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Wishful thinking? Bus franchising and the Tyne and Wear QCS

The UK Transport Act 2000 gave GB local authorities the power to move to a franchised bus network under a quality contract scheme (QCS). The North East Combined Authority (NECA) has looked to use this power, with two (separate) Oxera teams providing advice to bus operators, Stagecoach and Arriva, on the economics of the proposal throughout its development. This article reflects on the experience in light of the current bus policy debate, with next year's Buses Bill set to include bus franchising powers as part of the government's devolution agenda

Local bus networks are a cornerstone of Great Britain's transport infrastructure. In 2014, bus journeys constituted four times as many journeys as those made on the London Underground, and three times as many as those made on national rail services.[1] Nearly 3bn of these journeys were made outside London, where buses are by far the most frequently used form of public transport. A recent proposal for bus franchising in Tyne and Wear marks the latest chapter in a long-running debate over how—and by whom—bus services should be organised and operated.

Following the Transport Act 1985, there has been deregulation of bus services across Great Britain,[2] with legislators aiming to foster competition between bus operators by allowing competing firms to freely enter and exit the market. The notable exception to this is London, where bus services are provided under contract to Transport for London. This legislation was set against a backdrop of declining bus usage, which had fallen from nearly 13bn journeys across Britain in 1950 to 6bn by 1985.[3] However, since this time bus use has continued to decline: 4.5bn bus trips were made in Great Britain outside London in 1985, which is around 40% more than today.[4]

While the increase in car ownership in Great Britain is likely to have played an important role in driving the fall in bus patronage over this time,[5] some have suggested that other factors may be at play. In 2011, the UK Competition Commission (CC, now part of the Competition and Markets Authority) concluded a detailed investigation into the market for local bus services, finding that 'on the road' competition between operators can work in principle but was not effective in many regions, and that this can lead to lower service quality and higher fares for passengers.[6] In addition to remedies aimed at enhancing 'on the road' competition (e.g. related to access to bus stations), the CC considered two policy options:

- greater use of *partnership*: where local transport authorities[7] (LTAs) and bus operators make joint decisions on the running of the local bus network;
- greater use of *franchising*: where LTAs regain control of bus networks, and contract with operators to deliver the network through a competitive tendering process.

The CC tentatively encouraged greater use of partnership working (as part of a wider package of measures), while franchising schemes were considered likely to prove expensive and not much more effective than alternative remedies, and thus did not form part the final recommendations.[8] However, the CC did draw a distinction between the aims of its market investigation—to increase competition in the local bus industry—and the policy objectives of LTAs, which can encompass a much wider range of concerns.[9]

On this basis, LTAs have long had the option to introduce franchising through a QCS, governed by the Transport Act 2000 (as amended 2008). If implemented, a QCS allows LTAs to control the provision of bus services in their regions through a tendering process, and free entry into the market by operators is no longer permitted.[10]

The legislation stipulates that, for a QCS to be implemented, the LTA must be satisfied that it meets five 'public interest tests' (known as criteria A to E) designed to ensure that the scheme is both economically sound and beneficial to the public. To determine whether this is the case, the LTA must subject its proposal to review by an independent QCS Board, whose role is to assess whether these public interest tests are met.

The proposed QCS in Tyne and Wear

The proposal for a QCS in Tyne and Wear (a region in the North East of England encompassing the cities of Newcastle and Sunderland) was developed by Nexus, the executive arm of the NECA. The development of the proposal began in 2012,[11] and continued through a statutory consultation in 2013 before the NECA formally voted to proceed with the scheme in October 2014, with the proposal going forward to the QCS Board for review.[12] The Board held oral evidence hearings into the proposed scheme in July 2015 and published its conclusions on 3 November 2015, more than a year after the initial referral.

Under Nexus' QCS proposal, operators would be contracted to provide bus services that Nexus would pay for out of bus fares. It was assumed that operators would earn a lower margin under their QCS contracts than in the current market, with the remaining fare revenue (representing operator margin) transferred to the LTA.

The proposal approved by the NECA made no changes to the existing bus network. In its 2014 submission to the NECA, Nexus notes that:[13]

> The QCS Network will replicate as closely as possible the deregulated bus network in place at the point that the QCS is adopted.

As such, the QCS did not have the intention of delivering incremental benefits for consumers through enhanced service provision relative to the current network. Instead, Nexus asserted that the QCS proposal was needed to maintain the *existing* network in the face of anticipated cuts in funding from both central and local government, by generating additional net revenues for the LTA.[14]

As an alternative option, the operators in the Tyne and Wear area offered a partnership proposal (a voluntary partnership agreement, VPA). A VPA is an agreement defined under the Transport Act 2000 whereby one or more local authorities make improvements to bus services for passengers, and one or more bus operators provide services of a particular standard.[15] In October 2014 the NECA chose to pursue the franchising model ahead of this partnership offering.[16]

Nexus' proposal did not meet the public interest tests

The QCS Board review process involved a thorough and detailed debate of the merits of Nexus' QCS proposal. Two of the public interest tests in the Transport Act put economics at the heart of the QCS Board's deliberations. These were the requirements that the scheme provided 'value for money' (criterion D); and that it imposed adverse effects on operators only to the extent that these were 'proportionate' to the benefits created (criterion E). Oxera witnesses gave their views on the economics of the case at the QCS Board hearings.

One fundamental economic challenge was the question of how a QCS proposal that left the network unchanged would generate the benefits needed to justify the costs and disruption (criterion D) and adverse operator impacts (criterion E). The transfer of a portion of operating margin from the private sector to the public sector was central to Nexus' financial plans—but such transfers do not create economic value in themselves. This issue was identified by Oxera at the statutory consultation phase of the QCS, and ultimately conceded by Nexus.[17]

More broadly, any QCS needs to be affordable. The business model envisioned by Nexus was not risk-free, and financial viability depended on many factors outside the NECA's control—such as macroeconomic conditions and their impact on demand levels, and cost inflation (e.g. the price of fuel)—that are passed on through higher contract prices. Significantly, Nexus' proposal made firm long-term commitments regarding fares and service levels based on uncertain revenue flows, thereby opening up a significant risk of financial deficit to the local authority.

Notwithstanding these issues, Nexus asserted that the scheme offered value for money (i.e. that it met criterion D), largely due to the impact of 'quality factors' such as improved ticketing. While these were unrelated to 'hard' factors, such as the frequency, cost or speed of services, quality factors were assumed to create hundreds of millions of pounds' worth of passenger benefits for relatively little financial cost. However, the QCS Board found multiple shortcomings in Nexus' valuation of these measures. For example, the Board found that it was not reasonable to assume that concessionary passengers who did not purchase tickets would benefit from improvements to those tickets.[18]

These concerns, among others, led the QCS Board to conclude that criteria D and E of the public interest tests were not met.[19] Moreover, the QCS Board also found that the errors made in the economic analysis (such as those described above) should have been corrected and re-consulted upon by Nexus; and that by not doing so it may have misled consultees.[20]

The 'three wishes' of bus policy

While these conclusions relate specifically to Nexus' proposal, they have a number of implications for the wider debate on bus franchising. In particular, the economic findings with respect to Nexus' QCS proposal highlight a fundamental tension between 'three wishes' for future bus policy:

- increased LTA control of bus networks;

- no extra requirements for public funding;
- avoidance of a disproportionate adverse impact on bus operators.

The first wish follows from the current UK government's devolution agenda, which explicitly includes an aspiration to enable LTAs to franchise bus services where they wish to do so:[21]

> Delivering better bus services for local people is one of the key aims of Government and local authorities when thinking about devolution… Following the devolution deals signed with Greater Manchester and Cornwall in which we committed to providing the powers necessary to franchise their bus services, we intend to introduce a 'Buses Bill' in the current parliamentary session.

The second wish arises from continued government austerity, with local authorities forecasting that available funding will continue to be cut into this Parliament.[22] This means that it is desirable that future bus reform policy does not entail substantial increases in spending on the part of local authorities, or on the public purse in general. Under franchising, this would have direct consequences for passengers; if an LTA acquires control of the bus network and finds itself facing funding difficulties, fare rises or service cuts would be the only options to bridge the shortfall. The proposed franchising arrangements in Greater Manchester would result in the devolution of existing government bus funding, but no new money.[23]

The third wish (allowed for explicitly through criterion E under the previous 'Transport Act' framework) arises from regard for the legitimate business interests of existing operators. This means that any adverse impacts on operators caused by new franchising schemes must have a clear justification with reference to the net benefits that the scheme creates. In particular, any future framework (e.g. through the Buses Bill) will need to ensure compatibility of franchising proposals with Article 1, Protocol 1 of the European Convention on Human Rights, which protects the property rights of all legal persons, including bus operators.[24]

Through its QCS proposal, Nexus believed that it had found a way to meet all three wishes: by introducing a scheme that gave the local authority control of the bus network, actually *increased* available public sector funds, and had a proportionate effect on local operators, given its benefits. Oxera's analysis, and the findings of the QCS Board, showed that it had not.[25]

In all policy decisions, trade-offs are inevitable. Continuing with the current market structure means that there are no additional risks to public sector finances, and avoids the issue of adverse impacts on operators, but fails to give LTAs control over bus networks. The QCS Board identified the payment of compensation to operators as a possible remedy to the proportionality problem surrounding the introduction of franchising, but this will mean extra expense from the public purse.[26]

A compromise solution may be found in partnerships such as the VPA offered by operators in Tyne and Wear: these agreements do not give local authorities the same degree of control as a franchised network, but allow them to participate in decisions concerning local buses, and largely avoid tensions between public sector costs and impacts on operators. Such partnership agreements have been used to deliver bus network improvements in Oxford[27] and, more recently, in Sheffield.[28]

Implications for future assessment frameworks

It does not appear to be possible to meet all three policy wishes at once. The public interest criteria in the Transport Act 2000 provided one framework in which to balance these competing concerns, but any future framework under a Buses Bill will need to do the same. The difficulty that Nexus found in meeting the public interest criteria was not simply a function of the drafting of the Transport Act, but a result of the fundamental trade-offs that bus network franchising involves. There is no genie that can grant all three wishes.

The experience in Tyne and Wear does offer some lessons that can help to ensure that the right balance is struck. In particular, it highlights that control of the bus network brings a great deal of operational and financial responsibility: local authorities will need to be fully accountable for any decisions made concerning franchising. This could come through making the continuation of franchising agreements contingent on the schemes meeting particular strategic and financial objectives, with penalties if the schemes fail to perform. There was no such mechanism in place for Nexus' proposal.

Above all, the experience in Tyne and Wear highlights the need for independent and rigorous scrutiny of franchising proposals to ensure that they are viable and sustainable. The public and other interested parties should also be made aware of significant changes which result from this scrutiny, to ensure that consultees' views are not based on inaccurate information. As noted by the QCS Board, the long-run risks to an LTA following the 'franchise option' are numerous, and range from issues of network planning and contract management to disruptive technologies such as 'Uber'-style services and self-driving cars.[29] Any decision will have consequences reaching far beyond the term of the first franchise contract, with any later reconversion to an 'open access' market likely to be complex and disruptive to passengers.

Nexus believed that its proposals were able to promise local authorities a franchising model that was both proportionate and affordable, but the QCS Board process revealed shortcomings in its analysis which undermined these promises. Left unidentified, these issues could have resulted in the NECA being tied into long-term contracts that it could not afford to maintain. Far from being an unfortunate consequence of current legislation, the time given to independent testing of Nexus' proposals has been time well spent.

Such risks will be no less pertinent in any future franchising debates following the Buses Bill. The trade-offs in bus policy cannot be avoided, but independent assessment and scrutiny of proposals means that LTAs can strike a balance between competing policy concerns with their eyes open.

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[1] Department for Transport (2014), 'Transport Statistics Great Britain 2014', Table TSGB0102.

[2] Prior to 1985, bus services had typically been operated by public bodies. The Transport Act 1985 liberalised registration requirements which needed to be met in order to operate services, and saw the beginning of the privatisation of the vast majority of local bus routes.

[3] Department for Transport (2015), 'Department for Transport statistics', Table TSGB0102.

[4] Department for Transport (2015), 'Department for Transport statistics', Table BUS0103.

[5] Department for Transport (2013), 'Annual Bus Statistics: England 2012/13', 24 September, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/244332/annual-bus-statistics-2012-13.pdf.

[6] Competition Commission (2011), 'Local bus services market investigation', 20 December, section 14.

[7] Local authorities with responsibility for transport policy. In this case, the NECA is the LTA.

[8] Competition Commission (2011), 'Local bus services market investigation', 20 December, section 15.

[9] Competition Commission (2011), 'Local bus services market investigation', 20 December.

[10] Department for Transport (2009), 'Quality contracts schemes: statutory guidance', December.

[11] Nexus (2014), 'Bus Strategy Delivery Project Consultation Report', October, section 1.

[12] Traffic Commissioners for Great Britain (2014), 'Quality Contracts Scheme board announces deadline for oral evidence requests', 31 October, https://www.gov.uk/government/news/quality-contract-scheme-board-announces-deadline-for-oral-evidence-requests.

[13] Nexus (2014), 'Bus Strategy Delivery Project Report to the North East Combined Authority', October, para. 1.6.2(g).

[14] Nexus (2014), 'Tyne and Wear Quality Contracts Scheme Public Interest Test', October, section 3.3.2.

[15] Department for Transport (2009), 'Local Transport Act 2008: Guidance on voluntary partnership agreements', February, http://webarchive.nationalarchives.gov.uk/20110131045245/http:/www.dft.gov.uk/pgr/regional/localtransportbill/vpaguidance.pdf.

[16] NECA (2014), 'Draft minutes of the North East Leadership Board meeting 21st October 2014', http://www.northeastca.gov.uk/sites/default/files/minutes_document/Draft%20Minutes%20-%2021%20October%202014%20-%20North%20East%20Leadership%20Board.pdf.

[17] Oxera (2013), 'Are there logical flaws in the way in which Nexus has assessed value for money?', 22 November, section 2.2, http://www.nexus.org.uk/sites/default/files/Stagecoach%20Annex%20D%20-%20Oxera%20Logical%20Flaws%20Paper.pdf.

[18] The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, p. 46.

[19] The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, p. 58.

[20] The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, section 4.

[21] Department for Transport (2015), 'Bus reform workshops: background document', September, paras 1.1 and 1.2, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/462225/buses-reform-workshops-background.pdf.

[22] Local Government Association (2014), 'Future funding outlook 2014: Funding outlook for councils to 2019/20', July.

[23] HM Treasury (2014), 'Devolution to the Greater Manchester Combined Authority and transition to a directly elected mayor', Corporate report, 3 November, para. 15, https://www.gov.uk/government/publications/devolution-to-the-greater-manchester-combined-authority-and-transition-to-a-directly-elected-mayor.

[24] The question of compliance with human rights legislation was considered in the Tyne and Wear QCS process from the time of the consultation. See, for example, Michael Beloff QC (2013), 'In The Matter of Proposals for a Quality Contracts Scheme In Tyne And Wear put forward for consultation by the Tyne And Wear Passenger Transport Executive', Opinion, 22 November, http://www.nexus.org.uk/sites/default/files/Stagecoach%20Annex%20F%20-%20Counsels%20Opinion.pdf.

[25] See The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, pp. 32 and 55.

[26] The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, p. 70.

[27] Oxfordshire County Council, 'Bus service strategy and news', https://www.oxfordshire.gov.uk/cms/content/bus-service-strategy-and-reviews.

[28] South Yorkshire Passenger Transport Executive (2015), 'Partnership gears up for Sheffield bus changes', press release, 29 October.

[29] The QCS Board (2015), 'Proposal for a Quality Contracts Scheme in Tyne & Wear: Opinion', November, Appendix 1.