

The privatisation of Melbourne's public transport system (A)

On 16 December 2002, National Express, the biggest of the three private operators in the Melbourne public transport system, abruptly announced it was abandoning its train and tram franchises only three years into its long-term contracts.

In August 1999, in an effort to improve performance and lower taxpayers' subsidies, the government of the state of Victoria undertook a privatisation of the city's train and tram networks. One British, one French and one French-Australian company won 12- and 15-year contracts to operate parts of the system. With National Express gone, half the system was back in government hands. The government now had to decide what to do.

Public transport system profile

Melbourne's public transport system consisted of a tram network spanning 340 kilometres, a train network spanning 360 kilometres, and an extensive bus network (see *Exhibits 1 and 2*). There were over 450 trams in operation, providing 123 million passenger journeys each year. The train network consisted of 907 carriages and 208 stations, and provided 126 million passenger journeys per year. Public transport accounted for approximately 9 percent of total travel in Melbourne, with private cars accounting for the majority of trips.¹ The tram and train lines radiated outwards from the central business district, with privately-owned and operated bus services filling in gaps, linking and extending these rail services.

Apart from being a critical part of the commuter infrastructure in the city, trams had a special cultural significance for Melbournians. Melbourne was the only Australian capital city which kept its tram network intact following the rise in private car ownership in the 1950s and 1960s. For this reason, images of trams were widely used in tourism literature and promotional material for the city. The iconic status of trams meant that the community was especially sensitive to changes in the way they were managed.

This case was written by Tim Watts, Australia and New Zealand School of Government, for Professor John Alford, Australia and New Zealand School of Government. It has been prepared as a basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation. The assistance of the Department of Infrastructure, David Greig, Hubert Guyot and Bernie Carolan in preparing this case is gratefully acknowledged, but responsibility for the accuracy of the version of events presented here lies with the author.

© 2004 Australia and New Zealand School of Government, www.casestudies.anzsog.edu.au. Version 12-06-06.

Published by the Case Program, Australia and New Zealand School of Government, Parkville, Victoria, Australia. Further reproduction prohibited without express permission.

¹ D. Greig, "Rail Privatisation in Victoria," *Agenda* 9 (2002) 3: 237.

Reform efforts prior to privatisation

A range of different approaches to managing the public transport system had been attempted in the 1980s and 1990s, in order to improve service standards, to lower costs, and to strengthen the quality of the system's rolling stock and rail infrastructure. In the 1980s, the city's various train, tram and bus services were brought under a single structure called The Met where timetables and fares were integrated. In the 1990s, measures included the creation of a new comprehensive corporate structure, the Public Transport Corporation, which brought together the city and rural area services in the state for the first time. These initiatives had some success in improving service reliability and lowering costs.² But the Kennett Liberal-National Coalition government, elected in 1992, took the view that further improvement was needed. The power of the Public Transport Union made workplace and staffing changes difficult to achieve. There was also the view that the ongoing taxpayer subsidy of approximately \$850 million per year was high (relative to operating costs) by world standards (see *Exhibit 3*).

During the Formula One Grand Prix in March 1997, public transport workers went on strike to protest the cost-cutting and management changes that were occurring. The Premier, Jeff Kennett, whose government had with great fanfare won the rights to stage the Grand Prix in Melbourne, reacted angrily to the disruption the strike caused to the carnival. Referring to the Union's actions, he said: "They have made a terrible error for which they will pay a price."³

In August 1997, the Victorian government announced it would privatise its tram and train passenger services. The Transport Reform Unit (TRU), a team within the Department of Treasury, had been developing plans for a privatisation over several years. This group would now manage the implementation of the new policy. The TRU was staffed mainly by legal, banking, finance and economic consultants from outside the Department of Infrastructure, which had been administering public transport up to this point. A small number of experienced staff from the Public Transport Division of the Department of Infrastructure were seconded to the TRU, to provide input into the process.

According to David Greig, a director of the TRU who had previously worked on corporatisations and privatisations in New Zealand, the location of the TRU in Treasury was very important.

"It is very hard to reform something while you're actually running it. You need to maintain good relationships with operations staff and so on. This is a lot easier if the process is run quite separately from the outside."

The Victorian government had recently privatised other major state-owned infrastructure including water and electricity generation assets, earning higher than expected sale prices from largely American and European bidders. Public transport was reasonably new territory for privatisation, but the results of the gas and electricity asset

² The Victorian Auditor-General estimated that ongoing annual savings of at least \$245 million had been delivered by the early 1990s public transport reforms. The bulk of these savings resulted from labour shedding, with staff numbers falling from 18,000 to 9,600 between 1992 and 1997. Victorian Auditor-General, *Public Transport Reforms: Moving from a System to a Service* (Report No. 5, 1998) 1. Note dollar amounts used are in Australian dollars. At the time \$A = approx 56cUS.

³ A. Heasley, "Transport Still Not Quite the Ticket," *The Age*, 28 August 2002.

sales meant the government's confidence in its reform direction was high. In the mid-1990s, the United Kingdom had undertaken a complex privatisation of its substantial passenger rail system. According to Greig, the UK government did have some difficulties finding bidders for the first few of their 25 passenger operations, but it was generally considered an encouraging precedent. "The view was that we could learn from the UK experience, taking the best parts of their approach and adapting it where necessary."

A franchising model

Franchising was the privatisation model eventually recommended by the TRU and adopted by the government. A franchise differs from a management contract in the sense that a franchisee has a direct relationship with end clients (in this case, public transport users) rather than simply being a contractor to the ultimate service provider (the government). According to Greig: "Outright sale was rejected because the government would have been supporting an entrenched operation indefinitely. Without a ready performance benchmark it would have been forced into intrusive cost-plus regulation."⁴

Greig explained how outsourcing the management of public transport services was also unacceptable because it was thought to generate insufficient incentives for innovation in management and long-term investment in infrastructure. Under such arrangements, private companies would be contracted to deliver tightly defined services leaving all strategic decisions in the hands of the government. The private operators would concentrate on cost-control, not having the flexibility to adjust the overall management of the system.

The TRU proposed to establish four franchises, two in the tram system and two in the train system.⁵ Re-tendering would take place every 12 to 15 years. According to Greig, this approach offered the most flexibility and the capacity to create peer competition between operators:

"Division [of the tram and train networks] into two reduces the prospects of a monolithic operator extorting additional concessions from the government over time, provides backup in case of the failure of one operator, and provides yardstick competition (comparative performance data would be published quarterly by the government)."

The two tram and two train operators would operate on some shared stretches of track so there would be some overlap in responsibility for operating the signalling system and for maintenance of track infrastructure. For both the tram and train networks, it was decided to allocate full responsibility for half the shared infrastructure to one operator and full responsibility for half the shared infrastructure to the other operator. This arrangement would mean that each operator was a client of the other and so there would be an incentive to cooperate.

⁴ Under a "cost plus" contract, pricing is determined by an audit of the value of various inputs into the good or service being delivered, plus an allowance for an agreed profit margin level.

⁵ There were also publicly-owned passenger rail and freight services operating in rural areas outside metropolitan Melbourne. The TRU created a single franchise for the rural passenger services and arranged for the full sale of the freight services.

In July 1998, the Public Transport Corporation was formally dissolved and four new entities – two tram and two train operations – were established in preparation for the franchising process. The government set itself five main objectives for franchising:

- to secure a progressive improvement in the quality of services available to public transport users in Victoria;
- to secure a substantial and sustained increase in the number of passengers using the public transport system;
- to minimise the long-term costs of public transport to the taxpayer;
- to transfer risk to the private sector; and
- to ensure the maintenance of the highest standards of safety at all times.

A lengthy bidding process for these franchises was commenced in early 1999, with final bids received in May. In August, the successful bidders were announced:

- *National Express*, a company listed on the London Stock Exchange with extensive operating responsibilities throughout the United Kingdom's public transport system, won the right to operate a tram and a train franchise which it later called M>Tram and M>Train.
- *Yarra Trams*, a joint venture between French public transport operator Transdev and Australian infrastructure group Transfield Services, won the second tram franchise.
- *Connex*, a consortium led by giant French conglomerate Vivendi, won the second train franchise.

According to Bernie Carolan, an Australian member of the National Express bidding team: "The bidding process was in general very open and transparent. We felt comfortable that all the information we needed was available and that we could expect a productive working relationship with the government when we took over the franchises."

The winning franchisees collectively committed themselves to performance arrangements, which the government calculated would deliver taxpayers \$1.8 billion in savings in reduced subsidies over the lifetime of the franchises. The franchisees forecasted increases in patronage of between 40 percent and 84 percent over the 10 to 15 years of the franchise contracts. In addition, there was substantial provision for the purchase of new rolling stock, the construction of line extensions on the several train routes, and the addition of new evening services. David Greig said that, at the time, he thought some of the franchisees' forecasts "were quite optimistic".

National Express's bid was widely viewed as the most ambitious. Hector McKenzie, Franchise Manager – Trains in the Department of Infrastructure, who was seconded to the TRU for the bidding period, observed: "I think most people thought National Express especially had a lot of work to do [to meet its forecasts]."

Implementing the franchises

Immediately following the end of bidding in August 1999, operating responsibility for the public transport system was transferred to the three franchisees. The franchising

process was estimated to have cost the government \$70.6 million plus another \$45.6 million in redundancy payments and other restructuring costs, according to a subsequent review from the Victorian Auditor-General.⁶

In October 1999, the Kennett government lost its bid for re-election and the Australian Labor Party (ALP) led by Steve Bracks formed a new government. In opposition, the ALP had been critical of the decision to privatise public transport. However, once in power, it did not make changes to the franchise structure.

Once management control had been transferred to the private operators, a new division was created within the Department of Infrastructure to manage the franchise contracts and relationships with the private operators. The new Public Transport Division contained about five or six members of the 40-person staff of the TRU.

The Director of the division, John Taylor, decided to establish a four-part management structure. There would be a franchise management team responsible for the day-to-day operation of the train and tram franchises; an infrastructure group which monitored the franchisees' spending on the maintenance and new purchases of trams, trains, track and other equipment; an information systems and technology group to oversee the gathering and management of data relating to performance; and a finance group to manage payments of subsidies, bonuses and penalties to the operators. John Taylor and his deputy, John McMillan, also had a monthly meeting with the CEOs of each of the franchises to talk through confidential issues.

The franchise agreements which governed the relationship between the Public Transport Division and the private operators were extremely detailed. Hector McKenzie noted: "I've spoken to very senior investment bankers and corporate lawyers about this deal and they say these contracts are at the very top end of the scale in terms of complexity." In addition to the contracts between the operators and the government, there were 144 separate inter-operator agreements among the franchisees (see *Exhibit 4*).

In the franchise agreements, an effort had been made to balance two objectives. McKenzie explained that the responsibilities of the operators had to be "tightly-enough defined" to ensure service and safety standards were maintained, but that operators also had to be provided with the freedom and flexibility to encourage new approaches and innovation in management.

In order to enforce the standard of performance required, there were a large number of performance benchmarks against which the private operators were to be regularly assessed. High performance on these indicators would qualify them for bonus payments from the government. Low performance on these indicators would mean operators incurred penalties, which were deducted from the base subsidy they received from the government.

In areas where the government sought to promote some flexibility, procedures were established whereby the operators could seek permission to vary their approach from the previous norm. This arrangement applied in areas including timetabling and major events.

⁶ Auditor-General's Office, *Report on Ministerial Portfolios* (Melbourne, 2000).

Performance: year one

In 2000, the first full year of private management, the operators created some highly visible improvements which included the introduction of a range of low-profile trams⁷ and “superstops”⁸ on busy routes; the introduction of a new range of services scheduled to enable better access to sporting and cultural events; the refurbishment of a range of trams and trains; and new information displays and upgraded carparks at stations. Surveys showed punctuality of trains and trams was up; the number of cancelled train services was down; and customer satisfaction was up. Yarra Trams and Connex were generally receiving bonus payments for exceeding performance targets. National Express’s train service, M>Train, achieved a mix of penalties and bonus payments, while its tram business, M>Tram, was not meeting targets at all and incurred penalties in each quarter (see *Exhibits 5 and 6*).

The relationships between the Public Transport Division and the operators started off smoothly because several key managers at the franchisees were previously employees of the old Public Transport Corporation. This personnel overlap was helpful according to both Bernie Carolan, who was appointed Commercial Director at National Express following his involvement in the company’s bidding team, and John McMillan, Deputy Director of the Public Transport Division.

However, there were some disagreements over differing interpretations of clauses in the franchise agreements. According to Bernie Carolan:

“There were quite a few examples where we felt the government was getting involved unnecessarily. We’d say we were taking a particular step, and acknowledging that the government had a remedy in the contracts, if it proved not to produce the results we were looking for, or if it was deemed to be outside contract provisions. But the government seemed to want to stop us doing this, before we’d actually taken the step.”

Hubert Guyot, chief executive of Yarra Trams, observed he was surprised by how rigid the government was in its management of the contract: “Both sides were trying to understand what was in the contract. There were more than 500 pages, so it was very complex. But we were surprised how rigid the government was. We were trying to work through the problems to find a compromise. But they were extremely sensitive to any risk at all.” He said the Public Transport Division seemed to be worried about appearing to make concessions to the operators. “Whenever we queried anything, they would call in the lawyers for a detailed opinion.”

“Early on I think we were a little too black and white in our contract interpretation,” acknowledged Hector McKenzie, Franchise Manager at the Public Transport Division. “But at the time, the franchisees were making some ambit claims⁹ in a few areas. It wasn’t simply a problem at our end. I think both sides made some mistakes in building those relationships at the beginning.”

According to David Greig, who ceased to work in public transport after the end of the bidding phase, the contracts leaned too far in the direction of prescription: “I think the

⁷ Trams travelling low to the ground for easy access.

⁸ Weather-proof shelters with features like electronic timetables.

⁹ Excessively high (or modest) figure used to start negotiations.

agreements in the end were slightly ‘overcooked’.” Concerns about eliminating every possible risk meant that not enough room was left for the operators to innovate.

Hector McKenzie disagreed with this view: “The prescriptiveness of the contracts wasn’t a problem. They needed to be detailed because these are essential community services. It is a major headache for the government if things go wrong.”

Hubert Guyot observed that the contracts allowed for some discretion from the Public Transport Division, but it chose not to use this flexibility:

“We needed a more commercial approach from the government – a recognition that this was a partnership. Of course, the government side was protective of taxpayers and sensitive to the political issues. I understand that. I too have my constraints. I have to report to my board and to our shareholders. But we should share these things, have an open book, so we can find a compromise for the benefit of taxpayers and Melbournians. I was disappointed that the government did not agree with this approach.”

Relationship building

The three operators took different approaches to building the relationship with the Public Transport Division. According to Hector McKenzie: “Yarra Trams management was by far the most consultative. They were more inclined to share information and to devote the resources necessary to understand the nuances of the way the system operated. They had a clear vision of what they wanted and that made managing the relationship easier. In France, local municipalities put [the Yarra Trams parent company] in as operational managers or expert consultants. They come from a culture used to working in partnership with government over a longer time-frame. It was clear they wanted to work with us, not against us.”

Yarra Trams also chose to appoint former politicians from both major parties and senior community figures to its board of directors. Guyot observed:

“With these appointments we were not trying to influence government. First there was a need to have independent people mediating between the French and Australian shareholders who each had 50 percent of the company. Second, I needed people at the board level to explain the constraints and limitations facing the government. Whenever I encountered difficulties, I would go to them for advice.”

National Express and Connex had a difficult working relationship with the Public Transport Division, according to McKenzie. “They both started off playing it very tough. If there was a problem, their attitude seemed to be: ‘Stay out of it, we’ll fix it’.” Both operators tended to bargain very hard over any disputed issues, he said.

Peter Fellows, an Assistant Franchise Manager in the Public Transport Division, observed Connex and National Express had a high rate of turnover of key managers:

“There were constant changes in the senior executive teams. National Express had a succession of three different executive teams take on running the franchises. The new teams weren’t very well briefed by the old team. It was frustrating having to go back and answer the same questions all over again.”

There were significant changes in the senior personnel at the Public Transport Division also. “We lost three senior staff in 2000–2001 and they weren’t properly replaced,” noted McKenzie. He said the office was under-resourced, and many people were doing more than one job. “We weren’t particularly good at making decisions and giving answers at this point.”

According to Carolan, sometimes his people would get conflicting answers from different people running different sections of the Public Transport Division. He also thought it “disconcerting” that the Director, John Taylor, tended to remain very distant from the franchisees. “We had regular contact with lower level people, but were surprised how rarely the Director was involved, especially once shortcomings in the arrangements emerged.”

The Yarra Trams team also had their frustrations with the Public Transport Division. Hubert Guyot observed:

“There was no efficient decision making at all. To operate a commercial contract you need someone who can make decisions day-to-day and they didn’t. I remember one issue where one of our trams had been delayed by the police blocking the street to investigate a crime scene. This affected our punctuality performance and we asked for it to be disregarded when our bonus payment was calculated. Pretty clear-cut, you would think? It was an external factor and there was nothing we could do about it. Well, the bureaucrats would not make a decision. It wasn’t specifically mentioned in the contract and so advice had to be taken, reviews considered and on and on. It almost had to go up to the Minister before we had a decision!”

Performance: year two

In 2001, the second year of the franchise system, service levels improved in both the tram and train networks. Reliability also generally improved, with all operators recording cancellations in less than 1 percent of services for the fourth quarter of year two. All operators received bonus payments in a majority of quarters throughout year two with Connex, M>Tram and M>Train each incurring a penalty once (see *Exhibits 5 and 6*).

However, by mid 2001, a range of issues of critical concern for the private operators had emerged. There were claims of higher than expected fare evasion, difficulties with the newly introduced electronic ticketing system,¹⁰ delays in relation to a new train control system that one operator had been contracted to implement for the whole system, and headaches driven by a perceived slowness on the part of the government in responding to concerns and queries from the operators.

According to John McMillan, the outcomes of these disputes “tended to be about 50-50. Half the time the franchisees got what they wanted, and the other half the Public Transport Division staff held its ground.”

¹⁰ The automatic ticketing system in the Melbourne public transport system was provided by OneLink, a subsidiary of Perth technology group ERG. The system was introduced in 1997–1998. Subsequently there were difficulties relating to malfunctioning ticket vending machines, high user dissatisfaction levels and high fare evasion. A contractual dispute between OneLink and the government over the performance of the system and subsidy levels also flared in 2000.

A particularly intense dispute flared over the allocation of farebox revenues. Under the franchise agreements, revenues were shared among the operators according to the results of surveys which indicated what proportion of passenger traffic each operator had carried in the previous month. If any operator disagreed with the allocation determined by the surveying, they could object and the allocation would revert to the previous month's proportions until the dispute was resolved. But from month one there were objections from operators every month, and throughout 2000 and 2001 the revenue allocation did not change. Given that this allocation was a primary mechanism for rewarding operators for good performance in increasing patronage, this was a very heated dispute. All the operators believed the surveys were not reflecting the traffic growth they had achieved on their routes.

"At the start in 1999 and 2000, we generally left it to the operators to sort the issue out among themselves," observed John McMillan. In early 2001, as the dispute continued to drag on, the Public Transport Division began to get more involved in negotiations between the operators, but was not able to reach a solution amenable to all parties.

According to Carolan of National Express, the intensity of this conflict over revenue sharing reflected deeper issues. He said his company was under severe financial pressure as it struggled to meet its cost-cutting targets and patronage-growth goals, and he suspected the other operators were experiencing similar circumstances:

"The difficulty was there was no mechanism for sharing these sorts of problems in a way that was open and didn't attach blame. I think all the franchisees were cautious about communicating these things to the government. It would have been an admission of failure on our part, given this was so early in the life of what were supposed to be 12 and 15 year agreements. The government as well was probably not ready to acknowledge how difficult things were for the operators. It would have meant admitting that the model they'd just put into place had some serious problems."

Hector McKenzie said there were signs during 2001 from all the operators that revenues weren't meeting expectations:

"It is arguable that we should have realised sooner that something needed to change. But at the same time no one came to us and said they were in diabolical trouble. Everyone was making claims for payments in all sorts of areas, but there wasn't a lot of cogent information."

Bernie Carolan observed: "For far too long the government regarded this as a problem among the operators. The attitude was 'Go away and sort it out and get back to us.' Technically by the terms of the contracts that was true, but the fact was that it was intractable. The government needed to be involved. They took far too long to realise this and we should have asked them to get involved earlier also."

A new deal

In December 2001, *The Age* newspaper reported that the funding shortfall facing the three private operators was estimated to be \$250 million a year. Patronage increases had not been sufficient to meet revenue growth forecasts, and the move to private management of the system had not brought the expected cost savings. In addition, the fallout from the September 11 terrorist attacks on the cost of insurance for the

franchisees was beginning to be felt. Bernie Carolan noted the rises in premiums were massive: “On its own this issue wasn’t that critical but on top of the other problems we were experiencing it had a major impact.”

Toward the end of 2001, the Public Transport Division brought all three franchisees in to negotiate a settlement to address the now very acrimonious revenue-sharing dispute and a range of outstanding claims being made in other areas.

In February 2002, the government announced a \$110 million payment to the operators to settle contractual disputes and to bolster marketing budgets. As part of the agreement, the government committed to review the terms of the franchise agreements in light of problems that had been encountered so far. Meanwhile, the franchisees would continue to operate on their existing contracts.

Negotiations underway

A negotiating team was established in the Public Transport Division to work out the new arrangements. Hector McKenzie was part of this team. “We were basically trying to find out what sort of trouble they were in,” he explained. “We wanted to know what we had to do to get to a position where public transport in this city was stabilised.” McKenzie said all the operators were treated equally: “We were obliged to be even-handed. We did not treat National Express differently because it had negotiated more aggressively earlier on.”

According to McKenzie:

“The government was prepared to negotiate changes that would provide stability for all parties, but was not prepared to merely renegotiate price or terms of the existing long-term contracts. The government wished to ensure it retained the right to re-tender the businesses or take them back into state operation, and was prepared to enter into interim arrangements to ensure this could be done in a stable environment. For their part franchisees were offered the right to participate in any re-tender process and to exit the existing contracts by agreement with the government without risking their performance bonds.”

Efforts to strike new deals with the three operators continued throughout 2002. “Everybody was trying to get as much money as they could – that makes sense, it’s what you would expect,” observed McKenzie. “We would ask for information from Yarra and Connex and we would get reasonable responses, allowing for a bit of spin. But with National Express we never landed in the same ballpark of reasonableness. We kept asking them for information and they’d send us the wrong thing. We’d give them a *pro forma* of what we wanted and they didn’t understand it. They clearly weren’t giving us the same access to information as the other two.”

Bernie Carolan from National Express said: “The government made us all sorts of promises that a resolution would be reached early in 2002. Then it was June and nothing had been resolved.” Carolan observed that the negotiations were hard-nosed, but from his perspective the individual relationships between the people involved remained strong:

“Everyone was frustrated but lack of trust was never an issue. National Express was very close to signing on to an interim operating agreement, but the sticking point was a couple of key clauses that the government wouldn’t agree to. These clauses related to the way we needed to present the resolution to the stock market back in London. We needed to assure the market that there would be no more bad news down the track.”

Victorian Premier Steve Bracks announced an election on 4 November 2002, and at this point negotiations were put on hold. Bracks and the ALP were re-elected on 30 November 2002.

Performance: year three

In 2002, the third year of operation, both train businesses, Connex and National Express’s M>Train, increased their on-time performance, with M>Train recording its highest ever level of punctuality in the fourth quarter. Both train operators held steady their cancellation rate at 0.4 percent of scheduled services. Yarra Trams held its cancellation rate steady while M>Tram’s rate slightly increased.

M>Train’s bonus payment for above-target performance rose from \$1.19 million in 2001 to \$3.52 million in 2002. Connex’s bonus payment fell from \$603,000 to \$479,000. M>Tram lifted its bonus payment from \$2000 in 2001 to \$589,000 in 2002. Yarra Trams was the most consistent performer, maintaining quarterly bonus payments above \$400,000 throughout 2001/2002.

National Express abandons its franchises

After the election, in December 2002, the renegotiation process with the three operators began again. Yarra Trams and Connex had reached agreement with the government on almost all the critical issues and were close to signing new contracts. National Express too had agreed to a wide range of important elements of a new deal. However, the company’s senior management team and the government were not making progress in several other areas.

On December 17, National Express formally announced it was abandoning its M>Tram and M>Train operations. “It was a Sunday and I got a call to come in for an emergency meeting with National Express,” said John McMillan. “They indicated they’d gone as far with this process as they could. They gave us seven days notice and that was it.”

M>Tram and M>Train were placed in the hands of receivers, with the government providing the temporary funding necessary to keep the services running. Yarra Trams and Connex indicated that they would continue to run their tram and train services as normal under the renegotiated interim operating agreements.

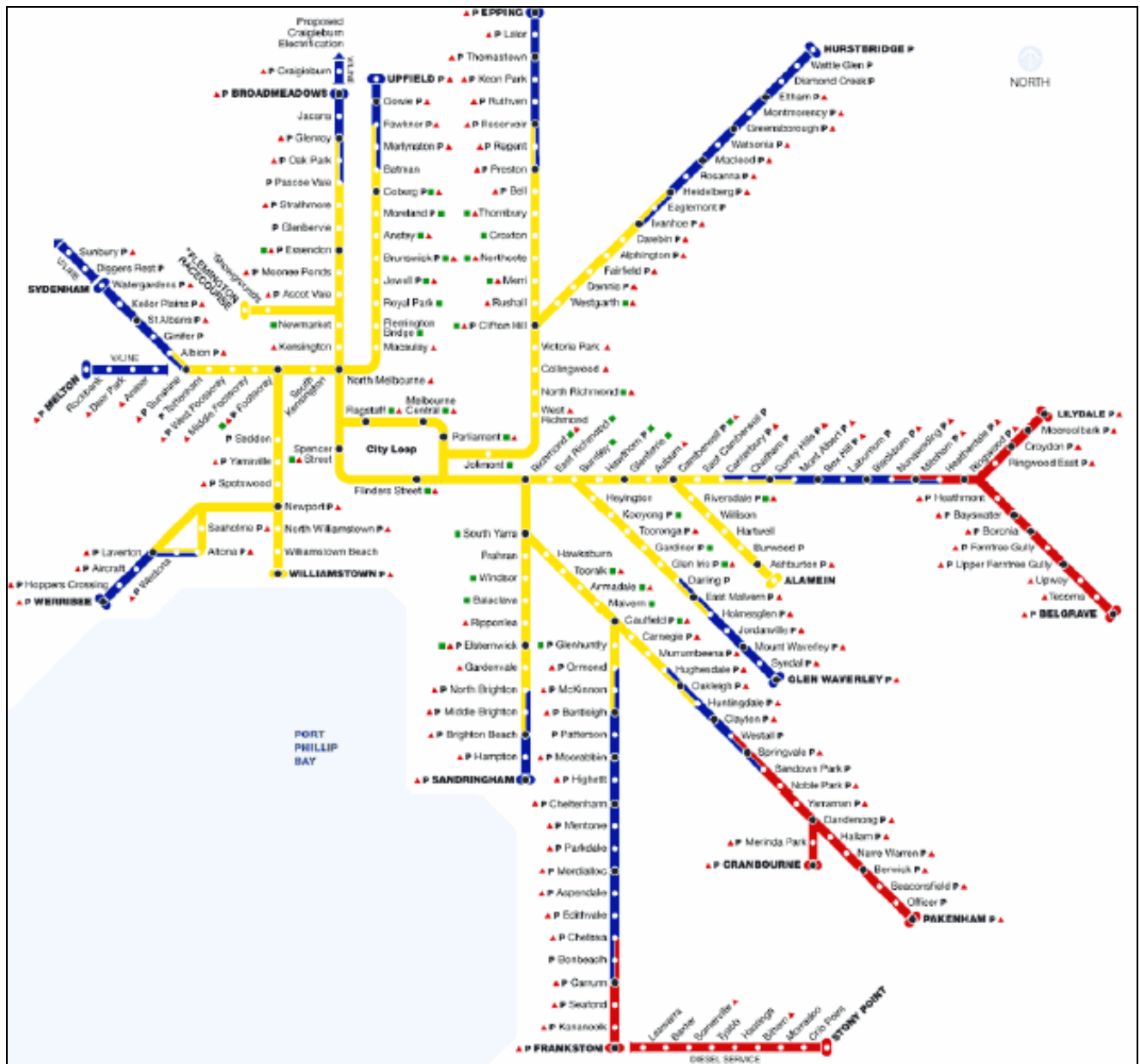
Where to from here?

There was now a single private operator running half the tram system and a single private operator running half the train system, with the government effectively responsible for running the remainder of the system. Both private operators were on short-term contracts of 12 months and were clearly experiencing financial stress. In just over three years, the privatisation regime for Melbourne’s public transport system was on the brink of collapse.

The Age newspaper's editorial on 18 December 2002 was titled: "A Bold Experiment Goes Off the Rails." It ran:

"The privatisation of public transport happened very quickly, and, on the face of it, has come unstuck almost as quickly.... (T)he government must resolve problems so great that the state's biggest transport operator could not see a way to make its business viable and wrote off \$270 million."

Exhibit 1: Map of the Melbourne train system



The **Connex** franchise covered the Epping, Hurstbridge, Lilydale, Belgrave, Alamein, Glen Waverley and Flemington Racecourse lines.

The **National Express M>Train** franchise covered the Frankston, Sandringham, Pakenham, Cranbourne, Upfield, Broadmeadows, Sydenham, Melton, Werribee and Williamstown lines.

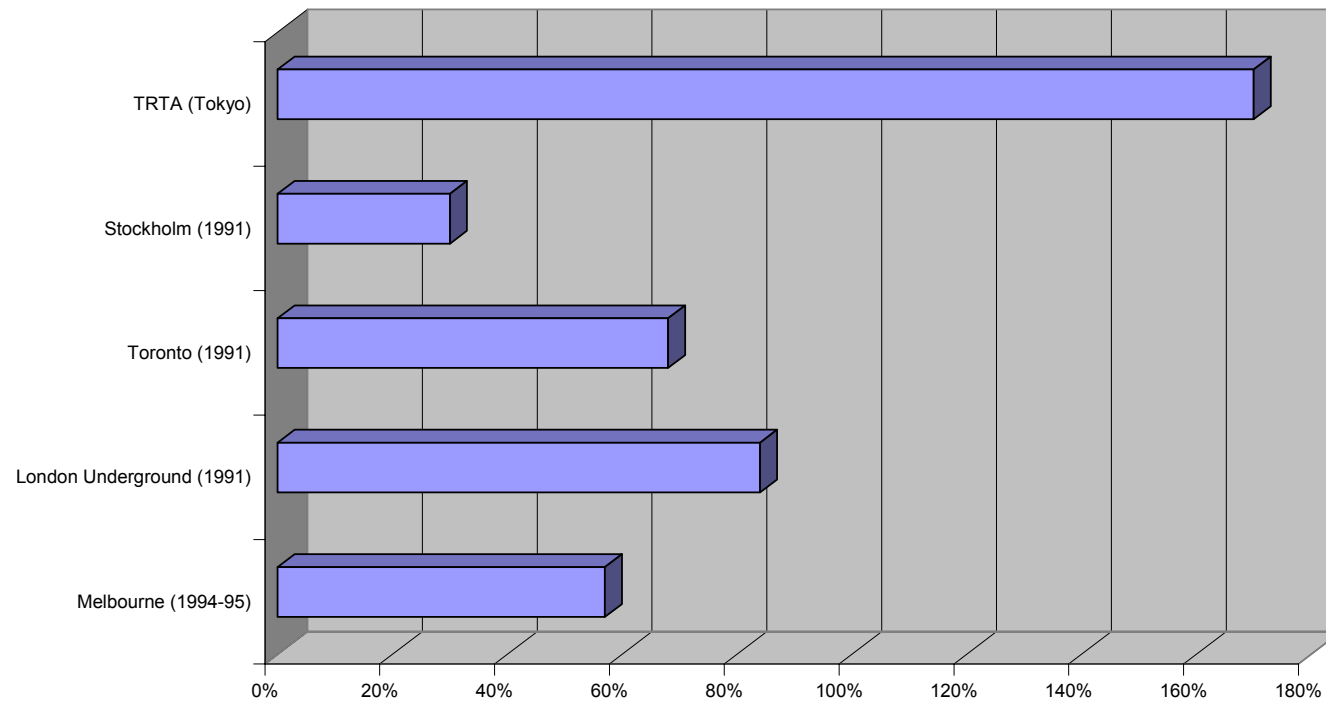
Exhibit 2: Map of the Melbourne tram system



The **Yarra Trams** franchise covered all the routes running East–West.

The **National Express M>Tram** franchise covered all the routes running North–South including the Chapel St, Glenferrie Rd and Footscray–Moonee Ponds routes.

Exhibit 3: Ratio of farebox-revenue to operation-costs for selected international public transport systems



Sources: David Greig, ACIL Tasman and K. Shoji, “Lessons from Japanese Experience of Role of Public and Private Sectors in Urban Transport”, *Japan Railway & Transport Review* 29 (2001): 12–18.

Exhibit 4: A selection of inter-operator agreements among franchisees in Melbourne's public transport system

- Track Access Agreements – Trains
- Track Access Agreement – Trams
- Train Control Services Agreement
- Tram Monitoring Services Agreement
- Electrol (Electrical Control System) Agreement for Trains
- Electrical Systems Operations Agreement for Trams
- Station Agreements
- Rail Square Agreements
- Revenue Agreements
- Victrip Shareholders Agreement
- Traction Power Agreements
- Rolling Stock Hire Agreement (Z3 Trams)
- Infrastructure Maintenance Agreements

Source: Department of Treasury and Finance, *Passenger Rail Franchising: An Overview* (Melbourne, 2000).

Exhibit 5: Punctuality and reliability data for Melbourne public transport, 1999–2002

Punctuality: On-time performance as a percent of services run (by quarter)

Operator	Q4: 1999	Q1: 2000	Q2: 2000	Q3: 2000	Q4: 2000	Q1: 2001	Q2: 2001	Q3: 2001	Q4: 2001	Q1: 2002	Q2: 2002	Q3: 2002	Q4: 2002
M>Train	97.4	96.2	94.6	96.1	96.5	96.8	96.4	97.2	96.9	97.4	96.7	97.3	97.9
Connex	97.0	94.2	95.0	97.0	96.7	96.3	96.5	96.8	96.9	95.9	95.6	95.7	96.0
M>Tram	72.6	70.4	69.2	71.6	70.7	71.1	71.4	72.3	71.7	71.7	70.0	69.9	69.6
Yarra Trams	79.8	77.4	77.7	78.0	75.2	72.9	73.3	72.4	71.2	71.2	70.4	69.7	68.2

Reliability: Cancellations of trains and trams as a percent of services scheduled (by quarter)

Operator	Q4: 1999	Q1: 2000	Q2: 2000	Q3: 2000	Q4: 2000	Q1: 2001	Q2: 2001	Q3: 2001	Q4: 2001	Q1: 2002	Q2: 2002	Q3: 2002	Q4: 2002
M>Train	0.6	0.6	1.9	1.0	0.8	0.6	0.7	0.4	0.8	0.7	1.0	0.4	0.4
Connex	0.3	0.4	0.7	0.3	0.5	0.7	0.4	0.3	0.2	0.4	0.3	0.4	0.4
M>Tram	0.7	0.9	1.0	1.4	1.3	0.6	0.7	0.4	0.7	0.5	0.5	0.3	0.4
Yarra Trams	0.3	0.3	0.2	0.3	0.2	0.2	0.2	0.2	0.3	0.3	0.4	0.4	0.4

Source: Department of Infrastructure (VIC), *Track Record* 1–13 (2000–2003).

Exhibit 6: Incentive and penalty payments (\$'000) (by quarter)

Operator	Q4: 1999	Q1: 2000	Q2: 2000	Q3: 2000	Q4: 2000	Q1: 2001	Q2: 2001	Q3: 2001	Q4: 2001	Q1: 2002	Q2: 2002	Q3: 2002	Q4: 2002
M>Train	518	97	-1501	-564	251	624	-186	1666	1157	1471	-336	1835	3518
Connex	813	-435	-440	965	335	-43	313	1140	1228	77	-60	268	479
M>Tram	-626	-1034	-888	-881	-402	375	489	560	58	196	190	966	589
Yarra Trams	-21	12	74	708	467	647	536	842	644	572	347	433	479

Note: A negative figure represents payment by a franchisee to the government

Source: Department of Infrastructure (VIC), *Track Record* 1–13 (2000–2003).

The privatisation of Melbourne's public transport system (B–Epilogue)

After National Express abandoned its tram and train franchises in December 2002, the government announced a plan to restructure public transport with the formation of a single tram operator and a single train operator within the next 12 months.

The abandoned franchises, M>Tram and M>Train, were put into receivership, and the Department of Infrastructure appointed new managers, retaining a number of key executives to ensure continuity of service.

New short-term contracts were signed with the two remaining operators, Connex and Yarra Trams, to cover the 12-month restructuring period. Negotiations were begun with Connex and Yarra to determine their ongoing role in Melbourne public transport.

On 9 June 2003, the creation of a new marketing and customer information service called Metlink was announced. The organisation was structured as a partnership between the city's private train, tram and bus operators and the government. Metlink's objective was to be a single, clearly branded source of public transport information for customers and would coordinate all marketing activities by the various operators.

Performance on punctuality and reliability during the first half of 2003 was consistent with the results achieved in the last year of National Express's operations. Surveys showed customer satisfaction levels were slightly higher.

On 25 November 2003, the government announced that fares would be increased from the beginning of 2004, with price rises averaging 10 percent across the board.

On 19 February 2004, the government announced that new five-year contracts had been signed with Connex and Yarra Trams. Connex, now owned by the French multinational Veolia Environnement, agreed to take on the operation of the entire train network. Yarra Trams, the joint venture between French multinational Transdev and Australian infrastructure group, Transfield Services, agreed to operate the entire tram network.

This case was written by Tim Watts, Australia and New Zealand School of Government, for Professor John Alford, Australia and New Zealand School of Government, as a sequel to case 2004-3.1. It has been prepared as a basis for class discussion rather than to illustrate either effective or ineffective handling of a managerial situation.

© 2004 Australia and New Zealand School of Government. Version 11-02-05.

Published by the Case Program, Australia and New Zealand School of Government, Parkville, Victoria, Australia, www.casestudies.anzsog.edu.au. Further reproduction prohibited without express permission.

Under the new contracts, the government committed itself to total payments to the operators of \$2.3 billion over the five years, about \$1 billion more than the \$1.3 billion subsidy earmarked under the previous agreements. Connex's subsidy rose to \$345 million per year, an increase of \$165 million from the amount it received previously to run half the train system. Yarra's subsidy rose to \$112 million per year – a \$36 million a year rise.

The contract length of five years was selected by the government because this covered the period over which a new “smart card” based ticketing system was scheduled to be introduced (on completion of the contract of the current ticketing provider OneLink) at the beginning of 2007.

At the announcement of the deal, the Transport Minister, Peter Batchelor, described the new arrangements as “partnerships” between the government and the operators, rather than franchises: “They’ve been designed with the demands and expectations of commuters in mind, in the spirit of financial viability and joint responsibility,” he said.

The Minister said that a key objective of the new structure was to continue the operational improvements that had occurred since privatisation. Patronage had increased at twice the pre-privatisation rate – over 3 percent per year. Late running and cancellations had dropped 35 percent. There were 5–10 percent more services running.

Under the new contracts, the responsibilities of the operators were:

- day-to-day operation of trains and trams to government performance standards;
- responsibility for customer service including ticket sales, passenger security and station staff;
- employment and management of staff; and
- maintenance and cleaning of vehicles, tracks and stations.

At the same time, the government's responsibilities were to:

- regulate safety;
- monitor the performance of operators and Metlink to ensure contractual standards were met;
- regulate fares;
- develop a new ticketing system;
- ensure long-term planning of the public transport network and major public transport investment;
- ensure integration between bus, train and tram services; and
- pay operators to run the day-to-day services.

The responsibilities of Metlink were to:

- represent the train, tram and bus operators across Melbourne;
- market public transport across Melbourne;

- manage day-to-day operation of the ticketing system through the contract with OneLink;
- provide service information to passengers through a website and call centre;
- collect data on patronage; and
- allocate revenue from ticket sales between public transport operators.