THE SOUTH AFRICAN EXPERIENCE WITH NEGOTIATED VERSUS COMPETITIVELY TENDERED BUS CONTRACTS

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OVERVIEW OF THE PAPER

This paper explores the policy background and rationale for negotiated contracts in South Africa, briefly review the current situation regarding the implementation of these two forms of contracting, and compare the respective advantages and disadvantages of each form of contracting. The paper will also discuss the respective positions of the Department of Transport, industry and labour regarding tendered versus negotiated contracts, as well as the perceived strengths and weaknesses of each form of contracting, as measured against a range of criteria. In conclusion, three different negotiated contracts will be discussed and some conclusions drawn regarding the negotiated contract system in the country.

INTRODUCTION

The South African White Paper on National Transport Policy of 1996 makes provision for tendered contracts and stipulates amongst other that no service may be subsidised if such service is not competitively tendered. Following the White Paper, further discussions between government and the organized bus industry took place on how to accommodate government-owned and operated bus companies in the tendering system, as these operators were not in a position to competitively tender for services (not financially ring- fenced in terms of the requirements to tender, and their fleets were generally run-down and under maintained). Hereafter the policy was amended to make provision for negotiated contracts where the government would, once only, negotiate a contract with government-owned (parastatal) and municipal transport operators, for the delivery of services.

For the purpose of this paper the following legislative requirements of negotiated contracts will be highlighted (Department of Transport, NLTTA, 2000):

A contract can be negotiated with an operator on the following conditions:

"(a) the negotiation of such a contract, in the opinion of the Minister, is necessary-
  - (i) to promote the economic empowerment of small business, or of persons disadvantaged by unfair discrimination; or
  - (ii) to facilitate the restructuring of a parastatal or municipal transport operator to enable it to –
    - (aa) comply with section 48 or to discourage monopolies; and
    - (bb) promote the economic empowerment of small business, or of persons disadvantaged by unfair discrimination; and

(b) the negotiation of such a contract will not lead to –
  - (i) a substantial increase in the services being provided by the relevant parastatal or municipal transport operator;
  - (ii) more than the prescribed percentage of the total value of subsidized service contracts in the transport area or province in question being subjected to negotiated contracts under this subsection; and
  - (iii) the cost of the negotiated contract, calculated in the prescribed manner, being substantially higher than what would have been the case were the service subjected to competitive tendering under similar terms and conditions;

(c) the service for which the negotiated contract is contemplated is not at the relevant time, and has not previously been, the subject of a current tendered contract or a contract negotiated under this subsection;

(d) the contract to be negotiated complies with all requirements prescribed under subsection (4)(a), is substantially in the form of the model tender documents contemplated in subsection (4)(b) and has a maximum validity period of five years

(e) the provincial department, transport authority or core city, as the case may be, prepares a business plan that-
  - (i) sets out how the negotiated contract will be implemented; and
  - (ii) states how the requirements of this section have been complied with; and

(f) the public transport operator concerned may not for a period of such negotiated contract calculated as 80 percent of that period, beginning on the date of commencement thereof, be party to any other current tendered contract or subsidised service contract, or another contract negotiated under this subsection; and

(g) the contract provides that the operator must, by a date stated in the contract, which may not be later than two years after the date of commencement thereof, be majority-owned by persons disadvantaged by unfair discrimination."

The main objectives of negotiated contracts can be summarised as follows:

- To assist parastatal and municipal operators to prepare for the open tender system
- To involve and empower small enterprises
- To promote the economic empowerment of persons disadvantaged through unfair discrimination
- To effect racial transformation of previously white owned bus companies

Although the initial aim was to mainly offer negotiated contracts to government-owned businesses, a number of private sector operators also applied for negotiated contracts under a

180 day window period provided specifically to lodge such applications. Not all operators however applied for such negotiated contracts which led to a later amendment of the NLTTA to allow any operator to apply to have its services negotiated.

Current Status and Characteristics of Tendered and Negotiated Contracts in South Africa

In both the tendering and negotiated contract regimes provision is made for a Model Tender Document (MTD), issued by the Department of Transport. Consultants are appointed by the provincial departments of transport to design the services (either for tenders or negotiated contracts) whereafter the service specifications are included in the contract document as Parts Three and Four. Part One and Two of the MTD describe the Tender Rules and the General Conditions of the tender, whilst Parts Three and Four give the Special Conditions of the contract as well as the Contract Specifications. Part Five contains the various Forms that the operator has to complete before submitting the tender.

The difference in approach between the tender and the negotiated contract regime is that under the open tender system operators prepare bids, based on Parts Three and Four of the MTD and submit such bids to the Authority for adjudication. Labour is not part of the agreement and only becomes involved once the contract is awarded to the operator and the operator enters into negotiations with labour regarding employment opportunities. In the negotiated contract regime the Authority, the operator and the operator's labour force negotiate the contract terms and conditions (in particular any labour implications), prior to the awarding of the negotiated contract. In practice, labour is consulted and quite involved in the negotiated contract system.

Since the introduction of the tender system in South Africa 79 tendered contracts (38 operators) and 9 negotiated contracts (five operators) have been concluded. These contracts represent about 50% of the commuter buses subsidised by the Department of Transport (Department of Transport, 2007). The remaining commuter services that have not yet been tendered represent 31 interim contracts[1] (26 operators). (Department of Transport, 2007) The number of commuter buses subsidised by the Department of Transport total 7500. This number excludes municipal services that are subsidised by the ratepayers of such municipal areas. These buses number about 1100.

Due to the complexity of the transition between interim contracts and tendered contracts, especially the labour issues, it was decided to formalise the transitional arrangements by means of an agreement between organised labour, the organised bus industry through its trade association, the Southern African Bus Operators Association (SABOA), and the DoT. This became the Tripartite Heads of Agreement (HOA) that guided the industry and the DoT on policy implementation.

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[1] Following the endorsement of the White Paper on National Transport Policy by Parliament, the industry and DoT engaged in extensive bilateral discussions on the way to implement the agreed policy of competitive tendering in the commuter bus industry. This led to the signing of the interim contracts with subsidised operators in 1997 so that the permit holders would, amongst others, hand back their operating rights (permits) to government when such services were put out to tender which would enable new services to be designed in the transport planning phase of policy implementation. These interim contracts were also designed to stabilise the industry in the run-up to the tendering regime. At present a significant number of operators still operate on these contracts due the lack of new tenders. These contracts are currently being extended on a month-to-month basis until the issues (See footnote 2) regarding tendering are resolved.

An Industry Restructuring Fund was also established to assist operators in retrenching those employees who are not offered jobs between the interim contracts and tendered contracts and also to make provision for accumulated benefits to which employees are entitled. These accumulated benefits are determined prior to the onset of the tendered contract (the so called "clean break provision") and provision is made for payouts towards the end of term of the tendered contract. The fund received R75m from the DoT; the operator responsible for the contract has to contribute .75% of the value of the contract; and labour agreed to a one week per year of employment claim (instead of the normal two weeks, as per labour legislation) to the fund.

Over the last six years (since 2001) no new tendered contracts have however been entered into due to a dispute between the Department of Transport, organised labour and the organised bus industry about the HOA and labour concerns regarding the tendering system.[2] However, a number of negotiated contracts have been concluded as the process to conclude such contracts differs significantly from the open tendering system.

The differences in approach between the two contractual approaches can be summarised as per Table 1 below.

Table 1: Differences In Approach Between The Tendering and Negotiated Contract Systems In South Africa

	Tendered Contracts	**Negotiated contracts**
Authority	Authority decides to tender services	Authority decides to negotiate services after approval from Minister of Transport
Public involvement	None, excepting to determine route network inputs	Notice to negotiate contract is published in the Government Gazette and other written media.
Operators	Operators tender against each other for the service A 10% right of first refusal for the incumbent operator	Contract is negotiated with the incumbent operator (private operators) but put out to some form of competitive bidding when services are privatised by the provincial or municipal operators (see the examples cited in the paper) No right of first refusal for the incumbent operator where the services are privatised
Labour	Not involved by tendering companies prior to such companies tendering. A "clean break" in service provision, even though the same operator may win the contract. This causes instability in the labour force	Involved in tender discussions prior to the finalisation of the contract. Continuous employment with the same operator (in the case of private sector operators) with the same conditions of employment for those employees offered employment. The same employer

[2] Organised labour registered its discontent with the HOA after it became clear that its members were losing some of their benefits (conditions of service) between contract types –interim contracts and tendered contracts, sometimes with the same operator. Significant job losses between interim contracts and tendered contracts were also a major point of disagreement about the HOA as labour wanted higher levels of job guarantees- higher than what the agreement originally made provision for. Other issues caught up in the dispute about the HOA included the severance agreement with labour when a service is put out to tender, a 10% right of first refusal that was meant to favour the incumbent operator in the tendering system (a transitional, once- off measure), set-asides for Small Medium and Micro Enterprises, outsourcing and sub-contracting conditions etc.

	Tendered Contracts	Negotiated contracts
		criterion is not however necessarily the case in parastatal and municipal operators if their owners decide to privatise these companies (see the three examples cited in the paper)
Conditions of service of labour	Negotiated after award of the tender with representative unions	Representative unions are consulted prior to the awarding of the NC
Contract price	Based on the most acceptable tender price. No negotiation on tender price	Negotiate a cost to operate the service with the incumbent operator or bid for the sale of a company where the ownership resides with a province of local authority
Vehicle specifications	Determined in the tender specification document	Determined in the tender specification document
Service specifications	Determined in the tender specification document	Determined in the tender specification document with the potential for variations as a result of the negotiation process
Contract duration	Initially five years, but extended to seven years in later amendments to the NLTTA	Initially five years, but extended to seven years in later amendments to the NLTTA
Contract monitoring	Independent monitoring company appointed by the Authority	Independent monitoring company appointed by the Authority
Subsequent rounds of tenders	Tendered service will be tendered upon expiry	NC once only, thereafter the services are tendered
Tender documentation	Documentation compiled by a service provider on behalf of the Authority	Documentation compiled by a service provider on behalf of the Authority
Black Economic Empowerment (BEE)	Operators include BEE in their tenders with a minimum of 10% of services for BEE. In practice most operators exceed this level in order to win tenders	Within 24 months the service must be operated by majority owned operator (Black people)

From Table 1 above it can be seen that there are some fundamental differences between the two regimes, the most notable probably being the way in which labour is treated. This has been a major problem in the tendering system as labour accuses management of negotiating in “ bad faith” due to the fact that such negotiations only take place once the tender has been acquired therefore constraining management in what it could offer to the labour force.

Advantages And Disadvantages Of Tendered Versus Negotiated Contracts

When evaluating the tendered versus negotiated contract systems against a number of criteria that are important in any tendering regime, the following general advantages and disadvantages become clear.

Table 2: Advantages and Disadvantages of Tendered Versus Negotiated Contracts

	Tendered Contracts		Negotiated Contracts	
Criterion	**Advantages**	**Disadvantages**	**Advantages**	**Disadvantages**
Costs	Market forces determine tender price	Tender prices reflect tender specification with no room for negotiations post tender event	The transport authority can exercise more control over service pricing than TCs	Authority has to use some form of cost benchmarking to determine a contract price
Transparency	Tendering results in transparent pricing and competition			Less transparent than tendering as services/costs must be negotiated
New entrants	Tendering results in an opportunity for new entrants to enter the industry		The business plan of the operator with whom negotiations take place has to include other operators (especially emerging operators) as joint venture partners, sub contractors or contractors in their own right	NCs are with the incumbent operator in the case of private operators
Operating area	"Area monopolies" can be broken up in the tender design to make provision for more service providers	A reduction in the number of services due to government cost pressures	More stable than tendered contracts as the operator is generally involved in the negotiations about the operating area	
Authority Expertise	Authority can outsource the tender design, evaluation and reward			Authority will need significant specialized expertise to negotiate the contract
Operator expertise		Could result in a loss of operator expertise if tenders are lost	Operator expertise retained as operator does not risk loosing service in NCs	An inefficient operator could be retained
Tender price	Market driven – authority has virtually no control			Cost of rendering the service is negotiated based on industry benchmarks
Empowerment		Authority has limited influence over the extent of empowerment excepting that it could enforce the	The operator has to meet the legal transformation target within two years	

	Tendered Contracts		Negotiated Contracts	
Criterion	**Advantages**	**Disadvantages**	**Advantages**	**Disadvantages**
		minimum requirement of 10%	Authority has significant influence over empowerment as the contract is negotiated	
Network integrity, integration and coordination		More difficult to achieve network integrity, integration and coordination	Easier to achieve network integrity, integration and coordination as services are negotiated	
Labour		Labour can loose out between different operating companies – lack of continuity of employment and conditions of service	Labour force stability as the incumbent operator's labour force is retained in the NC regime, inclusive of conditions of service (only for a 12 month period, thereafter retrenchments can take place)	
Transformation (to black ownership/involvement)		More difficult to control/influence when compared to NCs	Broad based transformation achieved within 2 years – majority owned bus company	
Flexibility		Operators tender on specification, little room for innovation and flexibility	Flexibility can be negotiated with the incumbent operator	
Training and development		Cost pressures in the tendering system often result in a reduction in available funds for training and development	Due to the negotiation process, the likelihood of a significant reduction in funding for training and development is less when compared to the TC system	

Views of the Department of Transport, the Bus Industry and Organised Labour on Negotiated Contracts

The views of the Department of Transport, operators and labour on negotiated contracts vary significantly. The following section describes the three parties' general positions on negotiated contracts. 3

Department of Transport views regarding negotiated contracts

The introduction of negotiated contracts as an alternative to the tendering system was originally conceptualized by the DoT as a measure to provide a transitional arrangement for provincial and municipal-owned bus companies "to get fit" for the tendering system. It was the opinion of the DoT, supported by these operators, that they would be uncompetitive in the tendering system as most of their bus fleets were run down and they would not be able to meet tender requirements such as the minimum age specification of buses, nor would they have the means to recapitalize their fleets prior to the introduction of the tendering system. Negotiated contracts were therefore initially introduced in support of provincial and municipal-owned bus companies. The NLLTA, which introduced the concept, was however worded in such a way that it also opened the door to other (private) operators to apply for negotiated contracts, provided that they met certain conditions such as being majority-owned within 24 months of the signing of the contract, and the economic empowerment of small business and historically disadvantaged people. It also had to be in the interest of the state to sign such a contract as it would result in the empowerment of previously disadvantaged operators.

To date, (June 2007) no negotiated contracts have been concluded with private operators but only with a number of provincial bus companies and one municipal operator. In the case of private operators the transport authority will have to negotiate the service with the interim contract operator based on the contractual agreement between the interim contract holder and the DoT. This is also the area that concerns the DoT the most, as there cannot be a test of the market to guide the pricing process other than to benchmark costs elsewhere in the industry.

In the case of provincially-owned or local authority-owned bus companies, their owners could decide (together with the provincial departments) on the manner in which such negotiated contracts could be concluded. In most cases, these owners decided to exit the industry (from an ownership and operations point of view, but not foregoing their authorities' responsibility to render public transport services) and have their bus companies privatized. This led to a varied approach to negotiated contract negotiations that is more fully described in section 5.

The following table sets out the perceived shortcomings and strengths of the negotiated contract system as seen from a DoT point of view:

[3] The views contained in this section are based on the South African experience with tenders and negotiated contracts, the characteristics of the country's public transport policies and the experience of the authors with both systems over a prolonged period of time.

Table 3: Department of Transport's Views on the Negotiated Contract System Versus the Tendered Contract System

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
Pricing	Can negotiate a service within its budget constraints (supply side approach) Not at the mercy of a competitive tendering pricing process where the DoT has no control over tender pricing	Lack of pricing transparency Will in all probability have to use benchmark costs to determine a cost for the service Difficult if not impossible to test the market for the "best price for service" criterion Benchmark pricing can be too low resulting in long term sustainability issues for the operating company Benchmark costs can be too high resulting in a wastage of scarce resources resulting in public accountability issues	New entrants into industry in contrast to negotiating with the incumbent operator Pricing transparency	Pricing of services could be higher than what is expected resulting in strained budgets For large services there could be too few operators bidding Tender specifications and conditions can affect pricing significantly
Negotiating skills	Can negotiate the levels and costs of service = flexibility and control	Need specialist skills to negotiate the price of the service as well as understand the dynamics and detail of a (complex) public transport system	No need to negotiate the price of the service	Little control over service pricing in a competitive market Skills needed to adjudicate the respective tenders but this can be outsourced
Transparency		There is a lack of transparency in the negotiation process compared to tenders	Transparent process of determining the price of a service Transparency w.r.t. new entrants into the industry	
Network integration and coordination	Could negotiate an integrated network of services	Pricing for additional services or a reduction in services is difficult to quantify (who	Contract specifies the services to be rendered	A need for detailed contract specifications for service integration and

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
		benefits?)		coordination Could be more difficult to achieve and has to be specified to some level of detail to ensure network benefits Could loose network benefits if contracts are not properly specified
Service provision stability	In the case of negotiated contracts negotiated with the same operator the public does not experience new operator issues Communication channels remain intact when the same operator operates the services There is less of a likelihood of service instability if the same operator retains the services		A new operator may result in increased service levels compared to the previous operator	It has been found that the commuting public is not always in favour of a new operator Communication channels between the public and operator need to be re-established Service instability often occurs with a new operator operating the services – this also happens when service designs are obsolete (the latter can however also occur in negotiated contracts as exemplified in section 5 of the paper)
Labour stability	Organised labour supports negotiated contracts as their conditions of service are negotiated A happier labour force when compared to tendered services	Could result in higher labour costs (when compared to the tender system) as the current operators' labour cost is perpetuated in the negotiated contract system	Market forces determine labour costs thus potentially correcting too high wage levels. Could result in lower levels of subsidy for the state as labour constitutes about 40% of total operating	Labour issues with the tendering system could result in a more volatile labour force Social issues and political pressure as a result of the way in which operators reduce prices at the expense

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
			costs of bus companies	of labour
Flexibility	More flexible than a tender system as service levels and details are negotiated.	Requires specialist skills in public transport management and operations		Less flexible when compared to negotiated contracts. Operators tender based on tender specifications with little scope for service innovation post award of the contract
Transformation	Transformation issues can be negotiated and will in all probability be more significant than in the tendering system Government achieves transformation sooner than in the tender system	Could result in favouritism in the selection of BEE partners by the incumbent operator		DoT cannot control operator transformation issues – this is up to the individual tenderers Can expect lower levels of transformation when compared to the legal requirements for negotiated contracts
Competition		Lack of competitive pressure or threat of competition Operator cannot loose its service due to competition from other operators	Significant direct competition for services as well as the threat of competition from new entrants. This should result in more competitive bidding	For large service designs there may be limited competition

Operator views on negotiated contracts

Operators in general prefer negotiated contracts. Due to the fact that labour forms part of the negotiation process, the latter is not left out, or form part of the cost squeeze often experienced in tender systems. The result is a more content labour force.

Operators also retain their senior management positions in negotiated contracts and provision is generally made for the development and training of staff at all levels. Career paths also generally remain intact under this form of contracting.

Operators also believe that negotiated contracts result in a more secure business environment which is more conducive to longer term investments. Service levels are also negotiated together with the related costs to render such services. If agreement is not reached on certain service levels, it is not offered and all parties arrive at a common understanding as to why such a decision is taken.

As a result of the negotiation on service levels and scope of services, negotiated contracts allow for easier integration and coordination of services when compared to the tender system.

Operators generally experience negotiated contracts as less stressful when compared to tendered contracts. In the latter, it is often not understood what criteria informed the contracting authority about the choice of bidders. Operators also retain their businesses (but lose out on majority ownership after two years), whereas in the tender system they stand to lose their entire business to potential competitors. The transformation requirements in negotiated contracts also force operators to incorporate the required BEE partners before a contract is finalized. The state’s requirements are also very clear and provide some form of certainty about transformation issues.

When compared to the type of agreement that operators have to adhere to in the tendering system (e.g. the Heads of Agreement), the negotiated contract process is much simpler to execute.

The ability to develop a business plan that will guide the process towards a negotiated contract also assists the operator in the negotiations with the authorities. The business plan is discussed at length and eventually agreed upon between the respective parties. This also forms part of the certainty inherent in negotiated contracts.

One of the drawbacks of negotiated contracts however is the ability of the state to direct the service costing process. This could impact negatively on fleet recapitalization, service delivery, as well as the conditions of employment for its labour force. This ability has, in the recent past, resulted in companies scaling down their fleet sizes, postponing capital investment programmes and reducing the work force after 12 months of operation.

Table 4: Operator Views on the Negotiated Contract System Versus the Tendered Contract System

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
Pricing	Services are priced based on negotiations	Could result in lower pricing levels than when compared to the tender system What happens if parties cannot agree to the cost of the service?	Operators can tender based on their cost structure and perceived levels of competition	Operators could loose their services if pricing is too high Operators could loose their businesses where especially new entrants tender very low to obtain services, or are not aware of the real cost of operating the service
Negotiating skills	Operators know their operations which gives them a distinct advantage over another external party	Authority negotiators do not always understand the intricacies of bus operations but have to conclude an agreement	There is no negotiation about conditions of service – the tenderer tenders based on tender requirements	
Network integration and coordination	Network integration and coordination is easier to achieve than through a competitive regime where it has to be designed into the tender process A proper specification of network requirements can result in potential savings (synergy)	Network requirements can increase the cost of the operation		If a large service is broken up into smaller tenders, and the tenders are not well designed, it could result in a loss of network integrity and coordination with the overall result of higher costs and lower levels of service
Labour stability	A labour force that is involved in the negotiating process insofar as labour issues are concerned results in a more stable labour force	In practice the design of the service is almost never the same as the original service and results in surplus personnel that need to be retrenched at some stage		The problems that labour have with the tendering system (mentioned elsewhere in the paper) could result in an unstable labour force impacting negtively on operators
Flexibility	More flexible than a tender system as service levels and scope is negotiated.	Requires specialist skills in public transport management and operations		Less flexible compared to a negotiated contract where the service levels are negotiated
Transformation	Known transformation goals	Operator has to be majority-	Could be seen as less	If there is insufficient

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
	and objectives	owned within 24 months of signing the contract The DoT negotiate/require higher levels of transformation and empowerment when compared to the tender system Owner will loose majority ownership over his own business within 24 months	onerous when compared to the legal requirements of negotiated contracts	attention to transformation, issues operators may not be considered for the service
Competition	Operator retains its services as there is no competitive pressure Less pressure to negotiate a competitive price as there is no threat of entry		A well-run business has a good chance to retain services in the face of competition	Competition could result in the loss of the entire service New entrants could be tendering below realistic cost levels to the detriment of existing operators that are familiar with cost structures and operating conditions

Labour views on negotiated contracts

Labour generally prefers negotiated contracts for a number of reasons. These types of contracts allow for labour's participation in the negotiation process, especially insofar as it concerns labour matters. This is contrasted with the tendering system where labour is not involved at the outset but is "roped in" after the award of the tender.

In most of the negotiated contracts labour is guaranteed that no retrenchments will take place within 12 months of signing the agreement which gives it more leeway with its members. Any retrenchments (prior to the commencement of the contract) as a result of service rationalization etc. are dealt with up front in the negotiation process. Any retrenchments, following the implementation of the contract, must be also be negotiated with labour in terms of existing labour legislation. In addition, the conditions of employment also remain the same for those workers that are transferred to the new entity. There is however one example of a negotiated contract (Durban Transport (see section 5.2) where the wages were reduced in the negotiation process prior to the commencement of the services.

More effective transformation is also achieved much sooner when compared to the tendering process.

One of the issues that labour has with the tender process is the break in the continuity of service between operators in the tendering system. In the negotiated contract process, provision is made to deal with accumulated past benefits and continuity of employment is ensured with the existing operator.

Table 5: Labour Views on the Negotiated Contract System Versus the Tendered Contract System

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
Pricing	Provision in made for labour costs at prevailing levels of remuneration Provision is also generally made for training and development in the negotiated price	Operators could misuse the situation and negotiate at higher price levels Operators are skilled negotiators which is not necessarily the case with government officials	Could be a more transparent system of determining the cost of operating a service	Operators often have to tender cost-aggressively to retain services which could impact negatively on labour negotiations post the award of the tender Once operators have tendered and won a contract they enter into negotiations with labour about conditions of employment. Operators's hands are tied due to the tender price which often leaves little flexibility in negotiations with labour Operators often tender competitively by reducing labour wages and salaries in their tenders Operators often reduce their spending on training and development to tender cost competitively
Authority negotiating skills		Authority negotiators do not always understand the intricacies of labour needs		
Labour stability	Labour is involved prior to the service being awarded and not after the award as in the tendering process Can negotiate a better deal for its members compared to the			Labour's involvement only after the award of a tender is considered as "bad faith" negotiations

	NEGOTIATED CONTRACTS		TENDERED CONTRACTS	
	Strengths	**Weaknesses**	**Strengths**	**Weaknesses**
	tender system where negotiations with labour take place post the event Can influence decisions on outsourcing thus protecting jobs A more transparent (labour) process when compared to the tender system Labour generally retains basic salaries and wages in contrast to the tender system where labour is often the "ham in the sandwich" in a highly competitive environment Continuity of employment			
Transformation	Can negotiate (within reason) transformation issues thus protecting jobs	Operator has to be majority-owned within 24 months of signing the contract. Could result in job losses for labour or a change in ownership The DoT could negotiate/require higher levels of transformation and empowerment when compared to the tender system. This could result in job losses for the operators' workforce	Less pressure on the operator when compared to negotiated contracts. This could be positive for labour as job losses could be minimised	Labour may feel that operators do not pay enough attention to transformation
Competition	Operator retains its services resulting in less stress to labour (no new employer)			

Examples of Negotiated Contracts in South Africa

As mentioned previously, a number of negotiated contracts have been concluded in South Africa. For the purpose of this paper, the processes followed by the authorities in three of the largest services to be put out to negotiated contracts are discussed below. Originally the three services were each operated by a single operator, but in the design phase of the negotiated contract these services were broken up into smaller parcels of services to allow for a number of operators to render the services.

Some of the results and methodologies followed in the three examples may contradict some of the general information in the tables, but this is because vastly different methods of negotiated contracts are to be found where parastatal and municipal services were negotiated.

It should also be noted that, in the examples discussed below, the services were previously provided by the relevant provinces (NTI and Great North) and a local authority (Durban Transport). Negotiated contracts thus represented an opportunity to privatize these companies.

These negotiated contracts were also concluded over a prolonged period of time. The first one to be concluded in the examples below was Great North followed by Durban Transport and NTI. Experience was therefore also gained in the process.

Great North Transport

Background

The company had its origins in the policy of separate development of South Africa in that it originally consisted of two separate parastatal companies serving two separate operating areas in the northern and north eastern parts of South Africa. Both were funded by the DoT subsidy scheme and had to provide affordable transport to people living in the outlying areas of the industrial areas of Pietersburg and Tzaneen. The two companies (Lebowa Transport and Gazankulu Transport) also reported to different authorities and therefore also had different operating philosophies. One such operating philosophy was related to subsidies. Lebowa Transport tried to phase out subsidies out while Gazankulu Transport negotiated aggressively for more subsidies. This eventually resulted in low levels of subsidy per bus for Lebowa Transport and higher, more sustainable levels of subsidy for Gazankulu Transport.

Following the elections in 1994 the two companies were amalgamated into a single company – Great North Transport. The owner of the new company was now the Northern Province Development Corporation, which later became the Limpopo Development Corporation. The Limpopo Development Corporation reports to the Limpopo Province's provincial Department of Economic Affairs.

The Limpopo Development Corporation commissioned a project in 1996 to restructure Great North Transport in order to get it "fit" to tender for its own business. The services were however never put out to tender.

In December 2000 however, the National Land Transport Transition Act (NLTTA) was promulgated which allowed companies (especially provincially-owned and municipal-owned companies) to apply for negotiated contracts. The Board of Directors of Great North Transport then took a decision to apply for negotiated contracts.

Permission was sought from the National Minister of Transport to enter into such an arrangement and soon afterwards he gave his approval to negotiate the contracts of Great North Transport's contracts.

A phased process was suggested where, at first, only three contracts were to be negotiated. These three operating areas were making huge losses at that time. These three operating areas were:

- Seshego
- Hoedspruit, and
- Mokopane

The remaining 10 operating areas were to be negotiated at a later stage once the first stage of the process was complete.

Process followed

The following process was followed in the run-up to the negotiated contract:

- A service design was completed by consultants contracted to the provincial authority. All loss making and low patronage routes were terminated in the design phase of the new services.
- The operational requirements for the contract were then determined. These related to the bus requirements (number of buses, seating capacity, age profile etc.), required operational kilometres, personnel and ticket machine specifications, and the required number of ancillary vehicles.
- A costing exercise was done by the consultants to determine the cost of the design and the potential subsidy requirements.
- A schedule of quantities representing the subsidy amount was completed.
- The above cost was then compared to other subsidised tendered contracts (to benchmark the costs) in more or less similar operating environments to determine whether the subsidy amount was in line with the competitive tender system.
- Following the costing and benchmarking exercise a detailed business plan was developed and presented to the provincial authority.

Empowerment issues

The company opted for a process where the majority shareholding (50% + 1%) would be transferred to previously disadvantaged individuals within a period of two years- in accordance with the requirements of the NLTTA.

Staff issues

Staff numbers were reduced in the restructuring process of the company. Salaries, wages and benefits of the staff that were offered employment in the new company were not negatively affected.

Bus fleet

Combined, the three operating centres comprised 135 buses (excluding non-operational buses), prior to the negotiated contract. After the conclusion of the negotiated contract, the number of buses in operation was increased to 210. The business plan suggested an entire new fleet of buses for all three operating areas. All buses were to be maintained under a full maintenance contract agreement with the bus supplier.

Prior to the negotiated contract, buses were often significantly overloaded. After the negotiated contract the bus loads were more evenly spread and overloading dealt with. On average (across the three operating areas) the passenger base increased by 8% during the first year of operation.

Subsidy

Following the negotiated contract, the subsidy burden was divided between the Department of Transport and the Provincial Department. The provincial Department carried the larger burden (+ 80%) and the National Department of Transport approximately 20% of the subsidy requirement for the service. One of the reasons for this decision was that the NLTTA does not allow for a large deviation (in this case it was a significant increase) in subsidy support in the negotiated contract process. As mentioned earlier on, the services were operating at significant losses, the fleet was in a dilapidated condition and also had very low levels of subsidy per bus compared to similar services elsewhere in the country.

On average the passenger revenue per bus increased by about 10% across the three operating areas in the first year of operation.

Current status

These three contracts are still operated under the negotiated contract. The remainder of the services are still operated under interim contracts concluded in 1997. Progress with the negotiation of the remaining services has been delayed due to funding and other issues within the province.

The transfer of ownership to historically disadvantaged individuals has not yet taken place (6 years after the contract was negotiated) due to reasons such as:

- It was felt that all operating areas had to be negotiated so that potential investors could bid for the entire service or sections of the service.
- A process began in 2005 where a transaction advisor was appointed to negotiate the 10 remaining operating areas, and to transfer the shareholding, as required by the NLTTA, to previously disadvantaged operators.
- The process is however being delayed for various reasons such as indecision by the authority to execute the new negotiated contract and a reluctance of the labour unions to accept some of the recommendations of the transaction adviser.

It is however believed that the entire process will be finalised during the 2007/2008 financial year.

Durban Transport

Background

Durban Transport operated a municipal bus service for many years in the greater Durban area. There were two distinct services, one for white commuters (the Blue Line Services) and another for black commuters (the Green Line Services).

As a result of the service characteristics and the subsidy policy of the DoT, the DoT subsidised the Green Line services whilst the Blue Line services was subsidised by the municipality. In the case of the Blue Line services funded by the municipality, a deficit subsidy mechanism was used and, in the case of the Green Line services, a ticket subsidy system was used – the latter being the subsidy mechanism used by the DoT throughout the country. These arrangements obviously complicated the management of the services tremendously, as management had to report to both the DoT as well as the municipality, and had to negotiate with both institutions for its annual subsidy increases.

As was the case with many other bus companies, subsidies were escalating at an alarming rate due to severe competition from the taxi industry. Over the years many studies were commissioned with the intention of streamlining the company and to arrive at answers as to how the municipality could get divest itself of the company. One such solution that was never implemented was to establish the bus company as a corporate entity, operated at an arms length from the municipality and managed on private sector management principles.

In 1999, the Provincial Department of Transport began a service design process for Durban Transport which was completed in 2001. During the same year the Durban Municipality appointed a transaction advisor to negotiate a contract with the contracting authority with a view to eventually privatising the bus service.

The 2001 service design was used as a basis for the negotiations in 2003.

Process followed

The following process was followed:

- The service design that was completed in 2001 was initially used to cost the service. The design made provision for the original service (Blue and Green Lines combined) to be broken up in 10 smaller service areas that could be contracted to a number of successful bidders.
- An options analysis was conducted and the ten smaller contracts were eventually combined into three larger services, as it was believed that it would be more economical for government in terms of subsidies.
- Hereafter a costing exercise was performed which was eventually approved by the authorities.
- A Request For Proposal (RFP) was put out to the market where prospective bidders had to tender for the following:
- The services as specified in the bidding documents
- A separate schedule was included where bidders had to tender for the assets, which were mainly the buses operated by the municipality

- The RFP document furthermore stipulated that 30% of the services had to be subcontracted to a company which was to be formed by the employees of Durban Transport and a 10% subcontracting component for the taxi industry.
- Approximately 50 entities tendered for the services.
- A shortlist was complied consisting of three preferred bidders.
- A thorough interview process followed whereby the preferred bidding companies' proposed pricing was negotiated downwards, each tenderer was evaluated critically in terms of their bus operating experience as well as their BEE proposals, and their financial capacity analysed in detail.
- At the end of the process a consortium consisting of a number of previously disadvantaged operators and individuals was appointed to operate the three services.

Empowerment issues

The empowerment of previously disadvantaged individuals was addressed in two ways; the first was that 30% of the services were to be subcontracted to employees of the municipal bus service and 10% to the taxi industry.

The second was the appointment of a consortium of previously disadvantaged individuals (operators) from the first day of operation. This differed from the NLTTA requirements which allowed for a two year period before the shareholding needed to be transferred to majority shareholders consisting of previously disadvantaged individuals.

Staff issues

All employees were retrenched through a clean-break process. In this process all accumulated benefits were calculated and paid out to the respective employees prior to the commencement of the new service. Retrenchment costs were also paid out to the employees not offered jobs in the new companies.

The new operator appointed most of the employees again but at a much lower wage rate. This however contradicted the general intention of negotiated contacts to transfer staff from one operator to another with a retention of at least basic wages and salaries. It does however point to a flexibility in the approach in dealing with labour matters in negotiated contracts.

Bus fleet

The operator opted for a fleet consisting of a mix of the existing fleet of Durban Transport as well as new buses. Some of the buses that were not contract-compliant had to be refurbished.

The bus fleet was significantly reduced through service design. Prior to the negotiated contract the fleet consisted of 660 buses and after the negotiations the fleet was reduced to 537 buses. The operator however, decided to continue operating the remainder of the fleet without a subsidy, mainly because of pressure from the community to render services that were terminated in the design phase of the contract.

The passenger base increased by about 8% after the negotiated contract was concluded (inclusive of the non-subsidised operations).

Subsidies

The subsidy burden is divided between two authorities. The Department of Transport, through the Provincial Department of Transport, pays a lump sum of R100 million per annum plus an annual escalation, while the remainder is paid by the Ethekwini Transport Authority (Durban City Council).

The subsidy required to operate the buses (537 buses) increased by 4% compared to the subsidy requirements prior to the negotiated contract. As fewer buses are now subsidised, the absolute subsidy per bus has increased by about 27%. The fleet is now used more intensely and has been partially strengthened with 100 new buses. A major portion of the remainder of the buses was refurbished to meet contract requirements.

Passenger revenue per bus increased by 12% in the year following the negotiated contract.

Ownership

The management of the contract resides with the Ethekwini Transport Authority although the Provincial Department of Transport renders assistance on a continuous basis.

Current status

The negotiated contract commenced in October 2003. At the outset it was found that the design that was approved in 2001 was outdated and did not cater for all the services rendered by Durban Transport. This caused the community to complain about the lack of services. The services were then redesigned which subsequently included additional services.

In early 2004, the Provincial Department clamped down on small operators that were transporting scholars in light delivery vehicles (one ton trucks). This gave rise to an increase in scholars utilising the bus services, necessitating an increase in services and subsidies.

Over the last few years, sustained economic growth, and therefore employment, also gave rise to an additional demand for services operating in the peak periods.

In 2006, approximately 60 buses were destroyed in a fire at a depot that put more strain on the operator, and led to significant overloading of buses, as it was not possible to replace that many vehicles in a short space of time.

The services intended for subcontracting to a company formed by the employees of the former Durban Transport (30% of the services to be subcontracted) has not yet materialised. A single board structure was created and the employees had a number of seats on the Board. This structure was riddled with difficulties and problems arose from the beginning due to issues such as the capacity of employee directors to fulfil their duties as directors and a lack of an understanding of the basic principles of management, finance etc. A new Board was recently appointed in an attempt to overcome the problems of the first Board.

North West Star

Background

Northwest Star (Pty) Ltd, as an operating company of North West Transport Investments (Pty) Ltd (NTI), operate commuter bus services in the north western part of the country.

These services are mainly rural in nature and transport people from outlying areas to the industrial areas of Mafekeng, Rustenburg and Pretoria.

Due to financial difficulties North West Transport Investments (Pty) Ltd (NTI) and Northwest Star (Pty) Ltd (NWS) (an operating company of NTI) was placed under judicial management in August 1999. The North West Provincial Government, in consultation with its judicial managers, decided to sell three operating entities of North West Star through a competitive tender process. NWS subsequently negotiated a subsidy level for each of the three services with the DoT. Following agreement on the subsidy levels the businesses were put out to a competitive tender process (with full disclosure of the subsidy levels to be expected, the assets, as well as the labour costs of the respective companies). Bidders had to tender a price for the businesses as going concerns.

Process followed

The following process was followed to conclude these negotiated contracts:

- A service design was undertaken where the services were optimised in the three operating areas. One of the operating areas was further broken up into four operating areas, but formed part of the same service.
- An options analysis was carried out by the transaction advisor to determine the most viable option. Part of this was a benchmarking process which determined a cost for the service designs.
- An Expression of Interest (EOI) was advertised for operators that were interested in bidding for these services. The three most important criteria in this expression of interest was:
- Previously Disadvantaged Individual (PDI) status and proposals in this regard
- Proof of financial capacity
- Experience in operating commuter bus services
- At the same time, a business plan for the negotiated contract was submitted by NWS to the Department of Transport which was approved soon thereafter.
- Following the EOI, a shortlist of prospective bidders was compiled and they were the only entities allowed to eventually tender for the businesses.
- The bidding process had the following conditions and characteristics:
  - Bidders had to bid a lump sum for an entity as a going concern.
  - Bus depots had to be rented from the Provincial Government.
  - Communication infrastructure had to be rented from the Provincial Government.
  - The services, as specified in the negotiated contracts, had to be rendered in terms of the conditions of the contract.
  - The successful bidder was required (at its own cost) to give notice of the sale to the competition authorities of South Africa, or alternatively, to furnish a written legal opinion to the effect that such a notification is not required under the South African competition legislation.
  - Contracts entered into with suppliers and customers of the company had to be honoured.
  - The sale of the entities, as going concerns, was zero rated for the purposes of Value Added Tax.
  - The seller did not accept responsibility for the correctness of the information contained in the contract documents (this relates especially to passenger volumes, kilometres to be travelled, projected fare box income etc.)
  - An employee share trust scheme of 15% had to be implemented.

  - The operator was obliged to subcontract at least 10% of its services to smaller operators.
  - Employees were to be transferred to the new companies with the retention of their wages and benefits at levels that were similar to that of NWS. This was to be maintained for a period of one year.
  - Provisions of existing contractual labour relations could only be altered by agreement between the employees/unions representing the employees.
  - The NTI provident fund was compulsory for the new companies.
- A data room was opened where prospective bidders could view historical information and management reports in order to compile their bids.
- The bidders were requested to submit two bids, a technical bid and a financial bid. The technical bid had to address all operational aspects while the financial bid concentrated on the financial issues and the calculation of the bid price.
- After closing of the bids, each bid was thoroughly evaluated.
- In all three cases the bid was awarded to the highest bidder.

Empowerment issues

The empowerment of previously disadvantaged individuals was twofold. The first was the compulsory participation of employees through an employee trust. The second was the appointment of PDI bus operators on all the contracts from the first day of operation.

Staff issues

No employees were retrenched and it was compulsory to employ all existing staff at their current wage and benefit levels, with the exception of managerial staff.

Bus Fleet

All operators opted for a mixed fleet of used and new buses. Bus refurbishment and replacement programmes were evaluated as part of the bidding process.

Following the sale of the businesses, the fleet was reduced through redesign of the services, from 505 to 475 buses.

Subsidies

The majority of subsidies are paid by the Department of Transport through the Northwest Provincial Department of Transport. The Northwest Provincial Department of Transport also however makes contributes to the subsidy.

Subsidy information was not available for two of the businesses but for one of the businesses the subsidy increased by 19% after the award of the negotiated contract. Passenger revenue in this business also increased by 11,5% in the first year of the contact and passenger volumes by 16,4%.

Ownership

The management of the contract resides with the Northwest Provincial Department of Transport.

Current Status

After the commencement of the services, it was found that the designs contained in the bidding documents were outdated and in some cases impractical.

The service designs have since been amended and operations are at present running smoothly.

CONCLUSIONS

This paper has dealt, in some detail, with the differences between tendered and negotiated contracts in South Africa. It is evident that the country is going through a learning phase with negotiated contracts, as each new contract appears to be more complex and the arrangements associated with such contracts, more elaborate.

What is evident from the three services mentioned in section five is that the empowerment initiatives, originally agreed to between the operators and the authorities, have not yet been implemented in full in at least two of the three services. This is a source of concern as it is one of the main objectives of negotiated contracts to effect a faster and more comprehensive transformation of at least the ownership of such companies. Some of the reasons that could probably be advanced for this situation are the lack of capacity of some of the new entrants to operate at senior and executive management levels, as well as internal politics between the shareholders of such companies.

When comparing the magnitude of the subsidy increase (in percentage) of the three services (from interim contracts to negotiated contracts) it initially appears to be quite significant. It however needs to be pointed out that, in all three circumstances, the cost and subsidy base of the companies was last determined in 1997 with the conclusion of interim contracts with these operators and has not been amended since. Annual increases were regulated through the escalation clause in the interim contracts. As pointed out as well, some of the companies were in financial difficulty due to a lack of sustainable income streams (passengers and subsidies). The subsidy increases experienced in the negotiated contacts thus far also appear to be in line with the findings of a study in 2001 (Walters and Cloete, 2001) where it was found that, in the tendered contract system, the average increase in the subsidy value, when analysing 18 operating areas/contracts, was 25%. The exception to this conclusion is Great North Transport where the percentage of subsidy increase was significantly higher when compared to the other two services for the reasons mentioned in this paper. However, when comparing the present subsidy levels for GNT to operators operating on the tendered contract system, the subsidy per bus appear to be in line with operators in comparable service areas.

In the three services discussed in this paper it is also apparent that passenger numbers increased by between 8% and 11.5% in the first year following the introduction of the services. In the tendered contract process the average increase was 4,2% (Walters and Cloete, 2001)

The transfer of the labour force from the incumbent operator to the negotiated contract operator happened at the same levels of remuneration (excepting for Durban Transport where the “clean break”). This could result in higher than necessary input costs to operate the services when compared to the tendered contract system. However, the issues that labour has with the tendered contract regime are avoided as labour forms part of the negotiating process (with regard to labour issues). With constrained budgets, higher than market related labour costs may however eventually result in a down-sizing of the services to the detriment of the labour force.

In many instances it was found that the network design specifications were no longer applicable (due to the time difference between the design of the services and the actual commencement of the services), as well as the elimination of some services to suit budgets. When the new operator began operating, these shortcomings often led to instability and protests from the travelling public. In many instances operators then reinstated these services at their own costs to appease the public.

All of the negotiated contracts mentioned above are, in essence, based on historic bus network services. There is a lack of intermodal integration, intermodal ticketing, seamless service offerings etc. This matter is only now being addressed with the development of Integrated Transport Plans and hopefully the negotiated contracts of the future will take cognisance of the imperatives of intermodal service offerings.

With the limited experience that the country presently has regarding negotiated contracts, it is evident that the "ideal" model still has to be found. Every contract is however a learning experience and no doubt will contribute to the body of knowledge regarding this form of contracting.

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LIST OF ACRONYMS

DoT: Department of Transport
EOI: Expression Of Interest
GNT: Great North Transport
HOA: Heads of Agreement
IC/ICs: Interim Contract/s
MTD: Model Tender Document
NC/NCs: Negotiated Contract/s
NLTTA: National Land Transport Transition Act, Act 22 of 2000
NTI: Northwest Transport Investments Ltd
NWS: North West Star bus company
PDI/PDIs: Previously Disadvantaged Individual/s
RFP: Request For Proposal
SABOA: Southern African Bus Operators Association
TC/TCs: Tendered Contracts