

Chair
Cabinet Economic Growth and Infrastructure Committee

PUBLIC TRANSPORT—IMPROVING VALUE FOR MONEY FROM URBAN¹ BUS AND FERRY SERVICES

Proposal

1. The purpose of this paper is to inform you of policy work being undertaken to increase use of urban bus and ferry services with less reliance on subsidies.

Executive summary

2. Over the past 10 years government (central and local) spending on public transport has increased significantly. The growth in government spending has not led to a commensurate increase in public transport patronage. In addition, within the bus and ferry sector, there has been a noticeable deterioration in the relationship between some bus and ferry operators and regional councils when good working relationships are critical to providing an attractive and cost effective service. These trends make me concerned that the government is not receiving value for money from its spending on public transport.
3. I have already taken steps to increase value for money from public transport expenditure. I effectively capped funding for public transport services in the 2009 Government Policy Statement on Land Transport Funding (GPS). In September 2009 Cabinet agreed to a new operating model for the delivery of metro rail services which, when fully implemented, should generate better value for money from metro rail.
4. In relation to urban bus and ferry services, a range of initiatives are being progressed to improve value for money. Collectively, these initiatives will contribute to more attractive and cost effective services that will result in increased patronage with less reliance on subsidies. Development of the *Public Transport Operating Model* (PTOM) and a sector-wide action plan to improve the effectiveness of public transport are the two key initiatives discussed in this paper.
5. The PTOM project is focused on developing a robust operating environment for the delivery of urban bus and ferry services. Central to the development of the PTOM is designing efficient public transport networks and rebuilding relationships between regional councils and operators to provide the basis for genuine partnership. A proposed PTOM has been developed in collaboration with Auckland Regional Transport Authority (ARTA)², Greater Wellington Regional Council (GWRC), Environment Canterbury (ECAN), the Bus and Coach Association, including bus and ferry operator representatives, the New Zealand Transport Agency (NZTA) and the Ministry of Transport.

¹ The reference to 'urban' bus and ferry services is to distinguish services provided within a city/region and covered in the region's Regional Public Transport Plan and other bus services that are provided on a fully commercial basis between cities and/or for tourism purposes.

² As of 1 November ARTA was replaced by the new Auckland Transport Agency.

6. The proposed PTOM has several key features, some of which differ from existing practices. Under the PTOM regional councils will be required to segment their public transport networks into units (containing all services on a timetable and be a minimum full route, full timetable), which replaces the existing practice of operators being able to register a single timetabled service on a route as 'commercial'. There is a strong emphasis on joined-up planning around unit development to create an efficient and effective network. Units need to be designed to relate to a readily identifiable customer base in order to attract the right commercial behaviour to grow that market.
7. All units will be subject to a performance based contract with a partnership focus that encourages local government and operators to plan and invest together unit-by-unit. Contracts with longer tenure length than the historical norm will also be encouraged to allow operators the opportunity to recoup capital investment over a reasonable time period and to support joint planning endeavours.
8. A mix of competitive tendering and direct negotiations to secure units is envisaged. Individual units or combinations of units will need to be put out to competitive tender to provide confidence that subsidy prices paid are efficient and to allow entry to local markets. These prices will provide benchmarking information on costs to complement patronage and revenue data expected from the introduction of integrated ticketing systems. The value of entering into direct negotiations with operators is expected to include providing operators with additional security to invest in public transport assets, a stable core of operators to maintain network integrity and as an incentive for operators to perform well.
9. Complete units can be registered as 'commercial' and not receive a public subsidy. New units, not encompassing existing units can be registered as commercial, by operators who see niche business opportunities.
10. Currently, development of the PTOM is being subjected to on-the-ground testing in a small portion of the Auckland and Wellington markets. I intend to report back to the Committee by April 2011 on progress of the PTOM testing. If at that time I consider that 'proof of concept' has been demonstrated and that the PTOM is a viable solution, I will be asking for Cabinet's agreement to the new model, including making changes to the Public Transport Management Act 2008 (PTMA), if necessary.
11. Improving the effectiveness of public transport is a sector action plan facilitated by the NZTA. The Public Transport Leadership Forum (PTLF) was established in August 2009 by the chief executives of the Ministry of Transport and the NZTA to develop a more coordinated approach to the development of public transport (rail, bus and ferry) in New Zealand. The vision of the PTLF is to *'grow public transport as a mode of choice in our cities by developing a cost effective, smart and reliable public transport network'*. The 3-year action plan directs the public transport sector's efforts toward achieving the vision by focusing on improving customer experience, providing a more integrated public transport network, and strengthening sectoral leadership. These workstreams complement the work being done to develop the PTOM.

Background

Benefit of public transport and why government supports it

12. Governments have supported the provision of public transport because of the wider economic and social benefits it can provide. Public transport contributes to economic objectives by reducing congestion, improving and enabling access to employment, health and education. Public transport systems can also contribute to wider economic benefits through agglomeration. This occurs where improved urban accessibility leads to productivity gains for businesses in compact central business districts. Without increased patronage growth it is unlikely that the full value of these benefits will be realised.

Overview of urban bus and ferry services in New Zealand

13. Urban bus services are the backbone of New Zealand public transport, accounting for 80 percent of all trips made on public transport in 2008/09. In 2008/09, there were 102,621,365 bus and ferry boardings in New Zealand. Auckland, Wellington, and Christchurch are the largest public transport markets in New Zealand, accounting for 90 percent of all bus and ferry boardings made in 2008/09.
14. Currently there are 30 bus operators and 6 ferry operators providing services across New Zealand. The single largest operator is NZ Bus, accounting for almost 58 percent of all bus boardings made in 2008/09 and receiving an estimated 42 percent of total contract payments made by regional councils. NZ Bus is the largest operator in New Zealand, operating primarily in the Auckland and Wellington bus markets. The other three largest operators are the Souter Group of bus services³, Go Bus and Ritchies. Accordingly, there is a substantial private sector investment in public transport assets and a strong incentive to ensure this capital is employed to best effect.
15. Urban bus and ferry services are a mix of commercial and contracted services. Under the Transport Services Licensing Act 1989 (TSLA)⁴, a commercial service could be a single timetabled service on a route (for example the 10:48 from Smithville to the city), several timetabled services on a route, or all the timetabled services on a route, as long as the operator did not require a contract payment from the regional council to deliver those services.⁵ It is up to operators to identify what services they wish to provide on a commercial basis. Commercial services must be registered with the regional council.
16. Contracted services are services that have not been identified by operators as being commercially viable, but are considered necessary by a regional council. Regional councils contract-in operators to provide these services through tendering rounds. Because commercial services do not need to be the full timetabled services on a route, regional councils frequently have to 'contract around' the commercial services

³ Howick and Eastern in Auckland and Mana Bus Services in Wellington.

⁴ The TSLA was in effect up until 31 December 2008.

⁵ Operators may receive an indirect subsidy in the form of a concessionary fare payment or SuperGold Card payment.

on a route to provide complete services (such as early morning, inter-peak and night time services).

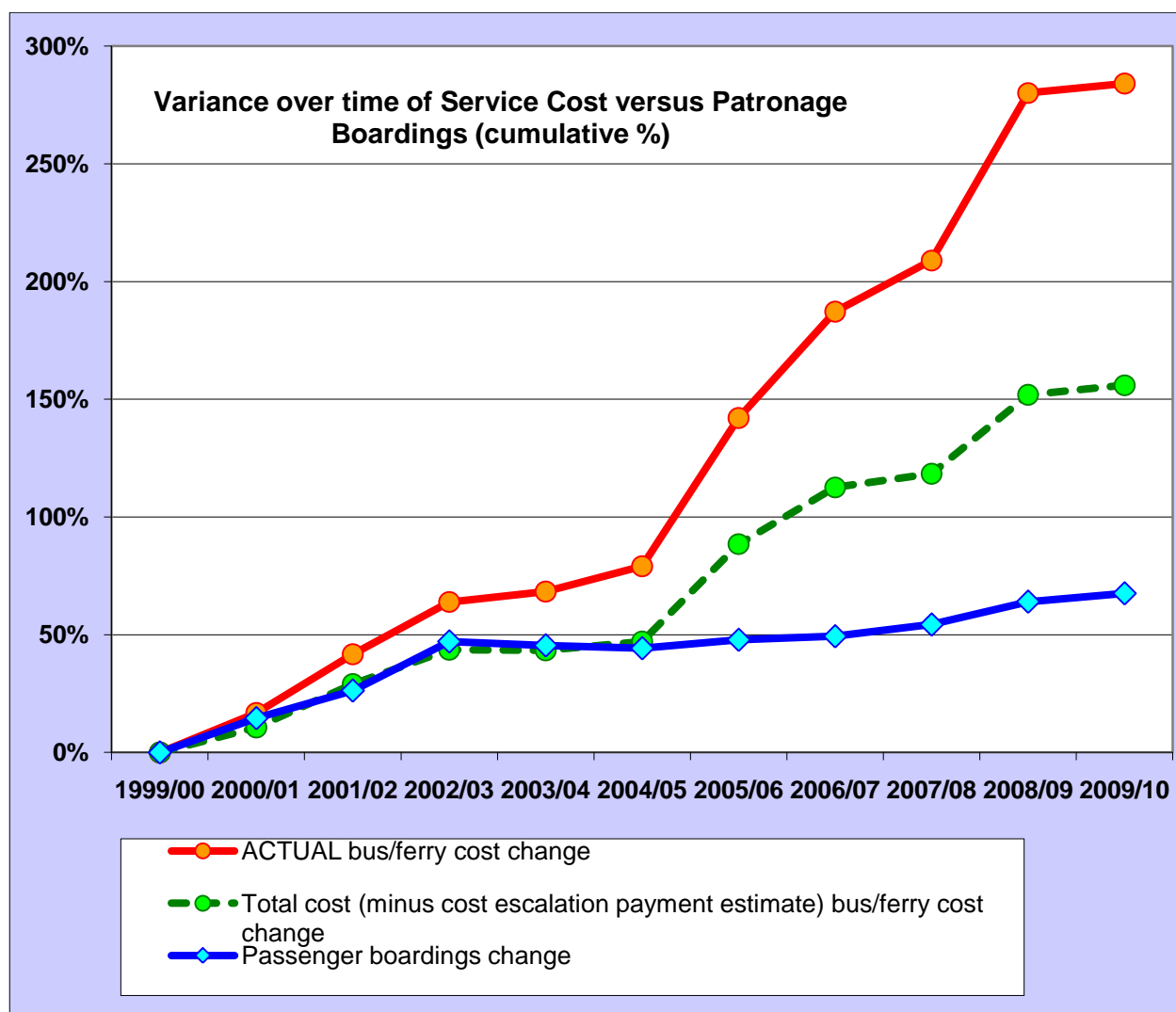
17. In Auckland, approximately 23 percent of single timetabled services are registered as commercial. In Wellington, approximately 25 percent of single timetabled services are registered as commercial. Operators in Auckland and Wellington have generally used commercial registrations to register single timetabled services rather than all the timetabled services on a route. The exceptions are airport services in the two cities and the largest ferry routes in Auckland. In contrast, in Christchurch only 3 percent of single timetabled services are registered as commercial and these services are all on a few routes and cover all the timetabled services on those routes. This is in large part a consequence of Environment Canterbury's decision to not accept commercial registrations for anything less than all the timetabled services on a route.
18. Responsibility for the delivery of urban bus and ferry services is split between regional councils, territorial authorities and operators. Regional councils are responsible for planning a public transport system that meets the needs of their communities and that they are prepared to pay for. Regional councils also provide network-wide support in the form of bus timetables, call centres, web sites and marketing. Territorial local authorities provide public transport infrastructure such as local roads, bus stops, terminals and bus priority measures. Operators provide buses and the associated infrastructure for example depots and delivery of the actual service (eg drivers and ticketing systems).
19. In 2008/09 the national farebox recovery rate (or the proportion of the total cost of providing bus and ferry services met by passengers) was 42.9 percent for bus services and 78.5 percent for ferry services. The shortfall between revenue and costs were met by regional councils in the form of contract payments and concessionary fare payments.
20. Public funding of urban bus and ferry services is split approximately fifty/fifty between the regional councils and the NZTA. The NZTA funding is sourced from the National Land Transport Fund (NLTF). Because the NZTA provides half of all public funding for the delivery of public transport, it has an influential role in shaping regional councils' public transport planning and procurement procedures.

Divergence of government expenditure and urban bus and ferry patronage

21. Between 1999/00 and 2008/09, service contract and concessionary fare payments⁶ increased by approximately 260 percent from \$57 million in 1999/00 to \$210 million in 2008/09. Over the same period, bus and ferry trips increased by only 63 percent from approximately 63 million trips in 1999/00 to 103 million in 2008/09. Of particular concern is that patronage growth was slowest when government subsidies were increasing the most rapidly, as evident in graph one.

⁶ Figure excludes SuperGold Card payments that only were introduced in 2008/09. Approximately \$12 million was spent on SuperGold Card payments in 2008/09.

Graph One: Cumulative change in central and local government expenditure on urban bus and ferry services compared to cumulative change in bus and ferry trips (1999/00–2008/09)



Notes:

1. Actual costs are based on the actual end of year total net subsidy cost
 2. The total cost is an estimate of the real cost impact based on the removal of the effects of the cost indices payments available to regions for fuel, labour and transport price movements, as applied to the actual cost.
22. The growing gap between funding and patronage levels has been reflected in a decline in the farebox recovery ratio. Current farebox recovery rates are much lower than they were at the beginning of the decade. In 1999/00 the farebox recovery ratio for bus services was 60 percent (2008/09 42.9 percent) and 93.1 percent (2008/09 78.5 percent) for ferry services.⁷

⁷ Ferry services achieve a higher farebox recovery ratio in large part because a large proportion of ferry services are provided on a fully commercial basis, and there is a strong tourism component to ferry services (such as the ferry service to Waiheke Island in Auckland).

Increased tension between regional councils and operators

23. The significant increase in funding for urban bus and ferry services and the 'locked-in' nature of services within a timetable registered as commercial, contributed to growing tensions between bus and ferry operators in the Auckland and Wellington regions and the Auckland Regional Council (ARC), ARTA, and GWRC. The regional authorities were frustrated because they felt that bus and ferry service operators were making it difficult for them to plan and implement an integrated public transport network, despite the large amount of public funding being provided. Regional councils also believed that some operators were using these single timetabled service commercial registrations tactically to enhance their bidding position, when services 'contracted around' their commercial services were put out for tender. Incumbent operators enjoyed an operational advantage over other operators, as they could use the same buses, drivers and depots used to deliver commercial services to deliver the contracted services.
24. In turn, operators were frustrated that regional councils were seeking excessive control over their operations, which would negatively impact the value of their businesses and constrain operator innovation at the expense of customers. Operators also vigorously disputed regional councils' claims that operators used single timetabled commercial services to give them a tactical advantage in a tender round.

The passage of the Public Transport Management Act 2008

25. Concerns about a lack of competition for contracted services, especially in Auckland and Wellington, created pressure for a review of the TSLA. Because the Auckland and Wellington regions account for the greatest proportion of bus and ferry trips made in New Zealand (71 percent and 95 percent respectively), and the largest share of government expenditure (71 percent), the previous government reviewed and then replaced the TSLA with the PTMA. The PTMA came into effect on 1 January 2009.
26. The passage of the PTMA was controversial, as it effectively completely re-regulated urban bus and ferry markets. Under the PTMA, regional councils could impose a range of controls on operators' commercial services, from adopting common signage on buses to requiring operators to run commercial services according to the frequency and times specified in a regional council's regional public transport plan. In addition, if deemed necessary, a regional council could require an operator to provide all their services under contract to the regional council (known as the 'Contracting Requirement').
27. While these changes were generally welcomed by regional and local government, a significant number of bus and ferry operators were not convinced. In addition, during inter-agency consultation on the PTMA, the Treasury and Ministry of Economic Development expressed concern that the proposed PTMA would undermine private incentives and advantages without necessarily increasing non-commercial benefits associated with stronger regional planning.

The situation at the end of 2008

28. When I became Minister of Transport in 2008 the public transport sector had been in limbo for a number of years. ARTA and GWRC had not been to tender for almost 5 years due to uncertainty about the review of the TSLA, and the final shape of the PTMA. Contracts were being rolled over for short periods which made an equally uncertain environment for operators, which compounded concerns regarding value for money (this is still occurring).
29. Even as ARTA and GWRC were shaping up to use their new powers under the PTMA, it quickly became apparent to me that the PTMA gave regional councils too much control over bus and ferry operators and this could chill private sector investment and innovation. I also saw that there was a real risk of legal action between ARTA and GWRC and operators over potential controls on single timetabled commercial services and contracting requirements, as the PTMA set fairly onerous conditions on regional councils when using some of their powers. This would further distract all the parties from the actual business of providing quality and cost efficient urban bus and ferry services and growing patronage.

Improving value for money from government expenditure on public transport

30. When investment and subsidies for metro rail services are also considered,⁸ the funding path that public transport was on prior to 2009 was clearly unsustainable, especially without a commensurate increase in public transport use. There was, and is, a need to turn the situation round so that there is greater use of public transport with less reliance on subsidies, and improved value for money.

All modes to 'pay their way'

31. It is my expectation that, as much as possible, all transport modes pay their own way. This expectation informs the development of much of transport policy and informed the allocation of National Land Transport Funding (NLTF) funds under the 2009 GPS. The review of road user charges, adjustment to fuel excise duty, and KiwiRail Group Turnaround Plan all seek to give effect to this expectation.
32. I have a similar expectation of bus and ferry public transport. While public transport generates benefits for non-users and therefore justifies some government financial support via the NLTF, I do not consider that existing financial support is being utilised as fully as possible for the benefit of non-users. To increase confidence that non-users are getting value-for-money from their support for public transport, there is a need to grow patronage, particularly where this contributes to congestion reduction, and close the gap between funding and patronage growth.

Wider initiatives taken to improve value for money from public transport expenditure

33. I have already taken steps to improve value for money from government expenditure on public transport. In the 2009 GPS funding for public transport services, when inflation is considered, has been effectively capped. This places greater pressure on the NZTA and regional councils to find more innovative ways to improve public

⁸ When current metro rail infrastructure projects are completed, central government will have invested in excess of \$2 billion in metro rail in Auckland and Wellington.

transport services and more thoughtfully consider what level of public transport can and should be supported.

34. In September 2009 I sought Cabinet's approval for a new operating model for the provision of metro rail services in Auckland and Wellington. When fully implemented, the model should improve value for money through increasing the contestability of metro rail delivery, better use of performance-based contracts to provide the right incentives to perform, and increasing transparency.

Improving value for money received from urban bus and ferry services

35. Work is well underway to improve value for money from urban bus and ferry services. In May 2010, the NZTA released its farebox recovery policy which outlined the NZTA's farebox recovery expectations (where no less than 50 percent of public transport operating costs are recouped from fares)⁹ and the requirement for each region to have a farebox recovery policy. At the same time it released a fare policy decision-making guide to assist regions in developing their farebox recovery policy. The guide identifies three ways in which regions can improve their farebox recovery rates: increase average ticket prices, increase patronage, and reduce the cost of services.
36. A Public Transport Leadership Forum (PTLF) was established in August 2009 by the chief executives of the Ministry of Transport and NZTA. The PTLF involves representation from chief executives of ARTA, GWRC, ECAN, the Bus and Coach Association (BCA), bus, ferry and rail¹⁰ operators, Wellington City Council, the Ministry of Transport, and the NZTA. The PTLF has been designed to develop a more coordinated approach to the development of public transport in New Zealand. The value of the PTLF is that representation comes from the highest levels within the participating organisations, ensuring that decisions made by the PTLF carry weight within those respective organisations.
37. In addition to communicating and meeting directly with key stakeholders, I have used the PTLF to provide the sector with guidance as to the government's concerns with, and expectations for, public transport. In relation to urban bus and ferry services I have advised the PTLF that:
- 37.1. the PTMA gives regional councils too much control and risks undermining the value operators bring to the delivery of services
 - 37.2. the priority for the sector is to grow patronage with less reliance on subsidy
 - 37.3. it should explore ways to better capture the value of desirable commercial behaviour to reduce reliance on subsidy support
 - 37.4. it should seek to attract and leverage private sector investment in urban bus and ferry services alongside public funding

⁹Actual regional farebox recovery rates may vary, but at a national level the overall recovery rate will be 50%. The NZTA expects to achieve this national recovery rate within the next two cycles of the National Land Transport Programme.

¹⁰Tranz Metro (Wellington) and Veolia (Auckland).

38. Currently, there are two main projects underway to increase value for money received from urban bus and ferry services.
- 38.1. *The Public Transport Operating Model* project (PTOM). The PTOM project is focused on developing a robust operating environment for the delivery of urban bus and ferry services.
- 38.2. *The Improving Public Transport Effectiveness Action Plan (Action Plan)*. This work contributes to the vision of growing public transport as a mode of choice in our cities, by developing a cost effective, smart and reliable public transport network.
39. Both projects are discussed in more detail later in the report.

The need for genuine partnership to deliver value for money

40. Before discussing the PTOM and the Action Plan in more detail, it is important to note that both projects complement each other and are collaborative exercises with significant involvement of all the key stakeholders in the development of solutions. It is clear to me that if people are to use urban bus and ferry services more, and more of the costs of the services are to be met from fare revenues, there is a need for a collaborative response from the stakeholders who are most able to influence the development of bus and ferry services.
41. Because of the interdependencies within the system, no one party should benefit at the expense of another. This leads me to believe that there is a need for more of a partnering approach, where risk is apportioned to those who are best able to absorb that risk, and reward is shared appropriately and equitably. This requires a more sophisticated procurement framework than is currently expected under the traditional 'purchaser-provider' model. In effect, I believe we need to encourage more of a 'public-private' partnership in this area.
42. Positively, the wider sector also recognises the need for genuine partnership. Operators recognise that they cannot operate fully commercial services without public sector investment in bus lanes, network wide marketing, traffic signal priority measures, interchanges, passenger and general information about the whole system, effective network 'connectivity'¹¹ and support for forward planning of service development.
43. Regional councils recognise that providing reliable and attractive services to passengers at an affordable price relies on operators' willingness to invest in buses, driver training, customer service management and innovation, on-the-bus marketing, and effective engagement in forward planning of service development.
44. Both operators and regional councils recognise that there is an increasing reliance on coordinated planning, investment and managed delivery of infrastructure services that support public transport provision. Given their role as road controlling authorities and

¹¹ Connectivity means that individual services are connected up in such a way to provide passenger with a wider array of trip destinations that are easy to get to (for example, little or no time delays due to the need to switch services). Such connectivity is necessary if public transport is to be an attractive transport choice.

providers of associated public transport infrastructure, the involvement of territorial local authorities is critical to such coordinated planning. Positively, the new Auckland Transport Agency will be able to do more of this type of coordination under one entity.

45. All parties recognise that central government is a major investor in public transport through the NZTA, and there is a need to consider national objectives in the development of public transport.

Public Transport Operating Model for Urban Bus and Ferry Services

46. In late 2008 I asked the Ministry of Transport to consider options for replacing the PTMA with a better framework for the regulation of urban bus and ferry services. I met and spoke with a number of organisations to gain their views on the PTMA. I then wrote to regional councils and operators in April 2009 advising them of my intention to review the PTMA.
47. In undertaking this review it became clear that legislation alone would not address key issues or lead to an improved public transport system that provided better value for money. It also became apparent that the operating environment for public transport was changing. There are broader issues than just legislation that need to be addressed, such as funding levers, procurement processes and the interaction and relationships between those who deliver public transport. I widened this review to address all these issues, and the Ministry of Transport has led this process.
48. To assist the Ministry and the wider sector to identify appropriate solutions for improving the operating environment, I set the following two dual objectives for the project.
 - 48.1. Grow the commerciality of public transport services and create incentives for services to become fully commercial.
 - 48.2. Grow confidence that services are priced efficiently and there is access to public transport markets for competitors.
49. In July this year the Ministry provided me with the outline of the proposed operating model for public transport. The model was developed collaboratively by the Ministry of Transport, ARTA, GWRC, Environment Canterbury, the BCA, the NZTA, and a number of bus and ferry operators.

The proposed PTOM put forward by the wider sector

50. The proposed model seeks to address the dual objectives I set for the sector, and my wider concerns, through:
 - 50.1. enhancing clarity about the respective roles and responsibilities of regional councils and operators that reflect their ability to add value and manage particular risks
 - 50.2. adopting more of a partnership basis to contractual relationships
 - 50.3. increasing confidence that services supported with public funds are priced efficiently

- 50.4. incentivising commercial behaviour to attract and grow patronage.
51. The proposed model has the following components.
- 51.1. The PTOM will require regional councils to segment their public transport networks into units. Units replace the existing practice of being able to register a single timetabled service on a route as commercial. A unit consists of all the services on a timetable (24 hours a day 7 days a week) on a route or group of routes identified in a Regional Public Transport Plan. Operators can register a unit as commercial, and operate it without any subsidy, but nothing smaller. Units support better management of the network as a whole rather than separate and discrete services. Units must relate to a readily identified customer market for the services so that the right commercial behaviour can be applied to grow that market.
- 51.2. The PTOM is dependent upon the implementation of integrated ticketing. Canterbury already makes use of integrated ticketing and Auckland is in the process of introducing it. Integrated ticketing improves the customer experience by allowing easier transitions between buses and other transport modes, and also enables patronage and revenue data to be shared by regional councils and operators. The success of the PTOM is reliant on this 'symmetrical' data being available as it will assist with planning networks and managing performance-based contracts.
- 51.3. The PTOM places strong emphasis on joined-up planning around unit development. Development of individual units is the building block underpinning operator participation in the preparation of a Regional Public Transport Plan. Strong planning is essential to ensure the development of an integrated, comprehensive public transport network, allowing efficient networks to be created and developed as land use and travel patterns change.
- 51.4. New units, not encompassing existing units, can still be registered as commercial by operators (incumbents and new market entrants) who see niche business opportunities (note that these operators would not receive a public subsidy for providing these units), as long the new unit does not adversely impact on subsidies required to provide services within existing units.
- 51.5. Under the PTOM, all units will be subject to a performance-based contract. In the case of commercial units where operators receive no contract payments, the delivery of those services will be subject to minimum quality requirements (such as vehicle standards, on-time running) to ensure a consistent service is provided across the region's network. In the case of other units, the contract will contain additional performance requirements linked to growing commerciality and patronage, reducing subsidies, and providing meaningful incentives and penalties. The performance contracts have a partnership focus that encourages local government and operators to plan and invest together unit-by-unit. There is intended to be a synergy here with 3-yearly local government planning cycles

- 51.6. Future contracts will have longer duration than was the historical norm. Tenure length is important for operators, both incumbents and new entrants, to recoup their capital investment over a reasonable time period. Longer tenure also supports better planning between regional councils and operators. Initial contracts are expected to be of the order of 9–12 years with opportunities for tenure to be extended if performance targets are met.
- 51.7. The PTOM proposes using a mix of competitive tendering and negotiation for units that have not been registered as commercial by operators. A competitive tender process is necessary to provide confidence that the prices paid for contracted services are efficient, and enable new entrants to enter the local market.

A portion of units (either individual units or combinations of units) will be subject to competitive tender to provide confidence that the prices paid are efficient, and to support the entrance of new operators into local markets. The portion that is subject to competitive tender will reflect the level of public funding needed to sustain a region's public transport network. That is, the more public funding that is required, the more of a region's network that should be subject to competitive tendering. The remainder of units will be secured through direct negotiation. Competitive price tension for negotiated contracts will be applied through performance measures and benchmarking the relative price performance of individual units against the price and performance of other competitively tendered and negotiated units in a region.

The benefits of negotiating some contracts as opposed to putting all out for tender include, providing operators with additional security to invest in public transport assets and participate more fully in developing a quality network, potentially lower transaction costs for both regional councils and operators in negotiating a contract, and a stable core of operators to maintain network integrity. Negotiated contracts also provide an incentive for both incumbent and new entrant operators to perform well, as high performance can be rewarded through the use of negotiation and longer tenure.

It is expected, as regions transition to the proposed operating model, that incumbent operators will be the first operators to have contracts awarded through direct negotiation rather than through tendering. This would be in exchange for surrendering existing single timetabled commercial services and acknowledgement of the value the incumbent operators bring to the delivery of public transport.

52. Having reviewed the proposed model, I consider it goes a long way to introducing the right type of incentives to assist with meeting the dual objectives identified under paragraph 48 and my wider expectations. It provides a better balance between regional councils' interests and operators' interests and comes back a long way from the most likely outcome under the PTMA—highly regulated urban bus and ferry markets. Also, because it was developed in collaboration with the sector, I expect participants will be more committed to making the model work.

An important trade off

53. The critical trade-off the PTOM makes is that not all units will be put out to tender and, once a contract has been secured,¹² the incumbent operator will have exclusive rights to provide services within the boundaries of the unit. The trade off being made is a potential loss in entrepreneurial competition between operators and creating an attractive, integrated and connected network that will attract more people to use urban bus and ferry services. As more people use the network, the cost per passenger should come down and the benefits to non-users (eg reduced congestion) should go up.
54. I note that some competition does exist between operators for tendered services. Competition continues to be strong in Canterbury and smaller regions. Competition in the two largest public transport markets of Auckland and Wellington, however, has been weak since the mid 1990s (an average of just over one bid per tender in both regions).
55. ARTA and GWRC consider that the ability of operators to register single timetabled commercial services was the main reason that competition for contracts in Auckland and Wellington has been weak. Canterbury, which has never allowed operators to register single timetabled services as commercial, is presented as the counter-factual. Without the registration of single timetabled services as commercial, they have not experienced the problems that GWRC and ARTA have experienced. ARTA and GWRC believe that more competition will occur under the PTOM than previously occurred under the TSLA, if not quite to the same level of competition that might be achieved if all units were subject to a competitive tender.
56. The PTOM does seek to limit the risk of reduced competition by creating competition between units, including those that have been negotiated. The relative performance of all units will be compared to encourage improved performance across the network. Operators with a directly negotiated contract will be expected to meet base quality and performance standards, and prices for negotiated contracts will be informed by prices received for competitively tendered contracts.
57. Operators with poor performing negotiated units will see those units at risk of going out to tender, and operators with good performing units, be they tendered or negotiated, may be able to extend their existing tenure. Performance contracts will need to be designed to accommodate this possibility.
58. In addition, I will also be looking to the further testing of the PTOM to provide me with confidence that units that are likely to be put up for tender generate robust competition between operators. The prices set for tender units will be important for assessing what is a fair price for negotiated units.
59. On balance, I consider the potential trade-off between competition and good network design is likely to generate better value for money outcomes than if all services were subject to competitive tender and incumbent operators did not have exclusive rights of operation. The PTOM requires genuine partnership between the key stakeholders to

¹² Either through a competitive tender or negotiation process.

create an attractive network, and the use of negotiation and longer tenure as incentives to work together may outweigh the costs of reduced competition.

60. I have yet to come to a final view on the trade-offs and whether the benefits do outweigh the costs. I am looking to the further development and on-the-ground testing of the PTOM to help clarify what the costs and benefits of the PTOM are.
61. If I consider progress in the next few months is successful and the PTOM looks to be a viable option changes to existing legislation and NZTA procurement practices may be required. The PTMA may need tightening up to ensure that practices developed during the testing period are carried on. The NZTA's procurement manual may require changes, as standard practice is to only use negotiated contracts in circumstances where the benefits outweigh the cost of closed negotiation.

Further testing of the PTOM

62. The parties in Auckland and Wellington who have been involved in the development of the proposed model are prepared to further 'flesh out' more detailed aspects and test the PTOM concepts. For example, there is a need to determine what a region's public transport network would look like when segmented into units, and what should be included in performance-based contracts. Importantly, this testing would identify what units should be subject to tendering or negotiation, and what units should be put out for tender as part of an initial tender round to maximise the probability of a truly competitive outcome and generate confidence in cost.
63. I am supportive of this testing period, as it will enable a more robust assessment of the proposed PTOM, and will provide a good indication of participants' actual support of the model.
64. ARTA, GWRC, the BCA, and operators in the Auckland and Wellington region are participating in this phase. It will be carried out under the current legislative framework provided by the PTMA. To ensure good faith, a memorandum of understanding will be agreed between the parties which will impose a voluntary limit on the scope of powers provided under the PTMA.
65. I understand that ARTA and GWRC will identify several units (likely to be three in Auckland, two in Wellington), that will be tendered out. At the time of tendering, these units will not contain any single timetabled services registered as commercial so there will be confidence that tenders will attract efficient prices and potentially attract new entrants.
66. A similar number of units (representing a relatively small proportion of the total network) will also be earmarked for a direct negotiation with the incumbent operator. Contracts for these units will only be awarded once robust price benchmarks are available from the units that have been competitively tendered.
67. It is important to note that regardless of whether I consider that the PTOM concept is viable, or not after the testing phase, I expect that contractual arrangements for the units that have been identified as being tendered or directly negotiated (as set out in paragraphs 65 and 66) will be honoured.

68. The good faith being shown by the parties to impose a voluntary limit on the use of certain powers available under the PTMA is a positive signal of their expectation that the PTOM is workable and desirable. This arrangement is premised however, on the expectation that if the PTOM is proved, the government will support appropriate changes to the legislation that remove the powers no longer required. No decision on these matters is therefore needed at this stage, but Cabinet should be aware of my intention to seek changes to the PTMA if further testing of the PTOM is successful and the changes are warranted.

Report back to Cabinet

69. I will be monitoring the testing phase closely and I have indicated to the Ministry of Transport, the NZTA and other participants the areas I will be making my assessment of the PTOM concepts. These areas are likely to include the following:
- 69.1. extent to which competition has been impacted, and is likely to be impacted
 - 69.2. the type of network outcomes the PTOM would generate
 - 69.3. whether the performance-based contract that would apply to all units is likely to deliver PTOM outcomes
 - 69.4. implications for regions outside of Auckland and Wellington.
70. The timing of my report back to Cabinet is dependent on the progress made by participants. However, I am expecting to be able to report back to Cabinet within the next 6 months. If at that time I consider that further testing of the PTOM demonstrates 'proof of concept' and means that the PTOM is a viable solution, I will be asking for Cabinet's agreement to the new model, including making recommendations for changes to the PTMA, if required.

Improving Public Transport Effectiveness Action Plan

71. The PTLF has agreed to a framework for improving public transport effectiveness and a 3-year action plan which incorporates existing sector work programmes and future work. The Action Plan is a sector effort that complements the development of the PTOM and involves many of the same people involved in the PTOM project.
72. The vision underpinning the Action Plan is to '*grow public transport as a mode of choice in our cities by developing a cost effective, smart and reliable public transport network*'. The Action Plan focuses on improving customer experience, providing a more integrated public transport network, and strengthening sectoral leadership.
73. The NZTA facilitated the development of the Action Plan and is facilitating its implementation. Key actions include:
- 73.1. developing a customer care culture for the Rugby World Cup and beyond
 - 73.2. improving public transport customer information and service reliability reporting

- 73.3. rolling out network improvements like public transport service planning with land use development and publicly reporting on on-time running and reliability for services
 - 73.4. implementing demonstration projects prior to the Rugby World Cup like fast track key priority routes, particularly between the city and airport in Auckland
 - 73.5. benchmarking public transport service performance
74. The action plan will be a catalyst to achieving further alignment and collaboration across the public transport sector. The short-term focus on improving effectiveness aspects of public transport in time for the Rugby World Cup gives impetus for the sector to commit to working together to achieve a common goal. From a customer perspective, customers should see real improvements across the public transport network and these will encourage increased use of services.
75. The NZTA will keep me informed of progress against the action plan.

Consultation

76. The Ministry of Transport has consulted with the Treasury, Ministry of Economic Development, Department of Internal Affairs, Ministry for the Environment, Ministry of Education, Office for Disability Issues, and Office of Senior Citizens.
77. The Treasury and Ministry of Economic Development are concerned about the potential loss of competition under the PTOM that is discussed under the heading “*An important trade-off*” (paragraphs 53 to 61), and will be looking closely at the competitive impact of the PTOM. Their main concern is that not all units will be subject to competitive tendering.

Financial implications

78. There are no financial implications associated with this paper. The on-the-ground testing of the PTOM is being done within baselines. Funding for urban bus and ferry services is provided via the NLTF through the GPS. In the 2009 GPS I effectively capped public transport expenditure over the next six years, and am looking to the above initiatives to achieve patronage growth without an increased need for public subsidy.

Human rights implications

79. The proposals contained in this paper do not have human rights implications.

Legislative implications

80. There is no legal barrier to further testing the proposed PTOM concepts under the PTMA. There was some concern that the on-the-ground testing might contravene the Commerce Act 1986. However independent legal advice received by the Ministry indicates that, provided the testing of the proposed PTOM is agreed to be within the ambit of the PTMA, it is unlikely there will be adverse implications under the

Commerce Act 1986. The Ministry shared this view with those involved with further testing of the PTOM and advised that they seek their own separate legal advice if they wanted further assurance.

81. Depending on the outcome of the testing and a decision on whether to proceed with full implementation of the PTOM there may be a need for some legislative changes in the future.

Regulatory Impact Analysis

82. As this paper is primarily an information paper and only seeks Cabinet's agreement that I report back in 2011 on progress with testing the PTOM concepts, a Regulatory Impact Statement (RIS) is not required.
83. If I decide to seek Cabinet's formal endorsement of the PTOM a RIS will be prepared by the Ministry of Transport. The RIS would look at a range of cost and benefits including the impact on competition for contracts, service costs, demand, subsidy levels, network design (service efficiency and effectiveness), implementation, and non-user benefits like reduced road congestion. The Ministry of Transport would also give consideration to the need for independent expert analysis to assist in the assessment of costs and benefits.

Gender implications

84. There are no gender implications associated with the proposed PTOM.

Disability perspective

85. The proposed PTOM does not directly impact on the delivery of services and is not expected to have an impact on the accessibility of public transport services. The development of a base performance contract applicable to all units should ensure minimum service and bus design standards will be applicable to all services whether provided on a fully commercial basis or under contract to a regional council.

Publicity

86. I intend writing to the participants involved in further testing the PTOM concepts and other parts of the sector advising them that Cabinet has been informed about the PTOM and its development, and that I will be reporting to Cabinet in 2011.

Recommendations

87. It is recommended that the Committee:
 - 1) **note** that central and local government spending on public transport has increased significantly over the last 10 years
 - 2) **note** that growth in government spending has not led to a commensurate increase in public transport patronage

- 3) **note** that within the bus and ferry sector there has been a noticeable deterioration in the relationship between some bus and ferry operators and regional councils
- 4) **note** that the increased spending on public transport is unsustainable and the lack of patronage growth and deterioration in relationships raise concerns about the value for money being received from public expenditure
- 5) **note** that I have already taken steps to improve value for money from public transport expenditure, but more needs to be done
- 6) **note** that in relation to urban bus and ferry services, a range of initiatives are being progressed to improve value for money that will contribute to more attractive and cost effective services that will result in increased patronage with less reliance on subsidies
- 7) **note** that work is progressing on a Public Transport Operating Model that is focused on developing a robust operating environment for the delivery of urban bus and ferry services and is reliant on a partnering approach
- 8) **note** that the proposed operating model was developed in close collaboration with the Auckland Regional Transport Authority, Greater Wellington Regional Council, Environment Canterbury, the New Zealand Transport Agency, the Bus and Coach Association, individual bus and ferry operator representatives and the Ministry of Transport
- 9) **note** that I believe the proposed operating model goes a long way to meeting the objectives and expectations for public transport that I have shared with the wider public transport sector
- 10) **note** that participants in the development of the proposed operating model intend to further test the model to 'flesh out' detailed matters associated with the proposed operating model
- 11) **note** that I am supportive of further testing of the proposed operating model to demonstrate 'proof of concept'
- 12) **agree** that I report back to Cabinet by April 2011 on progress and, if I consider that further testing of the proposed operating model demonstrates 'proof of concept', seek Cabinet's agreement to the proposed operating model, including making recommendations for changes to the Public Transport Management Act 2008, if required
- 13) **note** that the New Zealand Transport Agency is facilitating a project in close collaboration with the wider public transport sector to improve the effectiveness of public transport
- 14) **note** that the vision for improving the effectiveness of public transport is to grow public transport as a mode of choice in our cities, by developing a cost effective, smart and reliable public transport network

- 15) **note** that the project to improve the effectiveness of public transport complements work being done on a new operating model for public transport delivery
- 16) **note** that a 3-year action plan has been prepared by representatives of the wider public transport sector to improve public transport effectiveness, and I will be monitoring progress against the identified actions in the plan
- 17) **note** that I intend writing to the participants in the further testing of the public transport operating model and other parts of the sector advising them that Cabinet has been informed about the operating model and its further development, and that I will be reporting to Cabinet in 2011 on progress.

Steven Joyce
Minister of Transport