bus operations in Akershus county in the south-east of Norway are tendered. Akershus is a densely populated area, with a great deal of commuting towards Oslo. AS Stor-Oslo Lokaltrafikk (Greater Oslo Local Transport Plc) handles most public purchases and tenders of bus operations in the area surrounding Oslo.

The Akershus contracts are gross cost contracts, containing sanctions but no possible bonuses for the operators. The levels of incentives are relatively low. The contracts do allow for changes in the agreed upon production, and there are levels of financial compensation in the contracts.

There is a 3 % change in production allowed without economical compensation for the operator. The contract grants the authorities the formal right to initiate changes in production. When the volumes of production are increased above the 3 % level the operator is granted an economic compensation per cost/km according to predefined thresholds. In practise, the compensation is handled pretty much according to the contracts, but authorities allow leeway in informal negotiations. Formally, the operator does not have any rights to re-negotiations of contracts if the production volume changes, but in practice there are negotiations and informal talks anyway.

### **Vestfold**

Vestfold county is found to the south-west of Oslo. The county is densely populated along the coastline, and there is a great deal of commuting towards the greater Oslo area. In Vestfold the plc Vestfold Kollektivtrafikk (Vestfold Public Transport) handles all tenders of bus operations. All bus operations in Vestfold are tendered.

The Vestfold contracts are gross cost contracts, containing no bonuses and relatively low levels of sanctions. The contract is considered confidential by the Vestfold plc, but management have described the contract contents relatively detailed. There is a 1 % change in production allowed without financial compensation for the operator, and the formal right to initiate change lies with the authorities. In practice, the financial compensation for changes of production varies. There are no strict rules for such compensation, but operators are usually compensated for extra position driving or cost/km. The operators do not have a formal right to re-negotiate if production volumes change, but in practice negotiations are common and successful.

### **Oppland**

Oppland county is situated to the north-east of Oslo, where Lillehammer hosts the county administrative headquarters. The county administration handles all bus operation tenders, and Oppland was the first county in Norway to tender bus operations in 1994. Since then, Oppland county has carried out a number of tenders. In the winter of 2004-2005, Oppland county council stopped plans for a new tender in one of the counties small sized towns. As a consequence of this, the contracts for bus operations will in this political period be negotiated rather than tendered.

However, our basis for choosing Oppland as one of the case counties are the contracts entered into as result of previous tenders.

The Oppland contract is a gross cost contract, containing passenger related incentives and low levels of sanctions. The contract does allow for changes in production, and there are defined levels for financial compensation for such changes. A 2 % change in production is allowed without financial compensation for the operator. Authorities are granted the formal right to initiate change. Increasing volumes are compensated financially by 90 % of the cost/kilometres agreed upon for normal production. Formally the operators have no rights to re-negotiate if the production volumes are changing, but representatives of the

authorities have told in interviews that established informal conduct in the county is that re-negotiations are carried out on an irregular basis.

### **Rogaland**

Rogaland county is situated in south-western Norway. The largest city in the county is Stavanger, and most of the Atlantic coast in the greater Stavanger area is densely populated with a great deal of commuting to and fro the city.

It is the plc Kolombus that handles all public purchases of public transport in Rogaland county. Kolombus was established in 2001, in order to handle purchases more professionally than the county considered they could do in-house. Some activities, such as permissions, strategic planning and stipulation of fares are handled by the county in-house.

Rogaland county has carried out three rather large tenders for bus operations in the Stavanger area. All three were won by Connex, and the contracts following the competition have been subject to legal dispute that in the end was settled outside of the courts. The settlement granted the operator a substantial compensation for (among other things) changes in production volumes. One of the operators' claims was that the contract did not sufficiently define how changes in production volumes should be handled.

The Rogaland contract is a gross cost contract with no bonuses and low levels of sanctions. The contract allows for changes in production, and there are defined levels of financial compensation for the operator in the contract. Unlike the other Norwegian contracts we discuss in this paper, the Rogaland contracts do not allow for any un-compensated production changes. The authorities are granted the formal right to initiate changes. Increasing volumes are compensated financially per cost/kilometre, varying on daily hours. The operator is not granted any formal rights to re-negotiate if the production volumes changes, which is one of the reasons the contract was considered cloudy judicial waters by Connex' legal advisers.

### **Västernorrland**

In 1989, the Swedish parliament passed legislation to encourage public-private competition (Andersen 1994). Swedish counties tender public transport to a larger extent than Norwegian counties do, and since they got a head start, it is appropriate to say that Swedish counties have more experience than the Norwegians.

There are 21 Swedish counties (län), and the public purchase of public transport is for the most part handled by plcs called Länstrafikbolag (County transport companies).

Västernorrland is in the north-west of Sweden, and the largest city is Sundsvall. We have studied the Sundsvall net cost contract<sup>2</sup>. The contract does open up for changes in the contract, and there are levels of financial compensation stated in

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<sup>2</sup> The data collection for this project was done in august 2004. Management at "Din Tur", the plc in Västernorrland, informed us that new contracts were about to be signed. However, our work here is based on the older net cost contracts.

the contracts. There are no changes in production allowed without financial compensation for the operators. The formal right to initiate changes is granted to both operators and authorities. Increasing volumes are compensated financially per cost/kilometre (NB: this is a net cost contract!). The operator has a formal right to re-negotiate when the production volumes changes, and the financial compensation varies according to the result of negotiations.

### **Halland**

The county of Halland is situated in the south-west of Sweden, along the coast south of Gothenburg. The largest town in the county is Halmstad. For the last thirty years Halland shows the greatest percentage population growth of all Swedish counties. The plc Hallandstrafiken handles all public purchases of public transport in Halland.

The Halland contract is a gross cost contract with a substantial level of patronage incentives; 20-25 % of the total sum. The contract does open up for changes in the contract period, and there are stated levels for financial compensation for the operator should such changes occur. There are no changes in production allowed without financial compensation for the operator. The formal right to initiate changes are granted both authorities and operator. The financial compensation for increasing volumes are given according to thresholds predefined in the contract and comes in addition to patronage incentives. The operator is given a formal right to re-negotiate if the production volumes change.

### **Copenhagen**

Copenhagen has approximately 1.1 million inhabitants. Public transport in Copenhagen is carried out by bus, train and a metro system.

All public purchase of public transport in Copenhagen is carried out by The Greater Copenhagen Authority (HUR). HUR is a politically-governed regional organisation covering the greater Copenhagen region, and was established in 2000. The governing HUR Council is made up of regional politicians from the five local/regional authority units: the counties of Copenhagen, Frederiksborg and Roskilde and the cities of Copenhagen and Frederiksberg.

The Copenhagen contract is a gross cost contract, with some bonuses attached. The contract allows for changes in the contract period, and defines levels of financial compensation for changes. Changes in production are not allowed without financial compensation. Authorities are granted the formal right to initiate change. Financial compensation for increasing volumes is granted per cost/kilometre and per vehicle. The operator is given a formal right to re-negotiate if the production volumes must be changed.

*Table 1: Contractual contents and informal conduct regarding production changes during the contractual period in Scandinavian public transport*

	Oppland	Rogaland	Akershus	Vestfold	Oslo	Copenhagen	Väster-norrland	Halland
Incentives	Yes, low levels	Yes, low levels	Yes, low levels	Yes, very low levels	Yes, low levels	No	Yes, net-cost contract!	Yes, 20-25%
Bonuses	No	No	No	No	Yes	Yes	Yes	No
Malus	Yes	Yes	Yes	Yes	Yes	No	Yes	Yes
Does the contract open up for changes?	Yes	Yes	Yes	Have not seen the contract	Yes	Yes	Yes	Yes
Financial compensation levels stated in contract?	Yes	Yes	Yes	Have not seen the contract	Yes	Yes	Yes	Yes
Changes in production allowed without financial compensation	2 %	No	3 %	1 %	1 %	No	No	No
Formal right to initiate changes	Authorities	Authorities	Authorities	Authorities	Authorities	Authorities	Both authorities and operator	Both authorities and operator
Financial compensation for increasing volumes	90% of cost/km (average)	Per cost/km varying on daily hours	Per cost/km according to thresholds predefined in the contract	Have not seen the contract	Not predefined in the contractual clauses	Per cost/km. per vehicle	Per cost/km NB: Net-cost contract	According to thresholds predefined in the contract + patronage incentives
Financial compensation in practice	As above	-	As above, but leeway allowed in informal talks/- negotiations	Varies. No strict rule but compensation according to position driving or cost/km	Varies according to reason and mutual talks	As above	Varies according to negotiations	As above
Has the operator any formal rights to re-negotiate if changing production volumes?	No, but according to informal conduct	No (no information on informal conduct)	No, but according to informal conduct	No, but according to informal conduct	No, but according to informal conduct	Yes	Yes	Yes

## **A comparison of Scandinavian practice**

In the following we will sum up the findings from the eight cases, taking a further look at how the potential need for change is handled, comparing current practice among the Scandinavian countries.

### **How is the need for change handled?**

The Norwegian contracts state little or nothing about how the need for change should be handled. All contracts open up for changes in the contract period, but none of the Norwegian contracts grant the operators a formal right to initiate change. We see this in relation to the fact that they are all gross cost contracts. However, it varies to what extent the financial compensation for increasing volumes are defined in the contract. None of the contracts give the operator any formal rights to re-negotiate the financial compensation when the production volumes change.

The Danish and the Swedish contracts are more elaborate when it comes to how the need for change will be handled: They all give both operators and authorities a right to initiate change, allow no increase in production without compensation, and grant the operator a formal right to re-negotiate when production volumes change.

Having analyzed the different contracts, we interviewed representatives of authorities in each of the cases<sup>3</sup>. The main findings on this issue were that with contracts ranging from two to ten years, a need for changes in production rise on a regular basis in all cases: Needs for change are rather common, and are handled by operators and authorities all the time. This can be said for all the cases, independently of nationality. In addition, the longer the duration of the contracts, the lesser the predictability of future production will be. Thus, the need for procedural clauses on how to handle changes increases with the length of the contracts.

A need for contractual amendments may raise the level of conflict. However, we found this not to be true in the cases we examined. Authorities report a very low level of conflict with the operators, and the conflicts registered are small and easily solved. We know of only one contractual dispute in recent years that lead to lawsuit in Norway - the Rogaland contract.

### **A running dialogue on production issues**

Authorities and operators in the Norwegian cases have a running dialogue on production issues. When the need for change in agreed-upon production rises, it seldom comes as a total surprise for either of the parties. As pointed out above, the need to adjust production is common, and so is the ability among authorities of handling this issue towards operators.

There is a close and regular contact between representatives of the authorities and operators, where the people involved discuss production related issues such as network, timetables, patronage and fare structure. This regular dialogue does, over time, build personal relationships and trust between representatives of either organisation. Establishing trust between the parties is a requirement for this practice to work. We find evidence of this in our interview material.

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<sup>3</sup> Except for Vestfold county, where we were not allowed to read the contract, but instead went directly for interviews.



### **The Norwegian Way: Informal talks and negotiations**

The empirical analysis of contracts and practises indicate that how the Norwegian contracts are handled in real life is more important than how they are drawn up. This is the case in Norway, as opposed to the more formalised practice in Denmark and Sweden.

When we compare Scandinavian contracts, the most immediate difference between them is that the Norwegian contracts are less extensive than the Swedish and Danish ones. The authorities demand and define less in terms of at least two things: Mutual cooperation and establishment of arenas for such cooperation and development, and what are the authorities' responsibilities in the partnership. This is to a higher degree defined in the Swedish and Danish contracts.

The Swedish and Danish contracts are more extensive on a number of other subjects as well. Technical standards and work force qualifications are two variables where the specifications are numerous and detailed at another level than in the Norwegian contracts. The advantage of a highly detailed contract is that both parties have a formal framework for the cooperation, where there is little doubt as to what is demanded of either operators or authorities. The disadvantage is that with highly detailed contracts it may be difficult for the operator to fulfil all demands made, and it may be equally difficult for the authorities to control that the operator has fulfilled the demands. Another disadvantage is that a highly detailed contract gives the operator less room for creativity and room to manoeuvre in the market, which may lead to a weaker result. This is especially important when the contract in use is a net cost contract where one of the goals is to give the operator more freedom to act in the local market.

When there is a need for changes in contract, authorities usually negotiate. Negotiations occur when changes are larger than what is regulated by the contract. Representatives of the authorities express their understanding for the operators' focus on expenses under such circumstances. Authorities usually accept and pay a partly compensation, e.g. extra mileage. The Norwegian contracts are weak on this point, as they poorly regulate cooperation, mutual responsibilities dialogue and the explicit responsibilities of the authorities. These elements are primarily exercised without guidelines, and exercise is within an intuitive understanding of what is considered "fair practice".

We draw the conclusion that practice – how Norwegian operators and authorities in effect make business – is more important than the literal contract, because the detailing level is relatively low when it comes to re-negotiations and handling of contractual amendments.

### **Established tradition: An explanatory factor**

The duration of contracts is important when we explain why practice surrounding contractual amendments in Norway differs from the other Scandinavian countries. In Norway there is a tradition for long term negotiated contracts, in most cases renewed every tenth year. When contractual duration usually is ten years, stability

in relations is vital in order for the system to function<sup>4</sup>. Manpower seems to be relatively stable in operating companies as well as authorities' organisation, and the same individuals occupy central positions for a number of years, developing personal knowledge and less formalised relations between the contracting parties (Longva and Osland 2005). Hence, a tradition of pragmatic renegotiations of contracts is developed over time.

### **Conclusions and questions that arise from Norwegian practice**

Evidence in our material makes us draw the following conclusions:

1. The Norwegian contracts for purchases of public transport studied shows a lower detailing level than the Swedish and Danish counterparts.
2. This makes the actual practice and development of trust and arenas of cooperation between operator and authorities more important than in Denmark and Sweden, where the contracts are more developed, detailed and leaves less up to the needed establishment of personal relationships between employees of both parties.
3. The Norwegian system is more fragile than the Swedish and Danish systems due to the lack of formality: Cooperation between authorities and operator is dependent on personal relationships. As long as the informal, regular cooperation and dialogue between operator and authority functions all is well, but if the informal practice should collapse, Norwegians, in some cases, are left with a somewhat skimpy document that might be an insufficient basis for formal cooperation.

### **A changing market: Will contracts need to change as well?**

With the introduction of competitive tendering, the bus market has opened for international actors. Previous to tendering this market was exclusively worked by smaller, national operators, for the most part locally based. As long as operators are based in the same town or county as the authorities, the physical conditions for today's practice is present. The conditions for establishing and nurturing personal relationships are present. Incumbents also had the advantage of developing the relationship to authorities over a number of years – building trust and good contacts take time.

When and if multinational operators enter the Norwegian bus market, today's practice may be threatened. Will it be possible (or even desirable?) to establish tight relationships and regular dialogue with operators? Operators' headquarters may even be located in another country. Close relationships between operators and authorities may to a new extent be considered unwholesome and may trigger accusations of corruption.

New actors in the market may lead to new conditions, which in turn may lead to a need for more specific contracts. Trust and tight relationships might not be valid reassurance for a smooth public transport operation any more.

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<sup>4</sup> This is even more the case when the contracts formally regulating the relationship between operator and authority are underdeveloped.

### **Is Norway lagging behind?**

In some respects we might say that Norwegian authorities are lagging behind the Swedish and Danish authorities examined in this project. Competition in public transport operations was introduced later in Norway than in the other countries, and as a result the local bus market change took place later. The market, as well as practice, is gradually changing. With the establishment of new practice, more detailed contracts and an increasingly more professionalized authority practice of tendering competitions and contract signings, Norwegian authorities will catch up with the neighbours. In the meantime, Norwegian authorities have the advantage of learning from the neighbouring authorities who have tried and failed before them.

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