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**DESIGNING COMPETITIVE TENDERING
SYSTEMS FOR THE PUBLIC GOOD:
A Review of the U.S. Experience**

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TABLE OF CONTENTS

ABSTRACT	1
I. ECONOMICS, COMPETITIVE TENDERING AND THE PUBLIC GOOD	2
A. The Non-Competitive Environment	
B. Competition	
C. Public Control and Cost Effectiveness	
II. PUBLIC TRANSIT IN THE UNITED STATES	4
A. Public Transit Use	
B. Escalating Public Costs	
C. Competitive Cost Control	
III. COMPETITIVE TENDERING IN THE UNITED STATES	5
A. Extent of Competitive Tendering	
B. The Basic Approach	
C. The Record of Competitive Tendering	
D. Service Quality	
E. Is Competitive Tendering Successful?	
IV. METHODOLOGY	8
V. DESIGNING COMPETITIVE TENDERING SYSTEMS	9
A. Preparation	
B. Request for Proposal Information	
C. Length of Procurement Process	
D. Proposal Evaluation	
E. Fair Cost Comparison	
F. Pre-Proposal Conference	
G. Types of Contracts	
H. Renewal Options	
I. Contract Duration	
J. Rotation of Contracts	
K. Contract Size	
L. Market Share Limitation	
M. Service Specifications	
N. Vehicle Provision	
O. Insurance Coverage	
P. Performance Bonds	
Q. Performance Standards	
R. Penalties and Incentives	
S. Public Supervision	
VI. PRINCIPLES OF COMPETITIVE TENDERING DESIGN	20
REFERENCES	23
APPENDIX: MODEL STATE LEGISLATION	24

ABSTRACT

For two decades, most urban public transit services in the United States (US) have been provided directly by public authorities and supported by public subsidy programs. A substantial percentage of the public subsidies has been consumed by costs that have escalated well ahead of the inflation rate.

Concurrently, the private bus industry experienced unit cost decreases (inflation adjusted). In response to the cost escalation of public transit and the cost control of the competitive market, some public transit authorities have competitively tendered a portion of public transit services to private bus companies.

As US competitive tendering has grown, various approaches have been tried. Some public transit authorities have provided revenue vehicles for the use in tendered services; others have required private companies to supply their own vehicles. Tendering package sizes have varied from a single vehicle to more than 200. In some cases, public transit authorities have participated themselves in tendering, raising complex cost comparison and other issues. The success of or difficulties with tendering programs can be traced to such variations in competitive tendering system design.

Three principles are crucial to ensure that public objectives are met by public transit competitive tendering programs:

1. Public policy control should be retained over competitively tendered services.
2. A competitive supplier market should be fostered to ensure the most cost effective service.
3. The entire tendering process should be open to public scrutiny.

A number of guidelines flow from these principles, relating to the size of tendering packages, advertisement for tenders, public disclosure, length of contract period, participation of public transit authorities in competitive tenders (including guidelines on public-private cost comparisons) and other issues. These principles and guidelines were used by the author in drafting two legislative proposals. The Colorado public transit competitive tendering act was the first mandatory tendering legislation passed with respect to any public service in the US. The model Public Transit Consumer Protection Act has been adopted by the American Legislative Exchange Council (an association of state legislators).

I. ECONOMICS, COMPETITIVE TENDERING AND THE PUBLIC GOOD

An increasing share of transit service in the US is delivered through competitive tendering. This paper is a review of developments in the design of competitively tendered systems for bus service in the context of public policy objectives.

Throughout the paper, US dollars have been converted to Australian dollars at \$A1.164:\$US1 (rate quoted by Federal Reserve Board of New York, 16, January, 1989).

A. The Non-Competitive Environment

In a non-competitive environment such as a monopoly, a firm can obtain a higher price for its products than would be possible in a competitive environment. The portion of revenues of a non-competitive firm that exceeds what could be obtained in a competitive environment is referred to by economists as "monopoly rents" or "the welfare costs of monopoly." In a private, non-regulated monopoly, monopoly rents would be expressed as higher profits than would be possible in a competitive situation. In a private, regulated monopoly or a publicly owned monopoly, monopoly rents would be expressed as higher costs of production (wages, benefits, inefficiencies), because profits would be limited or prohibited by law.

Generally, the more competitive a market, the lower is the price to the consumer, and the less competitive a market, the higher is the price to the consumer. Consequently, consumers spend more of their income than necessary for products produced by a non-competitive firm, lowering the standard of living and making society in general poorer. Through regulation and anti-trust laws, therefore, US public policy seeks to prohibit private firms from obtaining sufficient market power to set prices outside a competitive environment.

The lack of competitive incentives in public transit (a publicly owned monopoly) have produced the same price escalation (fares and subsidies) as would be expected in an unregulated private monopoly. For 20 years, most US public transit has been operated in-house by public transit authorities (non-competitively). During that time, costs per mile have escalated at twice the rate of inflation and more than double the rate of increase of the private bus industry.

B. Competition

In response to escalating public transit costs, public authorities have begun to use competitive strategies, primarily competitive tendering, to improve the cost effectiveness of public transit services. The results of incorporating competition have been substantially lower costs for the same or better service and improved cost control.

Note: Deregulation of transit, like that in parts of the U.K., would also allow the competitive market to operate. However, the low per capita ridership, the high per capita automobile ownership (coupled with the propensity to abandon transit when fares are raised), and the dispersal of origin and destination in the US would result in competitive fares that are too high for the transit dependent and ridership that is too low to address traffic congestion and air pollution during peak hours. The public purpose of mass transit is to provide the maximum level of quality service for the minimum amount of money. There is no innate merit in either public or private provision of service. The crucial distinction is between competition and lack of competition rather than between private and public production or ownership. For example, prior to the public takeover, most US public transit services were provided through regulated private regional or local monopolies. While these companies controlled cost increases substantially better than the subsequent public authorities, they still experienced real cost increases (Cox, 1987). The private sector usually can provide service less expensively, not because its management is superior, but because it operates in a competitive market.

C. Public Control and Cost Effectiveness

Competitive tendering serves a public, not private, purpose. As a result, the public authority must retain full control and oversight of service design, service specifications and fares. The success of a competitive tendering program, then, relies on the following principles:

1. Public policy control should be retained over competitively tendered services to ensure that tendered services are operated consistent with public policy objectives.
2. A competitive supplier market should be fostered to ensure the most cost effective service.
3. The entire tendering process should be open to public scrutiny.

II. PUBLIC TRANSIT IN THE UNITED STATES

Before considering the issues of competitive tendering design, it is useful to outline the unique context of public transit in the US and the experience of competitive tendering.

A. Public Transit Use

The public transit environment in the US differs from that of other nations. Generally, US urban areas have far lower ridership per capita than in urban areas of similar size in Australia, New Zealand, Canada and the United Kingdom (Chart: "Annual Transit Journeys per Capita by Nation"). Per capita ridership in all Australian state capitals, Canberra, Auckland and Wellington is more than that of all US urban areas except New York, Chicago and Honolulu (Charts: "Annual Transit Journeys per Capita: Urban Areas over 2,500,000" and "Annual Transit Journeys per Capita: Urban Areas 750,000 to 2,500,000").

US public transit virtually has lost its discretionary market segment (customers who have automobiles but choose to travel by public transit). Discretionary patronage primarily is limited to work trips to the largest central business districts, and even that is declining. From 1970 to 1980, public transit's work trip market share declined by 30 percent. What remains is the small "captive" market composed of people who have limited access to automobiles because of low income. Public transit has become a poverty program in many US urban areas, and it is dependent on public subsidies and public policy control for its continued existence.

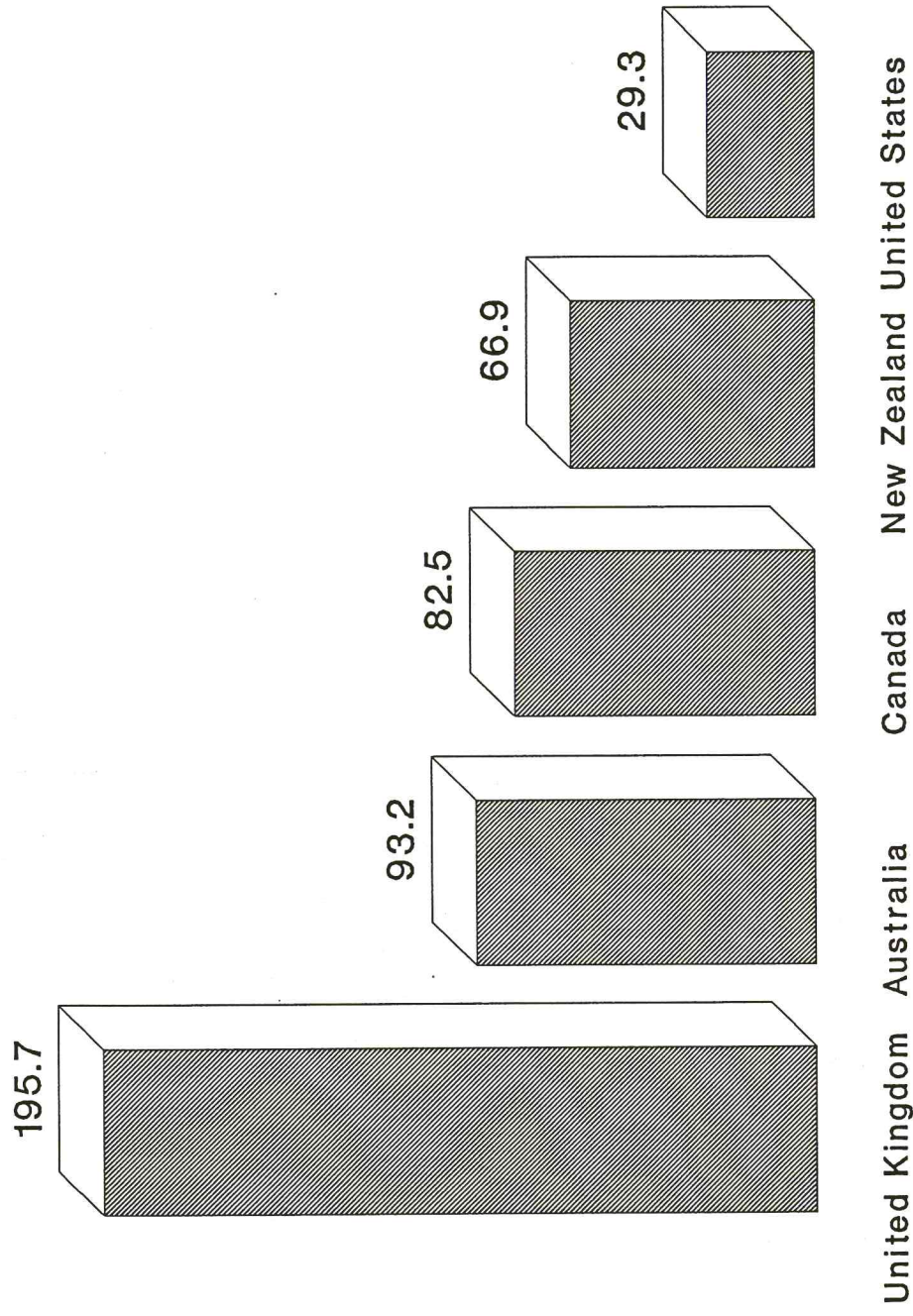
B. Escalating Public Transit Costs

For two decades, most urban public transit services in the US have been provided directly by public authorities and supported by public subsidy programs. A substantial percentage of those public subsidies has been consumed by costs which have escalated well ahead of the inflation rate.

From 1970 to 1985, public transit operating costs per kilometer increased an inflation adjusted (real) 64 percent, an annual real rate of 3.34 percent annually (Chart: "Inflation and Excess Costs"). This cost escalation outpaced every element of the Consumer Price (inflation) Index --- even that of medical care, a field in which the US has obtained an international reputation for lack of cost control. If public transit costs had been contained within inflation, the same service levels could have been provided in 1985 for \$7.5 thousand million, instead of the actual \$12.2 thousand million. While inflation accounted for \$0.38 of each new public transit dollar, \$0.49 was consumed by

ANNUAL TRANSIT JOURNEYS PER CAPITA

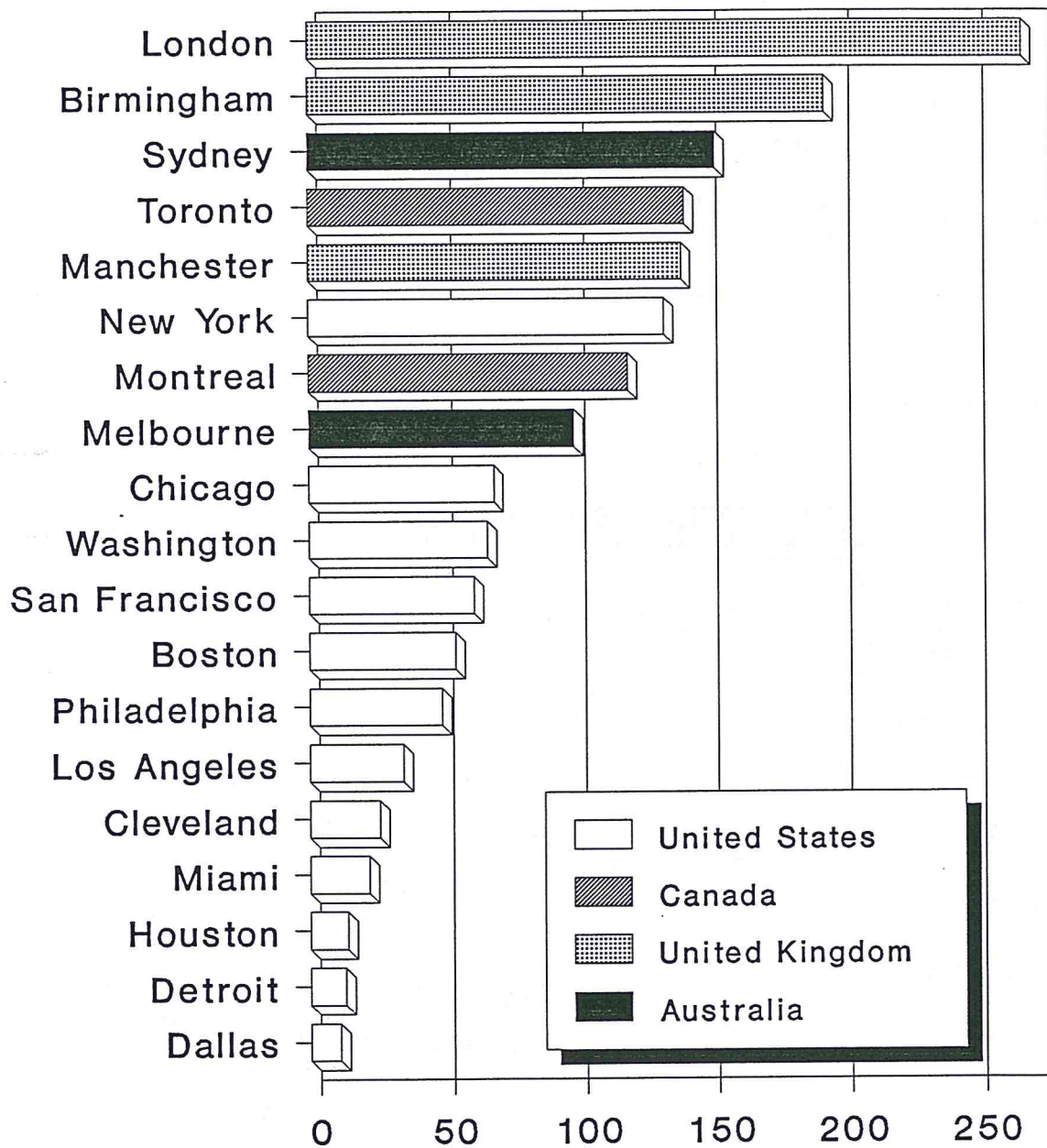
National: Urban Areas over 750,000



Calculated from 1984 & 1985 Data
Sources: Jans, UMTA, APTA,
Ontario Ministry of Transportation

ANNUAL TRANSIT JOURNEYS PER CAPITA

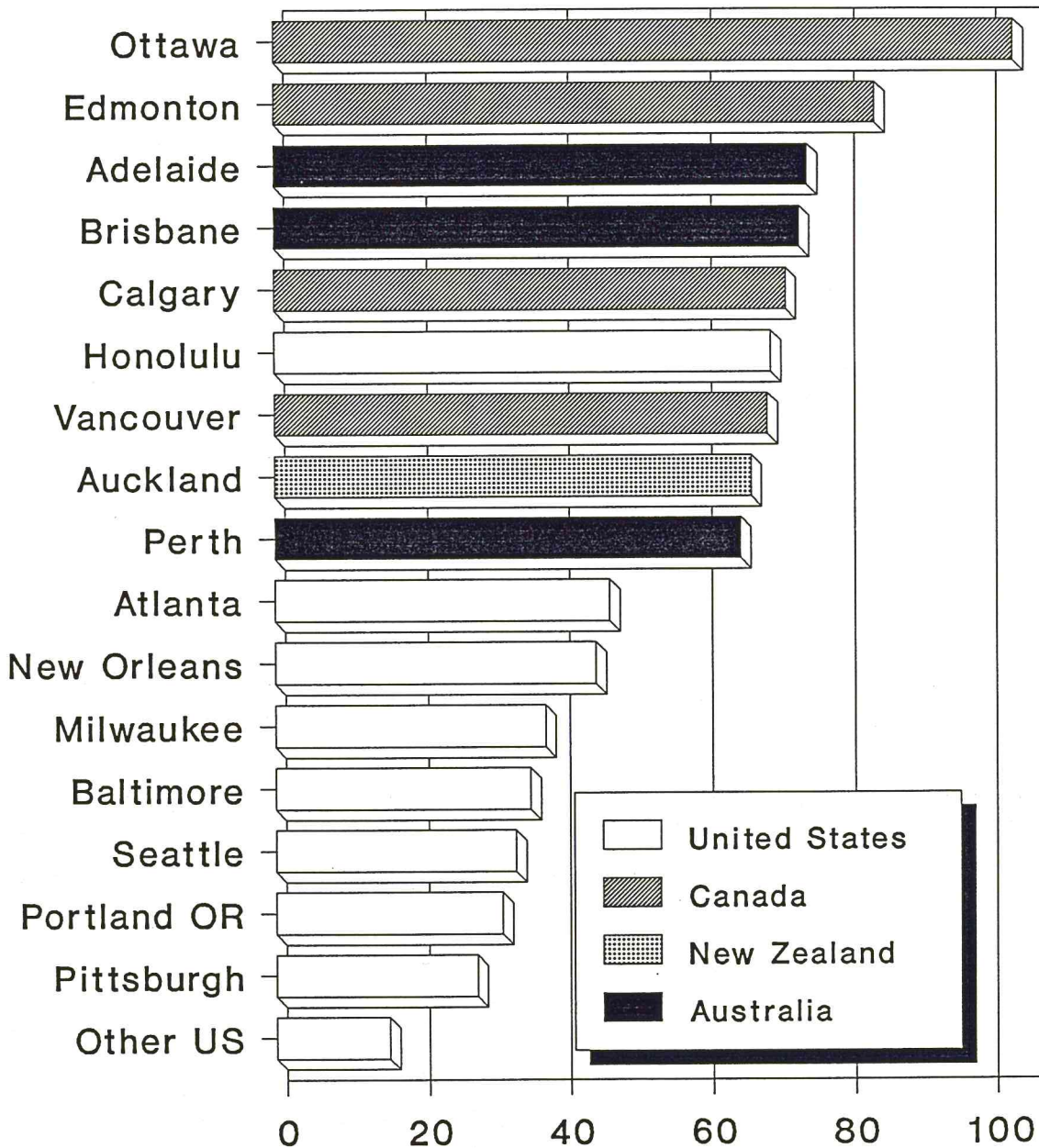
Urban Areas Over 2,500,000



Calculated from 1984 & 1985 Data
 Sources: Janes, UMTA, APTA,
 Ontario Ministry of Transportation

ANNUAL TRANSIT JOURNEYS PER CAPITA

Urban Areas 750,000 to 2,500,000



Calculated from 1984 & 1985 Data
 Sources: Janes, UMTA, APTA
 Ontario Ministry of Transportation

cost increases in excess of inflation, leaving only \$0.13 for expanded services and lower fares (Chart: "Use of Increased Public Transit Revenue").

C. Competitive Cost Control

Concurrently, the competitive private bus industry experienced unit cost decreases (inflation adjusted). From 1970 to 1985 real costs per kilometer declined 8.3 percent compared to the 64 percent real increase in public transit (Chart: "Public and Competitive Cost Increases"). If public transit costs had risen at the same rate as private bus industry costs, the same levels of service could have been provided in 1985 for \$A6.8 thousand million instead of the actual \$A12.2 thousand million. (The monopoly rent, therefore, is \$A5.4 thousand million.) The private bus industry operates more than 120,000 vehicles (four times the daily public transit requirement) and includes more than 3,000 firms, ranging from small local operations to large national companies (Cox, 1987).

III. COMPETITIVE TENDERING IN THE UNITED STATES

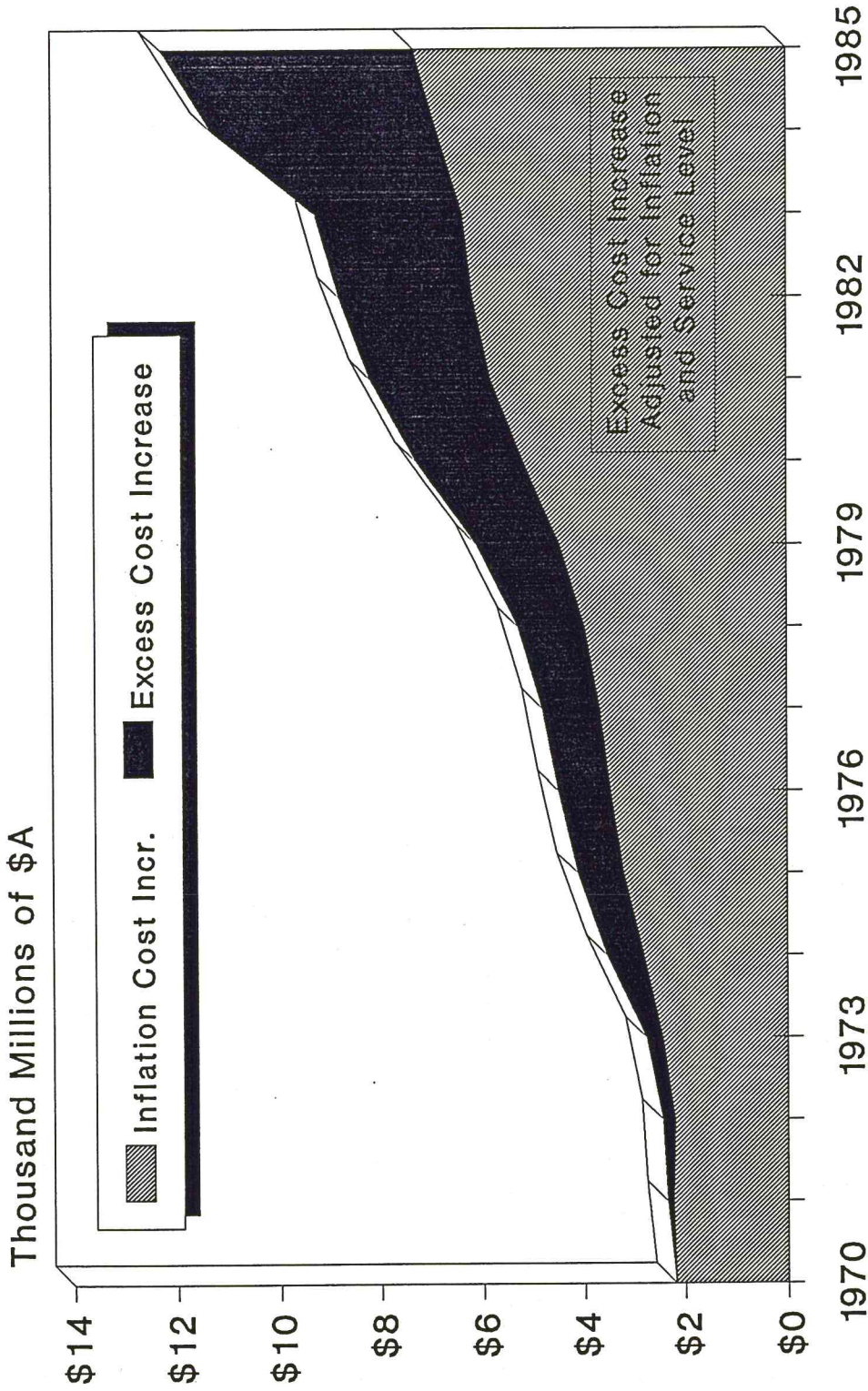
In response to the cost escalation of public transit and the cost control of the competitive market, US public transit authorities have competitively tendered considerable amounts of public transit services to private bus companies. The incorporation of competitive tendering has become a national trend, and has received attention from the national media, such as The Wall Street Journal (Carroll, 1988).

A. Extent of Competitive Tendering

More than half of the paratransit service (dial-a-ride or demand responsive service, largely for the disabled and elderly) is competitively tendered (UMTA, 1985), while less than 10 percent of total bus service is competitively tendered (Teal, Giuliano and Morlok, 1986). (It is ironic that competitive tendering is used for a substantially larger percentage of these specialized services than for less specialized bus services. Paratransit services represent a small percentage of all transit expenditures and is perceived by public transit managers or unions as a secondary activity.) While an increasing share of transit service is competitively tendered, the overall percentage remains small probably because of the reluctance of large public transit authorities to incorporate competitive tendering and the strong opposition of public transit unions.

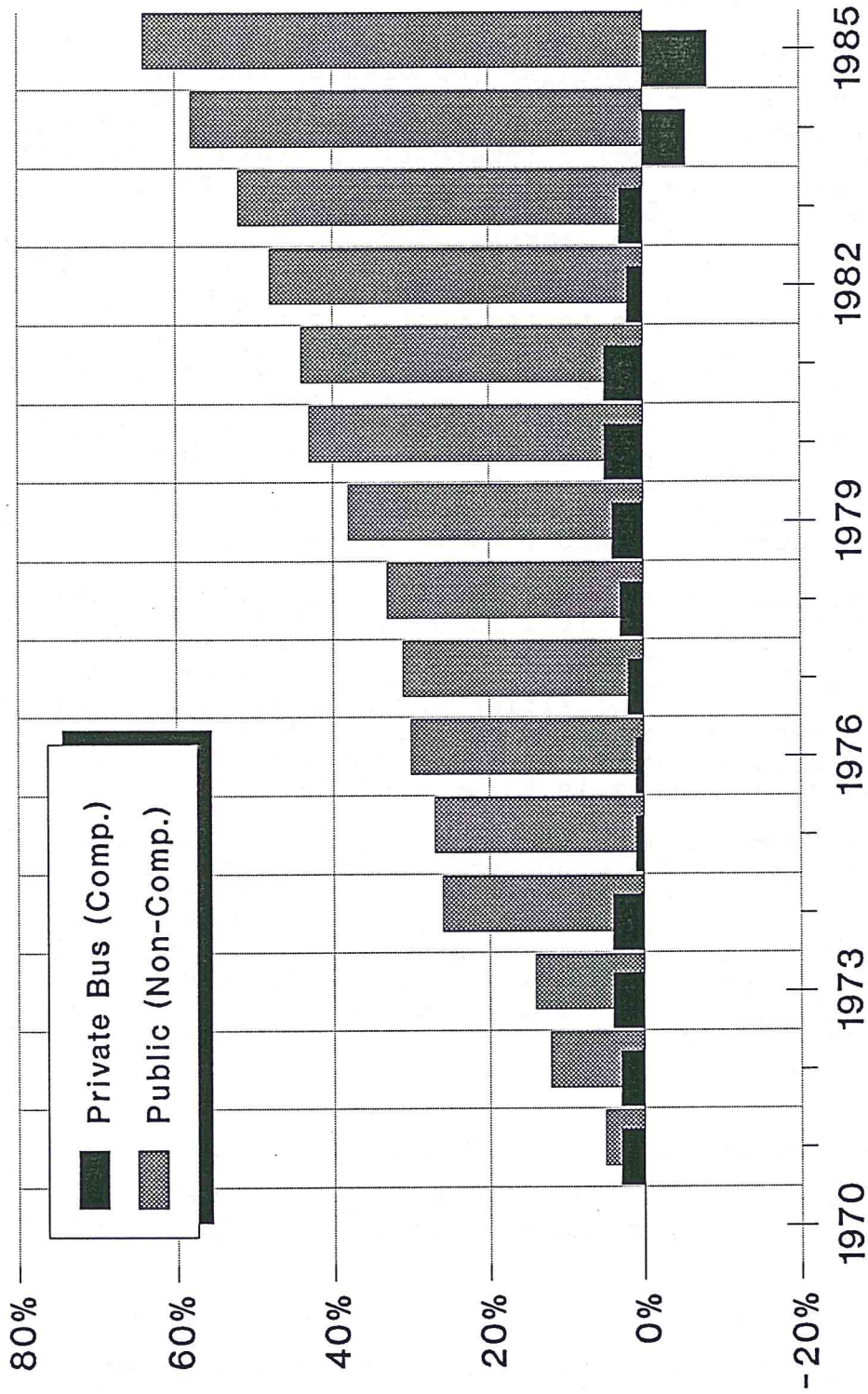
INFLATION AND EXCESS COSTS

U.S. Public Transit: 1970-1985



Derived from APTA and UMTA Section 15 Data

U.S. PUBLIC & COMPETITIVE COST INCREASES 1970-1985



Derived from APTA, Section 15 and Interstate Commerce Commission data

B. The Basic Approach

Under competitive tendering in the US, the public authority retains the service franchise (ownership) and controls the service. The public authority specifies route alignments, service frequencies, fares schedules and any other requirements deemed to be in the public interest. Private transportation companies respond to requests for proposals from public authorities to provide specific services for a limited period of time (no more than five years). The public authority awards a contract to the lowest responsive and responsible proposer. Winning cost proposals, final contracts, and requests for proposals are available to the public (see Section V). The jobs of present public transit employees are protected by restricting the competitive tendering conversion to the natural employee attrition rate. (This can be substantial. AC Transit in the San Francisco Bay Area was able to reduce its driving staff by nearly 10 percent in a seven month period, without a single layoff or redundancy.) In some cases, the public authority leases the vehicles (buses, etc.) to the successful contractor; in other cases the contractors supply their own vehicles.

The private contractor has incentives to perform effectively. The profit motive provides firms with an incentive to reduce costs within the constraints of the contract. Additionally, the contract may be cancelled for unsatisfactory performance; many contracts provide for penalties for unsatisfactory performance; and the private company will be interested in being favorably considered when the contract is re-tendered at expiration or when another service package is to be tendered.

Administered properly, competitive tendering always results in the lowest costs. Where private costs are less than public costs, the service is operated privately. Where public costs are less than private costs, the service is operated by a public authority under the same terms and conditions as would have been imposed upon a private company. In either case, the service is operated the least expensively. Competitive tendering in the public sector is analogous to "make or buy" analysis in the private sector.

C. The Record of Competitive Tendering

Competitive tendering has consistently resulted in lower costs through direct savings and moderation of in-house public transit costs.

1. Direct Savings

Competitively tendered public transit services have exhibited average cost savings of 30 percent. Cost savings have ranged from 10 to 60 percent (Teal, Giuliano and Morlok, 1986; Cox, 1987). For example:

-In Denver, the first competitively tendered services mandated by a new state law have resulted in cost savings of more than 50 percent.

-In Fort Wayne, Indiana, competitive tendering of public transit service has resulted in a 25 percent reduction in overall costs over the last two years, permitting a 60 percent increase in service level and a 33 percent fare reduction.

-In Los Angeles, two large contracts resulted in average cost savings of 42 percent.

-In Houston, park and ride service is operated for 33 percent less than public costs.

-In Seattle, express service is operated for 37 percent less than the public costs.

2. Moderated In-House Cost Increases

A competitive environment improves public cost performance. (This is referred to as the "ripple" effect.) For example:

-Lower cost increases have occurred in San Diego and Norfolk. In San Diego, public authority cost savings have been more than \$A115 million over the past 8 years compared to cost performance at similar public transit authorities operating without competitive incentives.

-The competitive environment has improved labor settlements in San Diego, Los Angeles, San Antonio, Phoenix, and other cities as it has become clear that there are alternatives to public monopoly service provision.

D. Service Quality

The data on comparative service quality is very sparse and largely unquantified. Generally, administrators of competitively tendered services have rated such services as equal to or better than in-house public service provision.

E. Is Competitive Tendering Successful?

Competitive tendering is a fluid public policy initiative. Unlike most public policy initiatives, competitive tendering is routinely reconsidered every three to five years through the procurement process. It would be simple enough for public authorities to abandon competitive tendering of public transit

service as contracts expire. The ultimate indicator of whether competitive tendering is a public policy success is the degree to which authorities choosing to competitively contract continue the practice. No US public authority that has used competitive tendering for bus service has discontinued the practice.

And the extent of competitive tendering is increasing. New public transit systems routinely competitively tender for services. Many public authorities not currently competitively tendering for service are considering the practice. Other public authorities that competitively tender for service are planning to increase the amount tendered. It has been estimated that a national competitive tendering program limited to approximately one-half the driver attrition rate could save between \$A32 thousand million and \$A51 thousand million over the next 15 years (Cox and Love, 1989 (#2)).

IV. METHODOLOGY

What follows is a distillation of research and experience in the design of competitive tendering systems in the US. The authors have had direct design experience in Detroit, Los Angeles, San Francisco, New Orleans, St. Louis, Minneapolis-St. Paul and Denver. Additionally, the authors have been involved in research of competitive tendering system design with respect to services in San Diego, Milwaukee, Chicago, Detroit, Kansas City, Sacramento, Los Angeles, Miami, Chicago Fort Wayne (Indiana) and other locations (Cox and Love, 1989 (#1)). Through this experience and research, the authors have developed a set of principles of competitive tendering design. These principles were used in drafting two legislative proposals.

Colorado Senate Bill 164, which was enacted in 1988, requires 20 percent of Denver public transit service to be competitively tendered over the next two years. This is the first state law in the US requiring competitive tendering of any public service.

Model state legislation has been published by the American Legislative Exchange Council (ALEC) to provide guidance to legislators interested in competitive tendering (American Legislative Exchange Council, 1989), and is included as the Appendix. ALEC is a national organization of state legislators that publishes "model" state legislation.

V. DESIGNING COMPETITIVE TENDERING SYSTEMS

Issues with respect to the design of competitive tendering systems are discussed below.

Qualification: The degree of competition for a given contract is directly related to both the quality of service provided and to the cost savings realized through competitive tendering. Competition is increased when the tendering process is open to public scrutiny.

An open process allows for maximum participation by all parties and reinforces the learning process for both the authority and the competitors. Service delivery is enhanced from the progression along the learning curve as firms compete on quality and service refinements as well as costs. Administrative and monitoring costs decrease as a function of the same learning process.

Within the US, most states and the federal government require open records for all entities that receive state or federal funds. These public information laws require the dissemination of final contracts, proposals, and prices to all requesting, interested parties. Initially passed to protect the taxpayers by ensuring public review of government, these laws increase the speed with which potential contractors and authorities improve the competitive process and help to ensure the integrity of the procurement system.

The following presupposes that competitive tendering occurs in an open environment.

A. Preparation

Public authorities have generally consulted with private transportation providers before designing and issuing requests for proposals. This consultation may be through informal meetings, hearings, or through formal committees of private providers under the sponsorship of public authorities. Advance consultation permits the public authority to consider alternatives for service and contract design that take full advantage of private sector capabilities, consistent with public requirements. As time goes on, the consultative process is becoming more routine as public authorities gain experience and increase their communication with private transportation providers.

B. Request for Proposal Information

Requests for proposals should contain a complete description of the service to be purchased, including schedules, service kilometers, service hours and any applicable service or safety standards. Further, requests for proposals should contain a clear description of the required proposal format. In some recent cases (New Orleans and Denver), public transit authorities have provided detailed questionnaires and cost forms, which, once completed, are the private company's proposal. This approach has considerable advantages. It reduces uncertainty about what is required in the private company's proposal and greatly simplifies the preparation of proposals. This simplification increases the likelihood that companies that have not previously proposed on public transit service will submit proposals. Requests for proposals should, at a minimum, contain detailed cost proposal forms to be completed and submitted as a part of the proposal.

C. Length Of Procurement Process

The time span between issue of the request for proposals to submittal of proposals may be the single greatest deterrent to the number of competitors. There should be sufficient time between issuance of the request for proposals and the submittal date for all potential proposers to solicit and receive copies of the request for proposals, to attend any pre-proposal conferences and to prepare their proposal. In general, the amount of time allotted should increase with the size of the service to be proposed and to the extent that the contractor would have to provide facilities, capital equipment, and vehicles.

Public authorities should allow adequate time for a thorough evaluation of the proposals received. The amount of time allowed between the award of the contract and service provision is usually specified in the request for proposals and the ensuing contract. Insufficient lead time will deter competent service providers from proposing.

D. Proposal Evaluation

Most public authorities divide the evaluation process into two parts: evaluation of service qualifications and specifications; and determination of the most cost effective proposal. For a company's price proposal to be considered, it must meet the service qualifications and specifications. Some public authorities require separate sealed envelopes --- one with the service proposal and qualifications and the other with the price. The price envelope is opened only for companies that have qualified in the first step. This approach is useful in building

the confidence of private providers in the procurement process and minimizes the potential for challenges by unqualified companies.

E. Fair Cost Comparison

Public transit authorities often compare in-house operating costs with proposed competitive costs before determining whether to award a contract to a private proposer. Private providers have alleged that public transit authorities have not fairly evaluated private proposals relative to in-house costs. Some public transit authorities have determined their in-house costs only after having reviewed the competitive proposals. In other cases, public authorities have understated in-house costs. As a result, a general mistrust has arisen in cases where public authorities administer competitive tendering processes in which they are also competitors. Because of these concerns, the authors of Colorado Senate Bill 164 did not provide for operation of competitively tendered services by the public transit authority.

Two public transit authorities took special steps in 1988 to assure objectivity:

-In Cincinnati, the Southwest Ohio Regional Transit Authority (SORTA) hired an accounting firm to prepare its internal proposal and submitted its sealed proposal by the deadline required of the private providers. Personnel assisting in the development of the internal proposal were not permitted to participate in the evaluation of proposals.

-In St. Louis, the Bi-State Development Authority separated the internal preparation of a proposal from the evaluation process. Bi-State did not permit personnel who prepared the internal proposal to participate in the evaluation of proposals.

Public transit authorities sometimes have understated their costs in third party procurements. (A "third party procurement" is one in which a publicly funded agency, other than the contracting authority itself, responds to a request for proposals. The publicly funded agency may be a neighboring transit authority, a university, or some other branch of state or local government. It is a third party procurement, for example, if transit authority B responds to a request for proposals issued by transit authority A.)

There are two adverse effects when a publicly funded agency wins a contract as a result of understating its costs:

(1) Overall competition for public contracts tends to decline resulting in long term cost increases. The private sector is not inclined to respond to requests for proposals where the process is perceived as unfair. (2) Total public costs increase (or services decrease), because the winning proposer must subsidize

the transit service it won with public monies that were earmarked for another purpose. The publicly funded agency must cut a service for which it was funded or must request additional funding (or increased fares or user fees) to cover the costs of the transit service. Public transit authority contract administrators have required detailed accounting from publicly funded proposers to eliminate this cross subsidization. The US Urban Mass Transportation Administration recently has ruled that public transit authorities must propose no less than fully allocated capital and operating costs when responding to requests for proposals (Chief Counsel, 1988).

The model state legislation permits public transit authorities to compete in competitive procurements, but contains provisions to ensure fair competition and fair proposal evaluation (Section 7).

To obtain the maximum level of competition and, therefore, the lowest price, it is important for public authorities to encourage the confidence of the private sector in the fairness of the procurement process. This is best accomplished by requiring that proposing public authorities be subject to the same rules as private companies and that public authorities propose no less than their true costs.

F. Pre-Proposal Conference

Many public authorities hold one or more pre-proposal conferences with potential proposers after issuance of the request for proposals. Pre-proposal conferences often result in changes in the proposal package as the public authority makes corrections in the original specifications or, as a result of questions from the potential contractors, becomes aware of alternative ways to deliver the service. Pre-proposal conferences can assist both the public authority and the private providers by improving the understanding of the service required, and this results in lower costs and more responsive private proposals.

G. Types Of Contracts

Most public transit authorities in the US require that proposers submit a final price that is unalterable throughout the term of the contract. This is called a fixed price contract. Other authorities have permitted the negotiation of prices over the contract term. Generally, fixed price contracts yield lower costs for the transit authority, and negotiated contracts tend to favor the contractor. Most contracts, including fixed price contracts, contain a provision that allows for minor changes in the amount of service. Typically, service levels may be increased or decreased by a certain percentage. Also, many contracts allow for modifications to route configuration if agreed to by both parties.

1. Fixed Price Contracts

The extensive use of fixed price contracts has been instrumental in maintaining the cost effectiveness of competitive tendering. The most important characteristic of fixed price contracts is that contract rates (prices) cannot be non-competitively manipulated. Fixed price contracts involve the proposal of a certain price for a given amount of service over a specific contract length, usually expressed in cost per unit of service, such as service kilometers or service hours. There are two basic forms of fixed price contracts, pure fixed price contracts and indexed fixed price contracts. (Both are permitted under Colorado Senate Bill 164 and the model state legislation.)

Pure Fixed Price Contracts: From the public perspective, the optimum level of competition and, thus, the lowest costs are likely to be achieved through "pure" fixed price contracts. Proposers are required to quote fixed prices for basic contract terms, for all option periods, and for downward or upward adjustments in service level. There is no price negotiation after execution of the contract and, therefore, no provision for adjustment of unit prices.

Indexed Fixed Price Contracts: Fixed price contracts may include forms of indexation that permit contract price adjustments based upon the change in generally accepted indices such as measures of inflation, fuel costs, or transportation industry costs. Indexing can reduce the risk for private contractors as they attempt to predict future costs. Potential contractors propose basic unit prices, but the unit prices are increased or decreased periodically according to specified indices. The price variation may be a percentage of the index's change or may be invoked only when a certain level is reached such as a 10 percent increase or decline from a base level. As in pure fixed price contracts, indexed fixed price contracts do not provide for price negotiation after execution of the contract --- remuneration can be altered only in response to changes in the appropriate indices.

Indexing can increase public costs, since US private sector costs historically have increased at rates slower than inflation and substantially slower than transportation industry indices. Also, all other things being equal, the proposer who estimates the lower rate of cost increases would always win the contract. On the other hand, indexing can provide a simple tool for dealing with major variations in cost that are outside the control of the contractors, especially fuel costs. Another item that would lend itself well to indexing is insurance; however, no reliable insurance cost index has been developed to cover the US bus industry.

2. Manipulation of Contract Prices

Unit price manipulation has been permitted in two situations, for elements of cost that rise extraordinarily and universally and for periodic price negotiation. (Provisions of Colorado Senate Bill 164 and the state model legislation [Section 5.D.] prohibit any manipulation of unit prices.)

Extraordinary and Universal Cost Increases: Because of fears that a private contractor might not be able to maintain service in an environment of general and extraordinary cost escalation in certain functions, some contracts have provided for reduced private risk either through negotiation or "pass through" treatment of such costs. For example, a contract might provide for negotiation or pass through to reimburse cost escalation of a function that is beyond the control of the contractor and has universally impacted public and private providers (such as the insurance escalation in 1985-6).

Periodic Price Negotiation: Another form of unit price manipulation is periodic price negotiation. Generally, price negotiation is annual and begins in the second year of the contract. Periodic price negotiation can be costly, because price competition is limited to only a part of the contract (such as the first year) and the winning contractor has a degree of market power over price in subsequent negotiations, which are non-competitive. Further, such negotiation consumes additional administrative time. Periodic price negotiation can lead to large auditing burdens, as well, to verify contractor cost changes.

In effect, periodic price negotiation is a "cost-plus" form of contracting. The net impact of periodic price negotiation can negate the very purpose of competitive tendering -- to obtain service for a competitive price. For this reason, there is a general trend away from this approach in the US.

H. Renewal Options

Contract duration can be defined in two ways by public authorities. Some public authorities offer contracts that have a specified term, such as three years, while other public authorities may award contracts for a basic term plus renewal "options." For example, a public authority may award a three year contract with a two year renewal option for a total contract term of five years. At the end of three years, the public authority may decide to exercise the two year option and have the incumbent company continue to provide the service. On the other hand, the public authority may decide to competitively procure the service again at the end of three years. The use of options can increase the incentives to the contractor to provide quality service and can give the public authority a way to change

contractors without invoking termination. Colorado Senate Bill 164 and the model state legislation permit a maximum contract duration of five years including options.

I. Contract Duration

Costs are likely to be higher for shorter contract durations because the risks will be greater, since proposers must recover fixed costs over a shorter period of time. Further, "start up" costs are incurred when a new private provider assumes a service. Costs will also tend to be higher because the number of proposers will decline as the risk increases. Contract duration can be shorter in cases where the public authority provides vehicles for the private contractor. Some contracts have been for only one year, while most have been at least two years. Where the contractor supplies the vehicles, contracts should be at least three years.

Alternatively, contract periods can be too long. Longer contracts require greater risks for both parties, since it is extremely difficult to project costs. Generally, contracts, including options, do not extend to beyond five years. (This is the maximum duration permitted by Colorado Senate Bill 164 and the model state legislation.) The primary reason is that, as contract lengths extend beyond five years, it is necessary to rely more on negotiated price increases and adjustments, which, in the absence of competition, are likely to result in higher public costs.

Finally, it is important to observe the same contract duration, regardless of whether the contract is awarded to a public authority or a private company. Failure to competitively re-procure a contract represents an abandonment of competitive incentives and is likely to result in higher public costs.

J. Rotation of Contracts

Where a public authority competitively tenders for multiple service packages, it is customary for procurements to be rotated such that no more than one service package is being procured at the same time. Limiting the percentage of service under procurement at any particular time reduces the incentive for an incumbent company to seek undue political advantage in the award process. It allows for winning/losing proposers to acquire/dispose of equipment in small parcels reducing the overall risks associated with entry and exit. Finally, rotation of contracts increases the likelihood of consistently good performance by current contractors who also wish to propose on the new service. (A contractor who is performing poorly on a current contract would not be likely to win a new package.)

K. Contract Size

Contract size is an important consideration because of the large number of small private providers and the important influence that these companies have on minimizing costs. The smaller the proposal package, the more likely that smaller companies will be among the proposers.

Competitive contracts have generally been relatively small with only a few cases involving more than 50 vehicles. Nonetheless, there are cases of competitive contracts of from 100 to 200 vehicles. While only a limited number of companies are able to propose on such large contracts, there is no evidence as yet that the costs have been significantly higher than in smaller contracts. However at least two public authorities that have procured service in large increments are now considering multiple and smaller future procurements to increase competition. The advantage of larger contracts for public transit authorities is that they can be simpler and less expensive to monitor.

Colorado Senate Bill 164 requires that "each individual request for proposals shall reflect the district's determination as to the appropriate size for each such request in order to maximize the number of qualified bidders without causing undue operating inefficiencies." The model state legislation contains a provision limiting procurement size (Section 6.F.).

A number of public transit authorities have sought a middle ground in which requests for proposals are structured to permit large contracts, if they are more cost effective, while permitting smaller companies to compete. This is accomplished by the issuance of a single request for proposals while permitting companies to submit proposals on part or all of the package. A variation of this approach involves the provision to propose a discounted price for the entire package. This approach has been adopted by the Regional Transportation District in Denver and the University of Minnesota in Minneapolis.

L. Market Share Limitation

Market share limitations have been designed to limit the ability of a single company to gain market power and thereby limit competition. Colorado Senate Bill 164 limits individual contractors to no more than 50 percent of competitively procured service, while the model state legislation imposes a 25 percent limitation where more than 60 vehicles of service are operated competitively under the sponsorship of the public authority (Section 6.I.).

M. Service Specifications

Public authorities clearly describe the service on which proposals are requested. This includes specification of route alignments, public timetables, estimated annual service miles and service hours, and vehicle descriptions. The public authorities also specify what ancillary services are to be provided, such as marketing, telephone information, etc. Public authorities also generally specify vehicle appearances (liveries).

N. Vehicle Provision

Vehicles for competitively tendered transit services may be provided by public authorities or by the private companies. Under public vehicle provision, the private company is given use of the vehicles under a contract to provide the specified transit service.

An advantage of private provision is that the private company has a greater incentive to properly maintain the vehicles to maximize their value in the used vehicle market. (Because US federal operating subsidies are low, and federal capital subsidies are high, transit authorities traditionally have replaced rather than repaired or adequately maintained vehicles. The private sector traditionally has maximized profits by adequately repairing and maintaining vehicles well past the 12 year life assumed by transit authorities. Transit authorities may not have the expertise to advise or supervise the private sector on optimal maintenance and repair.) A disadvantage to private provision of vehicles is that private companies have to finance such capital acquisitions through interest charges and must inflate their price to cover the rapid decline in market value of transit buses.

(Standard transit buses in the US have little value in the secondary [resale] bus market. There are two reasons for this phenomenon. (1) Public funds for capital equipment are designated for capital expenditure only and are received primarily from the federal government, so that the transit authority and the community it serves pay little or nothing [in cash or in opportunity costs] to acquire transit vehicles. There is no advantage to bargain on vehicle costs [so price is relatively high] and no advantage to properly maintain the vehicles past the 12 year life assumed by the federal government. (2) Private bus companies generally purchase and operate over-the-road coaches, vans, and school buses, because very little of the standard transit service in the US is operated by the private industry. The resale market for transit buses is thin and is composed of vehicles 12 years or older that often have been poorly maintained by the public authorities. The

market value for transit buses declines much more rapidly than their customary depreciation. Acquiring and disposing of transit buses, therefore, tends to be risky for the private sector.)

Avoidance of interest charges, which are not paid by public authorities, and amelioration of private operator risk associated with vehicle acquisition and disposal is an advantage of public vehicle provision. A disadvantage of public vehicle provision is that the public authority incurs additional costs of monitoring the maintenance records of the private company operating the vehicles. Nevertheless, in Miami, New Orleans and Denver, public transit authorities have made or plan to make public vehicles available for use by private contractors to reduce costs and to increase competition.

O. Insurance Coverage

Most public authorities require contractors to maintain accident and liability insurance limits at least as high as the public authorities carry themselves and similar to those required by the US Interstate Commerce Commission (\$A5.8 million per accident). Any requirement above this industry practice, even where it may be justified, adds to the costs of the contract.

P. Performance Bonds

Many public transit authorities require contractors to post performance bonds. Performance bonds serve two primary functions: to demonstrate the contractors' business soundness and to compensate the public authority for any losses resulting from contractor default.

Performance bonds probably represent the most simple and reliable indicator of the contractor's ability to perform. Public authorities are not skilled in judging the fiscal condition of private businesses and it can be unwise for a public authority to perform such a task. Bonding companies are skilled in corporate financial analysis, and a private company that is unable to obtain a performance bond of a reasonable size may not be competent to provide competitively tendered transit service. Performance bonds can be an easy, cost effective way for public authorities to minimize risks.

It is generally held that performance bonds should be limited to the maximum potential loss to the public authority in the event of a default by a private transportation provider, and a consensus is arising that a the maximum performance bond amount should be no more than three months' of the contract value. Even this may be excessive, since the nationally lost service days have been reported at fewer than five in the last decade. Since public transit service is readily available from the competitive market, the maximum foreseeable loss from a contractor default is

the incremental cost of purchasing substitute service while a new procurement process is undertaken. Added to this incremental cost should be the public cost of the unscheduled procurement process. San Diego County has developed its performance bond requirement by making such a calculation.

The necessity of ensuring the performance of private contractors must be balanced against the higher costs that are likely to occur from the requirement of performance bonds --- their value should be no greater than the foreseeable loss.

Q. Performance Standards

Most contracts provide for some standards of performance. These may include indices for service quality (cleanliness, color, lettering, and decor of the vehicle; driver attire; and driver courtesy), on-time performance, trip completion, record keeping, and safety. Interestingly, the standards set for tendered services routinely exceed those standards previously --- and often concurrently --- set for service provided by the public authority. In many cases, there were no preceding standards for performance, although limited performance records are required by the federal government.

-Safety: Most public transit contracts require that contractors include safety standards and vehicle maintenance standards.

-Service Quality: Various service quality standards are customarily included in contracts, such as on-time performance, trip completion, vehicle cleanliness, driver courtesy, passenger complaint rates.

R. Penalties and Incentives

Many public authorities specify financial penalties for unsatisfactory performance (in addition to the ultimate penalty, cancellation of the contract). Judiciously administered, financial penalties can enhance the likelihood that tendered service maintains high standards of quality and performance. Excessively high penalties or penalties based upon unreasonable standards impose additional costs on both the public authority and the contractor. Potential contractors will calculate the costs of excessive penalties and increase their proposal prices to compensate. Public authorities must evaluate the total costs and benefits of each penalty. Incentives generally have not been used in competitively tendered bus services because public authorities have assumed that the profit motive will be incentive enough for a responsible private provider.

S. Public Supervision

Public transit services require extensive supervision, whether they are provided by the public authority itself or a by private contract. The additional costs of supervising competitively tendered services are small. London Regional Transport has reported that its incremental contract monitoring cost was 2.5 percent of contract value for a program that involves more than 20 contracts and 800 competitively tendered buses. Ann Arbor (Michigan) reported incremental supervision costs of less than 2.0 percent. Common sense would indicate that the costs of supervision would be directly correlated to the extent of the monitoring effort. This is usually, but not always, the case. Public transit authorities have been innovative with regard to supervision. Miami uses temporary help to do random monitoring of on-time performance and service quality, permitting a higher degree of monitoring than would otherwise be possible. Carson (California) performs random monitoring but supplements this with routine calls to frequent riders for comments on performance issues.

VI. PRINCIPLES OF COMPETITIVE TENDERING DESIGN

The success of competitive tendering rests on three fundamental principles: public control, cost effectiveness, and open access and process. First, the public authority has a responsibility to the riders and taxpayers to ensure that public services meet quantity and quality standards that are set by government --- this requires public control. Second, competitive tendering programs must foster the development and maintenance of a truly competitive market so that costs are kept under control. Third, these two principles are best served when all interested parties have access to the procurement process and records. The implications of these three principles are described below:

Principle #1. Public policy control should be retained over services are operated consistent with public policy objectives:

- a. Public authorities should design the service consistent with schedules, standards, and performance criteria that it has established, and at the fares it has established.
- b. Public authorities should closely monitor service contract compliance as a routine activity, whether the contract has been awarded to a public authority or a private company. Public authorities should be prepared to invoke contract provisions such as may be required to ensure public service of specified quality and quantity.

c. Contracts should be awarded to the lowest responsible and responsive proposer: the public authority should ensure that it is obtaining service from a company that is capable of providing the service having proven its financial and management responsibility in similar services (responsible). Further, the public authority should ensure that it awards the contract to a company that understands the service package, having submitted a proposal that is sufficiently responsive to the public request for proposals that was issued for the service.

Principle #2. A competitive supplier market should be fostered, to ensure the most cost effective service.

- a. Requests for proposals should be provided to all potential proposers in sufficient time to permit well considered responses.
- b. Each request for proposals should cover the smallest increment of service practicable so that the maximum number of qualified proposers may respond.
- c. Requests for proposals should clearly specify all service requirements and contain clear and concise information on the required format of proposals.
- d. Service contracts should be subject to new requests for proposals at least every five years, whether the incumbent operator is a private company or a public authority.
- e. Contract expiration dates should be rotated to minimize the increment of service being competitively tendered at a particular time.
- f. No single company should be permitted to obtain contracts covering an excessive percentage of the public transit service. (This may not be feasible for public authorities a very small amount of service subject to competitive tendering.)
- g. Contract prices should be subject to negotiation after contract award only in extreme cases: No payment adjustment should be permitted except as specified in the contract according to the provisions of the request for proposals, or where extremely unusual circumstances have resulted in cost increases that are both outside the control of the contractor and have similarly impacted all potential contractors in the supplier market.
- h. Public authorities should participate fairly in the procurement process

1. Individuals and departments involved in preparing a public authority proposal should not take part in the evaluation of proposals.
2. Public authorities should submit sealed proposals subject to the request for proposals deadline.
3. Public authorities should be subject to the same proposal and contract terms, conditions, and performance criteria as would apply to a private company including termination provisions.
4. Public authority proposals should include the attributable fully allocated operating and capital costs for the functions proposed for purchase through the request for proposals.
5. Public authorities should include cost saving innovations in their proposals only to the extent that such innovations are used in other services provided by the public authority. (To permit otherwise encourages public authorities to reduce proposal costs for the purpose of winning contracts without reducing overall public costs.)
 - i. Where there are public capital facilities, they should be made available to the successful public or private proposer to provide the specified service. This will minimize capital and financing costs.
 - j. Public authorities should impose no contractor employee requirements beyond compliance with applicable labor laws.

Principle #3. Requests for proposals and final contracts and prices should be disseminated to any and all parties that solicit the information. Pre-proposal conferences should be open to all private operators and their designees. Public authorities should formally adopt, advertise, and abide by this principle of "open process" to assure the integrity of the procurement system and to encourage healthy, fair competition.

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APPENDIX: MODEL STATE LEGISLATION

The authors drafted the following model state legislation, which was adopted by the American Legislative Exchange Council (ALEC), and organization of US state legislators and published in The Source Book of American State Legislation 1989-1990.

THE PUBLIC TRANSPORTATION CONSUMER PROTECTION ACT

Introduction

The purpose of public transportation is service to consumers, including public transit riders and the taxpayers. Yet local public transportation policies have primarily addressed the means of service delivery rather than the purpose of consumer service.

Public transportation has typically been provided directly and non-competitively by public transit agencies supported by expanding public subsidy programs. Public transit has been characterized by unit cost increases well in excess of the inflation rate. Consequently, a substantial portion of public subsidies has paid for internal cost escalation, which provides no benefit to consumers, rather than financing increased service levels or reduced fares, which had been the rationale for public subsidies in the first place.

In contrast private bus industry unit costs have risen within inflation, demonstrating the inherent cost containment of the competitive market. Public transit subsidies have resulted in no consumer benefit to the extent that public transportation cost escalation has exceeded that of the competitive market.

Some public authorities have competitively contracted public transportation services to private transportation providers. Research has documented average cost savings of 30 percent for identical service. Under competitive contracting, the public transit agency determines the services to be contracted, service frequencies, fares, service quality standards, safety standards and other necessary requirements. Services are operated as an integral part of the public transportation system.

However, public transit operators have generally been inclined to favor internal service provision, limiting the consumer benefit achievable through competitive contracting. The Public Transportation Consumer Protection Act would create a competitive environment in which both public transit agencies and private transportation providers are fairly considered for operation of services. It would require that public transit agencies purchase public transportation services for no more than the competitive cost, and that savings be returned to consumers in the form of increased service levels, reduced fares, new capital facilities or reductions in subsidies. Service would be

required to meet the reasonable standards established by the public transit agency and the interests of existing public transit employees would be protected.

The Public Transportation Consumer Protection Act would focus local public transportation policy on the purpose of consumer service rather than on the means of service production. It is based upon a Colorado law (Senate Bill 164, 1988) and a California legislative proposal (Assembly Bill 2626, 1987).

Suggested Legislation

(Title, enacting clause, etc.)

Section 1. (Short Title.) This Act may be cited as the Public Transportation Consumer Protection Act.

Section 2. (Findings.) The legislature finds and declares that:

A. Public transportation services are provided to assist the transit dependent and the poor, to relieve congestion, and to minimize automobile pollution;

B. Protection of consumers, the public transit riders and taxpayers, requires that public transportation service be provided at the lowest possible cost consistent with service and safety standards;

C. Private transportation providers have been used under competitive contracts to provide public transportation services at lower costs and with lower annual cost increases;

D. Decisions on whether a public transportation service should be operated by a public agency or a private company should be made on economic considerations rather than on institutional considerations;

E. Obtaining cost effective public transportation services requires a competitive environment and a mechanism for competitive contracting of such services;

F. Facilities and vehicles purchased for public transportation service are public assets which are held in the public trust for service to public transit riders and the taxpayers.

Section 3. (Definitions.)

A. **Attributable Fully Allocated Cost:** The operating and capital cost of a public transportation service including the direct costs of driver labor and benefits based upon actual driver work assignments for the service, and a reasonable allocation of costs for replacement and spare drivers and all other costs of providing and administering transportation and maintenance for the service, minus the cost of any function not to be competitively contracted.

B. **Public Transit Operator:** Any public agency that provides or sponsors public transportation service and receives public subsidy.

Section 4. (Competitive Proposal Requirement)

A. On an annual basis, each public transit operator shall seek competitive proposals on at least ten percent of its fixed route bus service. The annual competitive proposal requirement shall be met only by the requests for proposal for services not currently operated under competitive proposals. The annual competitive proposal requirement shall be based upon the annual vehicle miles for the latest fiscal year for which information is available.

B. Notwithstanding the requirement of "A" above the competitive contracting required under this Act shall be accomplished through attrition of the public transit operator's full time drivers and mechanics in the employ of the public transit operator on the effective date of this Act. A public transit operator may hire new permanent drivers and mechanics only to the extent necessary to operate services that the public transit operator has been awarded through competitive proposals.

C. Any fixed route bus services operated under competitive proposals on the effective date of this Act or thereafter shall be subject a new competitive proposal at least every five years. In no case shall a service operated under competitive proposal be returned to operation not subject to competitive proposal. Renewal options that extend a contract beyond five years shall be prohibited.

D. The public transit operator shall determine the routes, schedules, and fares are to be included in any request for proposal.

E. Savings obtained through competitive service provision shall be used only for consumer benefit, including increased service levels, reduced passenger fares, new capital facilities and reduction of public transportation subsidies.

F. Each public transit operator shall make buses purchased after the effective date of this Act available for operation under competitive proposals by private transportation providers under nominal leases.

G. Each public transit operator shall maintain a list of interested proposers, which shall include all organizations that have requested inclusion on such list. The public transit operator shall advertise for additions to the interested proposers list at least annually in accordance with its general procurement policy.

H. A public transit operator may replace service with alternative service provision methods through competitive proposals if the public transit operator finds such alternative service methods to be in the public interest.

I. A public transit operator may execute standby competitive contracts with one or more private transportation providers to operate any service on an interim basis in the event that the public transit operator determines such operation to be required by the public welfare. Any service operated under a standby contract shall be subject to competitive proposal within six months of standby contract service commencement.

Section 5. (Standards and Requirements.)

A. Within six months of the effective date of this Act, each public transit operator shall promulgate reasonable standards with respect to experience, safety records, and financial responsibility by which private transportation providers can be qualified to provide bus services pursuant to this Act. Such standards shall not be designed to restrict the number of eligible participants in the competitive proposal process.

B. Within six months of the effective date of this Act, each public transit operator shall prepare a standard form of agreement to provide bus services. Such contract shall include:

1. Reasonable passenger comfort, safety and vehicle maintenance standards.

2. Standards for access to bus services for persons with disabilities, which shall be as specified in the public transit operator's plan for such services.

3. Standards for training and safety records to be required of any driver.

4. Requirements for reasonable insurance protecting the public transit operator from liability for the acts, negligence, or omission of private transportation providers, their agents, and their employees.

5. Reasonable standards for reliability and on-time performance.

6. Reasonable penalties for inadequate performance, including the public transit operator's right to cancel contracts.

7. Provisions and standards or the use of the public transit operator's logo, transfers, transit ways, bus stops, vehicles and other such elements as are owned by the public transit operator and appropriate for use by the private transportation providers under contract to the public transit operator.

C. A public transit operator may not establish any requirement relating to the wages, benefits, or union organization of contractor employees. All contractors shall comply with and give adequate certification of compliance with all applicable federal and state labor laws.

D. No change in contract payment amount to a private transportation provider shall be made except as specified in the contract. Payment changes in a contract shall be limited to indices, escalators, deflators, changes in service level and other expressly stated or calculable amounts, consistent with the request for proposal and the proposal of the private transportation provider awarded the contract.

E. Contract expiration dates shall be rotated to the maximum extent feasible to minimize the number of contract awards under consideration at any particular time

Section 6. (Requests for Proposals.)

A. Each request for proposals shall specify the route, service frequency, and fares as determined by the public transit operator.

B. The public transit agency shall seek the widest reasonable distribution of each request for proposals, and at a minimum shall send each request for proposals to each organization on the interested proposers list and to each additional organization which requests the specific request for proposal.

C. The public transit operator shall advertise each request for proposals within 10 days of issuance, and in accordance with its general procurement policy.

D. Proposal shall be required not less than 45 days from the advertisement date.

E. Services shall commence under any request for proposal within 120 days of the deadline for proposals.

F. Each request for proposals shall be limited to the least amount of service as may be commercially practicable so that the largest possible number of private transportation providers may respond. No single request for proposal shall include more than the greater of either:

1. Three percent of the public transit operator's weekday peak period requirement or
2. A 15 bus peak requirement.

G. Any qualified private transportation provider may respond to any request for proposals. Each public transit operator shall ensure that disadvantaged business enterprises, as defined in part 23 of title 49 of the Code of Federal Regulations, as amended, have the greatest possible opportunity to respond.

H. With respect to each request for proposals, the public transit operator shall award the contract to the private transportation provider or public transit operator whose responsible and responsive proposal offers the lowest cost.

I. No private transportation provider shall be qualified to be aggregately awarded contracts covering:

1. More than 25 percent of the annual vehicle miles of a public transit operator with a peak bus requirement of 60 or more.
2. More than 15 peak buses of a public transit operator with a peak bus requirement of fewer than 60.

J. No company, subsidiary of a company, parent of a company, or company related to a company holding a contract to manage the public transit operator shall be qualified to submit a proposal or be awarded any contract to operate public transportation services for the public transit operator.

Section 7. (Public Transit Operator Proposals.)

A. A public transit operator, including a public transit operator issuing the competitive procurement, may submit a proposal, and be awarded any such service, subject to the following conditions:

1. That it submit a sealed proposal before the advertised deadline for such proposals, that the proposal not be altered after that deadline and that the proposal be publicly opened and made public at such deadline.

2. That any labor provision assumed in the proposal either be specified in currently effective labor contracts or be executed before the proposal deadline in a written and binding agreement between the public transportation operator and the appropriate labor organization.

3. That it take reasonable steps to ensure an objective and fair evaluation process including prohibition of proposal evaluation participation by personnel or departments which were involved in preparing the public transportation operator's proposal.

4. That its proposal price be not less than its attributable fully allocated cost for the service, and that its proposal price not be based on part time labor provisions or other less costly labor provisions to a greater percentage than such provisions are employed in the public transportation operator's fixed route bus services which have not been subjected to competitive proposals, and that its proposal price be consistent with currently adopted budgets and financial plans.

5. That it shall make or be bound by no contract, agreement, or assurance which creates or extends any form of obligation for continued employment or employee compensation, except for pension, beyond the contract expiration date under the provisions of the request for proposal for employees assigned to the service.

6. That it shall be bound by the same terms, conditions and performance and other standards as would have applied to a private transportation provider awarded the contract under the request for proposal.

7. That its costs per vehicle mile, exclusive of capital costs, for fixed route bus services which have not been subjected to competitive proposals shall not at any point during the contract rise by a percentage greater than the cost per vehicle mile, exclusive of capital costs, for the competitive service in the public transit operator's proposal for the corresponding period.

a. Each adopted budget or budget revision and each United States Department of Transportation Urban Mass Transportation Administration Section 15 annual report shall be reviewed by the public transit operator to determine compliance with this provision.

b. If the public transit operator's cost performance is not in compliance with this provision, the public transit operator shall relinquish the contract and a new request for proposal for the service shall be issued within 90 days.

Section 8. (Performance Audit.) Each public transit operator shall contract with an independent certified accounting firm, other than the public transit operator's regular auditor, for a neutral and unbiased performance audit to be completed and reported to the legislature by two years after the effective date of this Act. Such performance shall analyze in a fair and equitable fashion the implementation of this Act including, but

not limited to, compliance with the competitive proposal requirement, equitable administration of the competitive proposal process, compliance with fully allocated costing requirements, the level of contract compliance by private transportation providers, the cost of such compliance and whether such costs will be recurring or may be reduced, application of savings to consumer benefit and taxes paid by private transportation providers.

Section 9. (Facilities and Vehicles)

A. The planning of all maintenance facilities, operations facilities, and garages shall include a thorough review of competitive alternatives available for efficient development, management, and or operations for such facilities. The planning process shall include private transportation providers, and any application for funding assistance shall include a full description of such alternatives reviewed.

B. No public transit vehicle, maintenance, or operating facility purchased or leased after the effective date of this Act shall be encumbered by any contract, agreement, or assurance which limits its use by private transportation providers in the operation of public transportation service under contract, subject to the policy control of the public transit operator.

Section 10. (Restrictive Agreements)

No public transit operator shall make or be bound by any contract, agreement, or assurance that restricts its ability to comply with this Act in any respect.

Section 11. (Severability Clause.)

Section 12. (Repealer Clause.)

Section 14. (Effective Date.)