

ENVIRONMENT DEPARTMENT

SCHEDULED BUS SERVICES CONTRACT NEGOTIATIONS

A BACKGROUND PAPER

The circumstances behind the appointment of a new operator for the bus contract are such that the States was not afforded the opportunity to debate the contract. Whilst such a debate was not a necessity the Department considered that much of the information that would have been made available in a States debate should, in any case, be placed in the public domain. As a consequence this report has been prepared and placed on the Government website.

Executive Summary

1. In its report dated September 2009 the Environment Department set out what was necessary to arrive at a position to be able to competitively tender, in accordance with States direction, the scheduled bus services contract upon the expiry of the then contract (extended until 31 March 2012). Those proposals were not accepted by the States and instead the review of the bus contract became part of the Fundamental Spending Review. After a prolonged period of investigations by the Value for Money Team carried out as part of the Fundamental Spending Review, negotiations commenced with Island Coachways. The negotiations sought to reduce and cap the cost to the States of providing the bus service, to remove any form of guaranteed or percentage profit and to increase the risk element faced by Island Coachways as service provider. Those negotiations broke down in November 2011. Commercial confidentiality prevents the public disclosure of the detail of the negotiations but that detail was provided to States members in a closed meeting held in November 2011.
2. At the closed meeting the Environment Department advised that it had two options open for moving forwards. The first was to form a States owned company to take over control of the assets and to ensure continuing provision of bus services. The second was to invite companies to present their proposals for moving forwards and to then appoint and negotiate with a preferred partner. Full open competitive tender was not an option as, due to the very severe time constraints, it simply would not have been possible to issue a comprehensive tender pack including a draft contract or for companies to establish robust costs in order to put forward a competitive tender. This view point has been confirmed by the States commercial/contract lawyers and by bus industry experts/advisors.
3. Following interest from a number of potential providers the second option was favoured. This report sets out the process adopted to engage with potential suppliers, the results of the assessment process and the outcome of the resultant negotiations with the preferred partner.

Background

4. Under the terms of the Public Transport (Guernsey) Law, 1984, the Environment Department has a duty to ensure that there are available at all times, sufficient, efficient and safe systems of public transport services in Guernsey to meet the requirements of the public.
5. For the purposes of this report it is not necessary to repeat the history of how the current form of contract came into being. It is sufficient to recognise that by the end of the nineties it had become abundantly clear that private bus companies could not survive in competition for the routes, that the commercially viable routes were insufficient to support an island wide integrated service and that if the 1984 legal obligations were to be met a States subsidised bus service was needed. In the event the States contracted with Island Coachways for the provision of the bus service.
6. The form of contract, which was reasonably common at that time, is known as a cost plus contract. It operates on the basis of open book accounting. The nature and the extent of the services are set by the States and the service provider is reimbursed with the full costs of providing that service plus a profit element. Whilst the contract was appropriate to the circumstances at the time, it is no longer the preferred form of contract and as set out in the Departments 2009 States Report other forms of contract could potentially provide a better platform for the ongoing provision of bus services.
7. Under the current form of contract the service provider sets out a budget for providing the services specified within the contract. That budget includes all salaries, consumables, equipment, materials, rents, utilities etc. Income arising from fares, advertising and other sales is deducted from the contract costs and the difference which is a deficit is met by the "States Subsidy". It should be noted that throughout the UK it is the norm for public bus services to operate under a government subsidy. The contractor is also paid a profit element.
8. A company's profit is, under most circumstances, recognised as a reward for taking on risk or for investing capital. The Environment Department, as part of the initial fundamental spending review scoping studies, identified the payment of profit in the absence of risk and investment as an undesirable element of the bus services "cost plus" contract. The Department observed that if the service was, in effect, "nationalised", the profit element being paid to the company could immediately be saved thus reducing the tax payer's costs. This is, of course, a simplistic view and other factors, in particular the issue of what services should be provided by Government and what services contracted out, comes into play alongside issues such as reducing the size of the States staff establishment. Nevertheless, in January 2009 the Department put forward the bus services as an area for examination under the initial Fundamental Spending Review. The resultant consultant's findings included the bus services as one of the Savings Opportunity Reports.

9. The Department also commenced work on a States report seeking the resources necessary to conduct a full review of the routes, fares, service provision and form of contract with a view to identifying the best way to take the bus services forward over the next decade. That report was submitted to the States in October 2009 but the Department's proposals were rejected.
10. The Department, therefore, commenced a stage by stage review utilising in house resources as available. Various amendments were made to the routes in order to facilitate the enhanced services required under the then transport strategy and in 2010 enhancements were made to the ticketing machines to facilitate the ormer card which can operate as both a stored journeys and stored value card.
11. The Department also reviewed the fares and considered that, in light of fares charged in other jurisdictions, a £1 fare was appropriate and presented, to the user, a low cost bus service. Simultaneously, the Fundamental Spending Review team had commenced examination of passenger carryings on the various routes in order to identify where services could potentially be cut to reduce the cost of the service. The Department, mindful of the Treasury and Resources concern that increases in any charges and taxation should represent a fair charge, approached that Department for comment prior to increasing the fare level and as a consequence the Value for Money Team was tasked to review fare levels and to comment on the Department's proposal. The team endorsed the Department's position that a £1 fare was appropriate. Fares were, therefore, increased in Summer 2010. The additional revenue was treated as part of the funds required to redress the States structural deficit and as such were not available to the Department to use on enhanced bus services or other operational matters.
12. For the latter part of 2010 through to early 2011 discussions were held in respect of the premises from which the bus services were provided. The premises are in two parts with two separate owners/landlords. One part – the Tram sheds – is leased directly to Island Coachways. The other part, which was acquired following the loss of the Bouet sheds to housing, is leased directly to the States. Both parts were necessary to accommodate the bus operations including garaging, fuelling, servicing, cleaning etc. Whilst both landlords were willing to extend leases the States was unable to take full control of both sites. As a consequence full use of the dual sites has been dependent on ICW being the service provider.
13. The Department had expressed a strong desire to competitively tender the bus contract and hence made representations in respect of other potential sites. Simultaneously the Tribal consultants commenced a search of available States sites including land around States Works and the Electricity Station, the Guernsey Water land at St Andrews, the Fire Station, the C  tel Hospital and the reclaimed land to the East of Marine and General. None of the sites examined were confirmed as being both suitable and available.
14. In spring 2011 attention turned to the form of contract let with Island Coachways. It had become clear that competitively tendering the service

was not viable within the time frame, that the research and advice the Department had identified as being necessary within its States report would not materialise and securing a suitable site to facilitate competitive tender was many months if not years away. As a consequence a negotiated contract with ICW became the preferred option.

15. The Transformation Executive set the criteria for negotiating the new contract with ICW as:

- remove the current guaranteed profit element, and
- replace it with the ability for the company to generate profit by meeting performance targets relating to the delivery of operational efficiencies.
- seek a reduction in the baseline (2010) cost for the current service of at least £250,000.

The full detail behind the negotiations that resulted is the subject of commercial confidentiality clauses contained in the current contract and as such cannot be made public. States members were, however, provided with the full details in a closed meeting held in November 2011.

16. Contract negotiations commenced in May 2011. ICW was advised that the States would be willing to sign a further contract with the company but not on the basis of an open ended cost plus contract. ICW was advised that under any new contract the company would have to take commercial risk, that the level of States contribution must be reduced and that the States exposure/risk to contract costs increasing must be capped. An inflation index was to form part of the negotiations once the 2010 baseline costs had been negotiated and the target was a short term contract whilst premises issues etc were addressed.
17. During the subsequent months options to achieve the desired outcomes were explored. During those negotiations comments were made and which led the Environment Department to believe that a negotiated agreement was achievable and would be delivered on time. Nevertheless, on November 3rd Island Coachways, in a meeting with the Minister of the Department, advised that it was withdrawing from the negotiations and had no desire to continue to provide bus services after its current contract expired. ICW kindly offered and the Department accepted a contract extension from 31st December 2011 until 31st March 2012.

Service Delivery Options

18. Notwithstanding the contract extension period, the time available (less than four months) presented significant problems in moving forward. Clearly the contract could not simply be awarded to a new operator but neither did time

allow for full open competitive tender. A full open competitive tender process would likely have necessitated:

- The issuing of an expressions of interest document
- Companies' submission of their credentials
- A first short listing exercise
- A round of interviews resulting in a second short listing
- The issuing of comprehensive tender pack to those shortlisted
- Companies' presentation of proposals and costing
- Post tender/contract clarification discussions
- Tender assessment and award

Such a process would normally be expected to take between 12 and 18 months and often takes longer. The Department considered, therefore, that it had two main options open to it. The first was to form a States owned company and bring the operations "in house". This option would have provided a period of stability during which time premises and other issues could be resolved with a view to dissolving the company and tendering a competitive contract at a later date. The second option was to seek a preferred partner with whom a negotiated contract could be agreed. That contract would be a short term contract of two to three years again during which time premises and other issues could be addressed with a view to letting a performance driven longer term contract at the end of that period.

19. The Department's initial preference was the States owned company option. The main benefit of this option being that work could commence immediately on addressing the very many work streams necessary to effect a hand over of operations. The Department also doubted whether another operator would be interested and able to step in at such short notice. Against this preferred option was the recognition that the States would be bringing in house a business that can, without doubt, be provided by the commercial sector. Not only would this run against the stated general direction of the States but it would also mean that the States would have to develop the hands on management and operational skills for this new business.
20. In the days following ICW's public announcement to withdraw from the provision of bus services the Department started to receive approaches from companies interested in taking over the contract. Informal discussions with those parties stressed the time constraints that would exist and the short term nature of the contract that could be offered. Those informal discussions led the Department to form the view that the second option, a negotiated short term contract with a new partner could be a viable option and that it would be inappropriate to pursue the "States owned company" option without fully investigating the alternative.
21. The Department, therefore, sought the views of the Treasury and Resources Department and the Policy Council and in light of the strong level of support received commenced a process to identify a preferred partner with which to negotiate a short term contract.

Preferred Partner

22. By 28th November the Department had been approached by seven companies including a number of major industry players. A significant number of those expressing an interest were companies that were involved in the Jersey bus tender process and it was clear they had been monitoring the situation in Guernsey. The Department was fully satisfied that the companies that had expressed an interest presented an excellent spread across the spectrum and the Department was satisfied that if it was going to be possible to identify a preferred partner with whom to negotiate a new short term contract then it would be possible to do so from those companies that had already, proactively, expressed an interest. This, along with the very real time constraints faced, led the Department to issue packs directly to those companies. It must be borne in mind that the approach being adopted was to identify a preferred partner with which to negotiate a contract.
23. Packs inviting companies to present themselves and their proposals, including any proposals/ solutions to address the hand over and continuity problems, were sent to all seven companies and a pack was also sent to Island Coachways. Packs were issued on 29th November.
24. Companies were required to confirm their continuing interest by December 8th and also to confirm their availability to attend interviews in Guernsey during the week commencing December 12th. Six of the companies confirmed their continuing interest and attended for interviews.
25. Prior to commencing interviews the Department, with the assistance of staff from the Treasury and Resources Department, established assessment criteria and scoring system. The allocation of scores matched the assessment criteria scores that had been included in the packs issued to the companies.
26. The proposals were impressive and it was clear that a number of the companies had put a considerable amount of effort into preparing for the interviews and were able to demonstrate competence, commitment and experience in setting up operations under very tight time constraints. HCT Group demonstrated an excellent appreciation of the issues involved and had clearly spent considerable time and effort developing and scheduling real solutions. The company's size and organisation presented an excellent fit for Guernsey and the company was able to demonstrate its ability to handle the handover in a proactive but sensitive way. Importantly the company was completely flexible in respect of the contract structure and duration whilst being open about its expectations on profit levels and risks. HCT Group was adopted as the preferred partner.
27. HCT Group is a social enterprise organisation focused on the transport industry. It is a registered charity but also a company limited by guarantee. The group started in 1982 filling social transport needs and has grown to a 2010 turnover of £28 million operating 320 vehicles out of 11 depots in the UK, managing 635 employees and delivering over 12 million passenger trips

per annum. Whilst these numbers are large in the Guernsey context HCT Group is a relatively small player in the transport industry. In this respect its size is an ideal match. The company size and structure is such that Head Office remains very close to its operating divisions and clients and the Chief Executive and his Deputy maintain a key presence in developing services with clients and ensuring the company and social enterprise ethos is delivered. At the same time the company is large enough to be able to provide centralised support in respect of training, marketing, finance etc to its operational subsidiaries.

28. In simplistic terms HCT Group operates as two entities. The central group and its commercial arm CT Plus. Commercial contracts, won in the marketplace, are delivered through CT Plus and in respect of the Guernsey contract a new subsidiary CT Plus Guernsey Limited has been formed. CT Plus Guernsey Limited, as a subsidiary, will exist alongside other subsidiaries including CT Plus (Humber) and CT Plus Yorkshire. These trading entities seek to make a profit and it is HCT's aim that one third of the profit earned by each trading subsidiary is invested directly back into the community served by that subsidiary. Guernsey will be treated in the same way. The monies invested back into the community are used to deliver community transport services including, for example, mobility scooters and voluntary car services. In delivering these community services HCT works directly with the local organisations and volunteers. The remaining profit arising from the trading subsidiaries' activities is returned to HCT group where it is used to fund its core central social enterprise transport activities.
29. HCT Group's ethos is to be an indivisible part of the community in which it operates providing social justice for all through using transport to deliver accessibility for all. In delivering these objectives HCT Group seeks to engage with the community both in respect of planning services, reinvesting profits, training and recruiting from the local workforce. Clearly, the Environment Department's key objective was to seek a partner with the ability to deliver a scheduled and school bus service. The Department believes HCT Group is more than able to meet that need. But the Department also needed to seek a partner with whom it believed it could negotiate the best deal for Guernsey over the short term whilst preparing the services ready for a longer term contract. In identifying HCT Group as its preferred partner the Department believes it has met and exceeded this objective and the potential exists to integrate environmental and social objectives principally in respect of transport but potentially with other positive outcomes.

Contract Negotiations

30. Following the selection of HCT Group as its preferred partner detailed contract negotiations commenced. The Department considers that it would not be in the best interests of Guernsey, especially bearing in mind the short

term nature of the contract and the desire to undertake an open competitive tender within the next few years, to disclose all the details of those negotiations. However the Department can advise that the following heads of agreement have been agreed.

- The contract is a two year contract which can be extended by one year at the discretion of the Environment Department and by a further two years by mutual agreement of both parties.
 - The contract is a fixed price contract with CT Plus Guernsey Limited taking commercial risk for operational costs and revenues. The contract includes an inflation index.
 - The States has retained the right to set fares, routes and frequencies but will obviously work with CT Plus Guernsey Limited to establish efficiencies and to put onto the market products that will encourage an increase in the number of passengers.
 - The States has a gain share provision allowing it to share in the success if profits grow above a set level.
 - CT Plus Guernsey Limited is responsible for all operational matters and penalties exist in the contract and would be exercised in the event of poor performance.
 - The contract requires CT Plus Guernsey Limited to assist the States to develop a long term future for bus services.
 - The cost of the contract to the States is in the order of £2.4 million per annum which is less than the projected spend for 2012 had no action been taken to renegotiate a new contract.
31. The above principles including the contract price were agreed by the Department and HCT Group on Friday 9 March and the decision to publicly announce the position was taken on Sunday 11 March. A public announcement was released on Monday 12 March.
32. The contracts were submitted to the contract lawyers during the week commencing 12 March. It is not at all unusual for a service provider to commence operations prior to formal contract signing provided the principal terms have been agreed nevertheless the relevant parties worked with the objective of contract signing before service handover if at all possible. During this period both parties committed to significant preparatory works ready for handover of the services. During this period the Department and HCT Group relied on the co-operation and ongoing good will of the incumbent operator. The Department is grateful to Island Coachways for the assistance given during this period.
33. The contract was signed on Friday 30 March and services operated by CT Plus Guernsey Limited commenced on 1 April.

Date 1 April 2012 ENDS