MANAGEMENT OF THE BUS CONTRACTS

REPORT OF THE COMPTROLLER & AUDITOR GENERAL

JULY 2011

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SECTION ONE – Introduction

1. This paper is the report of a review carried out into the States' management of the contracts for the provision of bus services. The terms of reference for the review are set out in Appendix One.

2. The history of the current arrangements by which bus services are provided in the Island will be described in Section Three of this paper. The current provider of those services is Connex Transport Jersey Limited (the operator or the contractor) who operate two contracts (the bus contracts):

   (1) A contract for the main bus services on the Island dating from 2002 and now extended until the end of 2012 (the main or first contract); and

   (2) A contract for schools and leisure services dating from 2007 and also now extended until the end of 2012 (the second contract).

3. The award of the existing contracts was a subject of significant scrutiny including examination by a Committee of Inquiry.[1] Where previous findings regarding the contract are in the public domain and do not fall within the terms of reference of this review, no further comment has been made. Thus, for example, this report does not comment on the process by which the States decided to place the 2002 contract with the current operator.

4. The Transport and Technical Services Department (TTS) is currently inviting tenders for a single contract for services to run from January 2013. This therefore seemed an opportune moment to review the management of the existing contracts.

5. The purpose of the review was principally to examine:

   (1) Rationale for the current contracts by which bus services are provided,

   (2) The policy objectives underlying the decision to place the contracts, and

   (3) The States' management of the contracts.

6. Apart from the value of the exercise in reviewing the management of the existing contract and informing the design of any new contracts the review seemed appropriate because

[1] RC58/2005.

the existing contract has some features that are similar to contracts under which services or functions are outsourced by public sector bodies. Since the management of outsourcing contracts is an important and developing skill both within the Island and elsewhere, the purpose of the review was to assess the success with which the States has managed the bus contracts with a view to relating lessons from these contracts to any outsourcing contracts into which the States might enter. Learning these lessons is especially important in view of the likelihood that as implementation of the Comprehensive Spending Review's proposals proceeds, more outsourcing contracts will be signed.

7. Part of the work of this review was undertaken at my request by PWC and fell into a number of principal sections:

    (1) Understanding the two main contracts;

    (2) Reviewing existing work and reports on the subject including two internal audit reports, a report of the Committee of Inquiry and the States' response to the Committee of Inquiry report;

    (3) Reviewing the States' management of the contracts incorporating a review of management's overall approach, the mitigation of risks identified during the review of the contract, management's use of and analysis of data and management's use of incentives and management's success in leveraging value;

    (4) Reviewing the States' approach in the context of the States' wider contract management policies and practices, the approach being taken to re-letting the contracts and good practice in managing large scale contracts.

8. A list of the people who contributed to the review is set out in Appendix Two.

9. The findings of the review are set out in the report under the following principal headings.

    (1) The background to the letting of the bus contract;

    (2) The extent to which the States' objectives were achieved;

    (3) Defining needs and requirements;

    (4) Incentive and leverage;

(5) Working capital; and

(6) Other detailed consideration.

10. First, in Section Two, I will summarise the principal findings and recommendations of the review.

SECTION TWO – SUMMARY OF FINDINGS AND RECOMMENDATIONS

Introduction

11. The review's findings and recommendations should be regarded as the accumulated lessons to be learned from the experience of managing the bus contracts rather than as criticisms of the way in which the contracts were managed. As such, they may be summarised in the following way:

Achievement of the bus strategy's objectives (Section Four)

12. In summary, the objectives of the original bus strategy have been achieved to a greater or lesser extent.

13. However, it is also clear that the States have incurred a substantial cost in arranging for the bus services to be provided and there are respects in which the operation of the bus contracts has not been satisfactory.

Defining needs and requirements (Section Five)

14. The initial contract was agreed on the basis of professional advice.

15. An initial failure to identify the benefits to be obtained from the contract and the later inability to align the terms of the contract with more recent corporate aims have influenced the whole contract period.

16. In future, on the basis of the experience gained from managing the bus contracts:

    (1) Contracts should be based on a clear understanding of the benefits to be obtained which should in turn be related to the States' current policy objectives.

    (2) As far as possible, any performance standards should be expressed in terms of outputs.

    (3) Contract terms should reflect this understanding.

    (4) Sufficient time should be allowed to achieve this.

(5) Contracts should provide for a process by which terms may be altered in the event that the States' objectives change.

(6) The initial agreement of a contract should include agreement of the means by which a contractor's compliance with performance standards is to be monitored so that the performance and penalty provisions can be applied in practice.

Collection and use of data (Section Six)

17. Whilst it is clear that the penalty regime provided in the bus contract was not implemented, in view of the uncertainty of the data available it is difficult to be precise about the consequences of this failure. However it seems reasonably clear that:

    (1) by implementation of the penalties regime the States would have been able to increase their influence over the way in which the contract was managed by the operator and thus the way in which services were provided.

    (2) the original contract terms were not originally established with sufficient clarity for penalties to be enforced and/or leverage gained from this.

    (3) the difficulty of implementing the penalty regime was maximised by the fact that it was targeted at a series of service failures (i.e. it was based on a series of input measures).

    (4) without the influence that implementation of the penalty regime would have created, the States were in a weak position to manage the nature and direction of the service being provided by the operator.

18. The new bus contract should be drafted with a view to supporting a practical penalty regime and in the expectation that the regime would be implemented in practice.

19. Once the new contract is in operation the penalty regime should be implemented.

20. As far as concerns procurement within the States generally:

    (1) incentive and penalty schemes are a necessary part of any out-sourcing arrangement.

(2) it is not sufficient merely to specify such schemes in contracts, they must also be implemented.

21. The States should not become involved in such major outsourcing contracts unless incentive and penalty schemes are implemented. This in turn will require the States to ensure that Departments create teams with the skills necessary to manage relationships with outsourcing contractors.

Incentives and leverage (Section Seven)

22. TTS should be aware of the significance of incentives in contracts and the possibility of leveraging value. The use of outcome based measures in penalty regimes and break clauses are examples of techniques which can be used to achieve this. Importantly, they can both serve to provide an equitable risk sharing arrangement which engages both parties in the contract. This sharing of risk is often a crucial element underpinning wider contractual relationships.

23. There needs to be a clear understanding of how such terms will be used. For the next bus contract this might include ensuring that both parties understand:

(1) The arrangements for monitoring performance.

(2) What will be measured and why, in line with the objectives of the contract.

(3) How data will be collected.

(4) How this data will be used to reinforce penalties and/or incentivise the contractor.

Contract terms (Section Nine)

24. The review of the bus contracts identified a number of minor issues:

(1) The official contract for the schools and leisure service was not signed until January 2010 although the service commenced in January 2007 owing to legal delays.

(2) The schools and leisure service contract is inconsistent in its description in the amount payable to the contractor in respect of the leisure service. All fare revenue is payable although some terms stated that all profit is paid over.

(3) The main service contract includes terms of revenue sharing designed to incentivise contracts. However, no terms were ever agreed.

25. None of these issues is significant in the context of wider management of these contracts. However, the States should ensure that the risks associated with incomplete or inconsistent terms and contracts which are not signed when the service starts are mitigated by ensuring that clear agreements are in force.

States-wide contract management (Section Ten)

26. Consideration should be given to ways of disseminating the knowledge within TTS as well as the more detailed recommendations from this review in the context of clear for general contract management.

SECTION THREE– BACKGROUND TO THE BUS CONTRACTS

27. Following a period of consolidation amongst companies, the Jersey Motor Transport Company (JMT), which I understand began operations in 1923, was the sole provider of bus services in Jersey by the 1970's.

28. By this time, after many years of growth supported by Jersey's flourishing tourism industry, the numbers of tourists began declining and the population's car ownership rates increased.

29. These two factors led to significant reductions in demand for bus services and consequent reductions in the level of provision.

30. By the late 1990's the operator no longer felt able to run its network on a commercial basis as had been possible until then and it was recognised by the States that in order to halt the continuing decline in bus use and to continue to provide a comprehensive network for the Island, a subsidised serviced would need to be established.

31. Between its formation in September 2000 and April 2001 the Public Services Committee attempted to develop a voluntary service level agreement (SLA) with the then bus operator. The Committee's purpose in seeking an agreement were:

> *"(1) The improve the quality of service provided to all residents of and visitors to Jersey, to achieve a reliable, timely, more accessible, safe and good value service;*
>
> *(2) To improve the environment of Jersey (by reducing traffic congestion as well as noise and emissions of pollution);*
>
> *(3) To develop a reliable and attractive form of transport for all residents to travel to and from work, school, the shops, hostelries and restaurants and to visit family and friends;*
>
> *(4) To encourage visitors to the Island to use the bus to visit the numerous tourist attractions, the parishes, the beaches and beauty spots."*[2]

32. In effect these objectives were the objectives of the Public Services Committee's bus strategy. In addition to this statement of objectives, the Public Services Committee reported to the States that it was engaging public transport consultants to assist in

2 P104/2001: 'Bus Strategy'.

drawing up a customer focussed Island-wide indicative service specification, laying down minimum service standards and including incentives for new investment and service innovation.

33. In particular they reported that:

> *"It is likely, at least, initially, that the specification will be similar to the present network; although the specification will not be too prescriptive, in order to accommodate innovative suggestions from the central operators. However, certain key features are likely to appear in the specification:*
>
> *(1) Route details.*
>
> *(2) Service spread (first and last buses).*
>
> *(3) Days of week operation.*
>
> *(4) Service frequency.*
>
> *(5) Customer care training.*
>
> *(5) Vehicle capacity, accessibility and other features such as provision of displays, on-board information, facilities for luggage etc.*
>
> *(6) Passenger charter and public consultation process.*
>
> *(7) Emissions policy compliance.*
>
> *(8) Seasonal variations.*
>
> *(9) Performance indicators.*
>
> *(10) Open book accounts and reporting."*[3]

34. As far as concerns the way in which the Public Services Committee intended the States should work with the chosen operator, the Committee reported:

> *"The SLA is a formal document which highlights the agreed service provision and quality standards expected by the Regulator from the provider of services in return for an agreed level of financial remuneration. The key phrase within an SLA is 'agreement' – all parties must reach an agreement otherwise the SLA will not be operable or be effective. They must be aware of and fully understand the objectives and processes of forming the SLA and of course it must be realistic. In essence, it is a partnership where both parties must work together collectively to achieve the desired and agreed objectives as well as its process. It will involve intensive negotiation between the two parties. In this case it will form part of a formal contract and be used within a service specification.*
>
> *The SLA above all will be customer focussed. It will ensure that the user's needs are addressed as practically as possible and will also recognise that different*

3 P104/2001.

clients will have different needs (e.g. tourists and residents). It will incorporate a cost effective monitoring mechanism so that the States can ensure that they are getting value for money and achieving their strategic aims, and, where public money is involved, a right of audit."[4]

35. In essence, therefore, the principal objectives of the Public Services Committee's bus strategy were:

    (1) The preservation and improvement of the existing bus service;

    (2) Providing a more customer friendly service;

    (3) Improving social inclusion;

    (4) Supporting tourism;

    (5) Introducing cleaner more modern vehicles.

36. In placing the contracts and in choosing the approach which would offer the best prospect of achieving these objectives, the department acted consistently on the basis of professional advice.

37. In the event, the new contractor was awarded a minimum cost contract to operate Jersey's bus service network in April 2002 for seven years.

38. Operations began in September 2002 using a fleet of low floor buses specially built for the Island's restrictions on vehicle width and length. The contract was tendered on a cost plus basis with Connex submitting anticipated operating costs plus a defined profit margin. Subsequently Connex also won the open tender for the school and leisure service contract which, along with the schedule services contract, was due to expire in 2009.

39. Under the terms of the contract, also fare income collected on bus services by the operator is passed to the States. The difference between the annual fare income and the annual sum paid to the operator represents the amount of public subsidy required to operate the service which is currently around £3.7 million per annum.

40. Both the scheduled services and the school and leisure contracts allowed for a maximum extension of three years after which a full competitive agreed tender process would be

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[4] P104/2001.

required. The extension option was exercised by TTS and both contracts operated by Connex will expire in 2012.

SECTION FOUR – ACHIEVEMENT OF THE BUS STRATEGY'S OBJECTIVES

Introduction

41. Against this background, the review therefore looked for evidence on whether the bus service provided under the existing contract has met these objectives by reviewing the evidence of:

(1) Bus ridership (since 2002).

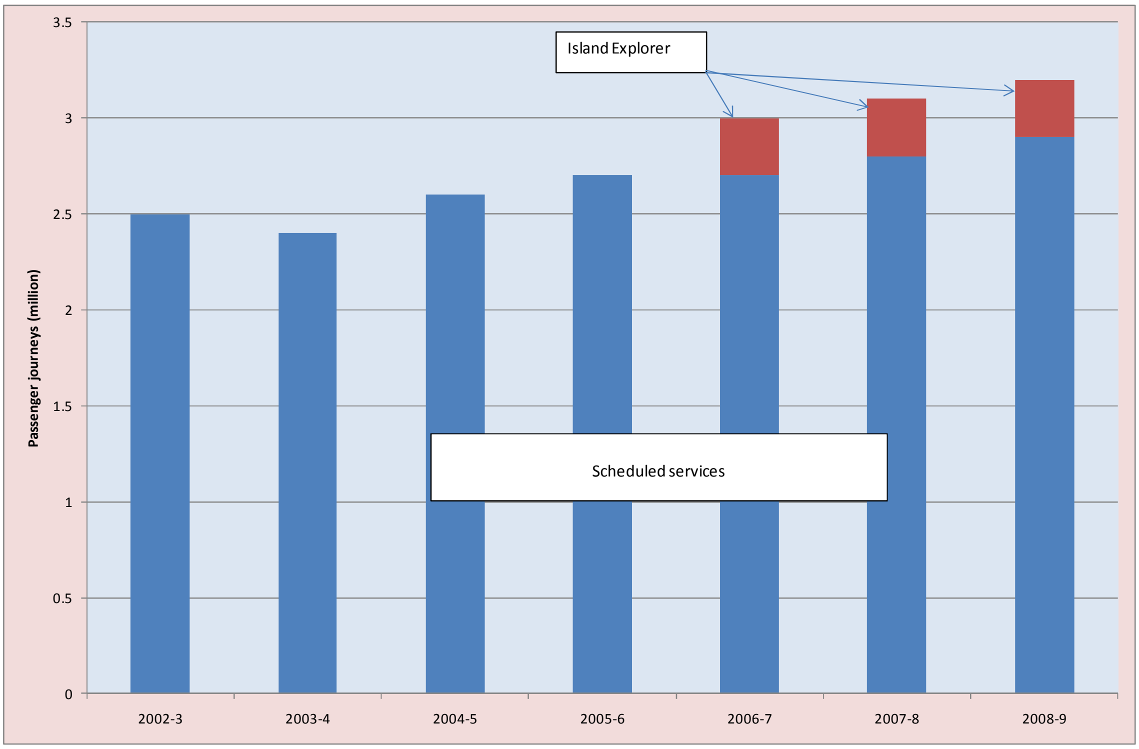
(2) Ridership per route.

(3) The financial out-turn of the contract and, in particular, fare income received.

(4) The evidence for customer satisfaction.

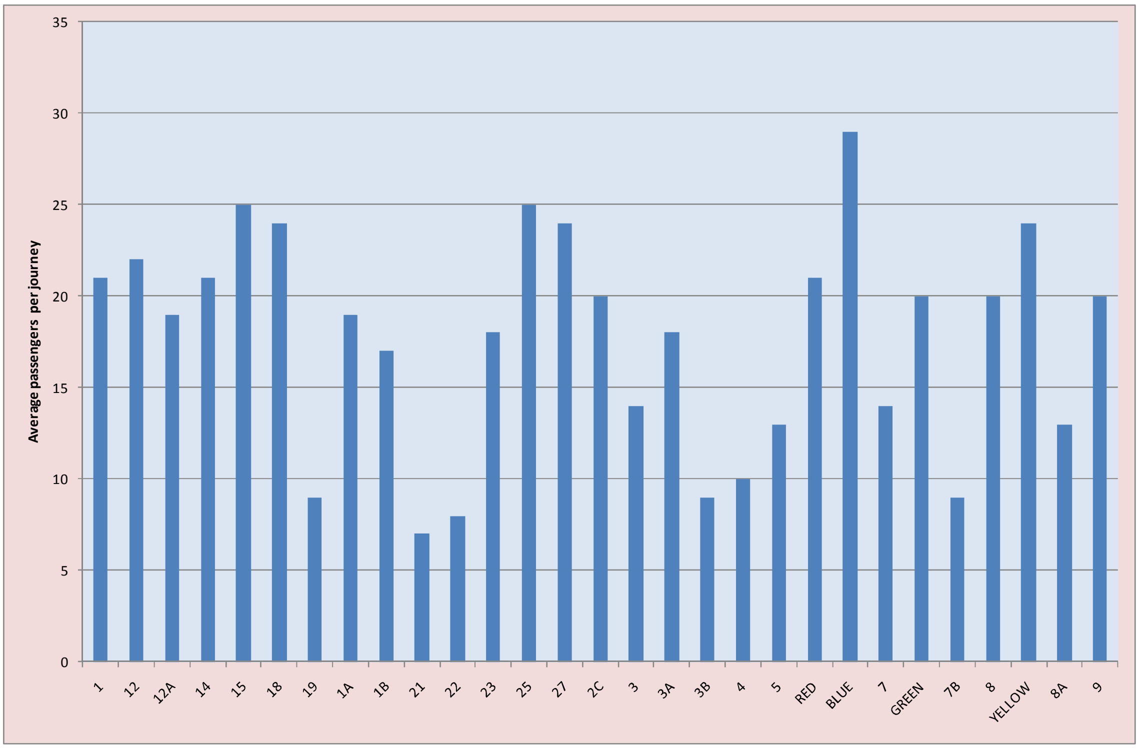
Bus ridership:

42. As shown in the following table, It is evident that bus ridership has increased markedly since 2002.



Ridership per route:

43. It is also evident ridership on routes within the bus network have been maintained as shown in the following table which shows the average number of passenger carried by each route per journey (counting outboard and return as separate journeys):

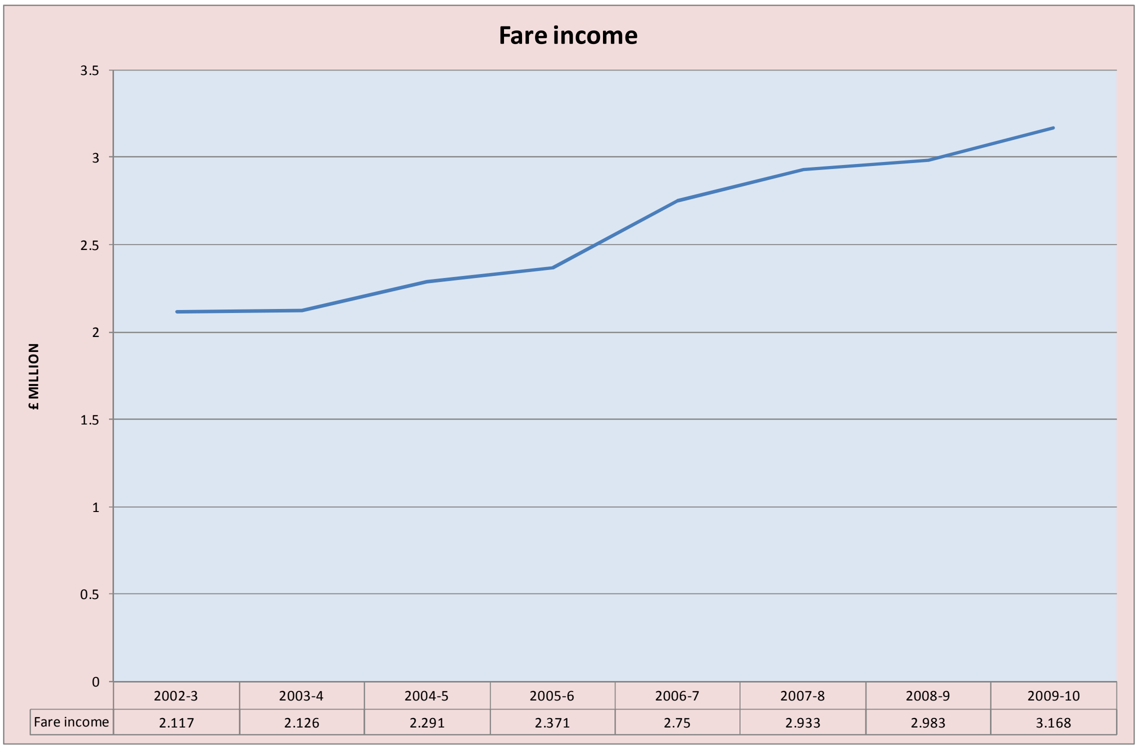


44. Unsurprisingly, this table shows that the average number of passengers per journey varies between routes. Certain popular high frequency routes on average carry 20-25 passengers while infrequent services catering to a particular need on average carry fewer passengers.

45. Ideally, one would compare this information (which relates to the latest available year) with the average number of passengers carried before the inception of the contract. The States do not hold that information (which is essentially the private information of the former operator) and the operator has not been prepared to disclose the information so such a comparison is not possible. As will be seen, the fact that such information was not available made the contracts more difficult to manage.

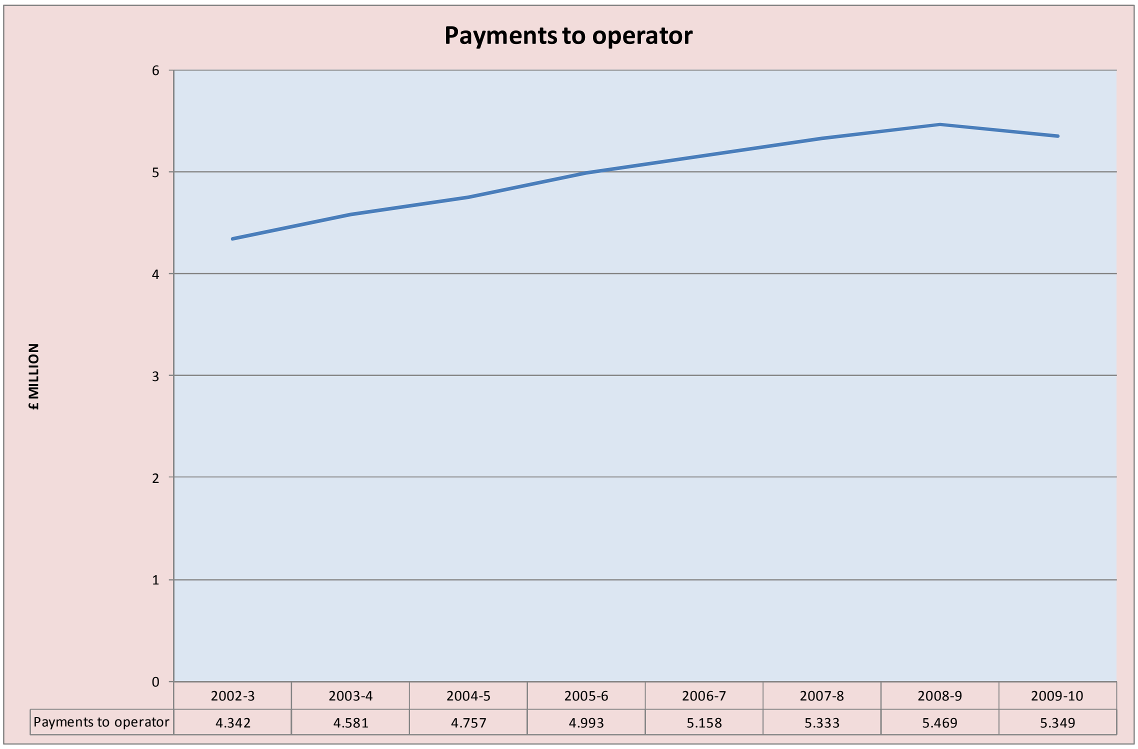
Financial out-turn:

46. It is also evident that the fare income from bus services has increased substantially:



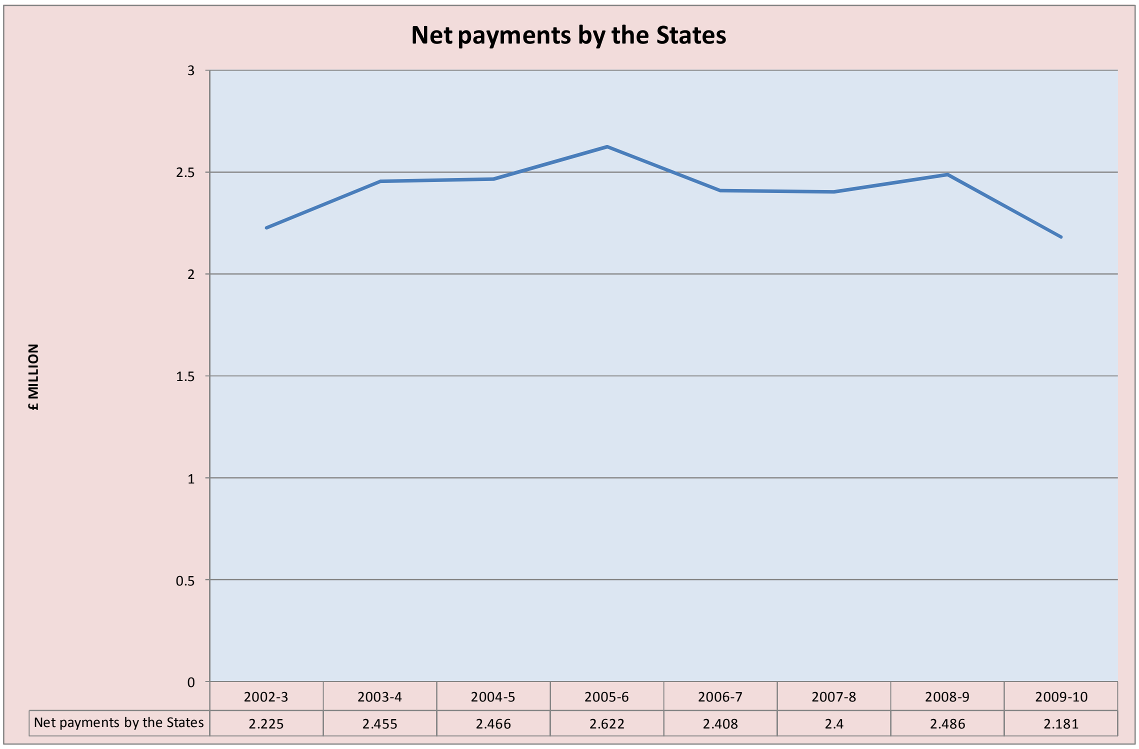
47. As before, it is not possible to compare fare income during the period of the contract with fare income received by the former operator because the information is not available to the States.

48. As explained above, the States receives the whole of the fare income received but also makes payments to the contractor at rates set under the contract for the agreed services provided. Those payments have amounted to:

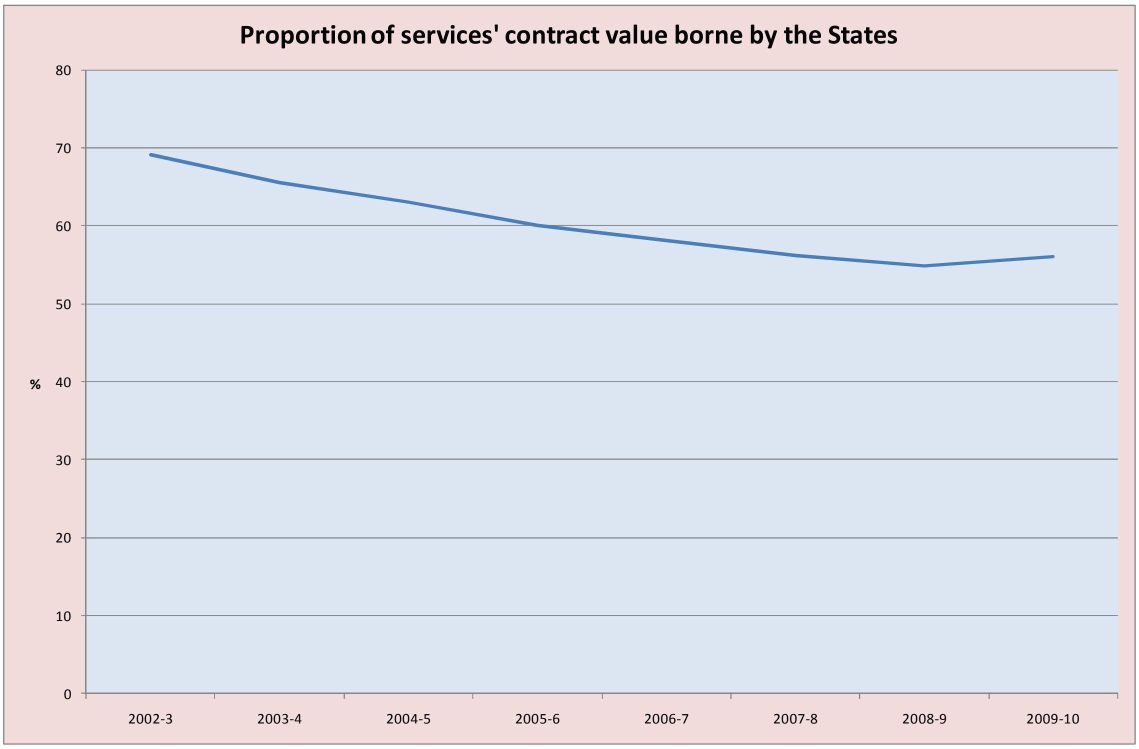


49. The fall in the last year shown reflects a change in treatment of rent for the bus station.

50. The net effect of the fare income received by the States and the payments made to the operator has been as follows:



51. Alternatively, the proportion of the States contribution to the total contract value of the bus services provided:



52. The trend shown by is affected by the fares charged for the Island Explorer service introduced for 2006-7 and subsequent years.

Customer satisfaction:

53. Evidence about customer satisfaction exists in the form of responses to surveys conducted in 2006 and in 2009.

54. In 2006, the Jersey Annual Social Survey included questions on Jersey residents' perception of the bus service. The responses showed that:

    (1) 81% who used the bus daily or at least weekly (i.e. frequent travellers) thought the buses were a 'good way to travel on Jersey'.

    (2) 79 % of respondents thought that the buses 'are clean and tidy'.

    (3) 67% of respondents thought that the buses 'do the journey quickly enough'.

    (4) 57% of respondents agreed that drivers were 'helpful and polite'.

55. More recently, during August 2009, a customer satisfaction survey was undertaken by BestChart which reported the following results:

%	*Residents*				*Visitors*			
	Very satisfied	*Fairly satisfied*	*Fairly dissatisfied*	*Very dissatisfied*	*Very satisfied*	*Fairly satisfied*	*Fairly dissatisfied*	*Very dissatisfied*
How satisfied are you with the reliability of Jersey buses?	35	56	9	1	83	16	1	1
How satisfied are you with the journey times of Jersey buses?	39	60	1	0	83	16	1	0
How satisfied are you with the fares on Jersey buses?	40	58	2	0	79	21	0	0
How satisfied are you with the bus quality of Jersey buses?	36	60	3	1	78	21	1	0
How satisfied are you with the cleanliness of Jersey buses?	35	52	13	0	79	21	0	0
How are you with the driver attitude on Jersey buses?	30	49	20	1	78	17	4	1
How satisfied are you with the overall service of Jersey buses?	34	58	8	0	77	23	0	0

56. This evidence suggests that a high degree of satisfaction has been achieved.

Modern vehicles:

57. As I have already indicated, in 2002, the new operator introduced new vehicles which had been designed to be suitable for the Island's environment. Since then, work has continued, including experiments with other vehicle designs to ensure that the most appropriate vehicles are used to provide the Island's bus service.

Conclusions

58. In summary, the objectives of the original bus strategy have been achieved to a greater or lesser extent.

59. However, it is also clear that the States have incurred a substantial cost in arranging for the bus services to be provided and there are respects in which the operation of the bus contracts has not been satisfactory.

SECTION FIVE– DEFINING NEEDS AND REQUIREMENTS

Introduction

60. The review identified a number of respects in which the original contract let to the contractor may not have identified the States' objectives with sufficient clarity. It also identified a lack of alignment between then existing contract and the current policies of TTS. Each of these points is considered in greater detail below.

States' objectives

61. Whilst the eventual contract did include a set of desired service standards it did not include a specification of the States' objectives in letting the contract.

62. It is also clear that the contract was not viewed as part of an integrated transport policy. Indeed, at that time, the States did not have an integrated sustainable transport policy: that has been developed more recently.

63. Finally, letting of the schools and leisure contract was partly reactive, since it was in part a response to another operator setting up an unlicensed leisure service. Advantage was taken of the fact that the schools service was due to be re-tendered to include leisure services which were being operated under an exemption to the law by vehicles not plated as omnibuses.

Alignment with States' policy

64. As has already been noted, the States had not adopted an integrated sustainable transport policy at the time that the contract was originally let. Such a policy was approved by the States in November 2010.[5]

65. The review identified a possible lack of alignment between the terms of the existing contracts and the current objectives of this policy. For example:

    (1) Within the terms of the contract, management were not explicitly given the means to influence service changes which would help deliver the sustainable

[5] P104/2010. Lodged au Greffe on 19 July 2010.

transport policy. For example, the frequency of many services does not assist in the achievement of reduced car usage. Further, there are significantly fewer services in the winter reflecting the historic bias of bus services towards tourists rather than towards the current focus on the usage of services by residents. Since the sustainable transport policy white paper was published after the inception of the current bus contracts this example demonstrates the need for any contract to provide the means by which the contract's definition of the services to be provided by the contractor may be varied to take account of changes in the States' strategic objectives.[6]

(2) The penalty regime did not match the requirements of users. For example, it prescribed a flat rate penalty for non punctual services rather than, perhaps, prescribing a penalty related to gaps between services. This example provides a demonstration of the difficulty of predicting precisely the way in which a penalty regime may operate in practice.

(3) The penalty regime was based on 'input' measures (i.e. measures that related to detailed aspects of the service provided) rather than 'outcome' measures (i.e. measures that related to customer's objectives).[7]

66. The review recognised that in practice, notwithstanding the provisions of the contract, TTS has been able to influence service changes to achieve greater alignment with the new transport policy. According to TTS, the improvements in bus services which have resulted include:

(1) the introduction of an 'award winning new look customer friendly timetable';

(2) the trial of double decker bus and proposals for a permanent service;

(3) an early morning red eye first flight service;

(4) improved rural services to St John and St Mary; and

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6 Published by TTS as a White Paper on 2 July 2010 under the title: Jersey's Sustainable Transport Policy.

7 When the contract was drafted, TTS took professional advice on the way in which a penalty regime should be drafted. The clauses that were introduced into the contract reflected that professional advice. As has been shown in section three of this report, the guidance now available supports a different approach.

(5) changes to reduce over-crowding on the Les Quennevais school service.

67. Both TTS and the operator have identified further improvements in the service which I have included in a fuller list in Appendix Three.

68. However, in retrospect it can be seen that the contract did not include adequate provisions to enable the States to ensure that service specifications could be changed to reflect changes in the policy of the States.

69. A further alignment problem undermines the value of the States' arrangements for monitoring the contractor's performance. Although the States monitor performance using a third party, and thus have the advantage of using independent evidence for the contractor's performance, the detailed monitoring and measurement does not appear to align precisely with the terms of the contract.[8] What is more, the third party reports on bus performance were commissioned without agreement with the contractor regarding how they could be reconciled to the terms of the contract and also without consideration of their statistical validity. As a result, whilst the detailed independent monitoring reports have been valuable in providing evidence of performance, they have not been used to support implementation of the contract's penalty regime. This matter will be addressed more fully below.

Conclusions and recommendation

70. The initial contract was agreed on the basis of professional advice.

71. An initial failure to identify the benefits to be obtained from the contract and the later inability to align the terms of the contract with more recent corporate aims have influenced the whole contract period.

72. In future, on the basis of the experience gained from managing the existing contracts:

[8] TTS has suggested that the independent monitoring arrangements were first introduced in response to allegations that cash had been mishandled. In other words, the principal purpose of the arrangements was not to check on the possibility that the opportunity to impose penalties on the contractor may have arisen. This represents a marked failure by TTS to implement the proposals in the 2001 bus strategy: 'It [the SLA] will incorporate a cost-effective monitoring mechanism so that the States can ensure that they are getting value for money and achieving their strategic aims, and, where public money is involved, a right of audit'. Paragraph 2.2 of P104/2001.

(1) Contracts should be based on a clear understanding of the benefits to be obtained which should in turn be related to the States' current policy objectives.

(2) As far as possible, any performance standards should be expressed in terms of outputs.

(3) Contract terms should reflect this understanding.

(4) Sufficient time should be allowed to achieve this.

(5) Contracts should provide for a process by which terms may be altered in the event that the States' objectives change.

(6) The initial agreement of a contract should include agreement of the means by which a contractor's compliance with performance standards is to be monitored so that the performance and penalty provisions can be applied in practice.

SECTION SIX – COLLECTION AND USE OF DATA

Importance of performance measures

73. In complex contractual arrangements, the collection and use of robust data are crucial to underpin strong decision making and management of the relationship with a contractor.

74. The performance measures specified in the contracts were based on professional advice at the time the contracts were agreed but were not based on outputs.

75. The importance of the use of performance indicators and incentives to lead a contractor to improve performance was accepted publicly by the States' Public Services Committee when its bus strategy was published in 2001:

> *"There is a significant amount of work to be done in a short space of time if the Island is to enjoy a period of stability in the provision of bus services, the benefits of increased private investment and public subsidy, the delivery of quality bus services by an* ***operator which has incentives to meet and even exceed its performance targets****, the assurance that the tax payer is getting value for money . . ."*[9]

76. Best practice has developed since 2002 when the original contract was placed so that it would now be best practice to ensure that performance measures in a contract are based on outcome rather than inputs.

Sources of data

77. There have been three key sources of data:

(1) Data provided by the contractor;

(2) Financial data on costs and revenue; and

(3) Information provided on service performance by a third party.

[9] Paragraph 1.6 of P104/2001. Emphasis added.

78. Of these sources, the second can be validated by the States. The first source has the disadvantage that it is not independent of the contractor.[10]

79. In fact, TTS did not arrange the independent collection of performance data from the inception of the contract. This was not done until TTS received reports from the States' Internal Audit Department on payments under the first bus contract.[11] As a result, TTS arranged for a limited number of inspections visits (in fact two each year) to be made by an independent team[12] for the purpose of observing bus services.

80. The monitoring has been carried out by reference to a number of generic measures (i.e. not by reference to the specific measures specified in the bus contract). It is important to note that the precise measures used and the extent of the monitoring carried out[13] were not agreed with the contractor.

Penalties and incentives

81. One consequence of this, and of a number other factors, is that the scheme of penalties and incentives specified in the contract has not been implemented.

82. The other factors included:

    (1) the fact that information was not available about bus service performance before the inception of the contract (for reasons that I have explained above). The effect was that it proved difficult to establish benchmark standards for performance which would be acceptable to both the States and the new contractor.

    (2) the probable cost of a comprehensive monitoring regime, which had not been fully anticipated.

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10 TTS accept that data provided by the contractor is not independent, but point out that the contractor has provided assurances that electronic ticket machine data are recorded in a 'locked' database so that subsequent interference with the data is not possible.

11 Internal Audit report 2203-52 dated January 2004 on 'Payments made under the contract with Connex'; and report 2004-116 dated January 2005 on 'Connex Transport cash controls'.

12 Provided by BestChart Limited (BestChart).

13 The monitoring was limited in extent with the result that there would be doubt about the reliability of any extrapolation from the sample results to the bus service's overall performance.

83. As a result, this potential source of influence over the contractor's management of the bus contract has not been available.

Evidence for performance

Introduction

84. As a comprehensive monitoring regime was not instituted one cannot with any certainty estimate the financial effect of requiring penalty payments from the contractor.

85. The purpose of a penalty regime is to influence the contractor's behaviour so that desired performance standards are achieved: it is not principally to secure a source of income in the form of penalty payments by the contractor. Thus, if the regime were to be effective, although applying penalties may lead to income in the short term, as the contractor's behaviour becomes more compliant the penalties and the income they represent will cease.

86. Indeed, if the incidence of poor compliance is too great, the correct response may be to cancel the contract rather than to apply heavy penalties.

TTS estimate

87. TTS estimate that the penalties that would have been chargeable under the contract might have amounted to approximately £89,200 per annum compared to a net cost to the States of the order of £2.4 million per annum (i.e. 3.7% of the net cost to the States).

PWC estimate

88. For the purpose of the review, PWC also calculated the extent of service failures against the measures specified in the contract assuming that the results of the monitoring by BestChart can be used to extrapolate performance for the bus service overall.

89. The monitoring reports include data on punctuality, driver quality and vehicle quality. The outcome of these reports suggests that theoretically it would be possible for substantial penalties to be claimed for the main contract. This is shown by the following table which evaluates the financial significance of the failure rates by extrapolating the failure rates reported by the independent third party to the average number of services using the

amount of the financial penalty specified for each type of failure in clause 21.2 of the contract.[14]

90. For the reasons already noted, the estimates set out below do not necessarily indicate the level of sustained income from penalties that could have been received by the States throughout the term of the contract.

	Service failure[15]	*Penalties prescribed by the contract*	*Failure rate*[16]	*Services p.a.*[17]	*Penalties p.a.*
A	Provision of a journey which is operated more than two minutes before or more than 10 minutes after the time specified in the schedules or failing to meet a connection as detailed in the Specification of Services	£40 points (4 points)	19.68%	81,996	£645,472
G	Failing to supply a vehicle in reasonable condition including unsatisfactory cleanliness or inadequate lighting ventilation or heating	£20 (2 points)	O.9%	81,996	£0
K	Inappropriate driver conduct including where the driver smokes or encourages others to smoke	£20 (2 points)	6.31%	81,996	£103,479
N	Failing to provide vehicles in an acceptable roadworthy	£50 (5 points)	0.0%	81,996	£0

14 Clause 21.2 provides that no penalty shall be paid unless the total penalty points in any period of twelve weeks exceeds 125. In preparing the table, it has been assumed that this threshold was consistently exceeded.

15 The other service failures specified by clause 21.1 of the main contract were: B failure to show destination or certain other signs, C failure to operate a service in accordance with the contract specification, D failure to carry ticket issuing machinery of related information, E failure to issue valid tickets, F failure to supply a vehicle to cater for available passenger traffic, H vehicle breakdown, I vehicle causing an accident or failure to notify an accident, J failure to comply with licensing requirements, L failure to carry working electronic equipment, M failure to notify the use of subcontracting or of a change in the provision of services, O and P failure to provide waybills or financial records within specified periods, Q failure to provide roadworthy vehicles or equipment when the safety of passengers may have been affected, R failure to operate specified services, S failure to provide publicity.

16 For service failures G, K and N, a failure has been assumed where the total score for the service fell below 25% of the maximum score.

17 The number of services is a figure provided by TTS on the basis of an analysis of timetables in 2010 taking into account ‘all route variations and exceptional service patterns such as bank holidays’. It does not therefore take into account variations in the numbers of services during all of the years of the contract.

	Service failure[15]	*Penalties prescribed by the contract*	*Failure rate*[16]	*Services p.a.*[17]	*Penalties p.a.*
	condition or driver conduct where that conduct may have adversely affected the safety of passengers				
	TOTAL PENALTIES				£748,951

91. This calculation implies that, theoretically, it would have been possible to claim total penalties of £748,951 for one year compared to a net cost to the States of the contract of about £2.4 million per annum.[18] It is possible that additional penalties could also be claimed for the leisure services.

Comparison of estimates

92. Both of the estimates are purely theoretical.

93. The principal difference between the two estimates is due to the fact that the PWC estimate does not take account of service failures which were beyond the contractor's control (e.g. as a result of adverse weather conditions)[19] because the necessary information was not available to PWC. The TTS calculation is based on application (on a sample basis)of the TTS record of roadworks which may have caused service failures: thus leading to a reduction in the applicable penalties. It should be noted that neither calculation takes into account the effect of adverse weather conditions which might also have caused service failures.

94. Both estimates represent the limit of the penalties that might be claimed rather than a good estimate of the penalties that could be claimed successfully because:

(1) even though the TTS estimate takes account of service failure which were due to roadworks and could not therefore have led to penalties, they do not take

[18] Under the contract, the States are obliged to pay the contractor an amount that was £.3 million in the initial period but in subsequent periods was to be subject to annual cost of living increases. In turn the contractor is obliged to account to the States for all fare income collected. The amount of any balance between these two amounts is the cost to the States of the provision of bus services.

[19] Clause 21.2 provides that the contractor may not be obliged to pay a financial penalty in respect of a services failure in any event of force majeure or if the cause of any breach, act or omission is otherwise outside the control of the contractor.

account of service failures that were due to weather conditions so adverse that they led to service failures that were beyond the operator's control.

(2) the monitoring reports are not statistically valid (for example, the reporting period is inconsistent and the reports do not indicate the times of the services observed which may affect the validity of any extrapolation from the results of the sampling) and thus may not give a reliable impression of performance. Moreover, the results of the monitoring that has been carried out appear inconsistent with the evidence of customer satisfaction (i.e. if the level of poor performance had been as high as the monitoring reports suggest, it might have been expected that customer satisfaction levels would have been lower).[20]

(3) the terms of the bus contracts are in some instances insufficient to set out how penalties should be applied. For example, the main contract does not specify which party should be responsible for monitoring performance and there is no definition of what constitutes poor driver or vehicle performance. Similarly, the measurement points for punctuality are unclear. As a further example, service failure K (cited above) refers to 'inappropriate driver conduct' but there has been no agreement between TTS and the contractor on what behaviours would constitute inappropriate conduct.

(4) there is no agreement with the contractor that the third party reports could be used for the purpose of substantiating claims for penalties.

95. Nonetheless, these estimates indicate the possible scale of penalty payments within the terms of the bus contracts and thus the scale of the influence that TTS would have been able to exercise over the contractor if the penalty regime had been implemented as had been proposed.

[20] The 2006 Jersey Annual Social Survey (JASS) reported that 81% of people who used the bus regularly (i.e. frequent travellers) thought the buses were a 'good way to travel in Jersey. Similarly the independent monitors' 2009 customer satisfaction survey recorded that 95% of users were satisfied with reliability and 97% were satisfied with the quality of buses.

96. It is also likely that the PWC estimate represents the maximum amount of the penalties that might have arisen which would have been reduced substantially in practice for the reasons I have explained.

Findings

97. Whilst it is clear that the penalty regime provided in the bus contract was not implemented, in view of the uncertainty of the data available it is difficult to be precise about the consequences of this failure. However it seems reasonably clear that:

    (1) by implementation of the penalties regime the States would have been able to increase their influence over the way in which the contract was managed by the operator and thus the way in which services were provided.

    (2) the original contract terms were not originally established with sufficient clarity for penalties to be enforced and/or leverage gained from this.

    (3) the difficulty of implementing the penalty regime was maximised by the fact that it was targeted at a series of service failures (i.e. it was based on a series of input measures).

    (4) without the influence that implementation of the penalty regime would have created, the States were in a weak position to manage the nature and direction of the service being provided by the operator.

98. The new bus contract should be drafted with a view to supporting a practical penalty regime and in the expectation that the regime would be implemented in practice.

99. Once the new contract is in operation the penalty regime should be implemented.

100. As far as concerns procurement within the States generally:

    (1) incentive and penalty schemes are a necessary part of any out-sourcing arrangement.

    (2) it is not sufficient merely to specify such schemes in contracts, they must also be implemented.

101. The States should not become involved in such major outsourcing contracts unless incentive and penalty schemes are implemented. This in turn will require the States to ensure that Departments create teams with the skills necessary to manage relationships with outsourcing contractors.

SECTION SEVEN – INCENTIVES AND LEVERAGE

Introduction

102. The use of incentives and the leverage of value from a contractor by putting appropriate pressure on a contractor are key elements of good continuing contractual management.

103. Good incentives encourage performance by sharing risks. A commercially orientated business will be spurred to ensure that its performance complies with the contractual specification where achievement of the expected financial return demonstrably depends upon compliance. Usually this will include the opportunity to make more profit although it is possible that other incentives may be effective (e.g. as access to markets). Good contract design and management ensures that these incentives are aligned with wider corporate aims ensuring that both parties to the contract benefit.

104. As a corollary, a failure to design and/or implement effective incentives may lead a contractor to be satisfied with performance that is not satisfactory from the purchaser's point of view.

Detailed findings

105. The review suggested that if the opportunity of the re-tendering of the contract is used constructively, the institution of effective incentives could lead to improved performance, reduced costs and maximised revenue. In particular:

(1) Only one clause in the main contract was designed to incentivise the contractor. This provided for revenue sharing once revenue exceeded certain levels.[21] However, this was not invoked for a number of reasons:

(a) there was a fall in passenger numbers in 2002-2003[22];

[21] Clause 16.1 of the contract provides that if the actual revenue collected in a year is between 105% and 125% over the previous year, the contractor will be entitled to retain 50% of the amount between 105% and 125%. The proportion to be retained by the contractor would increase to 75% for amounts between 125.1% and 145% over the previous year. Above these levels any further retention was left to be a matter for negotiation between the parties.

(b) there were difficulties in establishing a true base line;

(c) there were difficulties in establishing whether improvements were caused by the States or by the contractor's initiatives; and

(d) there was no pressure from the contractor to implement it.

(2) There has only been effective innovation from the contractor since the contract was to be extended and during the current re-tendering exercise.

(3) Some detailed contract clauses provided perverse incentives. For example, since performance penalties were not being invoked the contractor could have run the services empty: this would have reduced the States income but minimised the contractor's costs and maximised their profit. There was no incentive for the contractor to monitor the accuracy of fare revenue, (e.g. in the issue of concessionary fares) since they did not benefit from any increased accuracy.

(4) In the early years of the contract the contractor charged 50p for timetables which would have increased revenue but could have reduced passenger numbers.

106. These issues spring from the nature of the original contract that was agreed with the operator. In principle, there are two main types of contract:

(1) Minimum cost: where the operator tenders on the basis of a fixed cost to operate the service and any revenue collected passes directly to the contracting transport authority. The authority thereby takes all of the revenue risks. It is on this basis that the Jersey contract was awarded.

(2) Minimum Subsidy – Where operators tender on the basis of the lowest subsidy required. These contracts involve bus operators retaining the cash revenue and calculating the short-fall in operating costs (plus a level of profit) and likely revenue. On this basis the winning operator absorbs all the operating risk.

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[22] This occurred at a time when the previous operator was continuing to provide the Easylink summer leisure services in parallel to the services provided under the current contract.

107. Neither contract type is ideal. Minimum cost contracts provide no incentive for the operator to improve importance and revenue whereas it was generally found that minimum subsidy contracts tended to be more expensive due largely to operators adding a premium to cover the risk of revenue falling below its expectations during the contract term. In some cases this could be a result of circumstances outside the operator's control such as new commercial services, roadworks and traffic congestion and changes in concessionary fare reimbursement.

108. The original bus contract was a minimum cots contract; and the review has confirmed experience elsewhere of such cost contracts:

(1) There is no incentive for the operator to improve passenger numbers and revenue

(2) The operator has no control over fares so that the ability to develop revenue is limited

(3) Service development initiatives are stifled because without approval it would simply add to operating costs and thus reduce the operator's profit as part of a fixed price contract

(4) The lack of any incentive on the part of the operator diminishes his role to simply a caretaker with no commercial flair to develop the business

(5) Despite TTS taking the revenue risk, sharing of data between the two organisations has been limited except for some summary data provided every four weeks on service performance.

109. In fact, clause 16 of the contract provides that "if actual revenue is between 105% and 125% over the previous years the contractor will be entitled to retain 50% of the amount between 105% and 125%". In addition, other clauses make allowances for revenue growth in excess of 125%. It is not clear however whether this revenue share agreement simply applies between the first and second year of the existing contract or for each year of the contract if revenue exceeds the previous year.

110. Clause 8.4 of the contract provides for an annual price review based on the Jersey Retail Price Index. RPI rarely reflects the internal inflation within the bus industry with fuel, insurance and drivers pay rates generally rising within excess of RPI.

111. In summary there was insufficient risk associated with the contracts from the contractor's perspective. There was insufficient benefit for the contractor to justify investing in improved performance and, as a result, there has been little incentive for improvement.

Leverage

112. The States were at times successful in leveraging greater value from the contracts. For example, as part of the negotiations to extend the contracts, the States estimate that a net benefit of £568,000 accrued to the States and the provision of six new buses. This included the negotiation of £100,000 reduction in the annual cost of the principal or first contract.

113. The awarding of the schools and leisure service to the contractor was achieved at a competitive price with significant non-financial benefits also accruing as a result of having both contracts delivered by the same contractor.

114. However, further pressure could potentially have been put on the contractor:

(1) The penalty regime could have been implemented.

(2) The extent of the service failures indicated that it might have been possible to default the contractor either triggering a full re-tendering process or re-negotiation of terms.

Implications

115. There are two potential approaches which could be used.

116. Firstly, more reliance could be placed on outcome rather than output measures, e.g. measuring passenger satisfaction rather than punctuality. The measures used could also be aligned to a States-wide objective such as reduction in car usage.

117. Secondly, under the current contracts the contractor has only responded to incentives/leverage when they perceived the cost of losing a contract or saw the opportunity of an extension. It is possible to produce similar pressure points during a contract period through break clauses which allow management to exit the contract earlier to reduce costs. This value would however be lost as a result of a number of factors such as ambiguities in the contract, delivery and quality failures, and poor or perverse incentives). Break clauses can act to ensure that service performance is consistent with that originally intended. However, there are associated risks since break clauses can effectively create multiple short term contracts with the result that contractors may be less willing to invest in the contract (e.g. via reduced capital spend) or may inflate prices to cover the risks associated with potential loss of a contract.

Conclusions and recommendations

118. TTS should be aware of the significance of incentives in contracts and the possibility of leveraging its value. Outcome based measures and break clauses are examples of techniques which can be used to achieve this. Importantly, they can both serve to provide an equitable risk sharing arrangement which engages both parties in the contract.

119. This sharing of risk is often a crucial element underpinning wider contractual relationships and should be seen in the context of the diagram since effective contractual terms need to be in place for these and other techniques to be effective. There also needs to be a clear understanding of how such terms will be used. For the next bus contract this might include ensuring that both parties understand:

(1) The arrangements for monitoring performance.

(2) What will be measured and why in line with the objectives of the contract.

(3) How data will be collected.

(4) How this data will be used to reinforce penalties and/or incentivise the contractor.

SECTION EIGHT – WORKING CAPITAL

Introduction

120. The pattern of payments as well and inflation arrangements which are agreed either within contract terms or in addition to the written terms have the potential to significantly influence the overall cost of the contract. This is particularly the case where a contract extends over a significant period.

Contract provisions

121. Under the first bus contract the arrangements are:

(1) Payment in advance of 80% of each four weekly period fee.

(2) Payment in arrears of the remaining 20% net of revenue from the period. In reality the revenue payable always exceeded the remaining 20% - the payment was made from the contractor to the States.

(3) An annual change in the contract price based on a mix of Jersey's Retail Price Index (RPI), Jersey's motoring expenditure index and Jersey's average earnings index.

(4) Similar arrangements were in place for the Schools and Leisure Service although the initial year's inflation was a flat rate of 2.5%.

Detailed findings and recommendations

122. The arrangements for making payments to the contractor were agreed on the basis of the advice of the States' consultant at the outset of the contracts.

123. The review's analysis of payments and receipts indicated that the contractor typically invoiced 10.5 days in advance of the end of a period and paid over revenue 18.5 days after the period end. In practice, the States make payments some time after the date of an invoice (at least 7 days). Had the States received fare income on the date it was received by the contractor and had payments been made on the last working day of the period (rather than 10.5 days in advance), the review estimates that the savings across the first

eight years of the contract would have been of the order of £200,000. This is based on the States achieving a return of 2% above the Bank of England's base rate.

124. For future contracts, the States should consider whether cash flow advantages can be gained through the management of payment terms.

125. The arrangements for adjusting the annual prices paid for the contracts appear reasonable since it corresponds to the contractor's main costs: staff and fuel. This serves to ensure that price changes do not disadvantage either party. However, whilst this is good practice there are a number of additional approaches which the States could consider for future contracts in order to mitigate the risks associated with inflation measures.

126. Firstly, consideration should be given to using RPI-X which excludes mortgage interest payments rather than RPI. RPI-X has historically been a slightly lower measure of inflation of RPI.

127. Many public sector bodies now use the consumer price index (CPI) rather than RPI. CPI has typically been around 0.75% lower per annum. Although at present Jersey has CPI measure.

128. 67% of the annual movement for the bus contracts is based on the index of average earnings. However, there is a risk that this index is skewed by the States' financial services industry, and an alternative index might be a better measure of Connex's costs. The States could use a range of measures in order to set the price change. Approaches used in other contracts include terms which state that increase will be the lowest of the increases indicated by the measures within the range. Two specific wordings should be used to further manage the risk:

129. Reference should be made to changes to the contract price, rather than increases, in order to mitigate the risk that a fall in the chosen index does not lead to a price change.

130. The States should ensure that the option to request a price change does not sit only with the contractor: this mitigates the risk that a fall in the chosen index does not lead to the contractor triggering a price change.

SECTION NINE – CONTRACT TERMS

Introduction

131. In order to reduce the risks associated with a contractual arrangement it is best practice to ensure that the contractual terms are:

(1) clearly and concisely set out in the contract documents;

(2) mutually understood by both parties; and

(3) appropriate to the States specific circumstances.

Findings

132. The review of the bus contracts identified a number of minor issues:

(1) The official contract for the schools and leisure service was not signed until January 2010 although the service commenced in January 2007 owing to legal delays.

(2) The schools and leisure service contract is inconsistent in its description in the amount payable to the contractor in respect of the leisure service. All fare revenue is payable although some terms stated that all profit is paid over.

(3) The main service contract includes terms of revenue sharing designed to incentivise contracts. However, no terms were ever agreed.

133. None of these issues is significant in the context of wider management of these contracts. However, the States should ensure that the risks associated with incomplete or inconsistent terms and contracts which are not signed when the service starts are mitigated by ensuring that clear agreements are in force.

SECTION TEN – STATES-WIDE CONTRACT MANAGEMENT

Introduction

134. Whilst the review concentrated on the bus contracts and TTS's management of these contracts, some consideration was also given to TTS's approach in the context of States-wide policies and procedures.

Detailed findings

135. The States have clear policies and procedures dated January 2006 which deal with expenditure on capital projects. The guidance sets out a number of detailed requirements but is limited in its application for large scale contracts since not all contractual arrangements are capital in nature and the policies do not cover the operation phases of a project.

136. Whist many of the requirements of contract management should be implicit in the States' wider financial code, there may be value in developing clear policies and procedures for contract tendering, award and management.

137. The review observed that TTS had put in place a number of structures and plans for the letting of the new bus contracts. These in part reflect 'lessons learned' from the existing contracts as well as from larger scale capital/contractual arrangements. However, there appears currently to be no mechanism such as a contract management code or a best practice guide which would allow other departments within the States to benefit from this accumulated knowledge.

Recommendation

138. Consideration should be given to ways of disseminating the knowledge within TTS as well as the more detailed recommendations from this review in the context of clear policies for general contract management.

APPENDIX ONE – TERMS OF REFERENCE

App-1. This review is commissioned in accordance with the powers of the Comptroller & Auditor General as set out in the Public Finance Jersey Law 2005 to take place in the light of:

(1) the controversy that attended the original placing of the contract for bus services; and

(2) the importance to the States of Jersey of ensuring proper management of contracts for the provision of public services.

App-2. The purpose of the review is to examine:

(1) the rationale for out-sourcing these services;

(2) the benefits gained from the contracts in comparison with the original business case and the business case for extending the contract;

(3) the States' management of the contracts; and

(4) any other related issues which come to attention in the course of this review.

APPENDIX TWO – PEOPLE WHO CONTRIBUTED TO THIS REVIEW

Name	*Position*
Caroline Anderson	Previously, Director of Transport, TTS (now CSR Leader, Chief Minister's Department)
Tristen Dodd	Director of Transport, TTS
Caroline Hastings	Director of Strategic Procurement, Resources Department
Eric Le Roux	Managing Director, Connex Transport Jersey Limited
Craig Miller	Transport Logistics Manager, TSS
Toni Miziolek	Projects Manager, TTS
John Rogers	Chief Officer, TTS
Christine Walwyn	Finance Director, TTS

APPENDIX THREE – IMPROVEMENTS IN SERVICE INTRODUCED DURING THE CONTRACT

(This list of service improvements is based on information supplied by TTS and the Contractor.)

MyBus Connexion: a transport on demand system in St Brelade, St Peter and St Ouen introduced in 2005. This service gave parishioners the facility to book a bus for travel between the areas mentioned complementing the existing MyBus network and creating connection points at key areas such as Red Houses.

Airport Express: service between the Airport and St Helier trialled during the summer of 2006.

Harbour Shuttle: A free shuttle service between Elizabeth Harbour and Liberation Station In July and August 2009: thus providing access to the full network.

Summer Leisure Services: the introduction of integrated ticketing in 2007.

Branding: The MyBus brand was introduced in 2003 to give the local bus service an identity.

MyBus website: launched in 2004 enhancing communication with passengers. Further developed and re-launched in May 2010 with such features as online real-time information, enhanced timetable information and an online feedback facility.

Passenger newsletters: the traditional paper format introduced in 2006 was replaced in 2010 by a more direct and environmentally friendly e-newsletter.

Films: in 2010 four television screens were installed at Liberation Station. The contractor produced a film promoting the MyExplorer routes which is also streamed on the newly re-launched website.

Range of passes: An unlimited travel annual pass has been introduced together with a range of family passes giving passengers a greater range of ticketing options. The range of passes is now available from local hotels and from Condor ferries in St Malo, Guernsey, Weymouth and Poole and through tour operators Buro Britain and Destination Specialists enabling them to be sold as a part of a person's travel package.

Wayfarer TGX ticket machines: introduced in 2002.

Smartcard ticketing: Being explored with a view to introduction in 2011.

Shadow timetable: Services operated to match services provided by the previous operator but not included in the original contract; service specification.