Contracts (public service)

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A Public Service Contract (PSC) in public passenger transport is a legally binding agreement whereby a transport authority entrusts an operator with the provision of transport services subject to Public Service Obligations (PSOs) together with financial compensation for the costs incurred and/or a level of exclusivity. PSOs refer to services that are considered socially desirable but that would not be provided (at all, to the same extent, or under the desired qualitative conditions) without public subsidy or by the market alone.

Contracting has not been a constant feature in providing public transport and securing PSOs. Direct public sector management under various forms and extents of political scrutiny has long been used and is still widespread across the world. The implementation of formalised contracting practices in public transport emerged during the latter half of the 1980s, predominantly shaped by the advent of New Public Management (NPM) principles. This resulted in a clarification of roles between authorities and operators, as well as an increase in outsourcing to the private sector through competitive tendering. The primary objective was to reduce costs and enhance service quality through increased efficiency and a focus on innovation, in comparison to previous public monopolies.

PSCs can be found in several sectors, including local or regional bus, tram or metro services, regional or national train services and airline services (flights to remote or sparsely populated areas). While a contract is usually an agreement between two parties that specifies respective rights and obligations, such as the delivery of services in exchange for compensation, other forms of contractual arrangements can also be encountered. In the context of EU law, it is possible for public transport service contracts to be constituted by an authority decision that sets out the conditions under which services are to be provided by the authority itself or by its internal operator.

The identification of required public services should be based on a prior assessment of service needs conducted by the transport authority in consideration of policy aims and available budgets. A variety of contracting approaches may then be used, ranging from a complete service specification (encompassing routes, stops, timetables, vehicles, fares, etc.) by the authority or its planning agency, to a functional specification by the authority (including only target accessibility levels and service supply norms for various service periods and areas, in relation to perceived social needs).

The resulting contracts where the operator is entitled to develop services and/or fares (in the bidding process, during the contract period, or both) are usually 'net cost contracts'; the operator carries both cost and revenue risks, often with some level of risk-sharing with the authority and is paid for the expected deficit in providing the services. The PSO definition constrains the freedom of the operator while (financial) contractual incentives direct its actions towards realising the PSOs. The contract thus serves to transform socially desirable but financially unprofitable services into activities that are financially attractive for the contractor.

A contract covering fully specified services is usually a 'gross cost contract'; the operator may not modify services or fares and receives a fixed amount to realise predetermined services. The operator carries the production cost risk on those services while collecting fares and transferring them to the authority, which carries the revenue risk. Operational quality incentives are added to incentivise the operator towards realising levels of quality set out in the PSOs (punctuality, reliability, etc.).

Other elements are essential to proper contracting. Clear procedures are needed to amend or order and reward services according to changing demand or evolving policy objectives. This may include contractual requirements for stakeholder consultation. A monitoring regime for service delivery and quality monitoring must be defined together with a performance-based incentive structure. When applicable, the acquisition, provision or transfer of existing means of production (infrastructures, rolling stock, personnel) must be organised in a logical relation to contract duration. Furthermore, arrangements for contract termination and transfer of assets and personnel to a subsequent operator must be made.

Contract awarding mechanisms usually aim for 'value for money for the public purse', focusing on cost efficiency, service effectiveness and service quality targets. Various awarding criteria and procedures have developed, on a competitive basis or not, influenced by national traditions, legal obligations and contractual purposes. Typically, these combine a contractual price (subsidy) with quality aspects or aim for service level maximisation for a pre-determined budget.

Alternative contracting and competitive arrangements have been studied extensively (Wong & Hensher, 2018). Overall, contracting and tendering can lead to service and efficiency enhancements when managed effectively, but the question of the best performing arrangements remains elusive. The primary challenge facing authorities contemplating the implementation of public service contracts is the need to fulfil the requisite conditions of the selected regime (van de Velde, 2016). This entails acquiring and maintaining an adequate level of legal, operational and financial expertise.

References/further reading

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