



## Franchising of Melbourne's rail services: assessment after six years\*

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### Abstract

This article reviews the recent experience of franchising metropolitan public transport services in Melbourne, Australia, to assess the extent to which the declared objectives of the franchising have been achieved. The failure of the initial franchise process is argued to be attributable, in significant part, to shortcomings in the Government's understanding of what was achievable from a public-private initiative of this nature, given the Melbourne context. Developments associated with the re-franchising process are summarised, the emphasis shifting towards a strong partnership relationship between purchaser and provider, with a more realistic risk allocation between the two.

*Keywords:* Competitive tendering; Franchising; public-private partnership.

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### Context

There have been significant changes in the delivery of many public transport services over the past two decades. From public monopolies functioning as both regulator and service provider, it is now increasingly common to see the service delivery role passed to the private sector. More recently, the public sector's role in system design has also come into question, with suggestions that that role too should pass to the private sector. This change process has been driven by expectations of lower costs to government, from more efficient service delivery by the private sector, and better service delivery outcomes, from a service provider more attuned to meeting customer needs.

Melbourne, a city of about 3.5 million people in the state of Victoria, is the only Australian city to have franchised both its passenger train and tram networks. The franchising occurred in August, 1999, as part of a much wider privatisation push by the

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\* This paper draws partly on earlier work by the current author (Stanley and Hensher 2004; Stanley, Betts and Lucas 2005). It has also benefited from the comments of an anonymous referee.

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Victorian (and other Australian Governments) at the time. In late 2002, just three years into the franchise period (of 12 years for tram services, 15 for train and 10 for country passenger services), the major franchisee failed. In 2004, the re-franchising of all metropolitan train and tram services was completed, confirming the failure of the initial franchising process.

This paper reviews Melbourne's experience with rail franchising and subsequent re-franchising, to assess what lessons might be learnt for the delivery of efficient and effective public transport services in a privatised operating environment. It begins with a review of some significant developments in public transport service provision in Melbourne prior to the initial franchising. The developments in that period were significant in terms of the subsequent franchising outcomes. Those outcomes are then discussed and reasons for the failure of the franchising process are suggested. This is followed by discussion of how some lessons from the initial franchising have informed the re-franchising process. The re-franchising demonstrates a major shift in approach: from a competitively tendered arm's length relationship to a partnership, founded on trust and mutual understanding, with the expectation that this change will deliver a more sustainable outcome and better goal achievement.

### **Corporatisation and the goals of franchising Melbourne's rail services**

In the early 1990s, Melbourne undertook a major public transport reform program. This program involved the creation of a state-owned Public Transport Commission and the corporatisation, as five separate entities, of two metropolitan tram services, two metropolitan train services, and one regional train/bus service (the latter service is outside the scope of this paper).

In 1998, shortly prior to the move to franchising, the Victorian Auditor-General (1998) reported that these reforms had achieved substantial recurrent cost savings (about \$250 million annually), mainly through labour shedding. The Auditor General concluded that the transport reform program had produced a number of benefits: it had reduced the call of public transport on the Victorian taxpayer; improved service reliability, with the notable exception of the peak period reliability of the suburban train fleet, and its aged rolling stock; improved punctuality, but not to world class standards; reversed declining patronage trends; and, improved service availability. However, he also noted that (VAG 1998: 8):

*After 6 years of cost-cutting and rationalisation of operations, there appears to be limited scope for further large savings to be achieved in an environment where a substantial proportion of existing rolling stock will need replacement over the next few years.*

This warning was lost in the subsequent franchising process.

The Victorian State Government's primary motivation in franchising the five corporatised services was to further reduce the public transport call on the public purse. There were, however, five declared goals. These involved a balance between financial and service delivery outcomes (DOI 2004: 6):

1. to secure a progressive improvement in the quality of services available to public transport users in the State;
2. to secure a substantial and sustained increase in the number of passengers using the system;
3. to minimise long term costs of public transport to the taxpayer;
4. to transfer risk to the private sector; and,
5. to ensure achievement of the highest safety standards.

Based on the successful bids, the franchised operations were expected to produce a progressive improvement in service quality available to public transport users, with service delays reduced by about 40% over 10 years, a planned 11% increase in services over 10 years, \$1.5 billion investment by the private sector in new/upgraded rolling stock and \$0.8 billion invested to renew existing infrastructure, leading to a substantial and sustained total increase in public transport patronage of 71% over 15 years. At the same time, the highest safety standards would be achieved and maintained.

These outcomes were to be achieved at much reduced long term costs of public transport for the taxpayer, with cost savings of more than \$1.8 billion in real terms predicted over 15 years, or about \$160 million annually in constant prices and present value terms (DTF 2000: 143). Because the franchisees would assume revenue, operating and legal risk, except in limited circumstances, risk transfer to the private sector would be achieved.

### **The initial franchises**

The National Express Group (NEX) won the franchise to provide one of the two metropolitan train services, one of the two metropolitan tram services and the regional passenger service. The franchises for the remaining metropolitan train service and remaining metropolitan tram service went to Connex and Metrolink Victoria Pty Ltd respectively, the latter operating as Yarra Trams.<sup>3</sup>

The franchises commenced late in 1999 but, within two years, franchisees had advised the government of financial difficulties. In early 2002, the state government committed an additional \$105 million to the franchisees. Part of the payment was described as “settling outstanding contractual disputes from the time of franchising,” but the full amount was widely interpreted in local media at the time as a bailout.

In late 2002, NEX ceased operations, a receiver was appointed, and interim operating arrangements were agreed with Connex and Yarra Trams. These interim arrangements subsequently led to re-franchising, with Connex to operate the entire train network and Yarra the entire tram network. The new agreements commenced in April 2004. In essence, the initial four metropolitan franchise agreements were replaced with two shorter five year management contracts with the remaining incumbents.

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<sup>3</sup> Connex was owned by the French firm Veolia Environnement; Metrolink was a joint venture between French Company Transdev and Transfield.

## Financial outcome of the franchising/re-franchising

The primary motive for franchising was to reduce the call on the public purse from subsidisation of public transport services. Figure 1 shows projected payments to franchisees over the period to 2009. It shows aggregate fixed operating payments from government declining to zero by 2009 and franchisee remuneration increasingly depending on incentive payments, related to patronage increase (revenue gain) and operational performance, plus payments for capital programs (essentially reimbursements, though with the franchisee carrying cost risk).

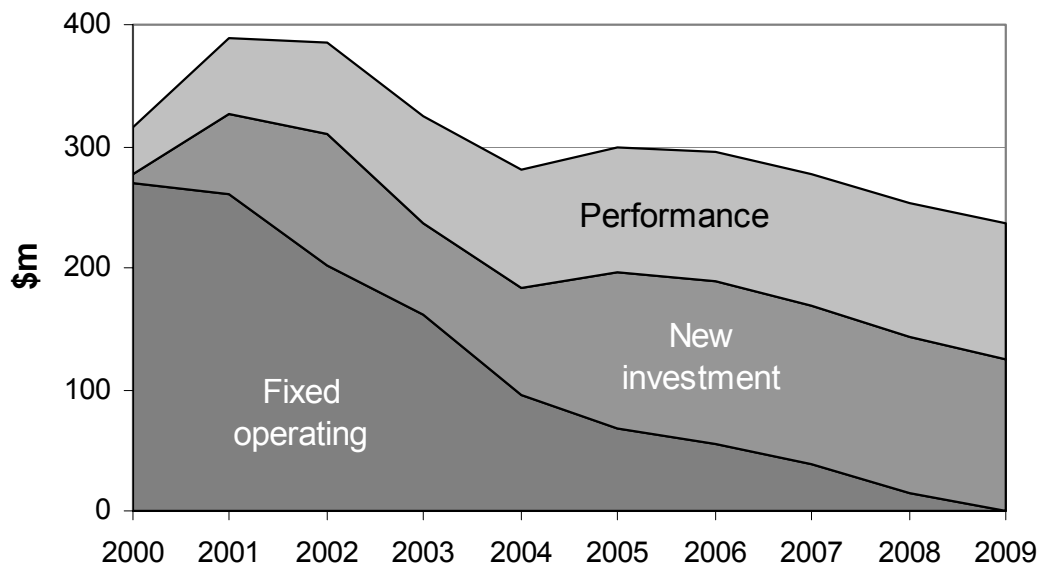


Figure 1: Expected Periodic Payments to Melbourne Public Transport Franchisees - 2000 to 2009 (1999 prices).

Source: DTF (2000).

At the time it announced the re-franchising, the State Government indicated an increased cost to Government of an expected \$200 million annually, compared to the franchise bids. Once allowance is made for inflation, the additional \$200 million compares reasonably closely with the \$160 million or so annual savings projected through the lives of the franchises.

In September, 2005, the Victorian Auditor General reviewed the re-franchising process (VAG, 2005). That review found that the cost of operating Melbourne's train and tram services has remained largely stable following franchising and re-franchising and is expected to stay at about the same levels, with the exception of the cost of new rolling stock. Payments to both franchisees increased by \$330 million in 2004-05, and were expected to stay at about this level above the initial franchise projections, most of this being needed to secure the franchisees' operations, with the government taking on additional risks. The initial estimate of a \$200 million annual shortfall thus appears to be low.

The Auditor General's report also points out that the franchise review and re-franchising team cost Victorian taxpayers some \$38 million (VAG 2005: 27), including both consultants and in-house staff. Earlier advice to government from the Franchise Review Task Force had estimated the costs of re-tendering or renegotiating at \$20 million. Had the re-franchising involved a new open tender round, it is reasonable to conclude that the incurred costs of \$38 million would have been higher still. Transaction costs were thus very significant sums in the re-franchising process.

The initial franchising process delivered financial savings in the three years to 2002, largely courtesy of the shareholders of the franchisees and, in the case of NEX, its creditors. However, the savings projected by the successful franchisees were unsustainable long term. Expectations have now been adjusted to more realistic levels. Most of the financial gains to be achieved from the reform of Melbourne's public transport system were delivered prior to franchising. The objective of reducing the call on the public purse from franchising has not been met and, in reality, was never likely to be met.

If the move to franchised services has not reduced the long term costs of public transport for the taxpayer, to what extent has it achieved the other declared goals of franchising? These goals were: a progressive improvement in the quality of services available to public transport users; a substantial and sustained increase in the number of passengers using the system; achievement of the highest safety standards; and, risk transfer to the private sector.

### **Improvement in quality of services**

The Victorian Department of Infrastructure reports several service quality indicators that allow some conclusions on trends in service quality to be drawn (DOI, various issues). Figure 2 reports overall train and tram on-time running outcomes for the period before and after franchising, including both the initial and re-franchising period performance under the "franchise" data series.<sup>4</sup> Not surprisingly, train on-time running performance exceeds that by tram, since Melbourne's extensive tram system primarily operates in mixed traffic flows, unlike the trains. The Figure suggests that train performance initially improved, as it had been doing pre-franchising, but that performance has deteriorated over the past two years.

Some key reasons for this deterioration in train on-time running in recent times are unrelated to the franchising/re-franchising process. The Victorian rail system has suffered from a lack of infrastructure investment for many years, with growing track congestion a consequence. In such circumstances, delays to one train can contribute to delays to others, particularly in the peak. Also, over the past year, Melbourne rail patronage has grown considerably, driven by high and rising fuel prices. This has increased train dwell times and had flow-on network delay consequences.

Figure 2 shows that tram on-time running performance has generally tended to decline, that decline being marked in the period after the NEX collapse but with a suggestion of some recent recovery. The remaining tram operator, Yarra Trams,

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<sup>4</sup> Based on averaging the outcomes for the two train and tram operators, when separate companies existed.

attributes much of deterioration to increasing levels of traffic congestion. For example, over the most recent five years, average tram operating speeds have declined by 8% (to 15.5 kph). The tram operator has agreed a major program with the State Government (called Think Tram), aimed at providing increased operating priority, to deal with the growing congestion problem. This program has a target of 25% improvement in average end-to-end journey time. The more recent improvements are likely to be due to better operating practices and the improved rolling stock.

On the available evidence, then, it seems that the franchised and re-franchised operations have not achieved much in terms of improving service punctuality but that some key reasons for these outcomes may be attributable to factors outside the control of franchisees. It can certainly be argued, however, that franchisees should have better understood these influences on the operating environment in which they were to be working and made more sanguine forecasts of what would be achieved under their system management. The same comment applies to those managing the initial franchising. These comments suggest a failure in the franchising process.

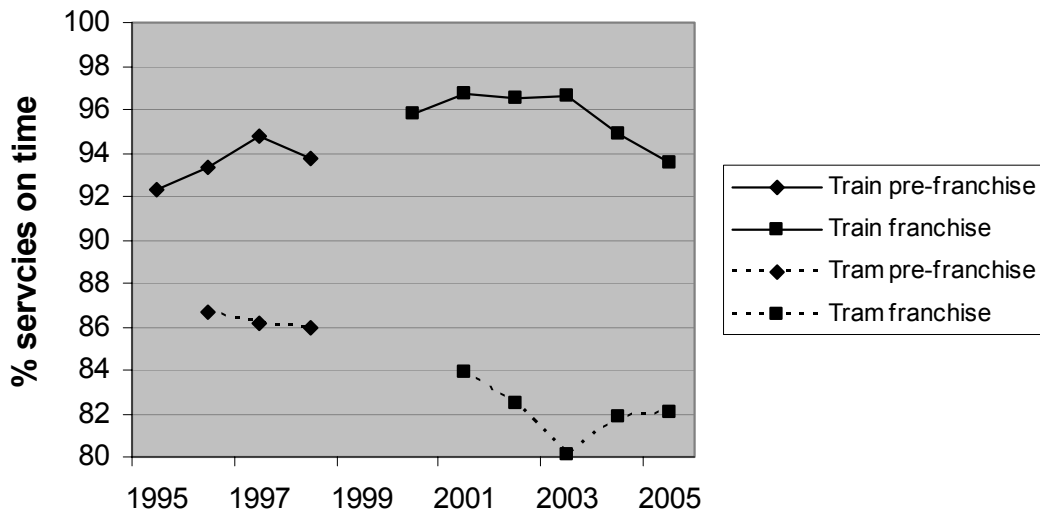


Figure 2: On-time Running Performance: Melbourne's Trains and Trams.  
Source: Derived from DOI, various issues; 2005 data is to the September Quarter.

Figure 3 reports service cancellations on metropolitan train and tram services, as an indicator of reliability. The data suggest early improvement for train and then a substantial fall-off in performance, into the re-franchise period. Tram has shown a small deterioration.

The train result is most likely related to issues such as a shortage of drivers and deferred maintenance, suggesting that financially-pressured franchisees under-invested in training and maintenance as they struggled to survive. The position is compounded by the long lead times on driver recruitment and training, with a 78 week period being the norm in Victoria to achieve a fully trained driver. A future measure of the success of the re-franchise process will be how quickly service cancellations are reduced, as the train driver shortage is overcome.

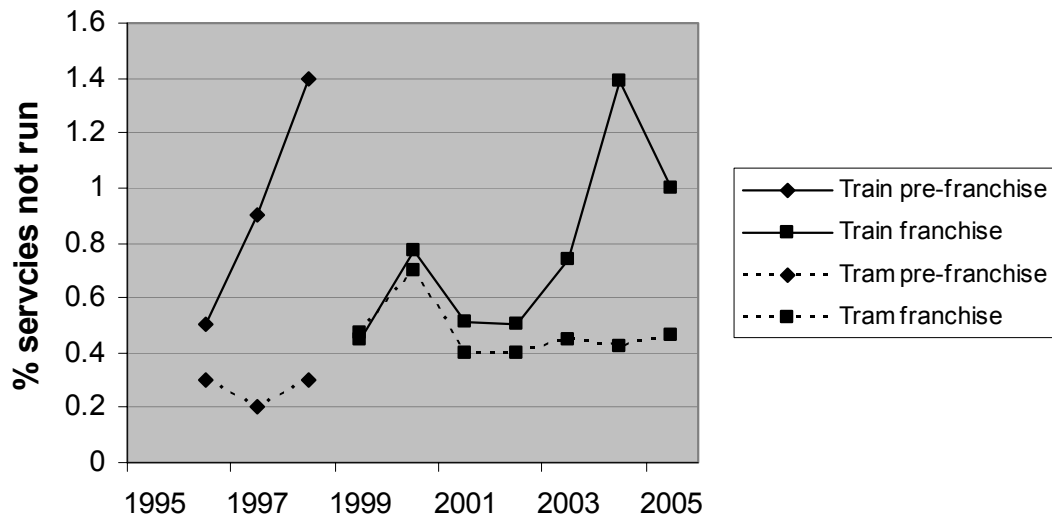


Figure 3: Service Cancellations: Melbourne's Trains and Trams.

Source: Derived from DOI, various issues; 2005 data is to the September Quarter.

Service quality improvements were expected from rolling stock upgrades and these, in turn, were expected to improve patronage. The upgrading of the tram fleet is probably the most visible outcome of the privatisation process. Upgrading the train fleet has been slower. Overall, the rolling stock upgrade program appears to have been delivered on-time and on-budget, with few operational performance problems. It is likely that the new vehicles would not have been introduced had it not been for the prospect of substantial cost savings from franchising.

A negative aspect of the rolling stock upgrade program was the decisions by the train and tram franchisees', respectively, to acquire their own types of rolling stock from their own preferred suppliers. For example, on the tram network Yarra Trams and NEX (M-Tram) purchased new low floor vehicles for their respective networks from separate suppliers. Floor heights were different, resulting in the creation of two sets of platform heights and limiting network integration under the re-franchised arrangements. This is an example of some of the problems that arose from the idea of comparator competition (two train and two tram operators competing by comparison), problems that led to re-franchising of whole train and tram networks, not separate parts of each.

Increased services were expected to involve increased operating kilometres. In the three years from 1999/2000 to 2002/03, State Budget papers reveal that total kilometres operated by trains and trams on the Melbourne metropolitan network increased by almost 5%. This rate of increase was lower than that achieved over the period immediately prior to franchising but was in line with the franchise expectation that services would increase by about 11% over 10 years. However, because of the importance of service frequency and coverage in generating patronage increases on Melbourne's public transport services, an 11% projected increase in service kilometres was never going to support patronage increases of the projected 71%, particularly given the high loading rates on many peak rail services.

Victorian public transport services have a long history of regular measurement and reporting of customer satisfaction. These surveys suggest that customer satisfaction has increased for tram but not for train (Fig. 4). Both tram operators achieved increased customer satisfaction levels during their initial franchises, most likely associated with

fleet upgrading. Tram customer satisfaction levels have stabilised more recently under the single franchise, at levels above those of the pre-franchise period. Customer satisfaction levels increased for both train operators for several years but have fallen noticeably over the past two years, as service cancellations have increased and on-time running has worsened.

Market research conducted for the franchisees suggests that dissatisfaction with the ticketing system (an issue on trams in particular) and concerns about perceived security around rail stations, both of which are beyond the scope of the franchise agreements, may partly explain why customer satisfaction levels have not increased to any extent. Franchisees report increased marketing efforts in an attempt to communicate improvements in these areas to their customers. Overall, however, there appears to be a hangover from the failed initial franchises that is still exerting an influence, especially in relation to train service quality and the problems flowing from driver shortages.

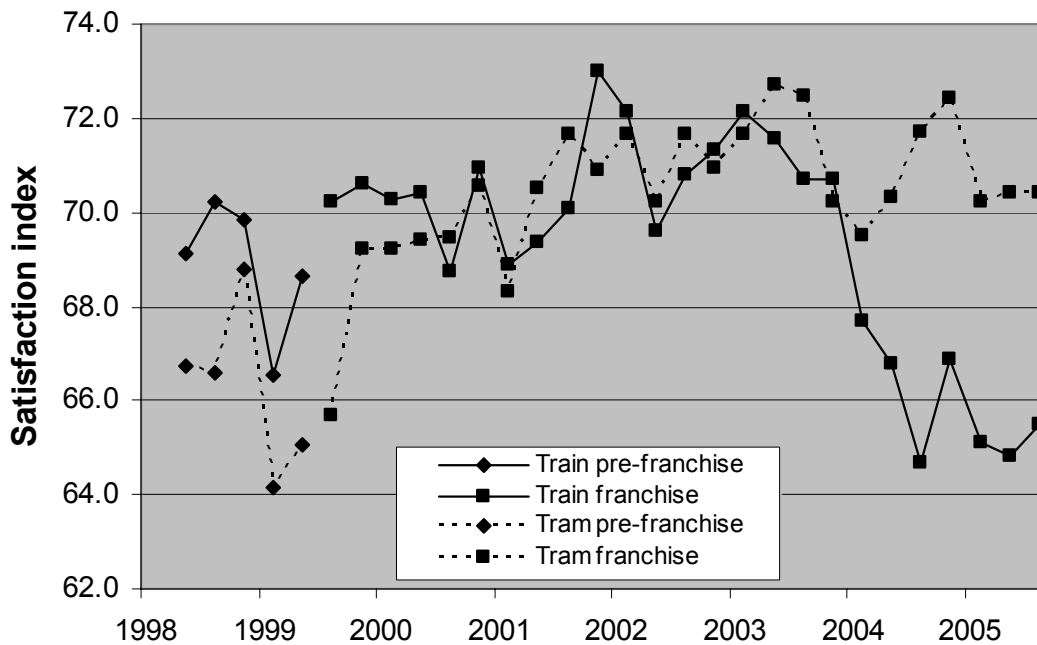


Figure 4: Customer Satisfaction with Melbourne's Trains and Trams.  
Source: DOI, various issues; 2005 data is to the September Quarter.

### Patronage

Solid patronage increases have been achieved. For example, total patronage increased by 5.3% over the two years to 2002/03, under the initial franchises. This was a good result, by comparison with the preceding period, but was still about one percentage point per annum less than was expected from the franchise bids. This shortfall in patronage was very significant in the financial problems of franchisees, because their revenue streams were closely linked to their patronage forecasts.



Over the six years to 2004/05, total train and tram patronage increased by 21.5%. This was faster than the rate of growth in metropolitan car use over the same period but was still below what the franchisees had forecast in their initial franchise bids. However, 2004/05 growth was in line with expectations under the re-franchising arrangements, which were more modest.

High oil prices in more recent times have helped to lift the rate of patronage increase, particularly on train. This has led to crush loading on some peak services, with adverse consequences for customer satisfaction. This outcome clearly reflects the dissonance in franchise bids between the forecast low increases in service kilometres and high increases in patronage levels. The capital equipment of the rail system, in particular, could not sustain large patronage increases with only very small increases in service kilometres, except if there was a very dramatic (and implausible) shift away from peak to off-peak and shoulder loadings.

### **Safety outcomes**

Although safety improvements were an objective of the franchising process, no data is published to allow assessment of such factors. Some franchisees claim significant improvements but anecdotal evidence is mixed.

### **Risk transfer**

The financial events of the past few years suggest that any risk transfer that was achieved from the initial franchising was temporary. Additional payments were made to franchisees, one franchisee failed financially and State payments have been increased to sustain services. The main beneficiaries seem to be the surviving train and tram operators, who are seeing their franchises expanded in spatial coverage, albeit with a shortened time span.

### **Some benefits from the initial franchising**

While the Melbourne initial rail franchising process did not deliver against its major aims of cutting the cost of train and tram services to the public purse and shifting risk to the private sector, there were a number of benefits that deserve mention (apart from the short term cost savings, fleet upgrade, small increase in service kilometres and some improvements in service quality noted above).

The performance monitoring system established during the franchise process, and which has generated most of the performance indicators cited in this paper, is a useful advance in public accountability and provides good benchmarking information. The franchising process itself was complex but met high probity standards, as did the subsequent re-franchising process (VAG 2005). To the credit of the Victorian

Government, when financial failure was imminent, it was prepared to allow this to happen and deal with the politically tough issues this raised.<sup>5</sup>

### **Why did franchising fail to deliver?**

In its review of the initial franchise process, the Department of Infrastructure concluded that there were four main reasons for the failure (DOI 2004: 9). These reasons were:

- unrealistic assumptions by the bidders in relation to patronage growth and cost reduction (by far the most significant influencing factor in DOI's view);
- flaws in, and disputes over, the contractual arrangements (e.g. over revenue sharing arrangements, where disputation was common and distracting, partly due to problems with the methodology used to distribute revenue between franchisees);
- poor performance of the ticketing system (which led to revenue loss); and,
- the introduction of the Commonwealth Government's Goods and Services Tax (which contributed to patronage and revenue loss for which the operators were not fully compensated).

DOI (2004: 9) comments that bidders were strongly influenced by buoyant growth rates in the UK public transport sector, that an intensely competitive bid process led to "bid fever" and that bidders failed to take account of the very different conditions in Victoria (compared to the UK).

These factors are obviously important but they do not appear to be a complete explanation. A seasoned transport planner looking at the bidders' projections prior to the franchise operation proceeding would almost certainly conclude that the anticipated gains and improvements simply did not add up. With the franchise operations being introduced following a period of significant cost-cutting, it was difficult to see that further major cost savings could be achieved. Also, the forecasts of patronage growth were inconsistent with the planned growth in service kilometres, suggesting a likely revenue shortfall, even allowing for operators being possibly able to make some inroads into the high level of fare evasion on the Melbourne system. In short, the bids were never going to be sustainable!

This raises several questions about both the franchisees and the overall franchising process. First, given that the franchisees were experienced international operators, the possibility of "winner's curse" (or bid fever) due to carelessness or ignorance seems difficult to accept in full. One possible suggestion is that the franchisees were simply buying market share, with a view to subsequent upwards contract price adjustments achieved by playing "capture the regulator", a game noted by other observers of franchising processes (see, for example, Alexanderson and Hulten (2003) who analysed

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<sup>5</sup> This situation was helped by the fact that the Government that was faced with dealing with the franchise failure was not the one in office when the initial franchising occurred. Interestingly, the failure does not seem to have increased the political probability of the decision to privatise service delivery being reversed.

competitive tenders in Swedish public transport). Arguably, it is easier for a government to increase payments to an existing financially troubled franchisee and continue services than it is to face the political odium of major service disruptions. The widespread perception of bailout payments in early 2002 gives some credence to this possibility. However, the more important questions should be directed at the franchising process and those conducting it, questions that were not addressed in the report of the DOI franchise review (DOI 2004) or in the recent Auditor General's review of the re-franchising process (VAG 2005).

Macario (2001) emphasises the importance of an integrated system-wide approach to policy, planning and service delivery in public transport. The long term franchising of any individual components of the system will have the greatest chance of achieving a government's intended outcomes from the franchising process if the policy (strategic) level and system-wide planning/development (tactical) levels are in place to bind government policy outcome goals with service delivery (at the operational level).

The Melbourne franchising process was undertaken without an integrated view of how the public transport system as a whole would develop. 10-15 year service delivery contracts will always struggle when there are no intact system-wide planning/delivery frameworks within which they are located. Arguably, the Victorian Government of the late 1990s lost sight of its public transport system, focusing instead on franchising separate services. Ironically, the language of the time sought to shift the emphasis in public transport operations from a "system" to a "service". This reflected a desire to change the culture in operations from a "supply side" driven public enterprise culture to a "demand side" driven private sector activity. However, it appears that the critical importance of the overall system, and how its parts work together, got lost in the process. Operators compounded this by working in their own "silos", with little attempt at presenting a system-front, possibly understandable in view of their financial difficulties.

The franchising process was run by a group located within State Treasury, firmly committed to competitive tendering but with significant gaps in understanding of what was feasible in terms of patronage/service quality/cost outcomes in the Melbourne setting. Some of those involved had experience of the British privatisation but the prior arrangements and operational circumstances in that setting were vastly different to Melbourne. Had those managing the initial franchising process understood influences like the state of rail infrastructure, the limited capacity that was available to accommodate rail patronage growth, the degree of rail track congestion and the pervasive influence of traffic congestion on tram operation, they would have been more likely to conclude that the initial bids that were accepted were not going to be sustainable.

Stanley and Hensher (2004: 49) conclude that:

*The ideology of competitive tendering appeared to win out over the professional expertise required to assess what is feasible in terms of service delivery and service costs.*

## Lessons from the initial franchising failure

The Victorian franchising experience suggests that a competitive tendering process may encourage excessively optimistic forecasts of both revenues and costs, which are essentially undeliverable. The recent compelling evidence by Flyvbjerg et al (2003) that the large infrastructure projects in all sectors investigated (predominantly transportation) exhibited substantial cost overruns supports this proposition on the cost side.<sup>6</sup> This is not necessarily an argument against competitive tendering per se but it is a warning against holding unrealistic outcome expectations from such a process and in favour of applying solid professional understanding of what might actually be possible when undertaking the bid evaluation processes.

Lessons from the initial experiment in franchising have had a significant impact on the re-franchising process and on more recent public transport system thinking in Melbourne. The State Government's reasons for re-franchising, rather than going to the market afresh, are explained as follows (DOI 2004, p. 16):

*The alternative to re-tendering was to negotiate with the franchisees...Negotiations could achieve the Government's "one train, one tram" objective, retain existing system knowledge and experience, and maintain the stability of the public transport system...The challenge in renegotiating the franchise contracts with the existing franchisees was the need to demonstrate that any resulting deal constituted good value for money for the State.*

The government was also concerned about a shortage of prospective bidders and recognised that the first round competitive tendering process had delivered a financially unsustainable result. Pragmatism was more important the second time round, but with careful attention to probity and ensuring value for money (e.g. through use of a public sector comparator assessment). The Auditor General's recent review of the re-franchising process was complimentary about that process and concluded that good value for money had been achieved (VAG 2005).

While the re-franchise contracts have essentially become management contracts (with incentives), the negotiation process that underpinned the contracts, together with the subsequent operational environment, have emphasised a partnership relationship, as distinct from the purely commercial relationship embodied in the initial franchise. Under the new arrangements, several elements reinforce a partnership focus:

- an agreed basis has been established for sharing of risks between government and the franchisees, in line with the principle that risk should be allocated to the party best able to manage it. This matter is discussed further below, because of its centrality to a sustainable partnership;
- revenues are being shared between service providers in fixed proportions, to encourage working together to grow system patronage and fare revenue;

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<sup>6</sup> Although the levels varied widely, the great majority of cost overruns were in the 10-40% band but some notable exceptions are well above this range, such as Boston's artery/tunnel project (196%), the Humber Bridge (UK) (175%), the Shinkansen Joetsu rail line (100%), the Channel tunnel (80%), the Paris-Auber-Nanterre rail line (60%) to name but a few examples.

- a new private company (Metlink) has been established, owned by the train and tram franchisees but with close contractual links with the State's Director of Public Transport and Board level involvement by the bus industry, to handle system-wide issues such as system marketing, revenue protection processes, complaint handling procedures (i.e. system-wide customer-oriented functions) and system advocacy<sup>7</sup>;
- there is provision for franchisees to contribute to development of long term strategic plans and major projects.

Risks are now allocated to the party thought likely to be best able to manage them. In Victoria's passenger rail franchises, the franchisee bears almost all cost risks, while the State carries responsibility for the long term development of the network. Revenue risk, however, is effectively shared through a mechanism which provides for the State to provide additional funding to the franchisee when revenue falls below certain defined thresholds. Similarly, insurance risks are shared: the franchisee self-insures up to a defined "deductible", whilst the State procures commercial insurance above the threshold level and pays the relevant premium.

Open-book accounting and benchmarking processes are being used to maintain transparency and accountability in moving from competitive tendering to a negotiated outcome with remaining operators. The process is also now being informed by stronger input from people well versed in public transport operations and economics, all providing confidence of a more sustainable outcome.

A clearly enunciated view of the tactical level remains missing but much needed groundwork has been done. The Strategic framework against which services and system development takes place is now set out in two State Government documents, a metropolitan development strategy and supporting transport plan.

Stanley, Betts and Lucas (2005) and (Duncan 2005) describe key elements of effective partnerships in public transport service planning and delivery. Key elements include common objectives tied to public policy purposes, shared governance arrangements (with emphasis on forging and managing a partnership relationship in the pre-contractual phase and sustaining it during the course of the contract), written agreements on governance and financing (including risk sharing), and mutual trust between the partners.

Factors likely to encourage trust include confidence in a partner's capacity to deliver, demonstrated good faith in making and keeping arrangements, agreed governance arrangements and accountability/transparency arrangements (Stanley, Betts and Lucas 2005: 11). The current Victorian arrangements are seeking to embody these dimensions. The accountability/transparency element, inter alia, serves the valuable purpose of protecting the community against any risk that a "trusting partnership" might degenerate into a "regulator captured by the provider" relationship.

In the case of Victoria's rail franchises, an atmosphere of mutual recrimination, following the near-collapse of the original franchise deals, has given way to one of genuine partnership. None of the parties wishes to revisit the turbulence of the past. Both the State and the private operators have taken "ownership" of the outcomes of re-franchising, having worked in partnership to forge the contracts and, through that process, gained a strong understanding of each other's aspirations and fears. While some service quality indicators cited earlier in the paper have not been moving in the

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<sup>7</sup> The current author is a director of Metlink.

right direction under the re-franchised operation, the partnership relationship has helped to facilitate an examination of the reasons behind the trends noted and a willingness to work through solutions, some of which have been noted above to be beyond the control of current franchisees (e.g. infrastructure condition).

The re-franchised arrangements operate under management contracts with incentives on revenue, operational performance and service quality. The length of contract (5 years with the possibility of a short extension) is probably too short to encourage operator initiative in some areas. Given the origins of re-franchising, however, the current short contract length is understandable. The re-franchisees have been, in effect, given a new opportunity to show their credentials. Longer contracts are likely to be on the agenda for the next round.

In Victoria, similar partnership-based principles are also beginning to emerge as the basis for new relationships between the State and the bus industry. Representatives of the bus industry have committed time and energy to important State-led initiatives, such as planning for the Commonwealth Games, for a new smartcard-based ticketing system and for improved passenger information services across Melbourne. In return the State has endeavoured to mould its own policy positions to accommodate those of the industry and has acknowledged the opportunity cost of the operators' time, through additional financial support, affirming a willingness to engage in a genuine partnering process.

## **Conclusion**

The Melbourne process of rail franchising and re-franchising demonstrates a major shift in approach by the Victorian State Government, from a competitively tendered arm's length relationship (which failed to achieve its goals) to a partnership, founded on trust and mutual understanding, with the expectation that this change will deliver a more sustainable outcome and better goal achievement. It is still early days in the re-franchised arrangements. While some key service indicators are yet to turn around, it is acknowledged that this is substantially attributable to factors beyond the control of the re-franchisees. The possibility of a contract roll-over at the end of the current arrangements, rather than re-tendering, should be a strong incentive for franchisees to be co-operative and effective partners and to deliver on those matters that are under their control. The Victorian partnership approach is searching for a balance between the flexibility needed to respond to change and encourage innovation and the contractual obligation needed to assure delivery against goals. The outcome of this experiment in relationship-based contracting should add to understanding of what is possible in terms of purchaser-provider arrangements in public transport service provision.

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