

Chair
Cabinet Economic Growth and Infrastructure Committee

INTRODUCTION OF A NEW POLICY FRAMEWORK FOR BUS AND FERRY PUBLIC TRANSPORT SERVICES

Proposal

1. This paper provides a report back on the development of a new public transport operating model for urban bus and ferry services and seeks agreement to the introduction of a new policy framework to improve value for money from these services.

Executive Summary

2. Value for money from government spending on public transport needs to improve. Increases in government spending over the past 10 years have not been met with commensurate increases in public transport patronage. Within the bus and ferry sector, relationships between some operators and regional councils have deteriorated and regulatory uncertainty has led to a 'deadlock' in some regions, with contracts being repeatedly extended and not going out for tender. Direct competition is virtually non-existent, because of the limited size of New Zealand's public transport market, and where tendering has occurred the number of bids has been low, particularly in Auckland and Wellington. There has been little market pressure to improve quality and drive down costs.
3. To improve value for money, I effectively capped central government funding for public transport services in the 2009 Government Policy Statement on Land Transport Funding (GPS). I also looked to the sector (regional councils, operators and the New Zealand Transport Agency) to develop a new operating model that supported my goal to grow patronage with less reliance on public subsidies. In November 2010, I provided you with an update on the development of a new public transport operating model (PTOM). At that time, I considered that further work was needed to confirm that PTOM would deliver on my goal. This work is now complete, and I am seeking policy decisions and legislative amendments to support the implementation of PTOM.
4. In an ideal world, competition drives improved quality and decreased prices and provides consumers with choice. However, this is not happening in the urban bus and ferry market and is unlikely to develop naturally. We needed to look at a different model which creates the necessary incentives for operators to reduce prices and improve service quality whilst also enabling the delivery of joined-up public transport services through more of a public-private partnership approach between regional councils and operators.
5. The introduction of PTOM represents a fundamental shift in the delivery of urban bus and ferry services. Under PTOM public transport services, that form part of the region's urban public transport network, will be grouped together into units and provided under contract with the regional council to enable stronger network co-ordination and a basis for joint investment. This replaces the existing practice of

operators being able to register single timetabled services on a route as commercial, and regional councils having to 'contract around' these services with subsidised services — a practice that led to poor tender outcomes and network development.

6. Units will be operated on an exclusive basis for the duration of their contract, and where appropriate procured through a mixture of competitive tendering and direct negotiation based on unit performance. Sufficient units will have to be put out to tender to ensure confidence in costs. Operators will still be able to set up new public transport services outside of the existing urban public transport network. These services will be exempt from contract and will not have exclusive operating rights (ie other operators will be able to set up competing services).
7. Both legislative and administrative changes will be required to implement PTOM. PTOM encompasses a range of planning, funding and procuring tools that have been developed with the needs of the three largest public transport markets (Auckland, Wellington and Christchurch) in mind. Many of these tools may be utilised by smaller markets, but not all will be mandated through legislation. I recommend that amendments to legislation be kept simple and limited essentially to the introduction of the unit concept and the requirement for all public transport services to be under contract with the regional council unless exempt.
8. Properly implemented, PTOM will introduce competition to the system by incentivising operators to compete for exclusive operating rights and directly negotiated contracts. Contractual arrangements allow regional councils to prevent exploitation of these provisions through regulating fare setting and use of cost benchmarking. I consider that PTOM will deliver on my goal and provides a better way forward, to improve value for money, than currently exists.

Background

9. Public transport contributes to economic objectives by reducing congestion, improving and enabling access to employment, health and education. It is also a significant employer in its own right. Governments have supported the provision of public transport because of the wider economic and social benefits it can provide. In 2009/10 central and local government spent approximately \$224.3 million purchasing urban bus and ferry services¹. This funding is in addition to government investment in public transport infrastructure.
10. Between 2000/01 and 2009/10, government funding for urban bus and ferry services increased by approximately 131 percent (in real terms) yet patronage grew by only 44 percent. This is of concern to me, as I do not consider that government is getting the best value for money from its spending on public transport. In November 2010, I updated you on policy work being undertaken to increase the use of urban bus and ferry services with less reliance on subsidies (CAB Min (10) 42/6 refers).
11. One of the key initiatives of this work was the development of a new public transport operating model (PTOM). When I reported to you in November, I had yet to conclude that the new model would deliver on my goal for public transport and asked for more work to be done to test 'proof of concept'. This paper reports back on this testing and

¹ This funding is broadly split fifty: fifty between central and local government.

seeks policy and legislative decisions to proceed with implementation of the new model.

The new proposed PTOM

Objectives

12. The development of PTOM has been undertaken through a collaborative exercise led by the Ministry of Transport over the last 2 years. I have looked to the sector to come up with a solution that meets my goal for public transport to grow patronage with less reliance on public subsidies. The key stakeholders that developed the model included representatives from the New Zealand Transport Agency (NZTA), Auckland Transport (AT), Greater Wellington Regional Council (GWRC), and the Bus and Coach Association (BCA). Environment Canterbury (ECAN) and other regional councils have also had input into the model through presentations at Regional Transport Officer (RTO) forums.
13. To assist the sector to develop an appropriate model I set the following two objectives.
 - 13.1. Grow the commerciality of public transport services and create incentives for services to become fully commercial.
 - 13.2. Grow confidence that services are priced efficiently and there is access to public transport markets for competitors.

Current situation

14. At the moment, public transport services are delivered through a mixture of commercial and contracted services. It is up to operators to identify what services they wish to provide on a commercial basis (ie without public subsidy). A commercial service can be a single timetabled service running from one point to another (for example the 10.48 am from Smithville to the city). Regional councils then determine what other services are necessary to the urban public transport network. These services are then 'contracted around' the commercial services to fill service gaps.
15. The practice of registering single timetabled services as commercial has hampered regional councils' ability to provide an integrated public transport network and achieve network efficiencies, as these services are not under contract with the regional council and do not have to conform to service standards or fare standards. The presence of commercial registrations has also arguably contributed to poor tender outcomes (on average just over one bid per tender in Auckland and Wellington) and higher prices than in regions where competition is more robust. This has led to increased tensions between regional councils and operators.

Components of PTOM

16. PTOM is essentially a combination of planning, funding and procurement tools that encourage the increasing commerciality of services (ie less reliance on subsidy to cover costs) and value for money from public expenditure. The model seeks to build more of a public-private partnership and improve the relationship between regional councils and operators. It will do this by creating an environment of aligned goals and objectives through collaborative planning, joint investment and risk and reward sharing. Components of the model are a result of detailed discussions and negotiation

between the parties involved in their development. The key tools, or components, of PTOM are outlined below.

Units

17. Under PTOM, the regional council will be responsible for determining what bus and ferry services are part of the region's urban public transport network, and segmenting these services into units, through the Regional Public Transport Plan (RPTP). A unit must be no less than a full route, and must include all the timetabled services for that route (ie 24/7). This will replace the current ability for operators to register individual trips as commercial under the Public Transport Management Act 2008 (PTMA), and provides a more appropriate basis for determining the commerciality of a service. Operators will still be able to initiate new public transport services, as long as these services do not require public subsidy, adversely affect the financial viability of existing units, increase the net cost of an existing unit, or cause traffic management issues, in which case the regional council may decline the service.

Contracts

18. Units, including those provided on a fully commercial basis, will be operated exclusively under contract with the regional council. This will replace the current ability for regional councils to impose controls or a contracting requirement on commercial services registered under the PTMA. Contracts will be performance based and used to ensure consistent service standards, fare structures and service co-ordination across the network. Contracts are also likely to contain a mechanism for sharing risk and reward between regional councils and operators, to ensure that both parties are incentivised to grow the patronage of the service.

Exempt services

19. Services that do not form part of a region's urban public transport network (as identified in a region's RPTP) will be exempt from operating as a unit under contract, and will not have exclusive operating rights. Other operators will be able to set up competing services to an exempt service, should they consider it financially viable to do so. Regional councils will not be able to specify service standards on these exempt services (such as integrated ticketing), or regulate their fares. However, details of exempt services will be held by the regional council on a public register.
20. Under legislation the following services will be exempt from inclusion in a region's urban public transport network as a unit under contract:
- inter-regional services
 - existing fully commercial ferry services, as at 30 June 2011
 - existing fully commercial bus services that operate on a full route/full timetable basis, without direct subsidy², and offer only 'special fares'³, as at 30 June 2011⁴

² Direct subsidy does not include funding that an operator may receive for a service through separate government initiatives such as SuperGold Card (\$22 million for 2010/11) or Concessionary Fare Scheme funding (\$12 million for 2010/11).

³ 'Special fares' are fares that do not conform to the regional council fare structure as set out in the RPTP. The existence of special fares (without the provision of standard fares) is used as an indicator to determine that the existing service is outside of a region's core public transport network. Services such as the Airbus in Auckland offer only special fares.

- ‘new’ fully commercial services, proposed by operators and not identified by the regional council in the RPTP, that operate on a full route/full timetable basis, without direct subsidy from 1 July 2011

21. A mechanism allowing the Governor-General, on the recommendation of the Minister of Transport, to either exempt a service or bring an exempt public transport service back under a unit contract, if certain criteria are met, is also proposed.

Unit procurement

22. Contracts will be let through a mixture of competitive tendering and direct negotiation. A competitive tender process is necessary to provide confidence that the prices paid are efficient, and to allow for new entrants. On the other hand, the ability to continue operating without facing a tender process is expected to incentivise operators to grow the commerciality and patronage of services, and encourage investment.

23. Where a unit is directly negotiated, contract tenure will be for 6 years. Where a unit is procured through a tender process, contract tenure will be for 9 years. Tenure length is important for both incumbent and new entrant operators, to recoup their capital investment over a reasonable time period. The longer tenure length for tendered contracts is to incentivise new entrants to enter local markets and provide them with time to get established. The shorter tenure length for negotiated units is to allow for benchmarking information from tender rounds (see paragraph 26 below) to be used to ensure these units are priced efficiently.

24. How much of a region’s services can be directly negotiated will depend on the overall commerciality of services within the region and the overall size of a region’s public transport network. That said, sufficient units must be put out to tender to ensure confidence in costs. Smaller markets, that operate fewer services, may need to put all contracts out for tender to ensure this. The NZTA will provide advice to regions on using direct negotiation as a procurement tool.

League table (commerciality and patronage growth)

25. The relative performance of each unit within a region (in terms of commerciality and patronage growth) will be compared to encourage improved performance across the network and competition outside of tender rounds. Units will be ranked in a league table, with the highest performing units at the top and the poorest performing units at the bottom. The league table can then be used to determine which units will be subject to tender or direct negotiation at the end of a contract. At the end of a contract term, units situated in the upper portion of the league table will be directly negotiated with the incumbent operator, whilst units in the lower portion of the league table will go out to tender. The direct negotiation of a new contract does not guarantee that negotiations will always be successful. Regional councils will still be able to tender units, where direct negotiation has failed. Incumbent operators will then be able to apply for the contract, along with others, through the tender round.

⁴ This date has been used so that regional councils and operators can not change current services to use this clause to either exempt or contract existing services.

Cost benchmarking

26. To increase confidence in costs for negotiated units, costs set will be benchmarked against tender prices. Cost benchmarking based on information from competitive tender rounds will be used to inform both direct negotiation with an incumbent, and gross cost resets during the contract term of tendered units⁵. If a mutually acceptable price is unable to be agreed during negotiations the unit will have to go out to tender.

Fully commercial units

27. A fully commercial unit is one that does not require a subsidy in order to run. However, a fully commercial unit may still receive funding from central or local government for initiatives such as SuperGold Card or concessionary fares which are not linked to the commerciality of a service. Operators and regional councils will work together to grow existing subsidised units into fully commercial units through joint investment, marketing and other initiatives that aim to improve the patronage of the service.
28. Once a unit is fully commercial it will still operate under contract with the regional council. The contracts for fully commercial units will have similar provisions to subsidised units but will be given a longer tenure length of 9 years. This tenure length is proposed as an incentive to operators to become fully commercial. It is important that these services continue to operate under contract with the regional council to ensure consistent service delivery and co-ordination across the network, and to recognise the investment that regional councils also make in growing these services.

Regional Public Transport Plans (RPTPs)

29. The adoption of an RPTP will still be required for all regional councils that enter into unit contracts for public transport services. RPTPs will be used to ensure regional councils act in a fair and transparent manner when making decisions about services that impact on operators. This will be achieved by requiring regional councils to include policies on these matters in their RPTP, and consult on them.

Revenue and patronage data

30. Revenue and patronage data for all units will be provided by operators to the regional council and the NZTA on an ongoing basis. The data must cover a period of at least 3 years. This is intended to improve transparency and allow for effective joined-up planning. Revenue information will be disclosed to potential bidders during tender time in a controlled manner. Patronage data will be published by the regional council.

Offence, penalty and appeal provisions

31. Under PTOM, it will be an offence to operate a public transport service that is not either an approved public transport service operating as a unit under contract with the regional council or a registered exempt public transport service. It will also be an offence to vary services or withdraw services without notification to the regional council. These offences will replace current offence provisions relating to commercial public transport services in the PTMA. The level of the fines will remain the same.

⁵ Gross cost resets are where recent cost information from tendering is applied to an existing unit through a benchmarking process to determine whether the estimated gross cost for the unit is consistent with prices being set for new unit contracts.

32. Disputes between operators and regional councils will generally be managed through standard contractual arrangements. Further recourse for operators will include an appeal procedure to the District Court and/or Environment Court if an operator considers there has been an adverse decision by a regional council under PTOM.

Transitional provisions

33. To support the transition to PTOM and recognise the value existing commercial registrations represent to incumbent operators, AT and GWRC have agreed with incumbent bus operators that a proportion of units will be negotiated on a 'like-for-like' basis. The proportion of units that will be negotiated on a 'like-for-like' basis will be based on the equivalent amount of annual in-service kilometres represented by commercial registrations as at 30 June 2011.
34. Bus operators who are offered units on a 'like-for-like' basis will receive an initial contract term of 12 years. 'Like-for-like' contracts will have exclusive operating rights over the contract term, but will also be informed by cost benchmarking results prior to being entered into. Subsequent terms, if a new contract is entered into, will either be for 6 years if negotiated or 9 years if tendered.
35. The provision of a 12 year contract is a transitional concession to operators from government. It recognises the investment that operators have made in commercial services, acting in reliance on the current legislative requirement to simply register these services with the regional council.
36. All existing commercial registrations held by incumbent operators will have to be de-registered before 'like-for-like' units are awarded. This is necessary to enable regions to undertake initial tender rounds on a unit basis and establish cost benchmarking information to inform 'like-for-like' contract negotiations.

Summary table

37. A summary table of the key components of PTOM and how they will apply to units is provided below. This table represents units in 'steady state', and does not include 'like-for-like' units which will have an initial tenure of 12 years as discussed above.

Key model components	Subsidised units	Fully Commercial units	Exempt services
Contract with regional council	√	√	X
Contract tenure	9 years (tendered) 6 years (negotiated)	9 years	n/a
Fares & services regulated	√	√	X
Exclusive operating rights	√	√	X
Included in the league table	√	√	X
Risk and reward share	√	√ (case by case basis)	X
Cost resets (after 6 years)	For tendered units	X	X

Proof of concept

38. In November I agreed to monitor further testing of PTOM, assess 'proof of concept', and report back to you on:
- the extent to which competition has been impacted, and is likely to be impacted

- the type of network outcomes PTOM would generate
- whether the performance-based contract that would apply to all units is likely to deliver PTOM outcomes
- implications for regions outside of Auckland and Wellington

Extent to which competition has been impacted, and is likely to be impacted by the introduction of PTOM

39. Competition, where effective, encourages businesses to deliver benefits to customers in terms of price, quality and choice. To assist with assessing the competitive impact of PTOM, the Ministry of Transport commissioned an independent competition assessment of PTOM. The findings of this work are discussed in the regulatory impact statement (RIS) that accompanies this paper. In summary, the analysis found that PTOM was likely to have both negative and positive effects on competition — with the overall effect on competition likely to be impacted by the way in which PTOM was implemented.
40. Areas in which PTOM might have a negative effect on competition include:
- contract length
 - exclusive operating rights
 - direct negotiation of some unit contracts
41. As a result of the competition assessment, revisions have been made to the model, including reducing proposed contract tenure lengths for directly negotiated units from 12 to 6 years, and for tendered units from 12 to 9 years. Also, I have ensured that there is greater clarity around the types of services that will be exempt from operating as a unit under contract (refer to paragraphs 19-21 above), providing an opportunity for competition to occur outside of a region's core public transport network.
42. I also propose to establish a robust monitoring regime to ensure PTOM is implemented as planned (refer to paragraphs 67-69 below).
43. Competition for public transport can either be 'in the market', that is for passengers, or 'to get into the market', that is for contracts. There is currently very little direct competition between operators for passengers. The New Zealand public transport market is not large enough to support more than one operator on most services. Nor is it clear that greater direct competition for passengers results in better public transport outcomes. A recent report by the United Kingdom Competition Commission has concluded that direct competition within bus markets between operators for passengers has not always led to the best outcome and has exacerbated fare growth.
44. There has also been very little competition for tenders and low contract turnover (ie replacement of an incumbent operator with a new operator), particularly in Auckland and Wellington⁶. Two likely causes of this low competition are the use of commercial registrations by operators for individual trips and short contract tenures.

⁶ A review conducted by L.E.K. on tenders undertaken in 2004/05 found: an average of 1.33 bids per tender in Auckland and 1.12 in Wellington compared to an average of 2.39 bids per tender in Canterbury and lower contract turnover in Auckland (17 percent), Wellington (12 percent) compared to Canterbury (39 percent).

45. The provision of exclusive operating rights and directly negotiated contracts is intended to incentivise operators to invest in their assets and marketing to grow patronage for services within a region's core public transport network. Regional councils will be able to limit exploitation of exclusive rights through contractual arrangements including regulating fare setting, entering into risk and reward sharing arrangements⁷ and use of cost benchmarking.
46. Although less of the public transport network will be put out to tender under PTOM, tendering on a unit basis, with longer contract tenure, should be more attractive to potential bidders. Increased competition for tenders will increase confidence in costs across a region's entire network as tender results will also be used to inform prices for negotiated units, through benchmarking.
47. In addition, use of league tables creates a post-tender competitive tension between operators. The incentive to perform above expectations and relative to the performance of other units is the potential to negotiate a new contract for a unit rather than bid for it through a tender round.

The type of network outcomes PTOM will generate

48. Under PTOM the majority of public transport services will be provided under contract with the regional council, ensuring the coordination and cooperation on service delivery within regions. Operators will have greater input in the development of RPTPs, through contractual provisions around service development and business planning. Joined up business planning and investment between regional councils and operators will contribute to more efficient service design. Units also provide a better basis for business planning purposes as the focus is on identifiable sub-markets and their needs, rather than individual trips.

Whether the performance-based contracts that apply to all units are likely to deliver PTOM outcomes

49. It is envisaged that the same base contract will be applied to all units within a region to ensure consistent service delivery. Contracts will provide a platform for partnership and will include appropriate key performance indicators (KPIs) and risk and reward sharing arrangements. KPIs will be linked to patronage targets, and the use of a financial risk and reward mechanism will also incentivise parties to perform in ways that promote patronage growth and generate fare-box revenue, thus reducing reliance on public subsidies.

Implications for regions outside of Auckland, Wellington and Canterbury

50. The components of PTOM can be utilised to serve smaller public transport markets but may require a level of tailoring. The key components of PTOM I have identified as applying to all regions are those that I am proposing as part of a legislative change, such as dividing the public transport network into units provided under contract. Other components of PTOM, such as direct negotiations for contracts, are tools that may be

⁷ Risk and reward sharing arrangements are where contract payments may be adjusted up or down to take into account increases or decreases in revenue collected through fares.

used by regions who can demonstrate a value for money case when seeking approval for procurement procedures from the NZTA⁸.

51. Outside of Auckland, Wellington and Canterbury, the Otago region is the most likely region to be affected by the implementation of PTOM⁹. The Otago Regional Council currently offers routes that are split between weekday services (that have often been registered as commercial) and weeknight/weekend/holiday services (that are contracted), which would not meet the PTOM definition of a unit. The NZTA will work with all regions during any transition to PTOM, to ensure that impacts are managed.

Other implications — ferry services, interest from non-incumbents, metro rail services

52. Urban ferry markets are small in New Zealand. Most ferry services, that perform a public transport function, operate in Auckland. Wellington and Christchurch have one ferry service each. These services are patronised by both residents and tourists. A few ferry services in Auckland are operating on a fully commercial basis (ie are not subsidised, and therefore not under contract with the regional council).
53. Ferries operating on a fully commercial basis (such as the Waiheke ferry), will be exempt from operating under contract and will not have exclusive operating rights. These niche services, like the fully commercial bus services with special fares, are not services that are integrated into the core public transport network. Because they are non-exclusive, operators of these services may face direct competition from other ferry operators. Ferry services that receive a subsidy will be operated as a unit under contract, with exclusive operating rights, and the regional council will be able to regulate fares and service standards.
54. Under PTOM, where exempt ferry services are operating there must be access to the market for other operators to ensure there is some competitive pressure to keep fares in check and maintain efficient service delivery. Consequently, I would expect regional councils and the NZTA to work to reduce barriers to entry for new services (such as limits to wharf access). Alternatively, if the efforts of the regional council and the NZTA do not prove effective in preventing monopolistic behaviour on the part of the operator, the mechanism discussed in paragraph 21, allowing the Governor-General on the recommendation of the Minister of Transport to require exempt services to be provided under contract with the regional council, could be used.
55. It has been challenging to determine the level of interest in PTOM from non-incumbents, as the competitive tendering envisaged in Auckland is yet to occur. It is highly likely that most of the potential competition for tenders will come from New Zealand based operators. Where New Zealand operators have actively competed with each other for tenders (eg Canterbury), resultant prices have been lower than in regions where competition has been weak. I am expecting regions embarking on tender rounds to take pro-active steps to ensure potential bidders are aware of upcoming opportunities.

⁸ The NZTA has an independent function under section 25 of the Land Transport Management Act 2003 to approve the procurement procedures of regional councils (these are set out a regional council's procurement approach, for example conditions around negotiated contracts, tender rounds, and monitoring competition).

⁹ The predominant procurement approach for most regions with smaller markets will be to competitively tender packages of services that operate on an exclusive basis for the duration of the contract. There are very few commercial registrations that are not already a full route, full timetable.

56. PTOM should not impact directly on metro rail services which are already provided under contract to AT and GWRC and operated on a unit basis. The procurement approach taken by PTOM and to metro rail services is consistent.

Conclusion

57. I consider, on the basis of the analysis above, that 'proof of concept' has been established.

Implementing PTOM

58. Legislative and administrative changes will be required to implement PTOM.

Legislative amendments

59. Public transport services are currently regulated under the Public Transport Management Act 2008. Officials have recommended that the PTMA be repealed and its provisions incorporated into the LTMA. The purpose of the two Acts are sufficiently aligned, and having one piece of land transport management legislation, with one purpose, makes sense from a legislative design point of view and from a user perspective.
60. To support the implementation of PTOM, I recommend that the legislative provisions relating to public transport services are amended. Amendments will be kept simple to aid the flexibility of PTOM and will be limited to the following PTOM components.
- A requirement for the regional council to segment all public transport services in its urban bus and ferry network into units for the purposes of procurement and planning (unless exempt), and identify new units through its RPTP.
 - A requirement for all units to be provided under contract with the regional council and operated on an exclusive basis.
 - A mechanism for regional councils to consider new public transport services or changes to services proposed by operators, and to decline or exempt these services.
 - A requirement for information on exempt services to be kept on a public register by the regional council.
 - Removing the ability for operators to register commercial services, and all requirements relating to commercial services (including the contracting requirement and controls).
 - Policies that the regional council must provide in its RPTP.
 - Information that operators must provide to regional councils and the NZTA.
 - Offence and appeal provisions.

Non-legislative implementation

61. Many of the components of PTOM do not require changes to legislation and can be implemented through changes to NZTA's procurement manual, guidelines for regional public transport plans and the development of guidelines for contract and tender best practice. The NZTA procurement manual will be amended to allow the use of tools such as the league table and cost benchmarking to enable a regional council to undertake direct negotiation with incumbent operators.

62. The NZTA has a statutory function under section 25 of the LTMA to approve regional council procurement procedures (which are a detailed account of a council's procurement approach). It will have an essential role in providing confidence to government that value for money is obtained from its use of the National Land Transport Fund for bus and ferry services through a PTOM approach. The NZTA also endorses regional council procurement strategies, which contain the council's high level approach to procurement, and which are expected to be consistent with their procurement procedures.
63. Regional councils can adopt PTOM components through amendments to their procurement strategies and procedures once these are endorsed and approved by the NZTA. This process can commence ahead of changes to legislation. The NZTA will also assist smaller regions to work through the implementation of PTOM components where appropriate.

Progress in Auckland, Wellington and Canterbury

64. At this time, AT is the most advanced with plans to implement PTOM and has identified all units for the Auckland region in its first RPTP that was adopted in 2010. It has since prepared a draft league table. AT is finalising a transition plan to these units including which units will be allocated to tendering and which will be negotiated. AT will proceed with the implementation of PTOM with the agreement of Cabinet.
65. GWRC is currently conducting a service review of Wellington city public transport services, due for completion in December 2011. When this is completed, the work to segment the region's public transport network into units will commence. It is expected that by mid 2012 GWRC will have revised its RPTP to incorporate PTOM and will have identified which units will be included in the region's initial tender and negotiation round under PTOM.
66. ECAN is in the process of implementing some aspects of PTOM as appropriate for post-earthquake circumstances. It is expecting to directly negotiate new contracts with incumbent operators, rather than going out to tender, given the significant changes to the network that are likely now and over the next 5 years. The council will use price benchmarking to assist with the negotiations. It is focussed on using a partnership approach and on growing commerciality. New contract agreements, the concept of a unit, collaborative planning, and a league table will be introduced.

Monitoring, evaluation and review

67. Monitoring and evaluation of PTOM, on an ongoing basis, will be led by the NZTA in consultation with the Public Transport Leadership Forum (PTLF)¹⁰. Regular reporting will occur through existing channels eg meetings with the Minister of Transport and annual and quarterly reporting.
68. The NZTA will monitor and report on key metrics that indicate how PTOM is meeting its goals and objectives. For example:
- obtaining value for money

¹⁰ The PTLF involves representation from chief executives of AT, GWRC, ECAN, the BCA, bus, ferry and rail operators, Wellington City Council, the Ministry of Transport and the NZTA. The purpose of the PTLF is to develop a more coordinated approach to the development of public transport in New Zealand.

- growing patronage with less reliance on subsidy (ie improving patronage revenue relative to in-service costs)
- improving regulatory certainty for stakeholders
- supporting cooperation and coordination between councils and operators
- maintaining and enhancing competition to restrain costs
- enhancing transparency of planning and procurement

69. In addition, I propose that the Ministry of Transport, in conjunction with the NZTA, and in consultation with the PTLF, prepare a report for the Minister of Transport on the operation of PTOM no later than 31 December 2015. This report will include a competition assessment.

Next steps

70. If PTOM is approved, I will write to key stakeholders informing them of Cabinet's decisions. I will also write to the NZTA outlining my expectations regarding its role in the implementation of PTOM. Once receiving the necessary procurement approvals from the NZTA, I would anticipate that the Auckland region will begin the transition to PTOM.

Consultation

Stakeholder consultation during the development of PTOM

71. As noted in paragraph 12, representatives from AT, GWRC and the BCA have been involved directly in the development of the model. ECAN and other regional councils have also been kept informed on the components of the model through presentations at RTO forums. The BCA has established its own channels of communication for bus operators during this process.
72. The Ministry of Transport has also consulted on this paper with representatives of the key organisations responsible for the development of the model (AT, GWRC, ECAN and the BCA). AT, GWRC, ECAN and the BCA are all broadly supportive of PTOM. Specific comments from AT, GWRC and the BCA are as follows.
73. AT officials are supportive of the PTOM policy framework (other than exempting existing fully commercial units) and considers it to be a key tool in the development of the Auckland public transport network to meet the needs of customers, while targeting increased efficiency and subsidy effectiveness. AT is seeking to progress with urgency PTOM implementation following Cabinet endorsement and NZTA approval of its revised Bus Service Procurement Strategy recently submitted to NZTA for consideration.
74. GWRC officials see a number of benefits from PTOM that will assist in growing an improved public transport network with higher patronage. GWRC particularly supports the grouping of services into units under contract; contract tenures that support competition, investment opportunities, and value for money; competitive tendering and benchmarking; and greater transparency of data that will enable it to be a better informed purchaser. GWRC notes that there are still details to be worked through as it

transitions the model into practise but with the strong relationships and good will that exists between the parties any issues that arise should be able to be resolved.

75. The BCA supports the objectives and key components of PTOM and consider it represents a workable model that better meets the needs of all stakeholders. In particular PTOM recognises the benefits that commercial behaviour can bring to public transport and provides operators with greater certainty for their businesses.
76. The BCA notes that the development of PTOM has required strong commitment by all parties to work collaboratively and to compromise, and will continue to work constructively towards the successful implementation of PTOM.
77. The BCA notes the new and theoretical nature of PTOM and that issues may arise during the transition into PTOM that will require a flexible and collaborative approach to resolve. The BCA recommends that the stakeholders involved in the development of PTOM continue to work together throughout the implementation to ensure the principles and integrity of the model are not compromised.
78. The Ministry of Transport has consulted with the operators of fully commercial ferry services¹¹ on the implications of the model for these services. These operators support the proposal for fully commercial ferry services to be exempt from operating under contract with the regional council.

Departmental consultation

79. The Ministry of Transport has consulted with the NZTA, the Treasury, Ministry of Economic Development, Parliamentary Council Office, Department of Internal Affairs, Ministry for the Environment, Ministry of Education, Ministry of Justice, Local Government New Zealand, Ministry of Social Development, Office for Disability Issues, Office of Senior Citizens and Te Puni Kokiri. The Department of Prime Minister and Cabinet has also been informed.

Financial implications

80. There are no direct financial implications associated with PTOM. The costs associated with developing the machinery of PTOM will be managed within existing budgets. Overall, central government funding for urban bus and ferry services is provided via the National Land Transport Fund through the GPS and was effectively capped in the 2009 GPS over the next 6 years. This amounts to half of the total subsidies with the other half provided by regional councils.

Human rights, disability and gender implications

81. The legislative proposals contained in this Cabinet paper appear to be consistent with the New Zealand Bill of Rights Act 1990, and the Human Rights Act 1993. A final view as to whether the proposals will be consistent with the Bill of Rights Act will be possible once the legislation has been drafted.
82. How services are delivered is a critical issue for some individuals with disabilities. PTOM should increase transparency around meeting the needs of people with disabilities by providing more detail on service expectations in RPTPs, than currently

¹¹ Fullers Group Limited and SeaLink Travel Group

required by the PTMA. In addition, as all services will be subject to a base contract, vehicle specifications and performance expectations should be more consistent across services.

Legislative implications

Withheld under section 9(2)(g)(i) of the Official Information Act 1982

83. [REDACTED] A Land Transport Management Amendment Bill is also currently being progressed (CAB Min (11) 19/7 refers). I have asked officials whether the two amendment Bills could be combined and progressed through the house as one LTMA amendment Bill.
84. As noted in paragraph 59 above, officials have recommended that the PTMA be repealed and its provisions incorporated into the LTMA. Officials are to provide me with further advice on the appropriate legislative process for doing so prior to the Land Transport Management Amendment Bill going to the Cabinet Legislation Committee for introduction approval.
85. The PTMA is itself binding on the Crown. Alteration to the functions and powers of regional councils over public transport services may indirectly affect the Crown in terms of funding such services, but as the amendments are expected to improve efficiencies I can see no good reason why the Bill should not bind the Crown. Accordingly, I recommend that the Bill bind the Crown.
86. Small matters of detail may still emerge as the legislation is developed. I am, therefore, seeking delegated authority to include outstanding matters of minor policy detail in the Bill before it is introduced.

Regulatory impact analysis

87. The regulatory impact analysis requirements apply to the proposals in this paper and a RIS has been prepared and is attached.
88. The Regulatory Impact Analysis Team (RIAT) has reviewed the RIS prepared by the Ministry of Transport and associated supporting material, and considers that the information and analysis summarised in the RIS meets the quality assurance criteria.
89. I have considered the analysis and advice of my officials, as summarised in the attached RIS and I am satisfied that, aside from the competition risks already noted in this Cabinet paper, the regulatory proposals recommended in this paper:
- are required in the public interest
 - will deliver the highest net benefits of the practical options available
 - are consistent with our commitments in the government statement 'Better Regulation, Less Regulation'

Publicity

90. Assuming Cabinet agrees to the content of this paper, I intend to announce that Cabinet has agreed to amend the PTMA to support the implementation of a new policy framework for urban bus and ferry services. I also seek Cabinet's agreement to

release this paper. The RIS and the independent competition assessment (with commercially sensitive information removed) will also be made publicly available.

Recommendations

I recommend that the Committee:

1. **note** that in response to government concerns regarding value for money, a new public transport operating model (PTOM) has been developed through a collaborative process involving Auckland Transport, Greater Wellington Regional Council, Bus and Coach Association representatives, the New Zealand Transport Agency and the Ministry of Transport
2. **note** that PTOM has been developed with the dual objectives to:
 - 2.1. grow the commerciality of public transport services and create incentives for services to become fully commercial
 - 2.2. grow confidence that services are priced efficiently and there is access to public transport markets for competitors
3. **note** that PTOM is a combination of planning, funding and procurement tools that can be implemented through changes to both legislation and administrative policies
4. **note** that the key components of the proposed model include:
 - 4.1. segmenting the urban public transport network into units (where a unit is at least a full route, full timetable (24/7))
 - 4.2. units being operated exclusively under a performance based contract with the regional council
 - 4.3. a commerciality ratio to measure how 'commercial' a region or unit is
 - 4.4. a league table and formulas to rank the relative performance of units
 - 4.5. a mixture of directly negotiated and tendered units to reward performance
 - 4.6. benchmarking principles to guide direct negotiations and gross cost resets
 - 4.7. fare setting, and risk and reward sharing mechanisms
 - 4.8. joint business planning and regional public transport plans
5. **invite** the Minister of Transport to write to the New Zealand Transport Agency and key stakeholders outlining his expectations in regard to the implementation of PTOM, and request that the New Zealand Transport Agency review its procurement and planning guidelines to give effect to PTOM

Transitional arrangements for Auckland and Wellington regions

6. **note** that Auckland Transport and Greater Wellington Regional Council, in recognition of the value that commercial registrations represent to incumbent operators in those regions (as registered at 30 June 2011), will directly negotiate a proportion of units with those incumbent operators on a 'like-for-like' basis as part of a transition to PTOM
7. **note** that 'like-for-like' units will receive an initial contract term of 12 years, and that commercial registrations must be legally relinquished before 'like-for-like' units are

awarded, so that tendering rounds of other units can proceed, and costs for 'like-for-like' units can be established through benchmarking

8. **note** that for other regions transitional arrangements have not yet been agreed to, but would only apply to commercial registrations in place as at 30 June 2011

Smaller markets

9. **note** that the components of PTOM can be utilised to serve smaller bus and ferry markets but may require a level of tailoring
10. **note** that those components that will apply to all bus and ferry services are those proposed as amendments to legislation, set out in recommendation 11 below

Legislative amendments

11. **agree** that the necessary legislative amendments be made to:

The public transport network

- 11.1. require all existing public transport services in a region's public transport network to be segmented into units by the regional council through its Regional Public Transport Plan, unless the service is granted an exemption
- 11.2. require all new public transport services proposed by the regional council to be identified as units in its Regional Public Transport Plan
- 11.3. require all units be provided under contract with the regional council and operated on an exclusive basis
- 11.4. define a unit as being no smaller than a full route including all of the timetabled services for that route (24/7)
- 11.5. provide for the exemption of public transport services (from operating as a unit under contract) if:
- 11.5.1. the service picks up or drops off outside of the region; or
- 11.5.2. the service is a fully commercial ferry service (as at 30 June 2011); or
- 11.5.3. the service is an existing bus service that operates on a full route, full timetable basis, does not receive a direct subsidy (not including separate government initiatives such as SuperGold Card funding or Concessionary Fare Scheme funding) and only offers special fares (as at 30 June 2011); or
- 11.5.4. the service is granted an exemption by the Governor-General through an Order in Council at the recommendation of the Minister of Transport, if:
- (a) the Minister is making the recommendation at the request of the New Zealand Transport Agency; and
- (b) the Minister is satisfied that the public transport service, while operating as an exempt service:
- i. will not receive direct subsidy; and

- ii. is not a reasonably integral part of the region's public transport network; and
 - iii. will not need its fares regulated
 - (c) the Minister is satisfied that the New Zealand Transport Agency has consulted with the regional council and affected operator
- 11.6. establish a process for new public transport services proposed by operators, not identified by regional councils in their RPTPs; and, changes to existing exempt services (including increasing or decreasing the frequency of services, the route, or ceasing to operate), to be notified to and considered by the regional council, whereby the regional council may either:
 - 11.6.1. exempt the new public transport service; or
 - 11.6.2. decline the new public transport service, or any change to an existing service, only if it:
 - (a) is likely to have a material adverse effect on the financial viability of an existing unit; or
 - (b) is likely to increase the net cost to the regional council of any existing unit; or
 - (c) is contrary to sound traffic management
- 11.7. provide a mechanism for the Governor-General through Order in Council to require an exempt public transport service to be provided under contract with a regional council on the recommendation of the Minister of Transport, if
 - (a) the Minister is making the recommendation at the request of the New Zealand Transport Agency; and
 - (b) the Minister is satisfied that
 - i. the public transport service is reasonably integral to the public transport network; or
 - ii. the fares of the public transport service need to be regulated; and
 - (c) the Minister is satisfied that the New Zealand Transport Agency has consulted with the regional council and affected operator

Exempt services register

- 11.8. require all exempt services to be held on a register by the regional council, with the following information:
 - i. the name of the operator of the public transport service; and
 - ii. if the operator is a company that is not a listed company, the name of each shareholder of the operator; and
 - iii. the contact details of the operator of the public transport service (including the operator's business address, telephone number, fax number (if any) and email address (if any); and
 - iv. routes and timetables of the public transport service

Regional Public Transport Plans

- 11.9. require that a regional council that holds unit contracts must provide, as part of its Regional Public Transport Plan, its policies on:
- i. the information that public transport operators must supply to the regional council and New Zealand Transport Agency for public transport planning, contracting and monitoring purposes and information that will be made publicly available; and
 - ii. quality and performance standards; and
 - iii. fares for public transport services contracted under units in the region or the method or formula or other bases for setting those fares, for example, time, zone or stage, mode of travel, number of journeys, and the availability of concessions; and
 - iv. managing unit contracts and monitoring and evaluating their performance; and
 - v. the process for establishing units and considering new public transport services and changes to exempt services proposed by operators, including appropriate consultation provisions
- 11.10. require that operators of units provide revenue and patronage data, covering a period of at least 3 years, on an ongoing basis to the regional council and the New Zealand Transport Agency, whereby regional councils will:
- i. publish patronage data for the unit
 - ii. disclose revenue data for the unit, only to potential bidders during tender time in a controlled manner

Offences and penalties

- 11.11. replace the current offences which apply to commercial public transport services with the following offences.

Offence	Maximum fine on summary conviction if first offence	Maximum fine on summary conviction if second or subsequent offence
Operation of a public transport service without notifying a regional council	\$30,000	\$60,000
Varying the operation of a public transport service without notifying a regional council	\$30,000	\$60,000
Withdrawing the operation of a public transport service without notifying a regional council	\$30,000	\$60,000

Appeal provisions

- 11.12. provide operators with a right of appeal against decisions by a regional council under the proposed legislation

Withheld under section 9(2)(g)(i) of the
Official Information Act 1982

Legislative process

12. **note** that there is a Public Transport Management Amendment Bill (that would implement the new policy framework for bus and ferry services described above) and a Land Transport Management Amendment Bill on the 2011 legislation programme
13. **note** that I sought advice from officials on whether the two Bills could be combined and they advised me that the provisions of the PTMA, as amended, could be incorporated into the Land Transport Management Act
14. **agree** that the PTMA be repealed and its provisions, as amended by recommendation 11, be incorporated in the Land Transport Management Act
15. **invite** the Minister of Transport to issue drafting instructions to the Parliamentary Council Office to prepare amendments to the LTMA giving effect to recommendation 11 and 14, including any necessary consequential, savings and transitional provisions
16. **authorise** the Minister of Transport to determine matters of minor or consequential policy detail that may arise in the course of preparing the amendments to the Land Transport Management Act
17. **agree** that the amendments to the Land Transport Management Act will be binding on the Crown
18. **note** that officials will provide the Minister of Transport with further advice on the appropriate legislative process for combining the amendments to the Land Transport Management Act with the Land Transport Management Amendment Bill (CAB Min (11) 19/7 refers) prior to that Bill going to the Cabinet Legislation Committee for introduction approval
19. **agree** that the Ministry of Transport, in conjunction with the New Zealand Transport Agency, and in consultation with the Public Transport Leadership Forum, report back to the Minister of Transport by 31 December 2015 on the operation of PTOM, including a competition assessment
20. **agree** to the public release of this Cabinet paper

Hon Steven Joyce
Minister of Transport