north east combined authority

Leadership Board

Thursday 24th March 2016 at 2.30 pm

Meeting to be held in a Committee Room, Durham County Hall, Durham, DH1 5UQ

www.northeastca.gov.uk

SUPPLEMENTAL AGENDA

Contact Officer: Victoria Miller Tel: 0191 211 5118 E-mail: victoria.miller@northeastca.gov.uk

To All Members

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North East Combined Authority

Leadership Board

DATE: **24 March 2016**

SUBJECT: **Membership of the North East Leadership Board - Appointment of the LEP Representative**

REPORT OF: **Monitoring Officer**

EXECUTIVE SUMMARY

The purpose of this report is to invite the Leadership Board to appoint Mr Andrew Hodgson, the Char of the North East Local Enterprise Partnership (LEP) and the LEP-nominated representative on the Leadership Board, as a non-voting member of the Leadership Board for the remainder of the municipal year 2015/16.

This appointment would fill the vacancy in the membership of the Leadership Board that had resulted from the recent resignation of Mr Paul Woolston from the LEP.

RECOMMENDATIONS

It is recommended that Mr Andrew Hodgson be appointed as the non-voting Member of the Leadership Board for the remainder of the municipal year 2015/16, representing the North East Local Enterprise Partnership.

1 Background Information

1.1 In accordance with the Order that established the North East Combined Authority (Combined Authority) and the Constitution of the Combined Authority, the Leadership Board is required to appoint a Local Enterprise Partnership (LEP) member, nominated by the LEP, as a member of the Combined Authority.

1.2 Mr Paul Woolston, the previous LEP member of the Combined Authority has recently resigned from the LEP. The LEP is required as soon as practicable to give written notice to the Combined Authority of the fact of the resignation and nominate another of its members in that person’s place. The notice and a nomination have now been received.

1.3 The LEP nominated Mr Andrew Hodgson, the recently appointed Chair of the LEP, for the appointment as the LEP member of the Combined Authority.

1.4 The Combined Authority is required to appoint the member nominated by the LEP.

2 Proposals

2.1 The Leadership Board is recommended to agree to the recommendation set out above to enable the Combined Authority to operate in accordance with the Order and the Combined Authority’s Constitution.

3 Next Steps

3.1 The appointment will enable the nominated representative of the LEP to participate in the business of the Combined Authority as a member of the Leadership Board.

4 Potential Impact on Objectives

4.1 The appointments will enable the Combined Authority to properly discharge its functions.

5 Finance and Other Resources

5.1 There are no specific financial implications arising from these recommendations.

6 Legal

6.1 The Combined Authority is required to appoint a member of the LEP as a non-voting member of the Combined Authority in accordance with the Order that established the Combined Authority and the Combined Authority's Constitution.

7 Other Considerations

7.1 **Consultation/Community Engagement**

The requirement to appoint a representative of the LEP, as nominated by the LEP, as a non-voting member of the Combined Authority is set out in the Order that established the Combined Authority.

7.2 **Human Rights**

There are no specific human rights implications arising from this report.

7.3 **Equalities and Diversity**

There are no specific equality and diversity implications arising from this report.

7.4 **Risk Management**

There are no specific risk management implications arising from this report.

7.5 **Crime and Disorder**

There are no specific crime and disorder implications arising from this report.

7.6 **Environment and Sustainability**

There are no specific environment and sustainability implications arising from this report.

8 Background Documents

8.1 The Durham, Gateshead, Newcastle Upon Tyne, North Tyneside, Northumberland, South Tyneside and Sunderland Combined Order 2014

The Constitution of the North East Combined Authority

9 Links to the Local Transport Plans

9.1 This report has no direct links to the Local Transport Plans.

10 Appendices

There are no appendices to this report.

11 Contact Officers

11.1 Vivienne Geary, E-mail: viv.geary@northtyneside.gov.uk Tel: 0191 643 5339
Victoria Miller, E-mail: victoria.miller@newcastle.gov.uk Tel: 0191 211 5118

12 Sign off

- Head of Paid Service ✓
- Monitoring Officer ✓
- Chief Finance Officer ✓

North East Combined Authority

Leadership Board

Date:	**24 March 2016**
Subject:	**Local Growth Fund – Project Approvals**
Report Of:	**Executive Officer for Transport, Head of Paid Service and Chief Finance Officer**

Executive Summary

This report provides an update on the Local Growth Fund (LGF) programme and approvals needed to actively manage the programme. The report sets out proposals to address funding gaps and enable high priority projects to proceed and outlines measures to maximise the use of LGF grant in 2015/16 and improve the delivery of the increased LGF programme in 2016/17. It also sets out a proposal to ensure full spend of the Regional Growth Fund (RGF) grant in 2015/16.

The report provides information about specific Local Growth Fund projects for approval, these being as follows:

- Enterprise Zone Projects – use of LGF grant in place of Growing Places Fund grant and scheduled borrowing
- South Shields Transport Hub – approval of LGF grant
- Lindisfarne Roundabout – approval of LGF grant
- Northern Access Corridor – approval to fund advance works
- Sunderland Central Business District – approval to bring forward the LGF grant

In order to maximise the delivery of the programme in terms of the use of LGF grant, it is proposed to bring forward capital spending originally scheduled for future years; to apply LGF grant to approved Enterprise Zone schemes in place of other funding that can then be carried over and used to fund LGF projects in future years; to approve advance works on schemes in the programme, prior to the approval of their full business case; and to reallocate LGF funding to enable two priority projects to proceed.

Recommendations

The Leadership Board is recommended to approve the following actions for the projects listed below:–

a) agree the use of LGF grant to fund Enterprise Zone schemes in order to maximise the use of the LGF grant in the current year as set out in section 3.1;

b) agree to increase the allocations of LGF by £2.5m (to £9.4m) for the South Shields Transport Hub and by £1.05m (to £6.15m) for Lindisfarne Roundabout, funded by a redirection of the grant for the Testos Roundabout/Boldon Business Park project of £3.55m, as described in section 3.2 and 3.3 of this report, and to agree to the full approval of the Lindisfarne Roundabout project based on the receipt of a final compliant business case;

c) agree the release of £3m of LGF grant for advance works and matched project construction works for the Northern Access Corridor Phase 2, as set out in section 3.4;

d) agree to bring forward spending on the Sunderland Central Business District LGF project from future years, with £1.592m to be included in the 2015/16 programme and £9.208m to be included in the 2016/17 programme, as described in section 3.5;

e) Agree the proposal to maximise the use of Regional Growth Fund grant in 2015/16, as set out in section 3.6.

f) note the actions being taken to manage the funding gaps on other priority projects set out in section 4; and

g) Authorise the Monitoring Officer to enter into amended funding agreements as appropriate in accordance with the recommendations above.

1. Background

Local Growth Fund

1.1 In January 2015 the Leadership Board agreed its capital programme for 2015-16, which included the list of approved schemes to be funded from the Local Growth Fund. Updates on the programme were reported in November 2015 and January 2016. This funding is related to specific projects that had been agreed by NECA and NELEP as part of the LGF Growth Deal.

1.2 In March 2015 the Government confirmed payment of the Local Growth Fund (LGF) grant for 2015/16 of £53.91m and set out the indicative profile of LGF funding for future years of £166.487m (£79.402m in 2016/17; £31.819m in 2017/18; £24.065m in 2018/19; £16.650m in 2019/20; and £14.550m in 2020/21). This included the funding for six highway major schemes.

1.3 The funding profile for 2016/17 and future years was subject to formal confirmation after the Spending Review. This funding uncertainty and the lack of funding for additional projects meant that it was not possible to include 'over-programming' in the 2015/16 capital programme.

1.4 A letter has now been received which confirms that the funding for future years is the same as set out in the earlier indicative profile.

1.5 It is important to demonstrate delivery on the 2015/16 programme, which includes achieving a high level of spending of the £53.91m LGF grant. The complexity of the projects in the programme combined with the delay in providing funding certainty has contributed to some delays and slippage of spending into future years. The delivery of the programme is being actively managed and options to fully utilise the LGF have been explored and specific recommendations are set out in this report for consideration and approval.

1.6 As part of active management of the programme a number of funding pressures have been identified, including the impact of tender price increases on the six priority highway major projects that had a relatively low level of contingency when they were included in the programme. Solutions are being found to enable these priority projects to proceed and these are described in sections 3 and 4 of this report.

2 Update on Local Growth Fund Programme for 2015/16 and Future Years

2.1 The January report to the Leadership Board identified a potential spend of £50.17m against the £53.91m LGF funding programme for 2015/16, subject to no further slippage occurring.

2.2 The latest estimate of spending indicates that there has been some further slippage of spending into future years, which before taking the actions identified in this report could reduce the estimated spend to around £45m and a number of actions are therefore proposed to seek to achieve the use of as much of the £53.91m LGF grant as possible in the current year. This objective has the support of BIS/DCLG. The actions that are recommended include bringing forward spending of £1.5m on a project from future years and the use of LGF grant to fund up to £10.6m of already approved enterprise zone schemes.

2.3 The programme spending is now heavily profiled into the last few weeks of the year. It is important that we can demonstrate strong delivery and appropriate use of the LGF grant this year and proposals set out in this report would help to achieve this.

2.4 Following guidance from DCLG that the LGF grant can be used very flexibly to fund capital expenditure in 2015/16, we are now proposing that we seek approval to use LGF grant to finance approved infrastructure spending on Enterprise Zone schemes this year in place of Growing Places Funding. These schemes are the approved infrastructure works in the Sunderland; the North Bank of Tyne and Blyth Enterprise Zones. It is expected that around £5.5m of LGF grant will be used to fund these schemes this year. NELEP/ NECA will release £5.5m of Growing Places Fund grant, which will be used to fund spending on LGF schemes that have slipped into future years.

3. Schemes covered in this report

3.1 <u>Enterprise Zone Projects</u>

3.1.1 Both the North East LEP Board and the NECA North East Leadership Board in January agreed to substitute LGF resources for borrowing (repaid by future Enterprise Zone (EZ) business rates receipts) in 2015/16 on the Sunderland Low Carbon and the North Bank of the Tyne EZ infrastructure projects. It is estimated that £5.1m of LGF grant can be used to replace borrowing on these two projects. This will avoid external interest charges and increase the overall EZ surplus. The potential to extend this funding swap if necessary to other EZ projects was agreed by the North East LEP Board.

3.1.2 In order to maximise use of the LGF grant in 2015/16 there is also an opportunity to finance approved spending on Enterprise Zone projects of an estimated £5.5m, which would have been funded by Growing Places Fund (GPF) grant from the NELEP investment fund. The GPF grant would then be used to fund spending on LGF projects in 2016/17 or future years. This includes estimated spending on the North Bank of Tyne Zone in North Tyneside (£3.6m); the Sunderland Enterprise Zone (£0.5m) and the Blyth Enterprise Zone (£1.4m).

3.1.3 To make such changes requires the North East LEP and its managing authority, NECA, to revise existing EZ funding agreements to advise recipients that a mix of funding sources will be applied. This variation in no way impacts on the conditions or obligations on EZ projects – they will continue to report and be monitored under EZ monitoring regimes.

3.1.4 The displaced funding will come back into the Growth Deal Programme to fund existing LGF projects coming on-stream in 2016/17.

3.2 South Shields Transport Hub

3.2.1 This project, which is jointly promoted by South Tyneside Council and Nexus, involves the construction of a new transport interchange in South Shields town centre that will better integrate Metro and bus services. The interchange will replace the existing Metro Station in the town and the bus shelters located along Keppel Street and Chapter Row. The project is a key element of the wider South Shields 365 regeneration programme that will improve the economic performance of the town centre, create a visually striking new gateway to the town and improve accessibility by public transport and promote sustainable travel. The interchange received detailed planning permission in November 2015. Following LGF prioritisation, the funding that was available to the project budget at LGF programme entry was £13.6m, with a revised level of LGF grant amounting to £6.9m.

3.2.2 A primary contractor has been appointed to manage the development of the wider 365 regeneration project in South Shields; however, the procurement of sub-contractors to deliver various components of the project is still outstanding. Final contract prices for the Transport Interchange are not expected to be confirmed now until Summer 2017, therefore the full business case with final prices is not yet available, and will be presented to Leadership Board for approval at the appropriate time. The project is on course to deliver the £1.6m of LGF expenditure within 2015/16 through a first phase approval for advanced works granted by the Leadership Board at its January 2016 meeting.

3.2.3 Following ongoing development of the project design and recent engagement with the supply market, the project cost estimate, as reported by the project promoters is currently £16.183m. This estimate takes account of the need to move the existing Metro station across the King Street Bridge where it will effectively sit above the new bus station. The scheme promoters and the primary contractor have carefully considered the cost of doing this and a detailed project plan and construction schedule together with fully costed risk register have been developed. This has included extensive value engineering that has ensured that value for money has been promoted throughout the design process without compromising the quality and impact of the proposed scheme.

3.2.4 In order to enable a timely decision on additional funding contributions to allow the project to progress into a Compulsory Purchase Order procedure to fully assemble the site, it is proposed that the LGF grant is reinstated back to the level prior to LGF prioritisation, funded through a reduction to the LGF grant to the future Testos Roundabout/Boldon Business Park project, which has a current LGF grant allocation of £3.55m. This would effectively omit this project from the current programme. It is not possible in the short term to consider and commit new LGF funding into this programmed project. This action has been agreed in principle by officers at the Council and will also release the necessary LGF funding to meet the shortfall in the Lindisfarne Roundabout project, which is reported on below. The increased allocation would be granted in principle and confirmed upon approval of the full business case. The intention of South Tyneside Council would be to look towards the reintroduction of the Testos Roundabout/Boldon Business Park project into the LGF programme by submitting an Expression of Interest to a future call for new LGF projects. This would be subject to assessment of proposal against strategic priorities and other potential projects at the time of consideration.

3.2.5 The draft project business case for the Interchange, taking account of the amended project costs, has demonstrated a benefit cost ratio of 5.6:1, maintaining a very high value for money.

3.2.6 The cost and funding for the project as included in the current programme and the requested approval is set out in the table below.

	Total	LGF Grant £000s				
	Approved Budget	Total	2015/16	2016/17	2017/18	2018/19
Current programme	13,600	6,900	1,600	4,830	470	0
Requested approval	16,183	9,400	1,600*	2,830**	2,970**	2,000**

* Phase 1 advance approval, including some land acquisition costs;
** Provisional phasing, subject to development of a final programme.

3.3 Lindisfarne Roundabout, South Tyneside

3.3.1 Lindisfarne Roundabout involves the improvement of traffic capacity at a major intersection (A19 with A194), with regionally significant network capacity and efficiency benefits. South Tyneside Council promote this project. Whilst the draft business case was approved in principle by Leadership Board in November 2015, tender prices were received by the Council in February 2016 and evaluation has subsequently taken place. On the basis of the tender that was judged to provide the best value for money, the total project cost has risen from £6.1m to £7.55m. This can be attributed to increasing market prices since earlier cost estimates were formed at project conception and programme entry. This was another project which was introduced into the programme with a reduced contingency. South Tyneside Council has sourced an additional local contribution of £450k to the project, taking the Council's own contribution from £1m to £1.45m.

3.3.2 The remaining £1.05m shortfall can be met by an increased LGF allocation, released by the reduction to the Testos Roundabout/Boldon Business Park project LGF grant, as described in paragraph 3.2.4 above. This has been agreed in principle with South Tyneside Council. Approval of this redistribution of LGF grant will enable this priority project to proceed to main contract award and construction phase on time, as well as ensuring planned related works are progressed as forecast. The project will also be able to secure LGF expenditure of up to £900k in 2015/16. This request to Leadership Board to vary the LGF allocation to the project based on a final project business case supersedes the delegated authority granted at the November 2015 Board meeting to NECA Head of Paid Service, and therefore full project approval and funding release is effectively requested by the Leadership Board at this meeting.

3.3.3 The project business case has been revised on the basis of the increased costs and demonstrated a new benefit cost ratio of 8.6:1, which maintains a very high value for money.

3.3.4 The current approved and requested revised LGF profile for the project is set out in the table below.

	Total	LGF Grant £000s				
	Cost	Total	2015/16	2016/17	2017/18	2018/19
Current programme	6,100	5,100	720	4,380	0	0
Requested approval	7,550	6,105	919*	2,389	2,797	0

* Increased expenditure within 2015/16, subject to wider budget approval.

3.4 Northern Access Corridor, Newcastle

3.4.1 This project involves a package of works between Cowgate on the A167 and the junction of Osborne Road with the A189, via Blue House Roundabout. The project will create an upgraded Urban Traffic Management system, enabling better management of congestion and improved journey times during peak periods. The overall cost of the project is estimated at £7.1m, with £4.09m to be funded by LGF grant. The objectives of the project include the reduction of congestion at peak periods, improving the punctually and attractiveness of bus services, improved pedestrian and cycle access, reduced injury road accidents, and to address social exclusion.

3.4.2 It was originally anticipated that the Northern Access Corridor Phase 2 would proceed to full business case development and sign off within 2015/16, under a delegated authority to NECA Head of Paid Service granted by the Leadership Board at its January 2016 meeting. There remain, however, a number of outstanding aspects to the project to allow the finalisation of its business case: chiefly completion of minor land agreements, planning consents and determination of final prices for sub-components of the project, as well as modifications to the project's management and economic cases. These outstanding elements are of low risk to overall project delivery and ongoing dialogue between Newcastle City Council, NECA and NELEP is taking place.

3.4.3 Advance and related project works have already been delivered, or are currently underway, and it is therefore proposed that a first phase approval and funding agreement is approved for the project in 2015/16 ahead of completion and subsequent sign-off of the full business case, which is now expected in Summer 2016. This first phase approval and funding agreement would be in line with the 2015/16 project expenditure presented to Leadership Board at its January 2016 meeting. Subsequent approval of the full business case can occur under the delegated authority to NECA Head of Paid Service previously granted by Leadership Board. In the event that the full project does not proceed to full business case approval or construction, a percentage clawback of the advanced LGF grant would be enacted.

3.4.4 The draft business case has indicated that an updated benefit to cost ratio of between 6:1 and 12:1 should be achieved by the project, which represents a very high value for money. This calculation is subject to the resolution of outstanding economic case and cost confirmation work.

3.4.5 The forecast LGF expenditure of £3m in 2015/16 comprises of the following elements, in line with January 2016 NELB report:-

- £1.25m Northern Access Corridor Phase 1 (Cowgate);
- £1.3m Gosforth Transport Corridor (referenced in the initial project proforma as match funding contribution to the NAC);
- £0.2m Variable Messaging Signals supply;
- £0.25m Scheme design and development costs.

3.4.6 The claiming of a proportion of the overall Northern Access Corridor package for Phase 1 works (£1.25m) and Gosforth Transport Corridor works (£1.3m) provides an opportunity to increase total 2015/16 LGF programme expenditure and ensure that progress on the wider package of related projects is achieved. This was set out to Leadership Board in the January 2016 Projects Approval report.

3.4.7 The current approved LGF grant profile for the project is set out in the table below. The overall project cost will be updated following finalisation of prices for all project elements.

	Total	LGF Grant £000				
	Cost	Total	2015/16	2016/17	2017/18	2018/19
Current programme approval	8,100	4,090	3,000	1,090	0	0

3.5 Sunderland Central Business District

3.5.1 The project represents the first phase of development on the brownfield former Vaux site. The funding will be used to contribute to the construction of the first building which will provide 5,060m² (54,500 sq ft) of lettable business space and 760m² of active use space, along with strategic infrastructure including roads, utilities, parking, landscaping, public realm and external works. It will provide accommodation for (but not limited to) growing SMEs as well as start-ups.

3.5.2 The intended purpose of the Vaux site is to create a high quality mixed use scheme including a new quality office location for the City Centre, the importance of which was recognised by government as part of the Sunderland City Deal and urban quarter which will reconnect the city centre with the River Wear. The proposed development will seek to maximise the benefits of the City's assets such as Sunderland's digital connectivity, the Port, its partnerships with the University and College, together with its planned and existing open spaces. When this is added to the city's ability to attract international business and funding, this major site has the potential to accommodate an exceptional project of national significance.

3.5.3 The total cost is estimated to be £25.4m, funded in part by £10.8m of LGF grant funding. This was indicatively included in the programme for 2017/18 and 2018/19. A full business case has now been submitted to NELEP and a detailed report to the NELEP Board has recommended that the grant of £10.8m be approved with £1.592m scheduled to be spent 2015/16 and £9.2m scheduled to be spent next year, subject to specific conditions being met.

3.5.4 A summary of the estimated costs and funding is set out in the following table.

Funding Sources	**2015/16 £000**	**2016/17 £000**	**2017/18 £000**	**2018/19 £000**	**Total £000**
Local Growth Fund	1,592	9,208	0	0	10,800
Sunderland Council	0	1,538	9,074	0	10,612
ERDF	0	2,169	1,831	0	4,000
Total	**1,592**	**12,915**	**10,905**	**0**	**25,412**

Project Costs					
Building & Construction	150	11,945	8,994		21,089
Fees	1,442	970	1,911		4,323
Total	**1,592**	**12,915**	**10,905**		**25,412**

3.5.5 The business case indicates a Net Present Value (NPV) of £70.87m and a Benefit Cost Ratio (BCR) of 2.24:1. The technical appraisal concluded that the assumptions utilised to inform the NPV and BCR around optimism bias, displacement, leakage and multipliers are reasonable.

3.5.6 The project still awaits the outcome of its application for £4m of ERDF funding. This is currently under consideration by the Managing Authority (DCLG). The decision is expected imminently but not within the tight timescale NELEP requires to defray funds this financial year. It is proposed that a condition of LGF approval be that Sunderland City Council underwrite any funding gap.

3.6 Regional Growth Fund (RGF) Programme

3.6.1 The Programme Team are closely monitoring projects to ensure the Programme hits it contractual commitment to spend £30m of Regional Growth Fund (RGF) Round 3 allocation. Discussions with live projects indicate that there remains every opportunity that they will meet their spend profiles by 31 March 2016. However, due to unforeseen issues encountered in a small number of projects, the North East LEP have sought alternative means to ensure the full defrayal of the £30m Regional Growth Funds within the required timeframe.

3.6.2 It is now proposed, with the agreement of RGF Secretariat Colleagues at BIS that, should it be required, a funding swap within the NEIF is actioned on the approved Durham University Centre for Innovation and Growth project. To date the NEIF has supported the project to the value of £10m with £8m from RGF and £2m from Growing Places Fund (GPF). The funding swap would see up to the £2m GPF expenditure allocated earlier this financial year, replaced with RGF monies. This will release the equivalent amount of GPF grant to be invested at no additional cost to the NEIF, to support the completion of the existing RGF projects that have suffered unforeseen delays, should this be required beyond 31 March 2016. For the North East LEP and its Accountable Body, the North East Combined Authority, this will be dealt with through an internal accounting transaction. The commitment to achieve originally contracted RGF outputs by the projects in question would remain unchanged. This is important as any underspend would result in a loss of grant to the area.

4 Addressing Potential Funding Gaps

4.1 A number of funding gaps have been identified on priority projects that are included in the LGF or Enterprise Zone programme. There are a number of reasons for the funding gaps, including the recent increase in tender prices received from construction companies, and the fact that six major highway projects were included in the programme with relatively low levels of contingency, as well as an increase in the scope or scale of a few projects for specific reasons.

4.2 The first of the six highway major projects to identify a cost pressure was the A1058 Coast Road scheme, which was granted an LGF grant increase of £0.700m last year. As higher tender prices have continued, cost pressures have emerged on two other highway major projects – Lindisfarne roundabout (which also included an increase in scope - previously reported to the Leadership Board); and the South Shields Transport Interchange, which are addressed in this report.

4.3 If higher tender prices continue, it appears likely that higher cost pressures will result in other funding gaps, for which solutions will also have to be found in order to enable these high priority schemes to be implemented. Of the three other major projects, Horden Sea View Rail Station in Durham is already estimating a potential funding gap of c. £5m – made up of £2m price inflation and a £3m loss of anticipated ERDF grant. Revised costs for two others are still being finalised: Newcastle Northern Access Corridor; and the Gateshead A167 Park and Ride Corridor.

4.4 Two of the Enterprise Zone schemes have also identified funding pressures – the East Sleekburn site in the Blyth Enterprise Zone where a funding gap of c £6m has been identified and the Sunderland Enterprise Zone where a gap of £3.5m has been identified.

4.5 Options to resolve these issues are being explored as part of the active management of the capital programme and will be reported to future meetings of the NELEP and NECA Leadership Boards. This includes value engineering solutions as well as consideration of the opportunities of other funding sources including the next round of LGF funding or devolution investment funding and opportunities for additional borrowing in enterprise zones funded by retained business rates.

4.6 In terms of the East Sleekburn site an option to increase the level for borrowing that can be supported by Northumberland after the end of the Enterprise Zone Period by an additional £2m, (in addition to the £5m contribution Northumberland had already agreed) and securing grant of £4m for the project. A mix of LGF grant and loans have previously been secured for two other round 1 EZ sites, in North Tyneside and Sunderland. The possibility of a call on LGF grant as over-programming on the 2016/17 LGF programme is being explored.

4.7 In terms of the Sunderland Enterprise Zone there is scope to extend the level of borrowing that can be funded from business rates. Both of these option will be developed further. The most appropriate solutions will be identified and will be report to future meetings of the NELEP and NECA Leadership Boards.

5. Next Steps

5.1 If the recommendations of this report are approved, the next steps are expected to be the amendment of the LGF programme, and preparation of 1st phase grant funding agreements for the South Shields Interchange and Northern Access Corridor Phase 2 projects and a full grant funding agreement for the Lindisfarne Roundabout project and the Sunderland Central Business District. These projects will then proceed to implementation.

5.2 Approved LGF and RGF grant funding swaps will be implemented in order to maximise spend of LGF and RGF grant.

6. Potential Impact on Objectives

6.1 Approval of the recommendations will enable the effective management of the LGF programme contributing to the delivery of the SEP objectives. The various projects listed have been tested and demonstrate alignment with the objectives of the Strategic Economic Plan and high value for money. Delivery of the schemes will therefore assist the Combined Authority in its objective of maximising the area's opportunities and potential.

7. Finance and Other Resources

7.1 The financial information is set out in the body of this report.

8. Legal

8.1 The NECA, as Accountable Body for the NELEP, enters into funding agreements with the recipients of Local Growth Funding. The agreements reflect the requirements and obligations of the funding providers including provisions relating to clawback, in particular those relating to State Aid. The recipient local authorities will be required to enter into funding agreements to enable the release of the proposed LGF funding contributions for each of the projects referred to in this report and approved to receive LGF funding.

9 Other Considerations

9.1 **Consultation/Community Engagement**

Full consultation of affected parties in relation to the transport and highway projects has been carried out and any necessary modifications made to the projects as a result. Stakeholder Engagement Plans have been developed as part of the relevant project business cases and will be implemented once the projects listed have been given approval to proceed.

9.2 **Human Rights**

There are no specific human rights implications arising from this report.

9.3 **Equalities and Diversity**

The implementation of the various highways and public transport scheme proposals listed in this report will have a positive impact on low income and vulnerable groups by making walking, cycling and bus travel safer, more reliable and more convenient.

9.4 **Risk Management**

Appropriate risk registers are created for each individual scheme. Actions are set out in the report to help manage the delivery risk in relation to the overall programme and to address the cost pressures and funding pressures on specific projects. A risk sharing arrangement with regard to advance approvals is currently being discussed with the LEP and the project promoters.

9.5 **Crime and Disorder**

There are no crime and disorder implications arising from this report.

9.6 **Environment and Sustainability**

Delivering the schemes outlined in this report will assist the Combined Authority in achieving a more sustainable transport system for the region.

10. Background Documents

10.1 "More and Better Jobs" – the Strategic Economic Plan for the North East – available at http://nelep.co.uk/wp-content/uploads/2014/11/North-East-Strategic-Economic-Plan-More-and-Better-Jobs.pdf

10.2 "More and Better Jobs" – the Strategic Economic Plan for the North East – available at http://nelep.co.uk/wp-content/uploads/2014/11/North-East-Strategic-Economic-Plan-More-and-Better-Jobs.pdf

Full business case for the following project:-

- Sunderland Central Business District
- Lindisfarne Roundabout

Working draft business cases for the following projects:-

- South Shields Interchange
- Northern Access Corridor Phase 2 (Cowgate to Osborne Road)

11. Links to Plans in the Policy Framework

This report includes projects that contribute to the delivery of the Strategic Economic Plan.

12. Appendices

Appendix A: LGF Funding Letter from DCLG

13. Contact Officers

Paul Woods, Chief Finance Officer (North East Combined Authority)
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14. Sign off

Head of Paid Service ✓

Monitoring Officer ✓

Chief Finance Officer ✓

North East Combined Authority

Leadership Board

Date: 24 March 2016

Subject: Modification to Tolls at the Tyne Tunnels

Report Of: Lead Chief Executive for Transport and Chief Finance Officer

Executive Summary

At the last meeting on 19th January, the Leadership Board agreed to increase the tolls on the Tyne Tunnels, with effect from 3 April 2016. This report seeks formal confirmation of information necessary to be provided to the Department of Transport DoT – that the 10% discount for permit holders will continue. It also confirms that the toll increase for HGVs (class 3 vehicles) will be 10p rather than the 20p previously reported; and confirms that the implementation of the increase will take place after the permission from the Secretary of State for Transport has been received, in accordance with the River Tyne (Tunnels) (Modification) Order 2011 which came into force on 9 January 2012 ("the Order").

Recommendations

The Leadership Board is recommended to:

i) Approve the increase in tolls for cars (class 2 vehicles) from £1.60 to £1.70 and for HGVs (class 3 vehicles from £3.20 to £3.30) to take effect from Sunday 22 May 2016, as set out in section 2.1;

ii) Approve the continuation of the 10% discount for permit holders as set out in section 2.1;

iii) Authorise the Monitoring Officer to publish the relevant notices and submit the necessary documentation to the Secretary of State, as prescribed in the River Tyne (Tunnels) (Modification) Order 2011.

North East Combined Authority

Leadership Board

1 Background Information

1.1 The first 'Concession Toll' was implemented on 1 January 2014, at a level of £1.60 for cars and £3.20 for HGVs with a 10% discount for permit holders. After that date, the Concession Toll could be adjusted by an amount to reflect actual RPI figures over time. This is the first such increase which has been triggered by RPI and is required to enable the Authority to match the real toll charged to users with the shadow toll structure built into the Project Agreement, which determines the contract payments made to the Concessionaire, TT2 Ltd.

1.2 Levels of inflation (measured by RPI in accordance with the Order) are now such that an increase in the tolls is possible and necessary to finance the tunnels in line with the tunnel financing arrangements.

1.3 The budget report to the Leadership Board on 19 January 2016 proposed an increase in the tolls from £1.60 to £1.70 for class 2 vehicles and £3.20 to £3.40 for class 3 vehicles, which would preserve the multiplier between HGV and car tolls at 2:1. It has subsequently been identified that the RPI increase is such that the increase in tolls for class 3 vehicles would round down to £0.10, as opposed to being rounded up to 20p, and it is therefore now proposed that the toll for class 3 vehicles be increased by only £0.10 to £3.30 accordingly.

1.4 The budget report also identified a proposed implementation date for the increase of Sunday 3 April. The Leadership Board is now recommended to agree an implementation date for the increase of Sunday 22 May 2016, which should enable the necessary process to be followed with the Secretary of State following this revised approval by the Leadership Board.

2 Proposals

2.1 It is proposed that the tolls be increased as set out below:

Vehicle Class	Toll	Description
1	FREE (no change)	Motorcycles
2	£1.70 (£0.10 increase)	Motor vehicles (Cars), 2 axles and height 2m or less; Motor vehicles (Cars/Vans) 2 axles and height less than 3m; Articulated motor vehicles with tractor 2m or less and trailer less than 3m
3	£3.30 (£0.10 increase)	Motor vehicle 2 or more axles and height 3m or more

Permits are available for all classifications and subject to 10% discount (no change in the percentage discount).

2.2 It is recommended that this toll increase be implemented on Sunday 22 May 2016, or such later date as may be necessary to enable the permission of the Secretary of State to be received.

3 Next Steps

3.1 The Order prescribes the process to effect an increase in the toll at the Tyne Tunnel. Following a decision to increase the tolls, the Authority is required to publish, in at least one local newspaper circulating in the area, a notice substantially in the form set out in the Order. Following publication of the notices, the Authority is required to submit to the Secretary of State:
a) Details of the decision taken to increase the toll – report and minutes; and
b) Evidence that the public has been informed of the decision by notice in the local press.

3.2 Upon receipt of this information, the Secretary of State has 21 days to make an order revising the tolls, subject to being satisfied that the Authority has correctly adhered to the provisions of the Order. The tolls revision order will come into force 28 days thereafter.

3.3 Having made an order revising the toll, the Order precludes the making of another such tolls revision order within 12 months.

4 Potential Impact on Objectives

4.1 The need to increase the toll at the Tyne Tunnels is essential to meet the financial commitments of the Authority in relation to teh funding of the Tyne Tunnels. The Tyne Tunnels improve accessibility and competitiveness for businesses on the A19 corridor and beyond and is a vital part of the local transport network.

5 Finance and Other Resources

5.1 This inflationary increase has been built into the financial modelling of the project over its lifetime. The initial budget for 2016/17 had assumed that the toll for Class 3 vehicles would be set at £3.40, and financial modelling indicates that the cost of restricting the increase to £3.30 will be approximately £90,000 which can be met from the Tyne Tunnels reserves.

6 Legal

6.1 There are no additional legal comments to make as the statutory process is set out in the body of the report.

7 Other Considerations

7.1 **Consultation/Community Engagement**
Consultation has taken place with TT2 Ltd., the Concessionaire to the Tunnels to identify an operationally suitable date for the revision to come into effect. The inflationary toll increase is in line with the Tolling Strategy of the Tyne and Wear Integrated Transport Authority which was subject to significant public consultation and engagement prior to the letting of the Concession Contract.

7.2 **Human Rights**
There are no specific human rights implications arising from this report.

7.3 **Equalities and Diversity**
There are no specific equalities and diversity implications arising from this report.

7.4 **Risk Management**
There are no specific risk management implications arising from this report.

7.5 **Crime and Disorder**
There are no specific crime and disorder implications arising from this report.

7.6 **Environment and Sustainability**
There are no specific environment and sustainability implications arising from this report.

8 Background Documents

8.1 The River Tyne (Tunnels) (Modification) Order 2011

9 Links to the Local Transport Plans

9.1 There are no specific links to the local transport plans arising as a result of this report.

10 Appendices

10.1 None

11 Contact Officers

11.1 Paul Woods, Chief Finance Officer, paul.woods@northeastca.gov.uk 07446936840

12 Sign off

- Head of Paid Service ✓
- Monitoring Officer ✓
- Chief Finance Officer ✓

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North East Combined Authority

Leadership Board

Date: 24 March 2016

Subject: Bus Strategy – Next Steps

Report Of: Chief Executive Officer for Transport and Managing Director (Transport Operations)

Executive Summary

A new Buses Bill is expected to be put before parliament imminently. Government has indicated that it will provide a more workable process for the introduction of bus franchising by devolved authorities, as well as introducing new powers to enable local authorities and bus operators to agree 'enhanced partnerships'.

It is therefore recommended that steps are taken to prepare options for using the new legislation, when it is enacted, to be considered alongside existing options to deliver the Bus Strategy.

This will include both the scoping of a bus franchising scheme covering all or part of the Combined Authority's area under the revised legislation, and consideration of other options for delivering improvements to bus services, such as enhanced partnerships, that may be brought forward by the new Bill.

Following receipt of the opinion of the QCS Board, it seems unlikely that the current legislation can be used to improve bus services through the introduction of a Quality Contracts Scheme in Tyne and Wear.

Recommendations

It is recommended that the Leadership Board:

- Instructs officers to develop options to deliver the Bus Strategy in light of the options available when the new legislation is enacted; and
- Notes Nexus' analysis of the QCS Board's opinion and agrees to bring the QCS process to an end.

1 Background Information

1.1 The Bus Strategy for Tyne and Wear is aimed at achieving three objectives:

- To arrest the decline in bus patronage;
- To maintain, or preferably grow, accessibility;
- To achieve better value for public money.

1.2 On 21st October 2014 the Leadership Board resolved to progress a QCS by referring it to a QCS Board. The QCS Board's opinion was published on 3 November 2015, and as previously reported to the Leadership Board it was more negative than expected.

1.3 In light of that the Leadership Board agreed for officers to develop four options, which are expanded by this report.

1.4 To comply with requirements under the legislation dealing with Quality Contracts Schemes, and due to the pre-election period, it is necessary for the Leadership Board to decide on any further action in respect of the QCS before the beginning of April 2016.

2 Bus franchising

2.1 Under the Devolution Agreement the government has committed to supporting the Combined Authority in the delivery of effective bus services in the North East, with the option for the Mayor to use additional franchising powers through the Buses Bill, subject to necessary legislation and local consultation.

2.2 As part of the industry engagement carried out by the DfT, Nexus has shared its practical experience of the QCS legislation and been involved in a number of discussions with civil servants who are developing the franchising aspects of the Buses Bill.

2.3 The draft Bill is expected to be introduced to parliament shortly. It is expected to establish a more straightforward process for the introduction of bus franchising than under current legislation, and in particular there is not expected to be any proposed equivalent of the QCS Board. The likely avenues of challenge open to opponents of bus franchising schemes would be judicial review and other established legal processes, which also provide greater certainty on timescales.

2.4 Therefore, subject to the Bill being passed in the form currently envisaged, it may be a route for the Combined Authority to implement a bus franchising scheme in order to achieve its bus strategy objectives. It should be noted however that the draft Bill has yet to be seen, and may be amended during its passage through parliament.

2.5 Nexus considers that many aspects of the QCS proposal could be transferred into a bus franchising scheme, for example in relation to fares and ticketing, customer experience, governance, procurement strategy and TUPE principles. However there will be substantial new work required in terms of refreshing data, carrying out new research, undertaking updated financial, economic and legal appraisals and updating the scheme's management and procurement proposals.

2.6 Nexus estimates that the early development of a bus franchising scheme is likely to take over a year, before it could be finalised and used as a basis for public consultation. If the Combined Authority wished to consider any option making use of franchising then, given that the process may still take some time to implement, it may be prudent for officers from Nexus, Durham and Northumberland to begin a scoping study. The study will consider the options for franchising, and in turn, form part of the consideration of the most appropriate way to deliver the Bus Strategy.

3 Collaboration with the Bus Operators

3.1 The Voluntary Partnership Agreement (VPA) that was put forward by operators in 2014 as an alternative to the QCS is still technically open to the Combined Authority. It was however unsatisfactory in many respects, not least because of its numerous termination clauses, its failure to achieve improvements in fares and ticketing, and because it did not achieve the required level of savings to prevent cuts to services. Although the bus operators proposed further changes to the VPA only three working days before the start of the QCS Board oral hearings, many of Nexus' concerns remain, including in respect of the level of reliance that can be placed on delivery of proposals by operators.

3.2 The Chief Executive Officer for Transport has written to the three large bus operators in Tyne and Wear, inviting them to enter into discussions regarding:

- Multi-modal smart ticketing;
- Improvements in young peoples' fares;
- Real-time information provision;
- Working to reduce the impact of funding reductions on passengers and the local community; and
- Any other opportunities that may help all parties to improve services for passengers.

3.3 The Managing Director (Transport Operations) is currently engaging in a series of bilateral discussions to determine where progress can be made on these matters. Nexus is of the view that the improvements offered by the bus operators to date do not need a formal partnership agreement to be introduced. However this will be kept under review and should formal steps be required in order to achieve the improvements sought, a further report on the additional benefits offered by a formal partnership will be brought to the Combined Authority.

3.4 It is anticipated that the Buses Bill will contain amendments to the partnership provisions that already exist, potentially making partnerships easier to use and more attractive to local authorities. It may therefore be possible to develop an improved partnership offer in the future as a result.

4 Progressing the current QCS

4.1 Based on various comments in the QCS Board's opinion, Nexus considers that it may hold an in-principle objection to the QCS as proposed. In particular it highlights the loss of future profits by incumbent bus operators without compensation being paid, and the transfer of financial risk from the private to the public sector.

4.2 The QCS Board believes that the economic benefits to the public arising from the proposed QCS are intangible and over-stated, whereas it considers that the financial dis-benefit to bus operators is tangible and highly likely to occur. The QCS Board's opinion concludes that the proposed QCS has not met three of the five public interest criteria, and that Nexus failed to comply with the statutory consultation requirements.

4.3 As previously reported to the Leadership Board, Nexus does not agree with the QCS Board's overall opinion, nor with much of the reasoning behind it. Developing the first QCS in the country was inevitably a complex and novel process, and the fierce resistance of the major local bus operators meant that the proposal was bound to be challenged. As a result Nexus sought independent legal advice at every step of the development of the proposed QCS, and relied upon expert advisors who have extensive experience of economic appraisal. Whilst the QCS Board has chosen to take a negative view of the proposal in its opinion, Nexus remains of the view that its proposal was appropriate and that its assessment was reasonable, and in accordance with the existing legislation.

4.4 A detailed analysis of the QCS Board's opinion is attached at **Appendix A,** and this sets out Nexus' position in more detail.

4.5 Taking account of this analysis, it remains open to the Combined Authority to disregard the QCS Board's opinion. In this case the next formal step under current legislation would be to publish a formal response to the QCS Board's opinion, after which the QCS could be introduced.

4.6 However, in these circumstances, the current legislation allows for appeals against the introduction of a QCS to be made to the Upper Tribunal, and because the QCS Board's opinion was negative an appeal could be brought on both points of law and of fact. The controversial nature of the QCS means that it is highly likely that such an appeal would be brought.

4.7 Defending against an appeal would be likely to involve a re-run of the QCS Board process, albeit before a tribunal with established procedures. There would also be a need to produce additional evidence to demonstrate to the Upper Tribunal that Nexus was right to disregard certain elements of the QCS Board's opinion. As an appeal could be on both fact and law, there is a risk of significant amounts of evidence being required for such an appeal.

4.8 It seems highly likely that defending against an appeal of this nature would involve significant additional cost and several years of further delay, as well as incurring a risk that the appeal would be successful. In light of the legislation emerging under the new Buses Bill, a less costly and more viable approach to implement a franchising scheme, should the Combined Authority wish to do so, may become available shortly.

4.9 An additional option under existing legislation would be to modify the current QCS, and then to re-present it to the QCS Board. Nexus remains of the view that the scheme it designed meets the relevant statutory requirements and would assist in effectively delivering the Bus Strategy – in fact the QCS Board did not criticise the objectives of the scheme or what it could achieve in terms of policy outcomes. The scheme was designed to offer the best policy results within the financial resources available, whilst remaining compliant with legislation covering bus regulation, procurement, and competition law.

4.10 As previously noted the QCS Board did not make any recommendations to remedy its concerns over the proposed QCS. There is therefore no clear basis upon which to make modifications to the scheme.

4.11 Furthermore, the apparent in-principle nature of the QCS Board's objections mean that even if modifications were made to deal with other concerns Nexus' view is that the QCS Board remains unlikely to be persuaded by the merits of any scheme covering Tyne and Wear that does not offer significant compensation to the bus operators.

5 Proposals

5.1 The forthcoming Buses Bill is expected to deliver new legislation that could enable the Combined Authority to pursue its ambitions for improving local bus services through bus franchising. In order to allow a new mayor the option to move forward quickly with a bus franchising scheme if he/she deemed it desirable to do so, it is proposed that Nexus, along with officers from Durham and Northumberland, begins work on a scoping study covering all or part of the Combined Authority's area.

5.2 The Buses Bill is also expected to bring forward other opportunities to improve local bus services through amendments to the partnership provisions and the introduction of 'enhanced partnerships'. It is therefore proposed that all options be considered if and when they are brought forward by the new Bill, alongside options that are already open to the NECA through existing legislation. If, following the introduction of the Buses Bill, the Combined Authority determines that it wishes to pursue enhanced partnerships, the discussions and continued dialogue referred to in section 3 of this report will allow the Combined Authority and operators to move forward quickly.

5.3 In light of the probable complexity, cost, and delay of continuing with the QCS, and in the face of a negative opinion from the QCS Board, it is proposed that the Combined Authority does not progress with the QCS process.

5.4 As new policy objectives are developed within the Transport Manifesto and the emerging Transport Plan for the North East, it is recommended that clear and demonstrable objectives are set for buses. This will allow any future proposals to be appraised against local policy objectives in a clear and robust manner and robustly compared with other options.

6 Next Steps

6.1 If the Leadership Board agrees to adopt the proposals set out above, officers will commence a scoping study into bus franchising and will continue dialogue with operators in relation to longer term collaborative working, reporting progress to the Transport North East Committee. Update reports will also take account of the progress of the Buses Bill through parliament and set out any substantive opportunities that the new legislation may present.

6.2 The Chief Executive for Transport and the Managing Director (Transport Operations) will continue dialogue with local bus operators to also make more immediate improvements for passengers through collaborative working.

7 Potential Impact on Objectives

7.1 All options to deliver the Bus Strategy must be evaluated against their potential to contribute to the achievement of objectives in the relevant transport policies of Tyne and Wear (LTP3 and Bus Strategy), Durham (LTP3) and Northumberland (LTP3 and the Northumberland Public Transport Strategy).

7.2 Also, should new objectives be developed as part of the new Manifesto and Transport Plan for the North East, they will need to be adopted by the programme and taken into account in development of options.

8 Finance and Other Resources

8.1 Nexus has expended £2.609m on the development of options to deliver the Bus Strategy; the majority of which relates to the development of the QCS but also includes the costs of developing the partnership option.

8.2 Should the recommendations to commence a scoping study into bus franchising and continue dialogue with the bus operators be accepted, Nexus will formulate a specific budget proposal in order to take this work forward. Based upon the experience of developing the QCS, the cost of developing a full franchising scheme is likely to be significant. Options to fund this will need to be explored.

9 Legal

9.1 Any key legal considerations are addressed in the body of this report.

10 Other Considerations

10.1 **Consultation/Community Engagement**

Whilst the QCS Board's opinion and Nexus response considers compliance with the statutory consultation requirements detailed in section 125 of the TA 2000 and the emerging Buses Bill references consultation requirements, this report seeks only to record those details. Any additional consultation requirements will depend upon the final options selected.

10.2 **Human Rights**

There are no Human Rights considerations in this report.

10.3 **Equalities and Diversity**

There are no Equalities and Diversity considerations in this report.

10.4 **Risk Management**

Whilst the QCS Board's opinion and Nexus response considers risk quantification and management, this report seeks only to record those details.

It is anticipated a new risk register will be developed as part of the next steps of the process.

10.5 **Crime and Disorder**

There are no Crime or Disorder considerations in this report.

10.6 **Environment and Sustainability**

There are no Environment and Sustainability considerations in this report.

11 Background Documents

11.1 Report to the Leadership Board, Quality Contracts Scheme Update, 17 November 2015

12 Links to the plans and policy framework

12.1 Please refer to section 7 of this report.

13 Appendices

13.1 Appendix A – Nexus' response to the opinion of the Quality Contracts Scheme Board.

14 Contact Officers

14.1 Tobyn Hughes, Managing Director (Transport Operations)
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15 Sign off

- Head of Paid Service ✓
- Monitoring Officer ✓
- Chief Finance Officer ✓

APPENDIX A

Nexus' response to the QCS Board Opinion

March 2016

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1 Introduction

1.1 On 21st October 2014 the North East Combined Authority's Leadership Board resolved to progress the Quality Contracts Scheme (QCS) to the next stage of development, as required by the Transport Act legislation, by referring the scheme to a QCS Board ("the Board").

1.2 Over the period October 2014 - June 2015, Nexus, the bus operators, and several other interested parties provided evidence and witness statements to the QCS Board in preparation for oral hearings, which were conducted over a two week period in July 2015.

1.3 The opinion of the QCS Board ("the Opinion") was published on 3 November 2015.

1.4 The QCS Board's full (non-confidential) opinion considered that two of the five public interest criteria have been satisfied, but that three were not. It also considered that Nexus failed to comply with the statutory requirements for consultation. The QCS Board did not offer any specific recommendations to address these issues.

1.5 This paper outlines Nexus' detailed analysis of the Opinion of the QCS Board.

2 The key findings of the QCS Board

2.1 The QCS Board is required to form an opinion whether the proposed QCS passes a public interest test as set out in The Transport Act 2000 (as amended) ("The Act") and whether statutory consultation requirements have been met.

2.2 When considering the proposal for a Quality Contracts Scheme in Tyne and Wear, the QCS Board found the following:

a) Nexus failed to comply with the statutory requirements on consultation;
b) The proposed scheme could not demonstrate that it would increase use of bus services because its affordability is not demonstrated;
c) Service quality would improve;
d) The proposed scheme would contribute to the implementation of the local transport policies;
e) The proposed scheme does not provide value for money; and
f) The proposed scheme imposes disproportionate adverse effects on operators.

3 Requirements of consultation – Section 125 Transport Act 2000

3.1 Section 125 of the Act sets out the notice and consultation requirements to be complied with when developing a Quality Contracts Scheme. The QCS Board's Opinion summarises Nexus' three stage approach to consultation (informal, formal and supplementary consultations). The Board acknowledged that extensive public awareness activity was undertaken in parallel and all statutory consultees were engaged. It was therefore satisfied that the consultation process was such that a compliant consultation could be achieved[1].

3.2 However, the QCS Board's Opinion identified two categories of concerns regarding the content of the consultation documents:

a) The QCS Proposal referred to the QCS Board is materially different to that which formed part of the public consultation; and
b) The information in the consultation documents relating to the impact of the QCS contained material errors and/or was based on assumptions that were incorrect.[2]

Principles of consultation

3.3 It is important to note that the Board was satisfied that the QCS proposal, in so far as it relates specifically to the arrangement of the scheme itself, was not materially different to that upon which consultation was undertaken[3]. This was a relevant point advanced by Nexus and accepted by the Board.

3.4 However, the Board was concerned that the movement in the value for money indicators, which are included in the consultation document but not referenced in the scheme document, could be such that the consultation no longer satisfied the requirements for a procedurally fair and lawful consultation. Such requirements are known as the Sedley criteria, and were adopted in R v *Brent London Borough Council, ex parte Gunning (1985) 84 LGR 168 and* more recently considered in the Supreme Court *(R (Moseley) v London Borough of Haringey [2014] UKSC 56, at [23] and [24], per Lord Wilson.*)

3.5 A proper consultation requires that the authority must consult when proposals are at a formative stage, it should offer enough information and time to allow consultees to give intelligent consideration and provide an intelligent response, and the authority must conscientiously consider the responses to consultation when the ultimate decision is taken. It is further advised that it is appropriate to consult on alternative, as well as preferred, options.

[1] Paragraph 4.1, Proposal for a Quality Contracts Scheme in Tyne and Wear, Opinion, November 2015.("Opinion")
[2] Paragraph 4.2, Opinion
[3] Paragraph 4.3, Opinion

3.6 Nexus believes the consultation complied with, and exceeded, these standards. This is evidenced in the BSDP Consultation Report[4], Counsel's advice on 'Consultation and Process'[5] and the following three key principles employed by Nexus during the QCS process.

3.7 Firstly, throughout the QCS process, Nexus has amended its approach only in light of the conscientious consideration of consultation feedback (with the exception of the removal of an early commitment to expand the network by 18 buses). This is a key principle of open and effective consultation. However, the Board was concerned that the Proposal referred to them was materially different to the documents consulted upon. It is concerning to Nexus that, in amending the proposal to reflect feedback received and ensuring procedural fairness, it could then be found to have not complied with general consultation requirements by the Board.

3.8 Secondly, Nexus considered alternative delivery methods by consulting on the VPA (an approach endorsed by the Board[6]) and alternative options within the QCS during the Supplemental Consultation process[7].

3.9 Thirdly, acknowledging the importance of stakeholder feedback, consultation between Nexus and key statutory consultees (including the bus operators and Local Authorities) was an on-going process and stretched beyond the formal periods of consultation. This can be evidenced by the continuing communication exchanges and was demonstrated in the evolution of the 'value for money' case, the issue particularly highlighted by the Board.

<u>The key findings</u>

3.10 Within its Opinion, the Board has produced a table (originally developed by Oxera for Stagecoach with the exception of the final column) which sets out the movement of the value for money indicators.[8] It is reproduced below.

[4] BSDP Consultation Report, Nexus, October 2014
[5] Advice on Consultation and Process, James Pereira, Jack Connah, October 2014
[6] Paragraph 4.26, Opinion
[7] Supplemental Consultation Document, April 2014
[8] Paragraph 4.10, Opinion

Indicator (vs *do minimum*)	Nexus Consultation 2013	Nexus October 2014	Nexus May 2015	QCS Board Nov 2015
QCS				
Effectiveness (£m)	1606	373	398	251
Economy (£m)	-262	-100	-120	-121
Efficiency	1.2	3.7	3.4	2.07
NPV (£m)	262	272	279	130
VPA				
Effectiveness (£m)	7	229	251	190
Economy (£m)	-3	-65	-51	-47
Efficiency	1.9	3.5	5.0	6.30
NPV (£m)	3	165	200	141

It is based on these numbers and the timing of the production of these numbers that the Board argues that the gap between the options has narrowed very dramatically with the passage of time. It claimed that despite having potentially misled consultees by including erroneous material in the initial consultation, Nexus failed to take steps to prevent the situation from continuing. Specifically, the Board stated that;

a) the value for money numbers presented in the consultation document were seriously in error;
b) the errors were born from a straightforward lack of understanding of the terms;
c) it was knowable that they were in error at the time they were published;
d) Nexus was in error not to re-consult on the revised numbers given both the interest expressed by the Local Authorities in the affordability of the scheme and the partnership alternative and the potential impact on operators; and
e) the narrative presented the VPA in a dismissive manner so presenting the VPA proposal as not a valid alternative at all.

3.11 For the reasons outlined below, Nexus disagrees with these assertions.

3.12 **The value for money numbers presented in the consultation document were seriously in error**[9]. Nexus does not accept the numbers were 'seriously in error'. As noted in 3.9 above, consultation was an on-going process and Nexus engaged in detailed dialogue with the economic advisors of the bus operators to develop this complex area. The formal responses to consultation and on-going dialogue highlighted some mistakes in the appraisal and also proposed changes to the economic modelling methodology. Nexus accepts that errors were made during the development of the economic appraisal but (with the exception of matters that were considered to be differences in expert opinion that were not accepted) Nexus corrected them at the earliest opportunity and advised the operators accordingly. Importantly, such model development and correction, and

[9] Paragraph 4.23, Opinion

the evolution of the economic appraisal, is very typical for transport scheme models that use complex modelling methodologies. This is why the DfT often reviews draft models in the early stages of any major scheme process. It appears the Board did not acknowledge this, nor fully credit the benefit of Nexus' on-going dialogue with the operators' expert advisors. Noting this was the first such application of a methodology intended for developing and evaluating capital transport schemes to a revenue based scheme, it was inevitable that the appraisal would evolve.

3.13 Also, whilst the numbers in the table presented by the Board indicate a significant variation in some of the numbers over time, it is not appropriate to rely on the numbers alone. Accompanying text should also be considered to avoid misunderstanding. For instance, the NPV (which takes into account benefits and costs) represented the economy measure in the consultation materials in 2013, yet the QCS Board does not appear to reflect this in its Opinion. Indeed, the Board incorrectly added a minus sign to the figure presented. In this context, it would have been more appropriate for the Board to present the economy value as +1,344, supporting the efficiency ratio calculation of 1.2.

3.14 It is also important to note that the NPV for the QCS, the most significant measure for Nexus, has not been subject to any significant change throughout the stages of consultation and approval. Nexus accepts that the NPV for the VPA has changed largely in line with the evolution of the VPA itself, such that it became closer to the NPV of the QCS. However, this scheme evolution and the resulting changes in economic indicators occurred after the completion of the formal consultation process.

3.15 More generally therefore, even if the Board's figures were accepted regarding the movement in value for money indicators that occurred after the completion of the formal consultation process, Nexus considers that it was more appropriate for the Board to recommend that the amended figures should be subject to a re-consultation. Instead the Board stated the previous consultation process was flawed by not referencing information that only became available after that consultation had closed.

3.16 **The errors were born from a straightforward lack of understanding of the terms[10]**. Nexus does not accept this point. Nexus' advisors, Steer Davies Gleave (SDG), applied an interpretation of WEBTAG and the Green Book appraisal methodology. Referencing the initial 2013 indicators outlined in 3.13, the Green Book (paragraph 2.14) states 'Major costs and benefits should be described, and the values attached to each clearly shown rather than netted off in the presentation of the analysis'. SDG demonstrated an understanding of the terms and were correct in their application of the Green Book. However following consultation with operators' advisers, it was accepted that this interpretation could mask the incremental costs and benefits of the scheme (but not affect the net present value). Consequently the approach was altered to deal with this

[10] Paragraph 4.23, Opinion

concern regarding presentation. This was not a consequence of either an error or a lack of understanding.

3.17 **It was knowable that they were in error at the time they were published**.[11] Nexus is absolutely clear that at no point did it knowingly publish any documentation which contained errors. The QCS Statutory Guidance[12] expects that consultation documents should provide as much information as possible about the proposed scheme, consistent with the stage of development the LTA had reached. Nexus complied with this advice, releasing the most up to date and comprehensive information available to allow consultees to prepare intelligent responses.

3.18 The figures questioned by the Board were released in July 2013. Records shared with the Board in evidence indicate the operators first challenged our approach to Value for Money in a letter dated 4 October 2013 and repeated their concerns in the responses to the formal consultation on 22 November 2013. Nexus therefore fails to understand how the Board believes it was knowable the figures were in error at the time of publication in July 2013.

3.19 **Nexus was in error not to re-consult on the revised numbers, especially given the interest expressed by the Local Authorities in the affordability of the scheme and the partnership alternative, and the potential impact on operators[13].** Nexus does not accept it should have formally re-consulted on the revised numbers, and this was supported by Counsel's advice[14].

3.20 The Board made several assertions and advanced a number of arguments to support the need to re-consult. To provide context, the operators argued that consultees may have responded differently to the consultations if they had been aware of the evolving value for money figures. However, they provided no evidence to say other consultees would have responded differently.

3.21 Firstly, the Board questioned Nexus' belief that the statutory consultation did not need to be public[15] and, by implication, queried whether the public would be encouraged to comment if they saw the revised value for money indicators. Nexus maintains that the legislation, and the statutory guidance,[16] does not mandate a public consultation. However, the argument is irrelevant as through the statutory consultation and public engagement process, Nexus has extensively consulted with the public and their democratic representatives in the Local Authorities using a process that the Board confirmed was such that a compliant consultation could be achieved[17]. The public were made aware of the exercise, directed to the Consultation Document and offered summary brochures in both hard copy and electronic format and were pro-actively invited to submit

[11] Paragraph 4.23, Opinion
[12] Local Transport Act, Quality Contracts Scheme Statutory Guidance, Dec 2009, para 12
[13] Paragraphs 4.19, 4.20 and 4.25, Opinion
[14] Advice on Consultation and Process, James Pereira, Jack Connah, October 2014
[15] Paragraphs 4.14 to 4.16, Opinion
[16] Paragraph 9, Quality Contracts Scheme Statutory Guidance
[17] Paragraph 4.1, Opinion

the responses to the consultation. Some 69 organisations and individuals contributed to the process but none commented on the matter of value for money, only on the details of the scheme's proposals. All the reports to the ITA and Combined Authority containing updates on value for money indicators were publically available and placed on the consultation website but no comments were received about the material.

3.22 The Board also suggested the public and others did not engage with the economic analysis given the volume and detail contained in the consultation document.[18] Nexus fails to understand the Board's intent or expectation in this regard. Procedural fairness in consultation imposes a duty to provide sufficient information about a proposal to permit an intelligent response. Nexus provided this. In fact, in written evidence at least one bus operator argued Nexus did not provide enough information. Further, within the suite of consultation materials Nexus supplied summary documents for the public and, in particular, focused summaries for certain parties that encouraged engagement and participation. Nexus is therefore clear it is not due to volume of information being too great that the public did not comment on value for money.

3.23 Secondly, the Board questioned why Nexus did not re-consult on the revised value for money figures during the Supplemental Consultation process which commenced in April 2014.[19] In letters to Stagecoach and in evidence to the Board Nexus explained it was necessary to be clear about the preferred outputs of the potential scheme modifications discussed in the Supplemental Consultation before it could calculate the revised Value for Money position. It was therefore impossible to include revised value for money figures in the Supplemental Consultation. Further, the bus operators were aware that Nexus had accepted the vast majority of feedback regarding the indicators through the on-going discussions. They would therefore have gleaned little new information had it been included in the Supplemental Consultation.

3.24 Thirdly, the Board argued that several Local Authority consultees expressed an interest in the affordability of the scheme and the alternative partnership option, and as a result should have been further consulted on the revised value for money figures.[20] Nexus is clear the Local Authorities were aware of, and were directly consulted upon, the affordability of the scheme, the partnership alternative and the revised value for money indicators as a result of their involvement in the committees of the Combined Authority. Finance, legal and transport officers received detailed updates prior to the NECA considering the revised figures in October 2014, and in turn briefed their executive officers and leaders. The Board appears to indicate that the authorities would assume the modelling was automatically correct and would not interrogate Nexus. This is not correct. At no time would the authorities have assumed the figures provided in July 2013 had remained the same or were automatically correct. Officers were

[18] Paragraph 4.24, Opinion
[19] Paragraph 4.12, Opinion
[20] Paragraphs 4.19 to 4.21, Opinion

aware of the evolution of the appraisal, and the reasons for it, as a result of the on-going briefings.

3.25 Whilst the Board's view is that Nexus was 'under a common-law duty to re-consult to correct the erroneous statements'[21], it does not make recommendations as to how and when the re-consultation should have been done.

3.26 As explained previously, the evolution of the economic appraisal was an on-going process. Is the Board suggesting that Nexus should have re-consulted after each significant discussion on this topic? If so, this is contrary to the approach it advocates for consultation on the VPA. The Board acknowledges it was unreasonable to expect Nexus to re-consult on further iterations of the partnership but it appears to suggest this should have occurred for Value for Money of the QCS.[22]

3.27 **The narrative presented the VPA in a dismissive manner so presenting the VPA proposal as not a valid alternative at all.[23]** Nexus disagrees with this assertion. The VPA was analysed over 46 pages of the Consultation Document and, in Nexus' opinion, was fairly considered given the information available to Nexus at that time. A link was included to the actual agreement from the front page of the consultation web portal.

<u>Summary</u>

3.28 The QCS Board found that Nexus failed to satisfy the statutory duty on consultation because it had failed to correct material errors in the consultation document which had the potential to disadvantage consultees.

3.29 Nexus responds that:

a) The scheme itself, which outlines the majority of principles important to consultees and the public, did not contain errors and remains broadly unchanged;
b) The economic appraisal, which is discussed in the QCS Proposal, required a novel interpretation of guidance which evolved in response to consultation feedback; and
c) any errors, which were identified through consultation feedback and through the subsequent exchange of evidence, were corrected following careful consideration and all the consultees who had expressed an interest in the relevant topic were sufficiently engaged with the evolution of the appraisal to make re-consultation unnecessary.

[21] Paragraph 4.25
[22] Paragraph 4.26, Opinion
[23] Paragraph 4.23, Opinion

4 Increased use of bus services – Section 124 (1)(a) Transport Act 2000

4.1 Criterion A is satisfied if it can be demonstrated that the proposed QCS will deliver a greater use of bus services than the Do Minimum scenario.

4.2 The QCS Board found that Criterion A was not satisfied because:

a) the Nexus model overstates the likely fare increases in the Do Minimum, and paints an overly pessimistic picture; and
b) when considering affordability and risk, there was no application of optimism bias to the scheme costs. As a result, the level of risk contingency, which may not be available in the early years, is highly likely to be inadequate. The Board considered that it appears more than likely the scheme will run into funding issues and that will put pressure on the fares and the network.

<u>The Do Minimum scenario</u>

4.3 The Do Minimum scenario is Nexus' forecast of the local bus market if no intervention takes place and therefore current trends continue. A key assumption of the Do Minimum is the average rate of annual commercial bus fare increases. This has implications for changes in patronage (as people decide whether to continue to use the bus when fares increase), the resulting revenue growth and expenditure on concessionary travel reimbursement. Operators should be reimbursed for concessionary travellers on a 'no better, no worse' principle therefore commercial fare rises result in an increase in the level of reimbursement required from the concession authority.

4.4 The Board queried the following issues which underpin Nexus' Do Minimum scenario:

a) the approach Nexus employed when predicting future price rises and deriving the calculation of bus costs + 2 percentage points; and
b) whether the concessionary travel reimbursement process is, in fact, on a no better, no worse principle given it is subject to some negotiation[24].

4.5 Whilst accepting the use of historical price progression as an indicator, **the Board questioned whether the period of data and ticket types used by Nexus to inform likely future fare price rises was truly representative, and how Nexus treated 'shocks' in data from that focal period[25]**. It argued the assumptions employed by Nexus combine to overstate the likely average rate of fare increase in the Do Minimum. Nexus disagrees and will respond to each point in turn.

[24] Paragraph 5.4, Opinion
[25] Paragraphs 5.8 and 5.9, Opinion

4.6 Nexus contends that the eight year period of data from 2006 to 2014 is appropriate and representative of longer term fare price trends in the bus market. Much of Nexus' reasoning was presented to the Board in evidence[26] and is now summarised. The initial proposal in 2013[27] identified that bus fares increased at an annual rate of RPI + 3 percentage points. This was revised in light of consultation feedback from the operators who argued 'bus costs' was a more appropriate base indicator than RPI. The CPT index, which can be used to assess the level of bus operating costs, was only available from 2004.

4.7 Nexus identified that fare increases follow a cyclical pattern and therefore discounted the first two years of that period (2004 and 2005) so as not to skew its assessment. As one would expect, periods of low or no increases in fares are followed by periods of higher increases in fares. Similarly, periods of higher increases in fares are followed by periods of lower increases. Whilst Nexus recognised the benefit of looking at data over a relatively long period of time (Nexus considered a period of time longer than the period employed by two of the bus operators in their own analysis of fare increases), care was required not to base the assessment on a period that included either a disproportionate number of years of higher increases or a disproportionate number of years of low or no increases. For this reason when taking into account the most recent two years (where there has been low or no increase in fares) Nexus has discounted the first two years of the period i.e. 2004 and 2005, which were also years of low or no increases.

4.8 The Board noted that the excluded 2004 and 2005 data were years of below bus cost fare price rises. It referenced[28] the operators' argument that Nexus' reference period was selected to provide an artificially high fare increase figure as operators' own analysis (which considered shorter time periods that would generally be viewed as less robust) derived different results for average fare increases[29]. Whilst Nexus accepts the data can be interpreted in different ways, it is satisfied it made best use of the information available to it and, for the reasons outlined in evidence, maintains its position.

4.9 Nexus' view is that, while passing reference is made in its Opinion[30], the Board has failed to clearly highlight the fundamental point that including the full 10 year data set makes little material difference to the Do Minimum affordability model. Whilst the fare increase assumption may reduce from Bus Costs + 2 percentage points to Bus Costs + 1.7 percentage points when the ten years are all taken into account, the patronage levels in the Do Minimum are still lower than in the QCS and the variations in the value for money indicators are not significant.

4.10 When discussing the ticket types selected to inform the calculation of fare movements and the relevant metric in that calculation, the Board again appears

[26] First Witness statement, Mr Tom Clarke.
[27] The QCS Proposal, July 2013, 3.6.4b
[28] Paragraph 5.6, Opinion
[29] Paragraph 5.9, Opinion
[30] Paragraph 5.9, Opinion

to have misunderstood the matters under discussion.[31] With regard to the ticket types used in the modelling analysis, Nexus used adult single, day and weekly tickets which accounts for approximately 72% of the market. This was considered representative and furthermore no data was provided by the operators to evidence the trends in longer season or off-bus sales. Also, the exclusion of child tickets from the analysis was accepted by all parties. The Board indicates that Nexus accepted the metric surrounding the use of 'yield per journey' rather than 'yield per ticket' approach advocated by the operators, and expressed concern that the Do Minimum scenario was not updated accordingly. This is incorrect. Nexus continues to hold a different view to the operators and maintains the yield per ticket is the most reasonable approach. The model was not therefore updated.

4.11 Finally, the Board criticised Nexus for failing to compensate for 'shocks' which occurred between 2006 and 2014 in the analysis.[32] It provided examples of shocks which, in its opinion, have generated steep increases in fares and should be eliminated from the analysis. Firstly, Nexus does not credit the main example offered by the Board. It is suggested by the Board that a steep increase in fares in 2010 was a result of the reduction in BSOG which took effect on 1st April 2012. Both the timing and the fact that the fuel upon which BSOG is paid accounts only for 15% of bus costs does not support a direct cause and effect.

4.12 The Board also fails to acknowledge that during the period of analysis, beneficial 'shocks' have also occurred. For example, unprecedented low levels of inflation in recent years will have influenced the fare strategy of operators. The Board did not appear to consider whether this period of very low fare increases should also be removed from the analysis.

4.13 Whilst the Board maintains that the Nexus model overstates the likely fare increases in the Do Minimum and therefore paints an overly pessimistic picture, it does not properly define overly pessimistic. In its Opinion, the Board itself advances an alternative methodology for the bus costs + 'x' percentage points calculation[33]. We believe that the point the Board is attempting to make is that removal of outlying figures in a series can lead to different results, rather than proposing that this is the correct figure.

4.14 It is important to note that even when using the operators proposed fare increases, Nexus calculates the Do Minimum scenario may be delayed by only a year at most. It is not avoided or moderated. Fundamentally, even under the alternative methodology proposed by the Board, bus fares will increase ahead of inflation in the future and therefore bus patronage will fall. This is a decline that the QCS will avoid as fares are pegged to inflation. This is a point that the Board appears to have not understood.

[31] Paragraph 5.7, Opinion
[32] Paragraph 5.9, Opinion
[33] Paragraph 5.9, Opinion

4.15 **The Board stated that the reimbursement for concessionary travel was in reality more complicated than the 'no better, no worse' principle as it was subject to negotiation**.[34] By implication, this casts doubt on Concessionary Travel reimbursement assumptions in the Do Minimum scenario. Nexus is clear that its approach to reimbursement reflects the no better, no worse principle.

4.16 Despite its concerns, the Board still found that QCS patronage will be above that of the do minimum[35] which indicates Criterion A is satisfied. However, the Board then raised a number of other issues on Affordability, Risk and Optimism Bias which affected their conclusions, and which are considered below.

<u>Affordability, Risk and Optimism Bias</u>

4.17 **The Board considered the affordability of the scheme[36]**, asserting it is an important factor in deciding whether Criterion A is satisfied as it determines whether the intention to limit fare increases to RPI can be maintained. The Board stated that any judgement on affordability would be informed by a number of factors including an assessment of risk. Nexus notes that concerns regarding the affordability of the Scheme would affect each of the Public Interest Criteria and therefore applying this only in respect of individual criteria is inconsistent. Also, the affordability of the Scheme is not relevant only to Nexus' approach to fare increases, as this would be just one of a number of potential mitigation measures that Nexus would consider were affordability different to that modelled. This was clear from both evidence provided to the Board, and Nexus' overall case.

4.18 **The Board expressed concerns about the adequacy of the quantum of the risk contingency**[37]. Firstly, the Board suggested it was not clear why Nexus based its contingency on four risks when the QCS Value for Money Assessment: Record of Risk Assumptions identified 26 possible risks. This pays no regard to extensive written and oral evidence supplied by Nexus' Director of Finance and Resources[38]. He explained the methodology behind the identification of the risks (in relation to both costs and fare revenue) and the contingency calculation. The additional risks highlighted in the Record of Assumptions were not considered as likely, and were certainly not expected to crystallise all at once and for the duration of the Scheme. If the Board is suggesting that Nexus should have sought to extensively mitigate all downside risks, this is an approach that no transport body – public or private – would advocate. It is important to note that, in practice, Nexus was clear the contingency was not ring-fenced to specific risks and it would be used to mitigate any that arose.

[34] Paragraph 5.4, Opinion
[35] Paragraph 5.9, Opinion.
[36] Paragraph 5.10, Opinion
[37] Paragraph 5.20, Opinion
[38] Mr J Fenwick 210715:20:8 /3.11, Affordability Analysis, Nexus Oct 2014/ First Witness Statement of Mr John Fenwick, paragraph 58

4.19 Secondly, the Board questioned the acceptability of a contingency which would be adequate 69% of the time[39]. To say, by extension, that the risk contingency is inadequate 31% of the time assumes that Nexus takes no remedial action to rectify and mitigate any financial pressures, despite making clear in written and oral evidence that it already does in relation to other aspects of its operations and would expect to do so within a QCS[40]. As the Board acknowledges, there are several levers available to Nexus to manage the risks[41] but it fails to make that connection when forming an opinion.

4.20 Further, the Board makes no reference to Nexus' Director of Finance and Resources oral evidence[42] which noted that the same risk modelling indicated there was a 51% chance that the risk contingency would never be utilised and an equal 31% probability that the scheme would generate a surplus of £173 million. The Board, in fact, states that "it appears more likely than not that the scheme will run into funding issues".[43] The Board appear to accept the risk contingency will be adequate 69% of the time, therefore Nexus would suggest the use of the phrase 'more likely than not' is misleading and incorrect.

4.21 Nexus and the Combined Authority were also very clear that given their experience and ability to manage risks, implementing a scheme that has an adequate risk contingency 69% of the time was preferable to the alternative of the adverse impacts associated with a very certain Do Minimum scenario.

4.22 Thirdly, the Board argues that the QCS was structured in such a way that it would import the highest possible risk to the public sector because Nexus had accepted revenue risk, and it was not necessary for a QCS to be structured in that way.[44] It indicates Nexus elected to take revenue risk to address 'it's wider funding issues'. This is incorrect. Nexus had to accept revenue risk because it only had access to limited operational and revenue data as the incumbent operators refused requests to share such data. Market consultation was clear that operators who were not currently present in Tyne and Wear would not tender under any other arrangement due to revenue data not being available. This was a well-considered and researched decision that was not adopted to address wider funding issues.

4.23 Fourthly, the Board was concerned about the availability of risk contingency in the early years of the QCS[45]. Nexus does not share this concern. As explained by Nexus' Director of Finance and Resources and noted above, Nexus would take remedial action as and when risks arose. In addition it is likely that a sizeable amount of potential risks would crystallise before contracts are awarded, which means that Nexus would have significant opportunities to deploy

[39] Paragraphs 5.17 and 5.20, Opinion
[40] Examples include Paragraph 5.18, Opinion and Mr P Woods 200715:43:7
[41] Paragraph 5.16, Opinion
[42] Mr J Fenwick 210715:24:18
[43] Paragraph 5.29, Opinion
[44] Paragraph 5.19, Opinion
[45] Paragraph 5.28, Opinion

appropriate mitigation strategies before any expenditure on contracts was committed. This could have even meant not introducing the QCS at that stage if the affordability and risk modelling pointed to it. Adopting such remedial action, including the deployment of any mitigation strategies, would reflect the way in which Nexus and the Combined Authority currently manage local government finances on a day to day to basis.

4.24 Finally, Nexus questions the reality of the Board's expectations. Nexus maintains the introduction of the QCS is a contract management exercise, delivering an established service to an existing market. The Board did not enquire as to the risk contingencies currently allocated by the bus operators but Nexus estimate that a third of annual profits would need to be retained simply for risk mitigation if a similar standard was to be applied in the deregulated market.[46] This is not realistic or appropriate. The approach Nexus has taken when modelling risk is conservative; Nexus does not hold a contingency in its Metro budget on the same scale, and would argue it is highly unlikely that any bus operators do either.

4.25 The Board then introduced a concept which had not previously been raised as a concern by any party, including the operators. **It argues that Nexus should have applied an optimism bias to its figures**, using either the 'roads' and 'outsourcing' uplifts as sensible indicators[47] Nexus outlines its detailed position on Optimism Bias (OB) in Addendum A but the response is summarised here. Nexus rejects the Board's position as it is not supported by guidance and does not recognise the specific characteristics of the QCS. Primarily, optimism bias is applied where there is uncertainty over costs and this is not the case for most costs associated with the QCS.

4.26 The cost of the QCS comprises several elements including operating costs and the number of buses operating at the time of making the Scheme, the rate of growth of operating costs during the Scheme's life and the cost of quality improvements in the QCS. In the majority of instances, there is a reasonable degree of certainty about the costs, or there is evidence that Nexus has used independent, unbiased forecasts (thus rendering OB unnecessary) or they are capital costs to which OB has been applied.

4.27 Nexus maintains this is a defined, existing offer with well understood risks. The costs of a QCS will become significantly more certain *before* quality contracts are awarded. On receipt of tenders, it will be clear to Nexus whether its assumptions are correct and an appropriate strategy can be adopted prior to award. This further mitigates the need for OB during scheme operation.

4.28 The Board suggests rates of OB of between 15%[48] and 41%[49] could be considered. Given there are no relevant case studies, guidance invites the

[46] Mr J Fenwick 210715:21:16
[47] Paragraphs 5.21 to 5.27, Opinion
[48] Paragraph 5.24, Opinion
[49] Paragraph 5.26, Opinion

scheme promoter to consider downside cost risks in order to assess a sum to be set aside in contingency (as Nexus has done) rather than classify a scheme inappropriately on account of it being 'closer than any of the other options'[50]. Nexus has applied OB to the capital costs of the Scheme in line with guidance. Nexus has not applied OB to the operating costs of the Scheme, this has now been reviewed thoroughly (as set out in Addendum A) and Nexus' calculations, based upon a rigorous application of relevant guidance, indicate an adjustment of £620,000 might be appropriate (this represents 0.04% of the total operating costs of the scheme over 10 years) – this sum stands in contrast to the Board's suggestion that OB should be evaluated between £240m (15% of operating costs) and £656m (41% of operating costs).

4.29 Finally, Nexus considers that if OB is appropriate to the QCS, it should also apply to the VPA to reflect optimism in actual delivery, the timescales for delivery and the outputs of that delivery associated with the VPA.

<u>Summary</u>

4.30 Notwithstanding that the QCS Board found QCS patronage would be well above that in the Do Minimum they still found that Criterion A had not been satisfied because:

a) they concluded that the Nexus model overstated the likely fare increases in the Do Minimum, which paints an overly pessimistic picture;
b) they determined that there had been no application of Optimism Bias, which in their view meant that the level of risk contingency was highly likely to be inadequate, particularly in the early years; and
c) taking into account their view of affordability, they determined that it was more than likely that the scheme would run into funding issues and that would put pressure on the fares and therefore the network.

4.31 For the reasons outlined in this chapter, Nexus does not accept these arguments. Furthermore, the Board's conclusions do not demonstrate how they have linked these three requirements to the necessary impact on patronage under the QCS compared to the Do Minimum, making it impossible for Nexus to identify the basis of their decision. From Nexus' perspective, irrespective of the points raised by the Board, the Do Minimum scenario is likely to present a worse outcome than the QCS in respect of patronage levels, and the Board has not provided any compelling evidence, or coherent analysis, to support their conclusions.

4.32 As the QCS Board accept patronage in the QCS exceeds the Do Minimum before consideration of these factors, Nexus is strongly of the view that Criterion A has, in fact, been satisfied.

[50] Paragraph 5.24, Opinion

5 Service quality will improve as a result of the proposed scheme – Section 124 (1)(b) Transport Act 2000

5.1 Criterion B is satisfied if it can be demonstrated that the proposed QCS will improve service quality.

5.2 **The QCS Board found that Criterion B was satisfied**.

5.3 However, there are still two points to note. The Board did not credit that avoiding the service reductions in the Do Minimum represents a service quality improvement.[51] It argued that unlike Criterion A, arresting a decline in patronage is not relevant in Criterion B. Nexus accepts that the patronage carried by services which would otherwise not operate cannot be considered when assessing Criterion B. However, the retention of unique network links and services to key destinations such as schools, hospitals and places of employment that would otherwise not be offered should be considered a quality benefit of the scheme.

5.4 Whilst the Board also accepts that the QCS fares and ticketing offer does provide benefits and is a relevant improvement in quality[52], it highlights that significant improvements offered by the bus operators are reducing the differential.[53] At the time of writing, it is noted that the roll out of multi-operator smart ticketing within Tyne and Wear has yet to deliver in line with their commitment made to the QCS Board and in correspondence with the Chief Executive of Newcastle City Council. The credibility of partnership delivery commitments will be discussed further in **Criteria D and E**.

[51] Paragraph 6.3, Opinion
[52] Paragraph 6.4, Opinion
[53] Paragraph 8.22, Opinion

6 **The proposed scheme will contribute to the implementation of the local transport policies – Section 124(1) c Transport Act 2000.**

6.1 Criterion C is satisfied if the proposed QCS contributes to any of the transport policies published by the NECA.

6.2 **The Board found that Criterion C was satisfied.**

6.3 It is noted that the Board’s views in regard to the affordability of the Scheme affecting Nexus’ ability to satisfy Criterion A, is not extended to its consideration of Criterion C, which relies on the same benefits from a QCS being delivered. Nexus agrees with the Board’s judgement on Criterion C, but as set out previously does not consider the Board’s judgement on Criterion A to be appropriate.

7 The proposed scheme must provide value for money – Section 124 (1) d Transport Act 2000

7.1 Criterion D is satisfied if it can be demonstrated that the proposed QCS will contribute to the implementation of the policies in a way which is economic, efficient and effective.

7.2 The QCS Board found that Criterion D was not satisfied primarily because:

a) The effectiveness of the QCS was overstated due to errors in the modelling;
b) In particular, Nexus attributed benefits associated with simplified ticketing to passengers who did not buy a ticket;
c) The assertion that simplified ticketing and the customer charter were simply a proxy for a wider package of benefits is not supported by core documentation; and
d) It was unreasonable to include the soft factors benefits associated with the customer charter.

7.3 By way of context, Steer Davies Gleave (SDG) were commissioned in early 2013 to develop an economic appraisal for the QCS proposal. The appraisal, which was applied to both the QCS and the VPA, assessed the monetised benefits and costs of each option and compared them with the Do Minimum scenario. It drew inputs from both the Nexus Affordability Model and the QCS Economic Model. The latter model was designed by SDG to provide indicators of economic performance, using processes drawn from WEBTAG (the DfT's guidance on appraising transport projects and proposals). Specifically, WEBTAG informs practitioners of best practice in transport models that provide evidence in the appraisal of transport schemes. The appraisal evolved over time to reflect feedback offered by the bus operators, the only consultees to comment on the detailed methodology and approach to the appraisal. Despite this, detailed concerns were still raised in evidence and at the oral hearings about the application of certain economic benefits.

<u>Errors in Modelling</u>

7.4 Nexus accepts some errors were made during the development of the economic appraisal, but all were corrected following careful consideration. Some of the matters reported as errors by the operators' advisors were, in fact, differences of expert opinion about how matters of the QCS and VPA should be modelled. The treatment of the value of a package of bus soft factors in Nexus' economic appraisal, described in more detail below, is an example of this.

7.5 The process of developing the economic appraisal evolved over time, in light of feedback from consultation, detailed discussion on differences of expert opinion and the identification of some errors. Given this was a complex model without precedent it is unrealistic to expect that development would not be required. Despite the operators making much of the evolution of the Value for Money indicators, it is noted that Nexus' calculation of the Net Present Value of the QCS (consistently the key indicator from Nexus's perspective) remained stable throughout the process. The NPV for the VPA evolved but largely in line with the evolution of the VPA itself, such that it became closer to the NPV of the QCS.

7.6 The Board acknowledged this subject is complex and detailed[54], the outputs have been extensively scrutinised and it was satisfied the majority of issues had been addressed. The Board focuses the Opinion on the remaining areas of disagreement.

<u>Soft Factors – simplified ticketing</u>

7.7 **The operators expressed a concern that Nexus has attributed too high a benefit to existing bus users in the QCS arising from the implementation of simplified ticketing.**[55]

7.8 Firstly, they argue that Nexus' economic advisor had applied the wrong value of perceived time (using what is known as a non-segmented value) to reflect the introduction of simplified ticketing such that it would generate too high a benefit. Whilst Nexus does not necessarily agree with all aspects of the Board's rationale when evaluating this issue, the Board found Nexus' approach to be reasonable.

7.9 Secondly, **the operators complain that in applying the benefits of simplified ticketing and the customer charter to all passengers Nexus is in error** as it has applied the benefits of simplified ticketing to concessionary passengers who will not buy a ticket.[56] Whilst the Board credits this argument, Nexus does not. Nexus' advisor explained that the package of simplified ticketing and customer charter benefits was a conservative proxy for the value of a much wider package of soft factors benefits introduced by the QCS. He confirmed, given his extensive experience, that this compares well with the application of soft factors benefits for other transport schemes.

7.10 As the explanation of this approach is absent in full detail from the Public Interest Test report, despite being documented in great detail in evidence[57], the Board suggested the possibility that the advisor may have 'reverse engineered' his approach.[58] Nexus is disappointed with the Board's opinion on this matter, which appears to place limited weight on the testimony of our expert advisor.

7.11 Finally, the Board expressed a concern that **Nexus could now be in error applying the full benefit of simplified ticketing to the QCS without ascribing some benefit to both the VPA and Do Minimum**[59]. It acknowledged that it was appropriate for Nexus to apply the full value at the time of modelling but highlighted that the significant developments in fares and ticketing in recent months mean the Do Minimum would be 'greatly enhanced' and should be

[54] Paragraph 8.5, Opinion
[55] Paragraph 8.6, Opinion
[56] Paragraph 8.15, Opinion
[57] Paragraphs 115 to 117, First Witness Statement of Mr Stephen Hunter
[58] Paragraph 8.20, Opinion
[59] Paragraph 8.22, Opinion

reviewed. Nexus disagrees with the Board's interpretation. The offer does little to *simplify* fares or the product range. Instead, it offers new ways to pay for existing products and even adds to the number of products.

7.12 However, as a result, the Board elect to apply an arbitrary discount of 12.5% 'for the purposes of the report'[60] to the QCS simplified ticketing value with no justification or supporting evidence for that specific value. Given the lack of reasoning and the arguments above, Nexus disagrees with this finding.

7.13 Generally, this assertion by the Board raises significant concerns. It again demonstrates inconsistency in its approach. Elsewhere in Criterion D[61], the Board discounted evidence from Nexus which it argued was presented too late in process. NEBOA submitted a detailed letter to the Chief Executive of Newcastle City Council on 9th July 2015[62], two working days before the QCS Board hearings commenced. It outlined the fares and ticketing commitments which underpinned Mr Montgomery's oral evidence. It is to this evidence that the Board refers when applying a reduced benefit from simplified ticketing to the QCS. It is noted that these commitments are yet to be delivered by operators in the manner set out by Mr Montgomery.

7.14 It also raises the issue of when the business case should be 'frozen'. The bus market is an evolving offer, the business case process is complex and update of the supporting models is a substantial exercise. Nexus believes it is unrealistic to expect the business case and supporting models to reflect the market in real time.

Soft Factors – customer charter

7.15 When considering the customer charter, the Board expressed two concerns with which Nexus disagrees. Firstly, **the Board questions the degree to which it goes beyond that already in place in the main bus operators.** It fails to recognise that in the deregulated market there are at least 16 different companies that could be involved in the customer experience in Tyne and Wear. Rather than the specific characteristics of the charter, the primary benefit is the customer has one point of call and one set of standards to reference. Logically, this generates greater customer confidence.

7.16 Secondly, **as the soft factors research on the customer charter was based on the introduction of a Go North East charter, would the QCS charter offer more than current charters? The Board also questions whether it should be considered a statistically significant measure**[63]. Nexus' advisors used the best information available, drawn from a recognised study commissioned by the Department for Transport. Statistical significance is not, as the operators claimed, a binary measure that either has a statistically significant value or is zero. Instead, the value of benefit for the customer charter is a relevant measure

[60] Paragraph 8.22, Opinion
[61] Paragraph 8.30, Opinion
[62] Letter from NEBOA to Ms P Ritchie dated 9th July 2015
[63] Paragraphs 8.25 and 8.26, Opinion

but with a lesser certainty. Nexus believes the QCS customer charter will add additional benefits to passengers that will influence bus use which, as a minimum, are commensurate with the value ascribed to the Go North East charter.

7.17 Despite acknowledging the QCS customer charter had much to commend it[64], the Board therefore found it was unreasonable to include the soft factors benefits associated with the charter. Combining this with the removal of simplified ticketing benefits from concessionary travellers and the 12.5% discount to represent simplified ticketing benefits in the Do Minimum and VPA, (none of which are accepted by Nexus), generates a significant negative impact on the effectiveness, efficiency and Net Present Value (NPV) of the QCS[65].

VPA – Additional Buses

7.18 The version of the VPA proposed by the operators and before the QCS Board included provision for 50 additional buses into the network. The treatment and calculation of the benefits applied to those vehicles remains a significant area of disagreement between Nexus and the operators, and was discussed by the Board.

7.19 Firstly, the Board did not share Nexus' concerns regarding the deliverability of the benefits and saw no reason to discount the level of benefit derived from their introduction. In fact, the Board was extremely confident about both the delivery of the vehicles and the benefits attributed to them, stating 'The Board has no doubt that, should the operators enter into a VPA, they would deliver the promise to introduce additional buses. They are highly likely to do on the routes most likely to give a higher rate of return'[66]. Nexus queries how the Board reached this conclusion given the evidence provided by Nexus[67], and reinforced during the oral hearings[68], confirmed that there are currently no plans in place for over half of these vehicles.

7.20 Secondly, during oral evidence Nexus' advisor confirmed that should any of those 50 vehicles be introduced before the partnership commences, it was inappropriate to reference the benefits of those particular buses in the appraisal of the VPA. They would instead transfer to the Do Minimum evaluation. The vehicle uplift in the VPA would be reduced accordingly, or the operators must commit a further 50 new vehicles post partnership introduction to retain the level of benefit. The Board accepted this approach was technically correct[69] but disregarded it on the basis that it was 'too late to introduce this new argument'. Given evidence submitted by Stagecoach[70] the Board was aware that vehicles

[64] Paragraph 8.24, Opinion
[65] Paragraph 8.26, Opinion
[66] Paragraph 8.28, Opinion
[67] Paragraph 310, 1st witness statement of Mr Tobyn Hughes
[68] Mr N Knox : Day 3 150715/28/9 and Mr Kevin Carr : Day 4 160715/113/11, 160715/119/9
[69] Paragraph 8.29, Opinion
[70] Paragraph 83 iv to vi, 1st witness statement of Mr Phil Medlicott and P Medlicott : Transcript : Day 3 150715/7/5

may be introduced before the partnership started therefore this concept was not new.

7.21 Nexus believes the Board has again been inconsistent. As noted in paragraph 7.13, it saw fit to accept and rely on detailed operator evidence which was submitted two working days before the oral hearings commenced. However, here the Board disregarded evidence which was not new but was simply an explanation (established under cross examination) of the logical impacts of evidence already submitted by operators. Ultimately this information has a considerable bearing on the economic appraisal of the VPA. Should this benefit not be included, the VPA's performance would deteriorate when compared to the QCS. Also, as documented in paragraphs 7.11 and 7.12, the Board argued that it was appropriate to adjust benefits given the proposed developments in the fares and ticketing offer of the Do Minimum. Here, Nexus believes it is appropriate to adjust the benefits attributed to vehicles given changes in the Do Minimum yet the Board does not credit the approach.

7.22 The Board also argued that the approach of Nexus' advisor 'exposes a major weakness…in that operators appear free to introduce as many buses as they wish to the Tyne and Wear network and all those buses will become contracted from the date the QCS becomes live.'[71] It appears that in making this statement the Board is confusing the appraisal of passenger benefits with an assessment of affordability, consequently Nexus does not understand this concern. Rationally, it must be assumed any new buses will attract new revenues which will match or exceed costs if a commercial operator chooses to run that service. The Board itself implies this when suggesting vehicles will be introduced on routes 'which give a higher rate of return'[72]. The overall affordability of the QCS will therefore be unaffected.

Summary

7.23 The QCS Board found that Criterion D was not satisfied primarily because:

a) The effectiveness of the QCS was overstated due to errors in the modelling;
b) In particular, Nexus attributed benefits associated with simplified ticketing to passengers who did not buy a ticket;
c) The assertion that simplified ticketing and the customer charter were simply a proxy for a wider package of soft factors benefits is not supported by core documentation; and
d) It was unreasonable to include the soft factors benefits associated with the customer charter.

7.24 As a result of its findings, the Board revised the Value for Money indicators for both the QCS and VPA as detailed in the final column of the table below.[73] This demonstrates the significant cumulative impact of the Board's amendments

[71] Paragraph 8.29, Opinion
[72] Paragraph 8.28, Opinion
[73] Paragraph 4.10, Opinion

which are often offered without any detailed or calculated rationale so making it difficult to understand the detailed basis of the Board's conclusions. This is not appropriate in a process which, to date, has warranted all modelling approaches and assumptions to be explained and justified in great detail.

Indicator (vs *do minimum*)	**Nexus Consultation 2013**	**Nexus October 2014**	**Nexus May 2015**	**QCS Board Nov 2015**
		QCS		
Effectiveness (£m)	1606	373	398	251
Economy (£m)	-262	-100	-120	-121
Efficiency	1.2	3.7	3.4	2.07
NPV (£m)	262	272	279	130
		VPA		
Effectiveness (£m)	7	229	251	190
Economy (£m)	-3	-65	-51	-47
Efficiency	1.9	3.5	5.0	6.30
NPV (£m)	3	165	200	141

7.25 For the detailed reasons outlined in this chapter, Nexus does not accept the Board's position. Further Nexus would highlight:

a) Some of the matters reported as errors by the operators' advisors and accepted as errors by the Board were, in fact, differences of expert opinion about how matters of the QCS and VPA should be modelled;
b) The process of developing the economic appraisal evolved over time, in light of feedback from consultation, detailed discussion on differences of expert opinion and the identification of some errors. Any errors were corrected in a timely fashion following careful consideration;
c) Despite the operators making much of the evolution of the Value for Money indicators, it is noted that Nexus' assessment of the Net Present Value of the QCS (consistently the key indicator from Nexus' perspective) changed little throughout the process and changes to the NPV of the VPA were largely driven by the evolution of that agreement;
d) The NPV of the QCS, whether using Nexus' or the Board's figures (which Nexus does not accept), remains a significant positive value for money figure in its own right; and
e) Nexus and its advisor maintain their approach is compliant with WEBTAG and uses appropriate data sources to assess the economic performance of the QCS, VPA and Do Minimum.

8 Any adverse effects of the proposed scheme are proportionate to the improvements in well-being – Section 124 (1)(e)Transport Act 2000

8.1 Criterion E is satisfied if it can be demonstrated that any adverse effects of the proposed scheme on operators will be proportionate to the improvement in well-being of persons living or working in the area to which the proposed scheme relates and, in particular, to the achievement of the objectives mentioned in Criteria A to D.

8.2 The QCS Board found that Criterion E was not satisfied because:

a) The scale of losses for incumbent operators was considered too great;
b) The benefits to the travelling community of Tyne and Wear are largely intangible, and apart from where they contribute to patronage growth, are unlikely to be demonstrated to have been delivered; and
c) The VPA appears to be a less intrusive option.

8.3 Paragraph 68 of the guidance states that in determining whether this criterion is met, the Board can be expected to consider:

a) Whether the LTA has properly identified the significant adverse impacts on the operators that might arise and made a reasonable assessment of the potential severity of those impacts and their likelihood of arising;
b) Whether the LTA has formed a reasonable assessment of the likely benefits to persons living or working within the area of the scheme; and
c) Whether the LTA has acted reasonably in concluding, on the basis of all the evidence available to it, that the identified adverse impacts are proportionate to the identified benefits.

<u>The calculation of Adverse Impacts on Operators</u>

8.4 Throughout its discussion of Criterion E, the Board reiterates its basic concern that the quantifiable adverse effects on incumbent operators are too significant. The Board found 'it highly unlikely Parliament intended implementation of quality contracts schemes to lead to hard cash impacts of that order of magnitude on individual businesses'[74]. It compares the maximum adverse effects figure with a fine imposed on Barclays for unlawful activities by its staff when manipulating the foreign exchange markets to demonstrate why risking imposing a financial impact of a similar order through the QCS was 'clearly massively disproportionate'.[75]

8.5 Nexus maintains the adverse effects analysis is compliant with the legislation and supporting guidance, and therefore does not consider that the Board's assumption is correct or supported by evidence. The DfT Summary Analysis and

[74] Paragraph 9.25, Opinion
[75] Paragraph 9.26, Opinion

Evidence attached to an explanatory memorandum on QCS[76] outlines potential net benefits of up to £71m, certainly indicating adverse effects could be a sizeable number. It is on the basis of this type of evidence that Parliament would have made its decision. When debating the Bill itself, Lord Snape noted that '*Many people in the bus industry believe that if the quality contract route is to be followed without some of the safeguards that Ministers have indicated will be provided, much of their business—whether lawfully or not will be for the courts to say—will be confiscated*'.[77] This clearly demonstrates that Parliament was fully aware of the potential impact on operators. Nexus therefore contends that speculation about Parliament's intention and drawing comparisons to unrelated cases from other industries is an inappropriate basis for the Opinion.

8.6 There are several other matters in relation to the adverse effects calculation that are concerning for Nexus. Firstly, throughout its analysis, the Board has sought to mathematically compare only monetised benefits to monetised adverse effects[78]. Nexus would argue this weakens the Board's evaluation as it does not reflect the tenor of QCS guidance. The statutory guidance clearly states it will not always be possible to apply a cash value to impacts identified[79], indicating any assessment should be qualitative as well as quantitative. The Board did not appear to recognise the qualitative elements of the assessment.

8.7 Secondly, when completing its analysis, the Board adopted the mean figure of the adverse effects calculation as the comparator, the rationale being that 'neither the highest nor the lowest levels of impact are likely to happen'.[80] Nexus believes the adoption of the mean figure as a proxy for adverse effects is inappropriate and misleading, and the *range* of adverse effects must be considered when considering proportionality. Again, this is borne from the Board's intention to make the overall proportionality assessment a simple mathematical calculation, an approach Nexus and the guidance does not support.

8.8 Thirdly, when considering detail, the Board expressed concerns about the value of some adverse effects on incumbent operators[81], stating '…we are satisfied that these have been understated in a number of areas, for example in relation to costs associated with bus depots which are no longer viable'. However, it provides no detailed justification for this statement or further recommendations to allow Nexus to respond or review calculations. Using the only example offered, the figures included in the calculation of adverse effects were provided by the operators themselves, subject only to discounting to 2010 prices to ensure the figure was comparable to the economic analysis. Whilst Nexus appreciate much of the adverse effects evidence is confidential in nature, Nexus is permitted to

[76] Paragraph 10, http://www.legislation.gov.uk/uksi/2009/3244/pdfs/uksiem_20093244_en.pdf
[77] Local Transport Bill in the House of Lords, 18th November 2008
[78] Paragraph 9.18, Opinion, highlights this point
[79] QCS Statutory Guidance, paragraph 64, final bullet point
[80] Paragraph 9.25, Opinion
[81] Paragraph 9.5, Opinion

have sight of such material. It is therefore unhelpful that the Board did not offer further feedback or justification on a redacted basis.

8.9 Finally, in evidence, Nexus argued that the size and support of an operator's larger group is important in mitigating the impacts of adverse effects on a local operator. The Board indicated that it had seen no evidence that the size of the parent group is a relevant consideration when calculating adverse effects. However, this is contrary to its own findings[82]. It refers to the ability of the group to absorb vehicles which may not conform to the QCS specification, and therefore mitigate the impact of stranded assets. This demonstrates inconsistency in the Board's findings.

Well-being benefits

8.10 The Board's evaluation of well-being benefits in the QCS is limited and Nexus does not credit the points made. The Board suggested that wider benefits are 'largely intangible' and should therefore be given less weight.[83] This is an entirely subjective viewpoint. Nexus has used the best available information to quantify the benefits and the Board does not offer any suggestions as to how better such benefits could be quantified[84].

8.11 The Board used the assessment of well-being to imply Nexus completed a more extensive analysis of the QCS than the VPA. It cites the QCS analysis stretched to 23 pages as opposed to only 3.5 pages for the VPA[85]. The guidance requires that some consideration is given to alternatives. Nexus is very clear it has extensively considered the alternatives. Whilst Nexus contends a page count is not a relevant consideration, rather it is the substance of the material that is of importance, it is unclear what analysis of VPA benefits the Board has actually considered. The description of VPA benefits in the Public Interest Test, which is presented in the same format as the QCS, begins on page 285 and ends on page 312. This indicates 27 rather than 3.5 pages. It is of concern if the Board had not identified and reviewed such significant evidence.

Consideration of Alternatives

8.12 Criterion E requires some consideration of the alternatives, and accordingly the Board discussed the VPA. It particularly debated whether, in light of the termination arrangements included in the agreement, the VPA can be considered a reliable alternative. This was a particular concern of Nexus as it could undermine the delivery of all of the benefits claimed by the VPA and was flagged up several times during the evolution of the agreement[86] .

8.13 When evaluating this concern, the Board primarily referred to the commitments to review the termination clauses made by the operators in a letter to the Chief

[82] Paragraph 5.15, Opinion
[83] Paragraph 9.23, Opinion
[84] Paragraph 9.24, Opinion
[85] Paragraph 9.10, Opinion
[86] Paragraphs 9.12 to 9.15, Opinion

Executive of Newcastle City Council delivered two working days before the oral evidence sessions began.[87]

8.14 The Board's consideration of this matter is at odds with other elements of the Opinion. Here, the Board expressed significant sympathy with the view of Nexus that some of the benefits of the VPA may not have materialised, and despite the commitments in the NEBOA letter of 9th July[88], understand why Nexus continues to be sceptical about the likelihood of improving the termination clauses[89]. Where the Board has expressed similar concerns elsewhere in the Opinion, they have adjusted the benefit attributed[90] but no such action is considered here. This appears to be an important inconsistency which has a significant bearing on the consideration of both Criteria D and E of the Public Interest Tests.

8.15 The Board also failed to acknowledge that even if the VPA is considered a less intrusive option, it still does not achieve the same outputs and, therefore the same objectives, as the QCS. This is relevant when considering the legal tests which underpin proportionality[91] as achievement of the objectives is an important consideration.

<u>The proportionality assessment</u>

8.16 As explained in paragraph 8.6 above, the Board sought to make the proportionality assessment a mathematical calculation. Nexus does not agree with this approach.

8.17 The Board acknowledged that it is appropriate to attach different weight to different benefits and adverse impacts, according to the likelihood of them arising.[92] The Board argued that given the 'uncertainty' in relation to interpretations of the Aecom study regarding soft factors[93] and that 'the operators have demonstrated that at least the minimum level of impact is highly likely to occur'[94], it is appropriate to prioritise the quantified adverse financial impact on operators when assessing proportionality. Nexus agrees that benefits should not be compared on a like for like basis to the potential cost impact on the operators. However, Nexus would argue that the wider societal benefits may be viewed *a*s more important than the adverse effects because some societal benefits are not capable of being quantified but are nevertheless qualitatively important to the people of Tyne and Wear. This raises a fundamental point of principle as to whether weighing the public benefit against the private loss of existing operators is an appropriate test of the costs and benefits of a regulatory regime.

8.18 The Board's approach also does not acknowledge that lost or reduced future profits themselves are highly intangible given they have yet to be earned and rely

[87] Paragraph 9.12, Opinion

[88] Letter from NEBOA to Ms P Ritchie dated 9th July 2015

[89] Paragraph 9.14, Opinion

[90] For example, paragraph 8.22, Opinion

[91] Paragraph 9.17, Opinion

[92] Paragraph 9.23, Opinion.

[93] Paragraph 9.24, Opinion

[94] Paragraph 9.25, Opinion

on a number of factors that could be disrupted for numerous reasons – for example the arrival of new competition in the market, unexpected cost increases or the loss of public sector subsidies.

Summary

8.19 The Board did not find the adverse impacts on incumbent operators to be proportionate to the well-being benefits of the proposed scheme. As explained in the chapter, and primarily for the reasons summarised below, Nexus cannot credit this position:

a) The Board argued that the scale of impact on the operators, without compensation, is too significant and far greater than envisaged when the relevant legislation was introduced. As outlined in paragraph 8.5, Nexus analysis of the impact is compliant with legislation and statutory guidance;
b) The Board based its judgement on a narrow, monetised analysis, discrediting as 'largely intangible' the wider benefits to the travelling community of Tyne and Wear[95]. For the reasons outlined in paragraphs 8.6 and 8.10, and for its use of certain numbers as referred to in paragraph 8.7, Nexus does not believe this is a compliant approach;
c) The Board appeared to consider that the economic pound is worth more than social pound. As outlined in paragraph 8.17, Nexus believes the opposite. Collectively, the Board's position on this and the monetised nature of the calculation has a significant and adverse bearing on the final evaluation of proportionality; and
d) The Board considered that the VPA appears to be a less intrusive option. As outlined in paragraphs 8.12 to 8.15, Nexus believes the Board credits inappropriate evidence and is inconsistent in its evaluation of the alternative option and proportionality.

[95] Paragraph 9.23, Opinion

9 Other matters at issue

Pensions

9.1 Appendix 2 to the Opinion considers pensions matters. The information was classified by the Board as confidential in nature. Whilst Nexus has identified several detailed issues which cannot be replayed in this document, the Board's general approach reinforces concerns cited by Nexus when responding to other aspects of the Opinion, namely:

a) There are several examples where it is not clear that the Board has fully appreciated the arguments presented to it and, as a result, Nexus questions the assertions; and
b) Despite specialist evidence which indicated it may not be possible to accurately quantify the adverse effect of the QCS from pensions related issues, the Board propose a value with very limited justification or calculation.

Compensation

9.2 The Board's position on compensation is of particular concern to Nexus. The QCS Board commented that "…we do not consider that Parliament ever had in its mind that incumbent bus operators would be subject to losses of this scale without compensation"[96]. However, the Transport Act 2000 (as amended) is structured in such a way that area-wide schemes are permissible and the Act does not make provision for compensation.

Recommendations and evidence

9.3 Sections 126D and 126E of the Transport Act 2000 set out the formal remit of the QCS Board. Where in its opinion the criteria are not met or the consultation requirements have not been followed, it confirms the Board may recommend actions that the authority might take to remedy the situation.

9.4 As noted throughout this document, the lack of recommendations or suggestions for improvement has hindered Nexus' ability to ascertain whether a viable action plan can be established to address any perceived failings and, in respect of certain issues, to fully understand the Board's concerns.

[96] Paragraph 9.26, Opinion

9.5 This failure to fully explain certain of the Board’s concerns has been compounded by the limited justification and evidence offered in relation to several of the Board’s assertions.

10 Summary

10.1 Nexus disagrees with the QCS Board's position that further consultation was necessary as a result of changes to the economic appraisal. Any errors within or amendments to that appraisal identified through consultation feedback were addressed at the earliest opportunity. All the consultees that had expressed an interest in the economic appraisal were sufficiently engaged about the evolution of the appraisal such that further consultation was considered unnecessary. This reflected the legal advice provided to Nexus and the NECA when making the decision to refer the Scheme to the QCS Board. If this had been accepted by the Board, the statutory requirements for consultation could be satisfied;

10.2 For the reasons set out in chapter 4, Nexus disagrees with the QCS Board's conclusions arising from their consideration of affordability, risk and optimism bias in the context of Criterion A, and believes, that as a result Criterion A (increasing bus patronage) would be satisfied by the Scheme.

10.3 The QCS Board continues, in Nexus' view, to be overly generous in its consideration of the alternative partnership option. This has a direct bearing on the opinions in relation to Criterion D (value for money) and Criterion E (proportionality).

10.4 Nexus does not agree with the QCS Board's consideration of the scale of adverse effects, or with the prioritisation of the 'hard cash impacts' of the proposal on operators above the benefits to the wider public. If the approach was amended, Criterion E (proportionality) could be satisfied.

10.5 Throughout the Opinion, there are many examples where the QCS Board has been inconsistent in its evaluation of and response to evidence. Additionally, the QCS Board has offered limited or no justification for several critical adjustments made in response to perceived errors in the analysis. This undermines many of its findings across several of the public interest tests but particularly Criterion D (value for money) and E (proportionality).

10.6 Despite both the legislation and guidance expressly referring to its ability to do so, the QCS Board has offered no recommendations to Nexus to address its concerns. Had recommendations been made, it is possible that Nexus could have better responded to the Board's findings.

11 Process Review

11.1 Whilst the analysis to date has examined Nexus’ concerns with the QCS Board’s opinion, the opinion (and the QCS Board process itself) has highlighted a number of lessons to be taken into account in progressing options for delivery of the Bus Strategy.

11.2 Many aspects of the QCS process and the proposed QCS itself were not criticised by the QCS Board and indeed the QCS Board praised Nexus' ambition and intent in developing the QCS. These elements of the process and scheme will therefore assist in informing future option appraisal and engagement. This includes the practical approach to consultation and engagement, the consideration of cross boundary services and the design of employee allocation arrangements.

11.3 Some of the areas where Nexus was criticised by the QCS Board, including those where the analysis in this paper highlights continued disagreement with the QCS Board's conclusions, demonstrate the need for an even more rigorous approach in assessing different options for delivery of the Bus Strategy. These include:

a) embedding quality assurance into the process of development of options, to allow a more detailed process of iterative review of the modelling to take place in advance of consultation or external challenge. This will ensure a transparent justification for all the decisions made and improve understanding and confidence in any outputs. It will also reduce the risk of being expected to make material changes to any option due to late input of information following consultation, as occurred with the QCS.
b) ensuring a more specific information base in respect of ‘soft factors’ and other generators of patronage growth, by updating local research. This was a matter of particular uncertainty for the QCS Board and therefore more specific local research on the factors that generate growth from both current users and non-users will support any future option appraisal.

11.4 Additionally, the process of developing the Scheme to this point has provided a number of learning points that have fed into the industry engagement sessions which are informing the drafting of the Buses Bill. In particular, the need to be able to obtain complete, accurate and agreed data sets from the operators (on a confidential basis) will support effective analysis of the delivery options for the Bus Strategy. This was something that Nexus requested throughout the QCS process but never fully obtained. Provision of this data at an early stage would have allowed Nexus to carry out a more cost effective analysis, better supported the approach to network design suggested by the QCS Board in their Opinion, and reduced much of the argument at the QCS Board by allowing Nexus to carry out a full analysis of a robust data set.

11.5 Nexus has also provided feedback regarding ways that the process can be streamlined. The proposals would benefit local transport authorities, bus operators and passengers by reducing the cost and time for development of options (including potential franchising schemes), streamlining the assessment of such options, and hopefully reducing the timescale to implementation. This will ensure that passenger benefits can be delivered sooner. Nexus has also inputted on the need to reduce the risk of the legislative framework being ambiguous.

Addendum A

Tyne and Wear QCS – Application of Optimism Bias

The Tyne and Wear QCS Board, in its Opinion relating to the Tyne and Wear Quality Contracts Scheme published in November 2015, stated that Nexus' scheme was not able to deliver increases in bus patronage (Public Interest Test criterion A) because it had not applied optimism bias to the scheme's costs and delivery of the scheme was therefore too uncertain. The QCS Board suggested that a cost uplift of 41% (during the QCS Board hearings) or 15% (in paragraph 5.24 of the QCS Board Opinion) should be considered. This note sets out Nexus' position in relation to Optimism Bias and the QCS Board's Opinion regarding Optimism Bias.

1. What is Optimism Bias?

Optimism bias is an adjustment made to the appraisal of options, and defined by the Treasury Green Book[97] at paragraphs 5.61 and 5.62 as:

> *"… a demonstrated, systematic, tendency for project appraisers to be overly optimistic. This is a worldwide phenomenon that affects both the private and public sectors. Many project parameters are affected by optimism – appraisers tend to overstate benefits, and understate timings and costs, both capital and operational.*
>
> *To redress this tendency, appraisers should make explicit adjustments for this bias. These will take the form of increasing estimates of the costs and decreasing, and delaying the receipt of, estimated benefits. Sensitivity analysis should be used to test assumptions about operating costs and expected benefits."*

Paragraph 5.63 sets out the empirical basis for applying optimism bias, placing a focus on experience from past projects:

> *"Adjustments should be empirically based, (e.g. using data from past projects or similar projects elsewhere), and adjusted for the unique characteristics of the project in hand. Cross-departmental guidance for generic project categories is available, and should be used in the absence of more specific evidence. But if departments or agencies have a more robust evidence base for cost overruns and other instances of bias, this evidence should be used in preference. When such information is not available, departments are encouraged to collect data to inform their estimates of optimism, and in the meantime use the available data that best fits the case in hand."*

The Green Book draws a clear distinction between optimism bias and quantified risk assessment, the latter being the assessment of how the parameters controlling

[97] HM Treasury Green Book, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220541/green_book_complete.pdf

forecasts of future costs and benefits may outturn differently due to unanticipated influences and events. Paragraph 5.64 of the Green Book states:

> *"Adjusting for optimism should provide a better estimate, earlier on, of key project parameters. Enforcing these adjustments for optimism bias is designed to complement and encourage, rather than replace, existing good practice, in terms of calculating project specific risk adjustments. They are also designed to encourage more accurate costing. Accordingly, adjustments for optimism may be reduced as more reliable estimates of relevant costs are built up, and project specific risk work is undertaken."*

The Green Book offers further supplementary guidance on the application of optimism bias. The supplementary guidance sets out a methodology for:

- assigning a project "type" to the project in question;
- determining the lower and higher outliers of optimism bias for that project type, commensurate with optimism bias at the contract award (lower) and outline business case stages (higher) of the project;
- assessing the principal relevant causes of optimism bias for that type of project; and
- determining how each of those causes can be mitigated so that an optimism bias estimate is derived that is tailored to the particular details and stage of development of the project.

The evidence gathered in this supplementary guidance relates entirely to underestimates of project costs and durations.

The analysis above gives rise to a number of clear conclusions in relation to applying Optimism Bias:

i. Optimism bias relates to optimistic forecasts of future costs – it does not apply to costs that are current and known;
ii. Where no precedents exist that provide evidence of optimism bias, care should be taken in applying evidence of optimism bias from other similar projects; and
iii. As the detailed analysis of costs of a project advances, and assessment of residual risks becomes more robust, so optimism bias can be reduced.

2. Applying Optimism Bias in Transport Schemes: WEBTAG

WebTAG Unit A1.2[98] sets out the approach to optimism bias recommended by the DfT in relation to the costs associated with transport schemes. Paragraph 1.1.2 makes it clear that optimism bias in relation to transport schemes should be applied to forecasts of scheme costs and timescales. An approach is described in order to assess an appropriate measure of optimism bias for a specific project, where set optimism bias

[98] WEBTAG Unit A1.2, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/370867/TAG_Unit_A1.2_-_Scheme_Costs_January2014.pdf

parameters are provided for different scheme types at specific stages of scheme development (see Table 8 of Unit A1.2).

Paragraph 3.5.14 states that:

> *"There is currently insufficient evidence available for the Department to recommend any specific optimism bias uplifts for operating costs. Despite the lack of strong evidence, the Department expects scheme promoters to consider the sensitivity of their scheme's business case to changes in operating costs from those that have been forecast. Scheme promoters will be expected to justify the level of optimism bias applied to operating costs, and similarly justify a decision not to apply any uplift to operating costs."*

It is clear that in the case of operating costs, where there is no evidence to support a pre-determined level of optimism bias, analysis of the sensitivity of the economic case to variations in costs should be conducted. Promoters should justify whatever level of optimism bias that emerges from this sensitivity analysis.

3. Understanding QCS Operating Costs

There are a number of features of the QCS that should be borne in mind when applying the Optimism Bias guidance set out above:

a. The QCS's costs are almost entirely comprised of operating costs, the costs of operating quality contracts. There is a small amount of capital cost at the commencement of the scheme, but practically all of the £1.6bn costs of the scheme over the ten year period are operating costs.
b. Nexus has undertaken a detailed analysis of operating costs for the QCS, at a service by service basis, to underpin forecasts of future costs. Accordingly, the level of certainty about today's operating costs is high, which means that the lower end of Optimism Bias adjustments should be applied, if applied at all.
c. Nexus has assessed variation in these operating costs using its risk assessment model. This model undertakes, inter alia, a highly detailed and structured approach to assessing whether a risk contingency sum assigned by Nexus for the QCS will be expended.

It is instructive to analyse the components of the QCS's operating costs to determine whether, where and how optimism bias might apply, based upon the key points that emerge from guidance. The costs of operating the QCS (or the Do Minimum and VPA alternatives) can be broken down as follows:

a) The current **operating costs for a single bus**, comprising fixed costs of ownership and variable costs of operating on the road;
b) For that single bus, the way that **operating costs might increase in the future**, in response to cost inflation forecasts;

c) **The number of buses that are operated** on the road in order to deliver the QCS, which multiplied by the cost of operating each bus provides an estimate of operating costs for the whole QCS fleet;
d) The **cost of mandatory improvements to vehicles** that are required at the outset by the QCS, and the treatment of their costs;
e) The **cost of future improvements to vehicles** that may be mandated by the QCS during the contract term;
f) The **cost of mandatory and recommended improvements to staff terms and conditions** that feature in the QCS, and the treatment of their costs; and
g) The **cost of other infrastructure improvements** required for the QCS, such as new smart ticketing infrastructure.

We take each of the items in turn and examine the case for applying Optimism Bias to each.

3a. Current Operating Cost of a Bus

The current cost of operating a bus in Tyne and Wear is well understood by Nexus. The cost comprises fixed costs (the cost of owning the bus - such as purchase or lease costs, insurance costs, back office costs, etc) and variable costs (the costs of operating the bus - driver costs, fuel costs, tyres and maintenance costs, etc).

Nexus has undertaken analysis of standard cost parameters and compared these to the company accounts submitted by operators in relation to their Tyne and Wear operations, to develop estimates of current fixed and variable costs for operating a bus. These are not disputed by operators in the Statement of Common Ground.

These costs are equally applicable to a QCS operation, if the QCS was in place today. Other than the specific items considered separately at 3d below, there are no requirements of the quality contracts that would inherently change the cost of operating a bus under a QCS, compared with commercial operations. Because operators are responsible for managing operating costs under the QCS, in the same way as they are under today's commercial operations, the motivations to manage costs under the QCS are identical.

Operators have sought to claim that the QCS could lead to increased operating costs arising from needing to lease rather than purchase buses, Nexus rejects this claim because the QCS buses are "standard" and can both be assembled at the start of a QCS, and be used elsewhere in the country without modification at the end of a QCS, without significant cost. The QCS Board agreed with Nexus' position.

It is evident that the current cost of operating a bus is not a forecast, it is an estimated cost based on current evidence from Tyne and Wear operations. There are no material differences in the cost of operating a bus today in the commercial and QCS environments. **There is therefore no justification to apply Optimism Bias to the current operating cost of a single bus**.

3b. Future Operating Cost of a Bus: Application of Industry Inflation

Nexus has forecasted the way in which the current cost of operating a bus in Tyne and Wear will grow, based on established processes and forecasts. Nexus has used evidence from the Confederation of Passenger Transport (CPT) to assess the proportional cost of operating cost components – staff, vehicles, fuel, maintenance, materials, management, etc. Nexus does not consider that these component proportions are the subject of any Optimism Bias, they are drawn from current industry practice.

Each component is then inflated to future years through the application of various independent inflation forecasts – for instance staff costs are inflated by forecasts of Annual Weekly Earnings (AWE), fuel cost inflation are obtained from DECC forecasts, other costs are inflated by forecasts of Consumer Price Index (CPI). These same forecasts are used for all models of future bus operating costs – Do Minimum, QCS and VPA.

Each forecast parameter is independently sourced and has not been adjusted by Nexus. It is therefore not possible for Nexus to have viewed these forecasts in an optimistic manner. **Consequently, there is no justification to apply Optimism Bias to inflation forecasts that will determine future bus operating costs**.

3c. The Number of Buses Needed to Operate the QCS

Nexus has undertaken a detailed assessment of current commercial and secured bus timetables in order to assess the number of buses required to operate all bus services in Tyne and Wear – this is around 950 buses including spares. In the QCS, some of these vehicles (around 12%) will be operating on Excluded Services, and remain the commercial business of operators. The remainder will be operated through Quality Contracts.

The QCS requires that the service timetables at commencement of the Scheme will be the same as the network operating when the Scheme is made. Performance of services against those timetables will initially be based on levels of punctuality and reliability achieved at that time. There are no aspects of the QCS that would lead operators to require more buses to operate in the QCS environment, compared with the commercial environment at the time the Scheme is made. It is therefore reasonable that the number of vehicles required at the time the Scheme is made is the same as the QCS Day 1 number of vehicles required.

As the QCS progresses, there will be demands to alter timetables and, at times, increase the number of vehicles operating. These alterations may be required to maintain existing frequencies in the light of increasing congestion and slower end to end bus journey times. These alterations may also be proposed as part of improving service – enhanced service frequencies, lengthening service mileage or creating new services. In each case, the Quality Contracts Scheme is clear that such enhancements will only be entertained if they can be considered affordable – either because surplus fare revenue has been generated to pay for the enhancement, or because commensurate operating cost savings can be made elsewhere in the QCS network.

This is exactly the same set of considerations that commercial operators currently make in order to ensure their networks remain affordable as they develop.

The QCS is therefore clear that network enhancements can only be introduced if affordable, at the time that they are proposed. No such enhancements have been built into the current QCS cost model. **There is no justification to apply Optimism Bias to the future number of buses required to operate the QCS**.

3d. Defined Mandatory Vehicle Improvements in the QCS

The QCS requires certain enhancements to the bus fleet operated in Tyne and Wear under the QCS from Day 1 – minimum emissions standards, maximum vehicle age and maximum average fleet age. The QCS also requires that vehicles offer certain on-board features such as low floor access, CCTV, electronic ticket machines and Automatic Vehicle Location equipment. These features are already standard in most fleets operating in Tyne and Wear and across the UK, and in these circumstances they do not impose any additional costs of operators.

The cost of replacement vehicles in 2012, when current baseline operating costs were assessed, is lower than the cost of replacement vehicles today, which must comply with Euro VI emission standards – there is a known price premium that applies to Euro VI, which Nexus has applied in its cost modelling.

The QCS also requires that by the first anniversary of the QCS, all vehicles are repainted with the defined QCS brand. Some vehicles will have been acquired new or repainted anyway during the transition phase and opening year of the QCS, as part of operators' normal maintenance regime, so the QCS imposes no additional branding costs for these vehicles. For the rest of the fleet there is an additional cost for repainting that Nexus has estimated. Repainting costs have been drawn from estimates provided by Tyne and Wear operators, however it remains possible that these estimates are the subject of Optimism Bias. These costs comprise 0.04% of the overall operating costs for the QCS.

There is justification to apply Optimism Bias to some of the costs of defined mandatory improvements to buses required by the QCS. However, these applicable costs represent a fraction of the overall QCS operating costs, some 0.04%.

3e. Future Mandatory Vehicle Improvements in the QCS

There are provisions within the Quality Contracts Scheme, and the accompanying contract documentation, to add further enhancements to existing and new vehicles during the life of the QCS. These further improvements might be a fleet-wide introduction of Wi-Fi, audio-visual next stop announcements, or future innovations not yet defined. The QCS is clear that such enhancements will only be entertained if they are affordable, i.e. that existing fare revenue surpluses can cover the cost of implementation. No such costs have been included in the QCS cost modelling, because of this affordability requirement.

There is no justification to apply Optimism Bias to the cost of future mandatory improvements to buses required by the QCS, as these costs have not been included and any costs that arise must be covered by fare revenue surpluses.

3f. Defined Mandatory and Recommended Staff Terms and Conditions Improvements in the QCS

The QCS legislation requires that TUPE applies to protect existing staff terms and conditions and pensions when transferring to a new QCS operator. The cost of employing staff to operate buses under a QCS is therefore the same as under commercial operations prior to the QCS.

The QCS requires certain enhancements to staff terms and conditions, namely a two year no compulsory redundancy guarantee for all QCS operators' staff. The cost of this enhancement has been estimated, and Nexus believes it has undertaken a robust forecast as the actual likelihood of compulsory redundancy by QCS operators is low. Nevertheless this estimate of operating costs, which comprises 0.22% of all QCS operating costs, could be the subject of Optimism Bias and an uplift might be justified to this cost.

The QCS also requires further recommended enhancements to staff terms and conditions that will not be mandatory, but will attract quality marks in the assessment of contracts during the procurement phase. These enhancements relate to the payment of a basic hourly rate to driving staff, and a living wage to all bus operator staff. Nexus has used information provided by operators about their staff to calculate the effect of this uplift, which represents 0.21% of all operating costs over the life of the QCS. Nexus has used existing data to assess the cost of this enhancement, which in any event is not mandatory for QCS operators to comply with. Consequently it is considered that there is no justification for adding Optimism Bias to this cost element.

Overall, there is justification to apply Optimism Bias to some of the costs of defined mandatory improvements to staff terms and conditions required by the QCS. **However, these applicable costs represent a fraction of the overall QCS operating costs, some 0.22%.**

3g. Additional Capital Investment Required by the QCS

This final element relates to additional capital investment required by Nexus and operators in order to comply with the operating requirements of the QCS. This largely comprises additional investments, beyond those already committed by Nexus and today's commercial operators, in electronic ticketing and AVL systems. These costs have been estimated by Nexus, and Optimism Bias has already been applied by Nexus to these costs.

4. Summary

It is clear from this analysis that the QCS Board's Opinion that Optimism Bias should be applied to the QCS at a rate of 15-41% of all operating costs, is incorrect. The analysis shows that Optimism Bias is already applied to some costs, and there is only a fraction of future operating cost estimates (some 0.26%) where Optimism Bias might be applicable. Applied at 15% (the lower rate is considered applicable given the level of detailed analysis of costs already undertaken) this would give rise to an additional cost of £0.62m (£1.6bn * 0.0026 * 0.15). This is affordable within the £2.7m surplus fare revenue forecast for the QCS over its ten year lifespan.

Even in an extreme case, where a higher 41% optimism bias adjustment was made to the above costs, plus the proportion of costs associated with the basic hourly rate proposal (0.21%) and the capital costs of scheme (0.05%) the optimism bias would give rise to an additional cost of £3.41m (£1.6bn * 0.0052 * 0.41). Nexus does not believe this optimism bias adjustment is appropriate, it simply provides an extreme scenario that can be compared against the QCS Board's findings.

To give some context to the QCS Board's claim that Optimism Bias of between 15% and 41% should be applicable to all QCS costs, consider the following scenarios whereby this might arise:

a) On the day the QCS is introduced the variable cost of operating a double deck bus for one hour increases from £23 to between £26-32, and the fixed cost of owning that bus increases from £44k per annum to £51-62k per annum – despite the fact that the exact same buses can operate under the QCS as those operated elsewhere in the UK outside London;
b) Government forecasts of increases in wages, fuel and consumer prices between now and 2027 are all inaccurate by between 89% and 218%, and all forecasts are underestimates; or
c) On introducing the QCS, operators will instantly require between 140 and 390 more vehicles to operate the same service, and all of these additional vehicles will generate zero additional farebox revenue.

Nexus considers that all of these scenarios, and other illustrative examples like them, are implausible. It is therefore concluded that the QCS Board's Opinion that Optimism Bias should be applied at rates of 15% or 41% of all operating costs is irrational and should not be supported for this QCS. It should be applied consistently and appropriately to any future options that are considered by the Combined Authority to deliver its Bus Strategy.

Nexus has already applied Optimism Bias to some costs of the QCS at the appropriate rate. An analysis of the operating cost components reveals that a further Optimism Bias adjustment of £0.62m, and certainly no more than £3.41m, may be applicable to the QCS – this has no impact on the Scheme's affordability.

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