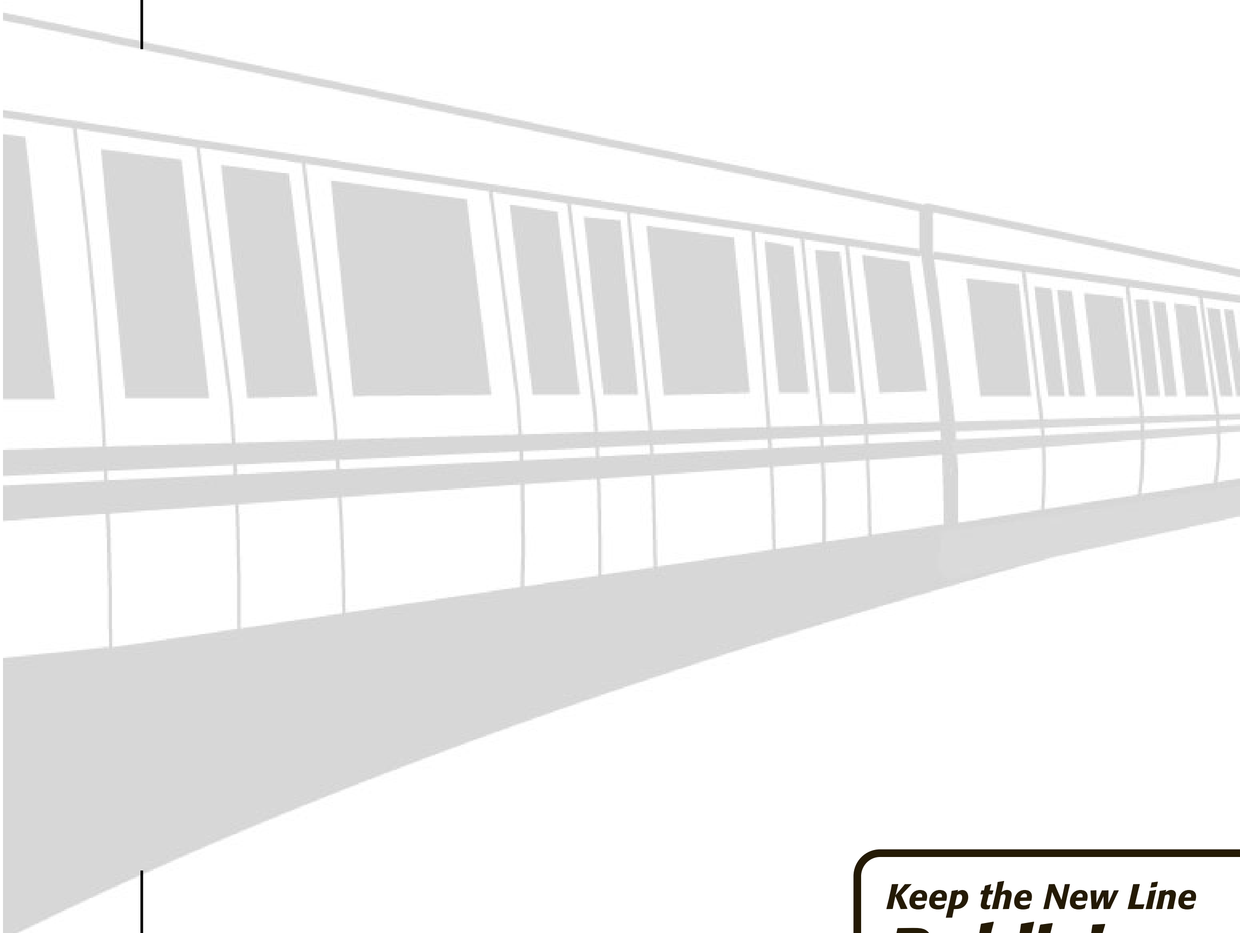
Public derailment?

Why publicly operated rapid transit is better for the Lower Mainland



Keep the New Line Public!

CUPE runs it better.

CUPE On the front line

A Report from Local 7000 (SkyTrain operators)
Canadian Union of Public Employees

May 2003

Introduction –
Don't take the 'public' out of public transit

The proposal for a rapid transit line to link Richmond, the airport and Vancouver, the RAV line, has at least one major flaw. Its proponents want a private company to design, build, operate and maintain the new line through a public private partnership (P3).

We oppose handing the operation and maintenance of a new line to the private sector, regardless of what technology is chosen. CUPE Local 7000 members have worked effectively for more than 17 years to make SkyTrain a world-class, public rapid transit service.

In our view, there is no sound reason to go private with the new line. In this report, we argue against such a proposal because it will effectively take the 'public' out of the Lower Mainland's public rapid transit system.

Who we are

We are part of an effective public sector team that has delivered quality service 24 hours a day, 365 days a year since Expo '86.

About 600 CUPE members provide maintenance of rails, components and associated guideway machinery, scheduled and unscheduled train maintenance, bodywork and cleaning. Our members are responsible for all electrical and electronic systems. We maintain and repair elevators and escalators. Our technical staff develops and tests new systems. Every expansion to the system, including the original system, has been tested and commissioned by our members.

SkyTrain attendants monitor crowd control in stations. We are trained to deal with all emergencies. All SkyTrain attendants can drive the trains manually if required and respond to minor train problems that they assess and repair as necessary.

In-house staff develops equipment training and sets standards that far exceed manufacturer's recommendations. Re-certification requirements mandated by the Railway Act of British Columbia are developed and taught by our members. We handle financial, clerical, purchasing and other administrative services.

We have an inventory of more than a million parts to deal with all components within the system. We monitor cameras and respond to all public safety issues and concerns that occur on the line. We operate the trains from the control centre and co-coordinate with emergency services.

Why we are here

Not surprisingly, our members strongly support rapid transit in the Lower Mainland. We view it as essential to making our cities livable. Whether it be fast bus service, light rail or SkyTrain, people must be able to move around quickly and cost effectively. We must reduce the traffic gridlock that pollutes our environment and frustrates drivers every day. We can use rapid transit to shape the growth of our communities in a planned and orderly fashion that is good for our families and our local economy.

We believe that a fully automated, grade-separated system (like SkyTrain) is the most effective transit system. It offers fast, regular service that cannot be held up in traffic. While we endorse this model, we recognize that it is possible that another transit mechanism could be chosen.

We are concerned about the priority being placed on the proposed RAV line. We think a higher priority should be given to completing rapid transit in the northeast. This would both increase ridership on already existing lines and better fit with the "Liveable Region Strategy" of the Greater Vancouver Regional District.

The GVRD's chief administrative officer has also raised such concerns. "In Greater Vancouver's case, a rail line to the airport may or may not be the right thing to do," he has said. "The notion that this project is the one the senior government wants is the wrong reason for making a decision."[1]

1 Krangle, Karenn, Ottawa's whims override local needs: city officials, Vancouver Sun, March 5, 2003, page b3.

The RAV proposal

As part of the RAV proposal, planners want to involve a private partner. This partner would contribute funding to the project over and above that contributed by the funding partners – the Greater Vancouver Transit Authority, the provincial and federal governments and the airport. This would amount to between $200 and $400 million.

As the consulting firm PricewaterhouseCoopers (PWC) stated:

"Private sector involvement will include a long-term operating contract of up to 35 years under which the private sector partner would be responsible for designing and building the system and for maintaining it and ensuring that it performed to standard. The private sector partner would be responsible for raising funding that was needed over and above the Agencies' contributions. In return it would receive payments from TransLink and the other agencies."[2]

The arguments for a public private partnership

We are concerned about the imbalance in discussions as to whether we should hand over the operation and maintenance of part of our rapid transit system to private operators. Why? Frankly, consultants' arguments have read more like marketing propaganda than analysis. But perhaps this is not surprising.

For example, Russell Goodman, managing partner in the Montreal office of PWC, sits on the board of the Canadian Council for Public Private Partnerships. The CCPPP is Canada's principle lobbyist for P3 business arrangements. In Britain, PWC acts as consultant in the delivery of nearly £20 billion worth of P3 services.[3]

2 PriceWaterhouseCoopers, RAVP Project Definition: Report on Financial Feasibility: Executive Summary, February 2003, page 3.
3 Gosling, Paul, Stitched Up: How the Big Four Accounting firms have PFI (Private Finance Initiatives) Under Their Thumbs, Unison, January 2003, page 5.

Tony Poulter, "the global head of PricewaterhouseCoopers,"[4] worked on the financial end of the RAV project plan. He is also a financial adviser on the partial privatization of the London underground. Before a parliamentary committee last year, Mr. Poulter was asked if his firm acted as an auditor for four separate firms involved in the partial privatization. His response: "I can certainly confirm three of the four, the second I am not sure about."[5] One wonders if these large, multinational firms, including Bechtel, will be bidders on this project?

Ernst and Young provided advice to the British government on the value for money assessment of privatizing the London Underground. The company also was the auditor for two of the firms in the consortia, Bombardier and Jarvis. At that time, London Mayor Ken Livingston was so concerned that he issued a release saying, "This appears to be a clear conflict of interest and on these grounds alone this report should be disregarded."[6]

We would have more confidence in advice on privatization that did not come from a firm so integrally involved in the delivery of privatization projects and with the private companies that do the work.

We also take issue with many of the specific propositions put forward by PWC and other consultants to the RAV line project.

Efficiencies

PWC makes sweeping promises for the results of private operation and management. They say:

"International experience suggests that involving the private sector, giving it scope to decide the best way of optimizing costs over the life of the project and a financial stake in how the project performs, can lead to very significant savings on the public sector cost estimates; sometimes in excess of 20%. In our view the scope for savings is significant but probably less than 20% on the RAV Project because the project team has already worked to optimize capital costs, and because the need to design the project to operate as part of the integrated transit network may limit the potential for efficiency gains."[7]

4 Bula, Frances, Who will use Richmond transit? Vancouver asks, Vancouver Sun, March 6, 2003.
5 The United Kingdom Parliament, Select Committee on Transport, Local Government and the Regions Minutes of Evidence, February 27, 2002.
6 Press release, Conflict of interest means PPP report must be disregarded – Mayor Livingston, 5-2-02. (http://www.london.gov.uk).
7 PriceWaterhouseCoopers, RAVP Project Definition: Report on Financial Feasibility: Executive Summary, February 2003, page 4.

The comments suggest savings of as much as 20 per cent, but they provide no evidence for such a figure. Nor do they suggest, except in the most general of terms, where these savings might be made. “Innovation” and “efficiency” are treated as a monopoly held by large private corporations.

The PWC reports also fail to stress that the largest potential savings are at the design and building stage of the project. These sorts of savings can be achieved without handing operation and maintenance of the line over to private companies.

Capital costs

Most of the capital to build the RAV line will come from senior levels of government. The project is predicated on a contribution of $300 million from the provincial government, $300 million from the airport authority and $450 million from the federal government.

The Vancouver Transit Authority anticipates making a contribution of $300 million. This money can be borrowed very cost effectively through the Municipal Finance Authority. The MFA is forecasting the cost of 25-year borrowing at 6.2 per cent (for budgeting purposes only). [8]

This leaves the private sector operator to make a contribution of between $200 and $400 million. This money will be much more expensive than money obtained through the public sector borrowing. Private companies provide funding for projects such as these through a mixture of investment of their own funds and borrowing. Private sector borrowing costs are significantly higher than public sector borrowing because there is a greater risk to lenders – private companies lack access to taxation.

The cost of money invested by a private operator is even higher. In England, companies involved in the London tube privatization are expecting returns equivalent to what we pay on our credit cards. According to news reports, “Companies that have taken over part of the London Underground admitted yesterday they expect to make a 19% return on equity, far more than the average for running public services.”[9]

8 http://www.mfa.bc.ca/marketrates.htm. Macalister, Terry, Tube investors to make 19%, The
9 Guardian, January 9, 2003.

What are the overall implications in terms of cost? This was a question addressed by the Underhill report to Vancouver City Council. The report found:

"The private sector is at a significant disadvantage in borrowing money. A combination of private equity/private debt financing could require an effective combined interest/return rate of 10-11%, whereas TransLink can finance public debt at about 6%"[10]

Over the life of the contract, the difference between $200 million borrowed at 6.2 per cent and private sector money at, say, 10.2 per cent, would be roughly $7 million a year. At the higher level of investment - $400 million – the difference doubles.

We made this argument to TransLink management. Their only response was that it really wasn't important because the private sector wasn't putting up much of the money anyway (14-24%). This does not seem like much of an argument for handing the operation and maintenance over to a private operator.

Of course we, like all people in the Lower Mainland, want more rapid transit. But we don't want to pay for it on our credit card. We particularly do not wish to pay for a private sector premium on our credit cards.

Operating and maintenance costs

This is not the first time that TransLink has looked at handing the operation and maintenance of SkyTrain over to a private sector operator. We have been through a lengthy process in recent years that examined just this subject. In the end, the process went nowhere. Again, as the Underhill report notes:

"A final reason to consider a PPP would be to capture any advantages there might be in having a private operator….TransLink previously explored the idea of private operations for SkyTrain and found at the time that costs of private operations would exceed TransLink's own costs."[11]

The Underhill report suggested that the PWC report would address this issue. If it did so it was in the section of the report that was not made public.

10 Porter, Mary Jo, Audrey Moreland and Jeanne Krikawa, Report to Vancouver City Council on the Richmond/Airport/Vancouver Rapid Transit Project Independent Review: Phase 1, The Underhill Company LLC, February 2003, page 50.

11 Ibid, page 51.

Risk transfer

Risk transfer is the magic bullet always cited by P3 proponents. If handing over management of a public service doesn't make sense, risk transfer is always dredged up.

PWC, in its expurgated report, says:

"DBFO [design, build, finance, operate] structures are becoming common in large public infrastructure projects, including urban transport. The objective is to transfer significant risk to the private sector and create effective incentives for performance by allowing the private sector to bring to the project its innovation and efficiency."[12]

The Underhill report was less convinced about the value of risk transfer in the RAV proposal. It asks:

"What risk will be transferred to the private sector to justify the substantially higher cost of private debt/capital (possibly about 4% higher) and of GST (7% for the private sector versus 3% for the public sector)?"[13]

It continues:

"Ultimately, the risk of the RAV project will fall on TransLink. If the project is design/build, or a full PPP – design/build/finance/operate – the private sector will assume some risk in building it and possibly operating it. However, the PPP as it is now structured does not appear to transfer substantial risk to the private sector.

"As currently structured, TransLink's risk would include:

- *cost overruns due to changes in design parameters*
- *a share of the risk related to ground conditions for the tunnel*
- *a share of the risk related to relocating utilities*
- *ridership (i.e. if ridership projections are optimistic and fares do not meet projections, TransLink will make up the shortfall)."*[14]

12 PricewaterhouseCoopers, RAVP Project Definition: Report on Financial Feasibility: Executive Summary, February, 2003, page 3
13 Op Cit Porter, page 10.
14 Ibid, page 43.

Finally, the Underhill report concludes:

"It's not clear what risk the private partner would be assuming, other than the risks commonly associated with Design/Build projects that are not PPPs."[15]

The other consultant working for TransLink on this project, Macquarie North American Ltd., also noted the weaknesses in the proposed model for risk transfer. They said:

"MNAL believe that significant improvement to the base case financial structure are achievable in terms of greater risk transfer and enhanced financial structure. The PWC model does not represent the optimal PPP model we consider will be achievable following further planned work."[16]

In our view, all of the advantages of risk transfer in this project could be obtained by going the route of a design/build project rather than the riskier and more expensive design/build/finance/operate/maintain route.

Experience in other jurisdictions

Comparisons chosen by consultants who work on projects such as these invariably offer a range of examples of successful private sector operations. Somehow, despite a century of public management, they are unable to find any examples of successful public operation. The consultant reports on this project follow the same pattern.

Some of the private success stories they cite are open to question. For example, not everyone sees the sale of Highway 407 in Toronto as a success. The Toronto Star printed the following in an editorial last year:

"It's not just motorists who got stiffed by the sale of Highway 407 to a private consortium. Provincial taxpayers did, too.

"An investment bank has pegged the value of the highway at $6.3 billion, more than double what the Tories, the self-described smart managers, sold it for in 1998.

15 Ibid, page 51.
16 Macquarie North American Ltd., Correspondence from Nicholas Hann, Managing Director and Duncan Bell, Vice President to Jane Bird, Project Director RAV Rapid Transit Project, February 13, 2003, page 2.

"Since the purchase, the company has made improvements to the highway that would boost its value. But double in just three years?

"Premier Mike Harris says the government struck a good deal when it sold the highway. Not surprisingly, his transportation minister claims the people who use the road are getting a fair shake.

"The decision to sell Highway 407 was flawed from the start. This key piece of public infrastructure should never have been sold off."[17]

The Macquarie report, at least, mentioned some examples that had failed. It said:

"Some recent examples of rail project defaults and government step-in or buyout decisions are:

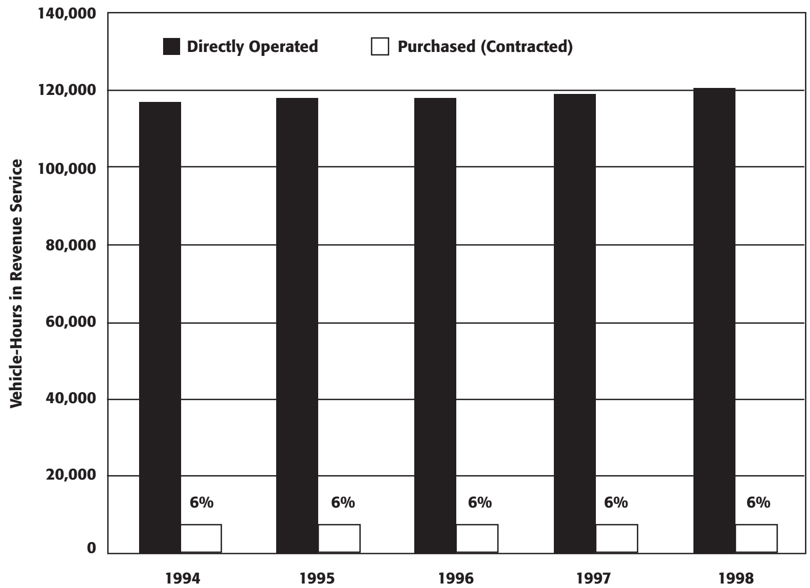
- *The Sydney Airport Rail Link;*
- *The Kuala Lampur Light Rail System;*
- *The Channel tunnel Rail Link in the United Kingdom."*[18]

Another noteworthy area of failure has been the privatization of rail service in the United Kingdom. In terms of rail service the U.K. is now known mainly for a series of fatal accidents.

The Macquarie report notes in its appendix 3, "There has been limited experience with transit PPPs in the United States."[19] In fact, this is not true. A recent study by the American Transportation Research Board examined transit practices in a survey of 500 transit providers. It discovered that contracted services had continued at a fairly low rate over the years.

17 Good deal for whom?, The Toronto Star, Friday, January 11, 2002, Editorial, A22.
18 Macquarie Draft RAV Report Part 1, undated, page 20.
19 Macquarie Appendix 3, page 7.

Recent Trends in Vehicle Hours Directly Operated and Purchased for Fixed Route Bus Services [20]



While this deals with fixed route bus services and not rapid transit, there are some common factors. General managers, asked why they did not contract, "cited a desire to maintain control over their operations, low anticipated cost savings, and little reason for changing current practice." [21]

Perhaps even more important was the experience of general managers who had ceased contracting out. About a third of the agencies that do not contract reported they had done so in the past. "The 30 respondents cited the desire for local control, improved service quality, contractor issues, and in-house cost savings as important reasons for no longer contracting. Although these respondents constitute a small group, the negative effects they cited as similar to some of the problems identified by agencies that currently contract."[22]

20 Committee for a Study of Contracting Out Transit Services, Transportation Research Board Special Report 258 Contracting for Bus and Demand Responsive Transit Services: A Survey of US Practical Experience, National Academy Press, Washington, D.C., 2001, page 19.
21 Ibid, page 7.
22 Ibid, page 117.

Perhaps the most prominent – controversial – rapid transit P3 is now underway in England with the partial privatization of the London Underground. It is now going forward despite opposition from the mayor of London and even concerns from the British House of Commons Select Committee on Transport, Local Government and the Regions.

In a report last year the committee said: "The shifting sands of the rationale for, and the assessment of, the PPP have lead to a process that has lost all credibility in the eyes of the public and professionals in the field."[23]

Service quality and length of contract

The issue of service quality is directly tied to the proposed length of contract in the RAV project. A 35-year contract leaves plenty of room for failure.

As British Columbia's assistant deputy minister of finance, Al Sakalauskas, told a conference last year, "If you think the fast ferry file was a disaster, just try entering a 25-year service contract on a highway or hospital and getting it wrong."[24]

Perhaps that is why service contracts of this length are virtually unknown in transportation contracting in the United States. As the following table shows, less than 3 per cent of contracts for fixed route busses are for more than five years.[25]

TABLE C-20
Total Years Initial Terms of Award Will Be in Effect

Years	Bus	Percent	DR	Percent	Other	Total Contracts	Percent
1	13	14.6%	36	22.5%	2	51	19.9%
2	6	6.7%	21	13.1%	1	28	10.9%
3	52	58.4%	63	39.4%	1	116	45.3%
4	3	3.4%	8	5.0%	0	11	4.3%
5	13	14.6%	30	18.8%	3	46	18.0%
Over 5	2	2.2%	2	1.3%	0	4	1.6%
Total Responding	89	100.0%	160	100.0%	9	256	100.0%

23 Seventh Report of the Transport, Local Government and the Regions Committee, March 6, 2002.
24 Notes taken at the Pacific Business and Law Institute P3 Conference, April 12, 2002.
25 Op cit, Committee for a study of contracting out…Chart C-20.

The Underhill report raises another issue about the 35-year contract.

"The 30-35 year timeframe, however, could work against TransLink's long term interests. As the end of the term approaches, the private concessionaire would have little incentive to perform major refurbishments or replace equipment. TransLink could find itself, when it takes control of the RAV line in 35 years, immediately faced with major capital costs to refurbish and upgrade the system to then modern standards."[26]

Service quality is raised repeatedly as an issue in the U.S. by both general managers who do and who do not contract out. Not surprisingly, general managers who formerly contracted out also raise it as an issue. We question whether TransLink can craft a sufficiently ironclad contract to guarantee service in the Lower Mainland if general managers of transit systems in the U.S. have not been able to do so. We risk finding ourselves in an inflexible, 35-year contract that does not meet our needs. This is a risk that cannot be transferred.

The public sector comparator

We have been assured that as part of the RAV project a public sector comparator (PSC) will be developed to permit a comparison with private sector proposals. TransLink officials have also assured us that should the PSC be superior to private proposals the project will be undertaken in the public sector.

We wish this had been stated more clearly and publicly. That said, however, we have concerns about the development of the PSC. We have been informed that PWC will develop the public model. We would be more confident if a company that had shown more commitment to the public sector was doing the work.

26 Op Cit, Porter, page 49.

Even more important, however, is a proposal found in the Macquarie report. Astoundingly, they say that:

"In Macquarie's view, there are significant advantages of making any public sector benchmark available to bidders as part of the process, particularly if government is likely to revert to a public sector delivery approach if the private sector does not meet its hurdle. Sharing the PSC with bidders:

- *Provides a transparent and objective benchmark against which bidders are assessed;*
- *Allows interested parties to analyze the methodology used in developing the benchmark and to foster confidence in the process. If there is a loss of confidence then unsuccessful bidders may not tender for future projects;*
- *Allows bidders to undertake an analysis of their bids against the benchmark and to evaluate areas where they may be able to improve."*[27]

In other words, the public sector proposal will be given to private sector bidders so they can adjust their own proposals. What kind of fair comparison is this? Further, we have not been assured that the PSC will be made public as it is developed. Does this mean that only bidders, and not the public, will be able to see it?

Why we are doing this

As we have tried to show in this report, there is no compelling reason why the operation and management of a third of our rapid transit system should be handed to a private operator. We believe there are serious flaws, particularly in trying to integrate two management systems in the same process. We see little indication of savings and less of risk transfer. Why then is this happening?

27 Op cit, Macquarie Draft, Part One, page 57.

We are concerned that it is happening because of provincial government pressure. We note the following comment in the Underhill report:

"It is our understanding from other staff that one of the Province's requirements for agreeing to contribute to the project is that it be a Public-Private-Partnership, with a private concessionaire responsible for design, construction, financing and operations." [28]

If this is so, we worry that what we are seeing is not a transportation process but a political process.

This political process risks tying us to a 35-year contract that is almost unprecedented in North America. It risks a partially privatized system that is more expensive to operate, yet which has contractual guarantees of profits even if ridership does not materialize.

It will create problems of system integration. It will drain resources from other areas of the system where they could be more valuably used, such as the completion of rapid transit in the northeast.

Conclusion – Together we can do the job

The partial privatization of our transit system is a high-risk venture for the people of the Lower Mainland. It cannot be justified.

Building rapid transit lines is not a new process for TransLink. And we operate them so successfully that we have retained the work despite competitive bids from the private sector.

We are a winning public sector team that has served the people of the Lower Mainland well. We urge that it not be derailed.

28 Op cit, Porter, page 41.