

**The Attribution Process of Delegation Contracts in the French Urban Transport Sector:  
Why is Competitive Tendering a Myth?**

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**Abstract**

*This paper analyses the French recent experience of franchising in the urban public transport sector in the light of transaction cost economics arguments. It provides theoretical arguments supported by empirical evidences explaining why the compulsory use of competitive tendering in this sector did not translate into better performance, the main reasons being the lack of expertise of local authorities and the existence of serious operators' collusive practices.*

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## 1. Introduction

Urban public transport in Europe is considered an indispensable element to support economic and social activities in modern cities, and this is probably the main reason why this sector is so politically sensitive and has been subject to State intervention all along its history mainly through regulation and subsidisation. In the recent decades however, urban public transport has moved from a profitable industry with a high modal share, to a loss-making one with, in most cases, a minority modal share. This situation of decline combined with the scarcity of public money has forced many countries to reconsider this mode of governance. The alternative advocated by the European Commission and chosen by several Member States among which France consists in introducing market mechanisms in the sector *via* competitive tendering (Commission of the European Communities 2002, MARETOPE 2002, SIPTRAM 2003).

Competitive tendering, or franchise bidding, refers to the awarding of an exclusive right to operate a route, or a network of routes, to an operator (or possibly a consortium) following a competitive process. Since the seminal paper by Demsetz (1968), this policy option has been considered as a tool of government to allow private sector participation and benefit from the efficiency advantages of *ex ante* competition while retaining some degree of control and guaranteeing the respect of community service obligations (Baldwin & Cave 1999). However, whereas the theoretical advantages of franchise bidding over traditional monopoly regulation are numerous, it turns out that, in practice, franchising public services encounters several difficulties that prevent from achieving the designated objectives (Williamson 1976; Goldberg 1976; Ekelund & Hebert 1981). Many studies, more particularly in transaction cost economics and incomplete contract theory, have indeed highlighted that the efficiency benefits from franchise bidding can be limited or even illusory (Priest 1993; Crocker & Masten 1996).

Our objective in this paper is to analyse the French experience of franchising in the urban public transport sector in the light of these arguments. We intend to assess whether the French model of regulation introduced in 1993, which combine competitive tendering rules with the *intuitu personae* principle, has been favourable to the improvement of the performance of the UPT sector. For that purpose, we rely on the transaction cost economics framework to confront the expected results of franchise bidding with the realised ones and to provide explanations of the discrepancies we observe.

The structure of the paper is as follows. Section 2 describes the French model of regulation of urban public transport and the institutional changes it has gone through. It provides a detailed description of the awarding procedure of delegation contracts in France. Section 3 provides empirical evidence on the impact of these changes on various performance dimensions and shows that the compulsory use of competitive tendering has not resulted in significant improvements. In section 4, we refer to the Transaction Cost Literature to review the sources of inefficiency of the franchise bidding process in the UPT sector in France. At last, section 5 offers concluding remarks.

## **2. The French model of regulation of urban public transport**

The recent history of the UPT sector is punctuated by two major laws, the Domestic Transport Orientation Law (known as the LOTI law) and the ‘Sapin’ Act which were promulgated in 1982 and 1993 respectively. Since these Acts, the institutional context in which urban transport services are provided in France can be concisely portrayed as follows.

Since 1982, responsibility for the organization and the management of urban public transport (UPT from now on) is decentralised to the local authorities<sup>1</sup> (LAs from now on). In other words, this means that there is no national regulator of this sector. The LAs have therefore the authority to define the characteristics of the service to be procured and to choose the mode of organization of their urban transport system. More precisely, they define the network route, schedules, fares as well as the amount of subsidies given to the sector. As regard organizational choices, regulatory rules prevent competition on the market, that is the coexistence of several operators in the same transport perimeter. The UPT services have therefore to be supplied by a single operator and for a certain period of time. The LAs can nevertheless choose between several modes of organization for the procurement of these services. Indeed, they may decide to operate the service directly, in which case the operator is a public administration. They may also choose to delegate the operation to a mixed company<sup>2</sup> (“*société d’économie mixte*”) or to a private one and have then to select a type of contractual arrangement among four main types which differ in their risk-sharing rules and hence in their payment schemes. A complete description of the organisational setting and of the contractual schemes of the French UPT is provided in Roy & Yvrande-Billon (2005). In a nutshell, the range of contracts can basically be reduced to a trade-off between cost-plus contracts

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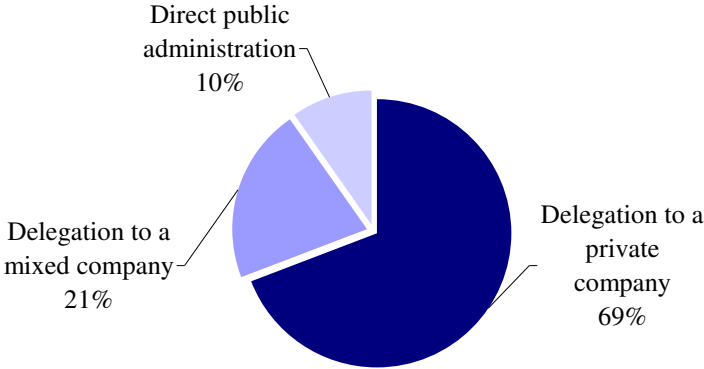
<sup>1</sup> The local authority can be any municipality or association of municipalities. Various legal forms of associations coexist (see GART 2002 for more details on this institutional aspect).

<sup>2</sup> In this case, the majority of the capital stock (at least 51% and at most 80%) is under public control.

(management contracts) and fixed-price contracts (gross or net cost contracts) (Laffont & Tirole 1993). Figure 1 and 2 summarize the situation in 2002.

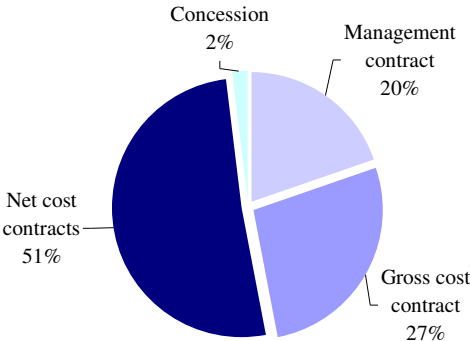
**-Figure 1: Modes of organization of the French urban public transport in 2002-**

*(in % of the number of networks)<sup>3</sup>*



**-Figure 2: Modes of delegation of the French urban public transport in 2002-**

*(in % of the number of networks)<sup>4</sup>*



A distinctive feature of France compared to other European, and more broadly OECD, countries is that about 70% of local operators are private (figure 1) and are owned by three large companies, two of them private and the third semi-public (Gagnepain & Ivaldi 2002). These companies, with their respective type of ownership and market shares in terms of number of networks operated are Keolis (private, 32%), Transdev (semi-public, 19%) and

<sup>3</sup> Source: our database of 165 local authorities out of a total of 241 existing local authorities in France. This dataset is described later on in the paper.

<sup>4</sup> Source: our database of 165 local authorities.

Connex (private, 22%). In addition there is an association of small local firms, AGIR (private, 11%), and few independent companies (private, 16%)<sup>5</sup>.

Until 1993, in the cases of delegation, the authority could select the contractor through a tendering process but was not obliged to. In other words, municipalities were not obliged to select their providers of public services by complying with objective criteria defined by law, as would be the case in a strict competitive tendering process that would impose to select the bidder proposing the lowest fee for a given level of quality. And indeed, the usual practice was to award provision contracts *via* negotiation and according to the "*intuitu personae*" principle only. Moreover, at that time, contracts were usually granted to operators for a five-years period and were usually renewed by tacit agreement. Therefore, before 1993, the French model of organization of local public services was characterized by little competition for the field and great discretionary power of the authorities.

However, following several affairs and considering the awarding procedures recommended by the EU Commission, a new law (the "Sapin" Act) was promulgated in 1993, introducing major changes in the institutional framework of the UPT sector. This Act, which aimed at preventing collusion and corruption and enhancing competition between operators, has made the use of competitive tendering compulsory and provided more explicit and detailed rules governing the attribution process. Moreover, with this law, the automatic renewal of contracts has come to an end. However, the competitive tendering legislation has neither forbidden negotiation within the procedure, nor called into question the "*intuitu personae*" principle. Indeed, since 1993, local public services providers are selected according to a two-step procedure (Institut de la Gestion Déléguée 1999; CERTU 2003b):

- *Step one: Pre-qualification of bidders.*

First, the public authority publishes a call for application in which is roughly described the service to be procured. She then draws up the list of candidates that are allowed to submit a bid. The selected candidates are those providing financial and professional guarantees<sup>6</sup>.

- *Step two: Selection of the final provider.*

Second, the local authority provides the pre-qualified bidders with a consultative document which may contain a more or less detailed description of the technical characteristics of the

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<sup>5</sup> Sources : CERTU (2003a).

<sup>6</sup> As reported by the CERTU (1996), the most frequent cause of rejection of an application is the absence of experience in networks of comparable size.

service (routes, schedules, fleet, personnel...)<sup>7</sup>, some financial information (annual reports, balance sheets...), as well as indications concerning the pricing conditions and the type of contractual arrangement the local authority intends to adopt. On the basis of the information given in this document, the selected candidates make their bid<sup>8</sup>. In average, they have 6.5 weeks to prepare and submit their offer (CERTU 1996, p.13). The local authority then chooses one or several bidders with whom she enters into separate negotiations to determine the detailed contractual terms. At the end of the negotiations, the public authority chooses the final provider.

What is important to underline is that local authorities now are bound by the “Sapin” Act to launch periodically an invitation to tender but are not bound to select the final set of bidders or the ultimate winner according to purely objective criteria. Several selection criteria can be defined in the consultative document and local authorities may refer to them<sup>9</sup>. But, on the one hand, they are not required to mention criteria. On the other hand, if they specify selection criteria, they are not bound to rank them (IGD 1999, p.85). At last, in accordance with the “*intuitu personae*” principle, local authorities are not obliged to adopt the selection rule of the lowest or even of the best bid as in traditional auctions. The French legislation indeed gives them the freedom to choose their utilities providers, considering that the assessment of the most suitable bidder is complex and cannot rest only on quantifiable criteria. This does not mean that the choice of the co-contractor can be discretionary and extraneous to the public interest. Local authorities indeed have to be able to justify their choice. The point is that their selection criteria can include subjective elements such as the reputation of the bidder or the confidence he inspires.

The second original feature of this attribution mechanism is that it combines two modes of selection that are usually considered as substitutes, namely competitive bidding and negotiation (Bulow & Klemperer 1996). The literature on procurement, in its recent developments, indeed views auction and negotiation as alternative ways to select a provider of goods or services, each one presenting its own advantages and limits (Manelli & Vincent 1995; Bajari, McMillan & Tadelis 2003). Thus, while competitive bidding is perceived to select the lowest cost bidder and prevent biased awarding of contracts, it may have some

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<sup>7</sup> Local authorities have a great latitude in the description of the services since the law does not define the level of details they must go into.

<sup>8</sup> But they can also decide not to participate. Indeed, those who are authorized to submit a bid are not bound to make one.

<sup>9</sup> The first selection criteria mentioned by the LAs are of technical and financial nature. But they also look at the bidders ‘ability to innovate, to adapt to the local context, and/or to develop a commercial policy.

highly undesirable self-selection consequences and fail to respond optimally to *ex post* adaptation. On the contrary, negotiation may lead to corruption and favouritism but allow local authorities and contractors to spend more time discussing the design of the contract and the characteristics of the service to deliver, therefore reducing the risk of *ex post* opportunistic haggling. Consequently, negotiation is advocated when the service is complex that is when *ex post* adaptations are expected, while competitive tendering is the recommended awarding mechanism for services that are simpler to describe (Bajari, McMillan & Tadelis 2003).

In the light of these theoretical arguments, it seems then difficult to assess the merit of the French attribution process, since it is a “hybrid” one, mixing competitive tendering and negotiation. However, what we will argue and try to demonstrate in this paper is that, at the present time, in the French urban transport sector, this awarding procedure “*à la française*” is inefficient since it combines the disadvantages of competitive tendering with the drawbacks of negotiation.

### **3. Competitive tendering in the French urban public transport sector: myth or reality?**

In this section, our objective is to provide some preliminary empirical evidences as regard the impact of the “Sapin” Act on the degree of competition and the contractual practices in the French UPT sector.

For that purpose, we use a database that assembles the results of two annual surveys conducted by a technical department of the French Ministry of Transportation (CERTU), on one hand, and by a nationwide trade organization gathering most of the local authorities in charge of a urban transport network (GART), on the other hand. The data are available between 1995 and 2002 and for a total of 165 networks (out of 241). Unfortunately, we could not have access to data for the period anterior to the “Sapin” Act. Nevertheless, since many organisational choices that we observe in our sample were made before 1993 and reconsidered between 1995 and 2002, we can still use this database to somehow assess the consequences of the “Sapin” Act.

For that purpose, we have analysed the changes that occurred following tendering procedures, that is to say we have evaluated the proportion of changes in the type of contracts and the proportion of operators that have been replaced. The results of our estimations indicate that out of the 123 bidding procedures recorded in our sample, 88% have lead to the renewal of the incumbent, that is to say only 12% have translated into a change of operator.

This result needs to be interpreted carefully. Indeed, the proportion of operators that have been replaced is likely to be a very imperfect indicator of the competitive pressure in the UPT sector. We can consider that the incumbents have renewed most of their contractual arrangements by proposing better bids than their competitors. In that sense, the proportion of replacements may underestimate the real impact of the “Sapin” law on the competition intensity. Whereas it is reasonable to view a change of operator as the result of a better bid from the winning new entrant, it is simplistic to deduce from the absence of changes that the tendering procedures did not have any effects.

Firstly, as already suggested, the incumbents may have faced competitive pressures during the bidding procedure and reduced the level of subsidies they asked for compared to what they were receiving before, all else held constant<sup>10</sup>. Unfortunately, we do not have, in our database, any data on the number of bidders nor on their offers. Such pieces of information are difficult to obtain because, surprisingly, they are not collected systematically by central agencies like the CERTU or the GART and because local authorities are reluctant to provide them, while they are bound by the law to be able to justify their choices before users. Therefore, available information on this subject matter remains scarce and, according to us, this lack of transparency as regard the awarding process reveals a dysfunction.

Secondly, one has to keep in mind that the incumbents may have kept “their” networks but their contractual arrangements may have changed. As a matter of fact, the descriptive statistics provided in table 1 illustrate that an absence of change in the identity of the operator is not synonymous of an absence of change in the type of contractual scheme.

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<sup>10</sup> The results of the recent competitive tendering process in the city of Lyon are very illustrative of this argument. Indeed, to renew its contract, the incumbent, Keolis, facing a fierce competition from a new entrant, RATP Développement, had to reduce its original bid by 300 millions euros: his final bid was 1,542 millions euros, compared to the 1,841 millions euros proposed at the beginning of the attribution process. (*Les Echos*, 7-8 janvier 2005).



**-Table 1: Distribution of the contractual changes-**  
 Period : 1995-2002; Number of observations: 123  
 (in % of the number of changes by operating mode)

| <i>From</i> \ <i>To</i>             | <b>Direct Public Management</b> | <b>Cost-Plus contracts</b> | <b>Gross Cost contracts</b> | <b>Net Cost contracts</b> | <b>Concession contracts</b> |
|-------------------------------------|---------------------------------|----------------------------|-----------------------------|---------------------------|-----------------------------|
| <b>Direct Public Management (2)</b> | 0                               | 50%                        | 50%                         | 0                         | 0                           |
| <b>Cost-Plus contracts (22)</b>     | 9%                              | 0                          | 27%                         | 64%                       | 0                           |
| <b>Gross Cost contracts (19)</b>    | 0                               | 21%                        | 0                           | 74%                       | 5%                          |
| <b>Net Cost contracts (4)</b>       | 0                               | 20%                        | 80%                         | 0                         | 0                           |
| <b>Concession contracts (0)</b>     | 0                               | 0                          | 0                           | 0                         | 0                           |

Thus, out of the 123 auctions that were organized during the period we study, 38% (47) have translated into contractual changes and a vast majority of these changes are switches to more high-powered incentives contracts (either from cost-plus contracts to any type of fixed-price contracts or from gross cost contracts to net cost contracts or to concession contracts). These results may indicate that local authorities have taken contracts renewal as an opportunity to change the type of agreement regulating the operators, and more precisely as an opportunity to turn to net cost contracts. In other words, one of the consequences of the “Sapin” Act might be to have facilitated and accelerated the switch from cost-plus to fixed-price contracts, a phenomenon that is not attributable only to the Act, as shown by table 2, but which has been more pronounced since the implementation of the law.

**-Table 2: Evolution of the proportion of local authorities using management contracts<sup>11</sup>-**

| <i>Decade</i>                                     | 1970's | 1980's | 1990's |
|---|--------|--------|--------|
| <i>Average proportion of management contracts</i> | 100%   | 60%    | 25%    |

Indeed, as revealed in table 2, since the 1970's, there has been a tremendous change in the type of regulatory contracts chosen by local authorities to govern their relationship with external contractors. French experts have argued that local governments were strongly committed to the financing of the public transit system during the seventies, because the notion of universal service was extremely important for them during this period. This is why

<sup>11</sup> Source: CERTU (2003a) and GART (2002).

cost-plus contracts were popular until the beginning of the eighties. Afterwards, due to the uncontrollable increase of operating costs in the whole industry, these local authorities decided to decrease their financial responsibilities and switched to fixed-price contracts. This phenomenon turned out to be more pronounced after 1982 when local governments became fully responsible for the public transit system and after 1993 when operating licences started to be awarded through competitive tendering (Gagnepain & Ivaldi 2002).

Nevertheless, despite these changes in the contractual schemes and although our indicator of the degree of *ex ante* competition might be crude, it is reasonable to acknowledge that the new regulation of UPT in France has not translated into deep changes (CERTU 1996; Duthion, Vincent & Ziv 1999). In most of the networks, operators have remained the same and local authorities have not been less conservative as regard the regulatory schemes of their franchisees since the promulgation of the “Sapin” Act.

This absence of dynamics might be due to the fact that the UPT sector performs sufficiently well not to require any changes. The fact that local authorities do not feel the need to replace the incumbents might signify that these operators are efficient. Unfortunately, the performances of the UPT sector in France are far from being as satisfactory.

Indeed, as highlighted by a recent report of the French revenue court (Cour des Comptes 2005), networks are not effective enough to favour the development of urban transport and to reduce their financial deficit. Thus, the demand for urban transport keeps on decreasing (-8% of journeys per inhabitant between 1997 and 2002) while the number of vehicle kilometres supplied by inhabitant has been reduced in inferior proportions (-5.4% between 1997 and 2002). Hence, tariffs being constant, the financial situation of the networks has deteriorated, especially since labour productivity has decreased by 9.8% between 1997 and 2002. Thus, operating costs per journey have increased by 21.5% over the studied period and, for 2002, revenues from fares were estimated to cover only 34% of the operating costs in average while they used to cover 55% of the costs in 1992 and 80% in 1975 (GART 2002).

As regard the quality of service, the performances do not appear to be better even though some innovations have been introduced. Indeed, operators have tried to improve traffic fluidity and control and to reduce insecurity by investing in and setting up innovative tools of traffic regulation (video cameras, GPS, on board radios...). Comfort and information to customers have also been improved as well as accessibility to low mobility persons. However, the average commercial speed of the French networks remains low (18 km/h in average) and

is even decreasing in some cities (*e.g.* decrease of 3% between 1997 and 2002 in Grenoble). Furthermore, service frequency has not been improved and the repeated traffic interruptions resulting from strikes have kept on discouraging customers to use public transportation.

Consequently, the promulgation of the “Sapin” Act in 1993 does not seem to have had a significant impact on competition and on performance in the UPT sector. At least, what we can say for sure is that the compulsory use of franchise bidding did not allow supplying the market at a lower price/cost.

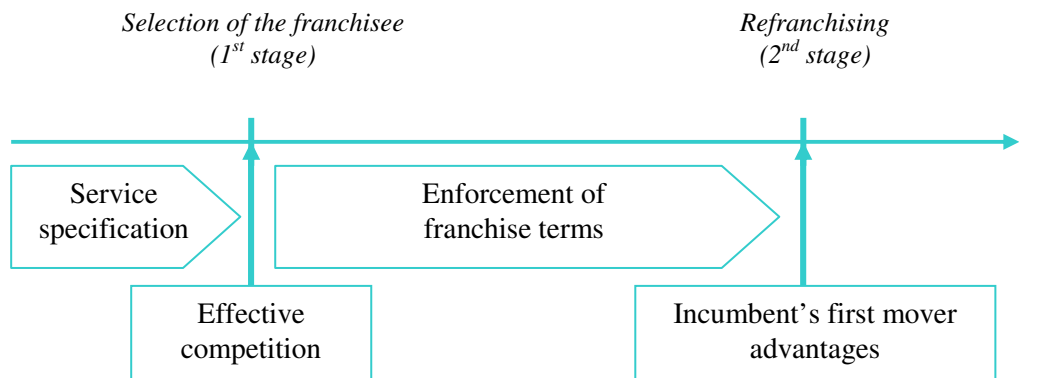
What we propose in the following section is to scrutinize the reasons of this “failure” by relying on transaction cost economics’ arguments relative to the efficiency conditions of the franchise bidding mechanism.

#### **4. The limitations of the French attribution process: a Transaction Cost Economics analysis**

Our objective in this section is to review the sources of inefficiency of the awarding process in the UPT sector in France. Considering several theoretical propositions made in incomplete contract theories -and more particularly in transaction cost economics- and various criticisms addressed by practitioners, we can identify several explanatory factors of the quasi-absence of competition for the field in the sector even after the promulgation of the “Sapin” Act.

According to the theory, problems associated with competitive tendering come from the contractual disabilities of the parties, that is to say from the existence of transaction costs. More specifically, as illustrated by figure 3, four types of problems are to be overcome if one wants the franchise bidding mechanism to be effective (Williamson 1976, Crocker-Masten 1996, Baldwin & Cave 1999).

**-Figure 3: Franchise bidding: problems to overcome-**  
(Yvrande-Billon 2004)



#### 4.1. Service specification : the award criteria problem

The first type of difficulty regards the specification of the service to be supplied by a franchisee and the choice of an award criterion. Indeed, while competitive bidding can for sure be an effective way of determining the lowest cost supplier where the price of the service being procured is the buyer's only concern, competitive bidding works less well for complex services where a vector of prices is to be determined and/or where the buyer cares about other attributes of the procurement like quality or reliability (Crocker & Masten 1996). In such case, the selection principles of the winning bidder are indeed difficult to determine. The issues addressed at this stage are therefore the following: On which basis should contracts be attributed? How to compare bids incorporating a quantitative dimension (the price of the service and the cost of procurement) and a qualitative dimension (the service quality)? As highlighted by Williamson (1976), the effectiveness of franchise bidding firstly depends on the ability of the franchisor to characterize the service he wants to put to tender. Adequate service specification is important in franchising, first as a basis for competition in the bidding process and, second, to set down benchmarks for evaluating bids. Indeed, if the franchisor fails to specify the subject matter of the bid with precision then uncertainties will result, costs of bidding will be increased, and applicants will be discouraged. The number of bidders being limited, the expected benefits of competitive tendering would consequently be affected.

Moreover, if the description of the service to provide is not sufficiently clear, competitive tendering may lead to situations of adverse selection and end by the selection of the most opportunistic bidder (Bajari, McMillan & Tadelis 2003). If contractual design is incomplete and service is complex, franchise bidding may lead to choose the bidder who is the most

aware of the contractual blanks he could exploit, that is to say the one who is able to determine where contracts will fail. Anticipating that he could take advantage of situations that are unforeseen in the contract by renegotiating the initial arrangement, this strategic candidate will not hesitate to propose the lowest price or the lowest amount of subsidies.

All these risks are summarized by Williamson (1976, p.81), “[...] *although franchise awards can be reduced to a lowest bid price criterion, this is apt to be artificial if the future is uncertain and the service in question is at all complex. Such awards are apt to be arbitrary and/or pose the hazards that “adventurous” bids will be tendered by those who are best suited or most inclined to assume political risks*”.

As indicated in different reports from specialists of the UPT sector (CERTU 2003b, Ries 2003, Institut de la Gestion Déléguée 2005), detailed service specification has proved to be a problematic issue for most local authorities, particularly in small networks, because of their lack of technical expertise. Indeed, in some cities or group of cities, there is no employee dedicated to the regulation of the sector. The ability of these local governments to define the characteristics of the service and design a contract is therefore limited.

Furthermore, there are several sources of uncertainty in the sector that prevent from designing complete contracts and therefore may discourage potential candidates to participate and/or induce opportunistic bids. As already mentioned, the greater the uncertainties felt by potential bidders, the smaller the expected number of bidders and the higher the final level of subsidy.

First, the quality and the evolution of the infrastructure and of the rolling stock is a source of uncertainty for bidders because a detailed and updated inventory is not always provided (Cour des Comptes 2005, p. 97). Although verifiable by a third party, the state of the network and of the fleet is difficult to evaluate because reliable information concerning the maintenance works made in the past by the incumbent or his subcontractors are not available. The French legislation (art. L. 1411-3 CGCT) obliges operators to deliver an annual report to the local authorities but does not define in details what this report must contain (Cour des Comptes 2005, Bausiaux 2005). Moreover, there is an uncertainty as regard the future quality of the equipments since it highly depends on the evolution of the transport policy chosen by public authorities.

In addition, due to political changeovers and/or modifications of the objectives of decision makers (change in the tariff policy, extension of the network,...), the characteristics of the service to be procured may evolve, which generates a high level of uncertainty for potential

bidders. This risk is even more amplified by the fact that, in the French regulation, local authorities retain large discretions as to the redefinition of the service to be provided. They can indeed change unilaterally contract terms once signed because contracts are of administrative nature. Of course, such changes are to be justified (for public safety reasons for example) and the private operators may claim for a fair compensation. Nevertheless, in case of conflict, franchisees have first to conform to the local authority's requirements before appealing to the court.

At last, candidates also face an exogenous uncertainty related to the overall economic situation (modification of the price of energy, demographic variations and consequently variation of the demand for urban transport).

Nevertheless, since contracts are operating franchise agreements and are therefore short-term contracts (6 years in average), it is not so much, to our opinion, the uncertainty resulting from service specification incompleteness that dissuades potential entrants to bid as the lack of clarity of the award criteria. Because the award of delegation contracts is partly guided by the “*intuitu personae*” principle and since negotiation is part of the process, new entrants may rightfully think that their probability of success is very low and, given the costs of bidding<sup>12</sup>, may decide not to bid. As demonstrated by Banerjee & Duflo (2000) or Bajari, McMillan & Tadelis (2003), buyers (local authorities in our case) rely on reputation to select a contractor if a negotiation is used. In other words, negotiated contracts tend to be awarded to larger, more experienced providers. As a consequence, mixing competitive tendering and negotiation, as in the French system, is likely to lead to a semblance of competition.

#### *4.2. Effective competition for franchises: the collusion problem*

The second important issue in franchise bidding is the traditional concern of competition policy –preventing collusive, predatory and entry-detering behaviour (Porter & Zona 1993; Klemperer 2002). As already pointed at by Demsetz (1968), an important condition for franchise bidding to be an efficient mechanism is that the cost of colluding by bidding rivals must be prohibitively high, that is to say must exceed the cost of competing (Demsetz 1968, p. 78). If, on the contrary, the market is collusive, there does not exist enough independently

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<sup>12</sup> A recent report evaluates that these fees can reach 30.000€ for a small network and up to 500.000€ for large ones like Lyon (CERTU 2003b).

acting bidders to assure that the winning price will differ significantly from the monopoly price. Hence, the benefits of franchise bidding are null.

As revealed by a recent investigation by the French Competition Commission (Conseil de la Concurrence 2005), bid rigging is common in the French urban public transport sector. The report denounces the existence of a cartel between the three leading operators, namely Keolis, Transdev and Connex, which have been imposed fines of 5% of their turnover in France, which correspond to 3.9 millions €, 3 millions € and 5.05 millions € respectively<sup>13</sup>. The investigation, which has focused on the market attribution processes between 1994 and 1999, discloses that the three companies have consulted each other to divide the market among themselves. The Competition Commission has recorded that the directors of these companies have met several times to coordinate their bidding policy and exchanged information concerning their strategy and the bids they had already made to be selected. Moreover, not only have the companies explicitly agreed not to compete with each other, but they also have controlled the attribution of at least 27 markets by threatening potential entrants that were likely to disturb their anti-competitive game. It has also been demonstrated that this anti-competitive game has led the companies to impose their price to local authorities who consequently have had to bear higher charges than those which would have resulted from a competitive functioning of the market. At last, the Commission has shown that, on several markets, the three companies have agreed either not to participate to the bid or to withdraw before the final decision of the local authorities and that, when several ring members bid, only one was a serious bidder, the other submitting phony higher bids.

Several clues, presented in details in the report, have led the Commission to the conclusion that the competition for UPT markets was not effective, at least between 1994 and 1999, because of the collusive practices of the three main transport operators. An illustration of the effect of the cartel, which is also considered as a clue of its existence, is the following table.

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<sup>13</sup> These fines correspond to the maximum penalties.

**-Table 3: Bids made by the three main groups in 1996, 1997 and 1998<sup>14</sup>-**

| Year  | Number of markets for which at least one application was submitted | Number of applicants |    |    | Number of markets for which at least one bid was made | Number of competing bids |    |   | Number of markets won by the three companies |
|-------|--|----------------------|----|----|---|--------------------------|----|---|--|
|       |  | 1                    | 2  | 3  |   | 1                        | 2  | 3 |  |
| 1996  | 38   | 18                   | 14 | 6  | 29  | 20                       | 9  | 0 | 22   |
| 1997  | 44   | 13                   | 19 | 12 | 34  | 24                       | 6  | 4 | 29   |
| 1998  | 39   | 13                   | 19 | 7  | 33  | 27                       | 5  | 1 | 25   |
| Total | 121  | 44                   | 52 | 25 | 96  | 71                       | 20 | 5 | 76   |

This table illustrates the behaviour of the three main operators on the 121 markets for which at least one of them applied in 1996, 1997 and 1998. It appears from these data that, out of the 96 calls for tender to which at least one of the incriminated companies answered, 71 received only one bid. In other words, in 74% of the cases, the cartel members did not compete with each other. Moreover, the cases where the three companies were competitors for the same market are extremely rare: it never happened in 1996, and it happened 4 times in 1997 and only once in 1998.

Therefore, the arguments we developed in section 3 to explain the stability of the incumbents need to be revised. The information provided by the Competition Commission and the resulting sentence indeed clearly reveal that the operators stability is, at least in some cases, the consequence of collusive practices. The situation is even worse than what we assumed in section 3 since the “Sapin” Act has not even succeeded in preventing collusion.

#### *4.3. Enforcement and adaptation of franchise terms: the execution problems*

The third type of problems to overcome with franchise bidding arises during the execution of the contracts. On the one hand, holding franchisees to their promises may turn out to be difficult if the threats of sanction are not credible enough. On the other hand, because “*all complex contracts are unavoidably incomplete, the parties will be confronted with the need to adapt to unanticipated disturbances by reason of gaps, errors, and omissions in the original contract*” (Williamson 2002), and this may lead to costly post-contract renegotiations (Prager 1990).

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<sup>14</sup> Source: Conseil de la Concurrence (2005), pp. 21 and 40.



In the French UPT sector, contract execution and adaptation are particularly problematic. Indeed, as already mentioned, present regulation does not impose precise conditions concerning the supply of data on issues that are relevant in evaluating the quality of the service delivered and the extent to which promises of performance are being fulfilled (Cour des Comptes 2005). Hence, the collection of information, which is the first aspect of enforcement, is problematic. Moreover, because of their lack of expertise, local authorities usually content themselves with trusting the data supplied by their franchisees. They rarely engage in comprehensive financial data collection and control monitoring. Qualitative appraisals and specific complaints investigations are not conducted and, whatever the indicator of performance, there is no standardized reporting procedure (Institut de la Gestion Déléguée 2005). Thus, the monitoring of franchisees in the French transport sector is not efficiently carried out while performance and service quality in this sector is to a significant extent measurable in terms of quantitative data on, for instance, volumes, revenues, services not operated, punctuality, lost mileage, and reliability (Baldwin & Cave 1999, p. 275). As a consequence, one cannot expect the various sanctions provided for in the franchise contracts to be credible. Franchisers are in a weak position to sanction franchisees because they do not supervise them properly. To add more and more sanction and penalty clauses in the contracts, as local authorities do, therefore appears to be a useless measure which increases transaction costs (more precisely the cost of writing the contracts) without yielding any benefits. As long as the information collected by the local authorities will not be complete and reliable, franchisees will not feel threatened and will not be incited to improve performance, even though they are regulated by more high-powered incentives contractual schemes.

The other crucial issue at the execution stage refers to contract adaptation. As already mentioned, a series of uncertainties can arise in the transport sector so that it would be very hard for local authorities to commit not to vary some contract terms as events unfold. As a consequence, contracts are necessarily left incomplete to allow for flexibility and scope for innovation after the award of the franchise (Armstrong, Cowan & Vickers 1994). Because contracts leave a number of aspects to be resolved, renegotiations are likely to occur and pressure to adjust franchise specification is to be expected. An important potential problem raised by critics of franchise bidding is indeed the ability of franchise winners to engage in *ex post* opportunistic behavior by reneging on the promises they made in order to win the franchise contract (Prager 1990, p. 211).

In the case of the French UPT sector, these risks should be attenuated by the fact that contracts are short-term (6 years in average) and contain index clauses which facilitate adaptive, sequential decision-making (Williamson 1976, p.83). But, as indicated by the significant number of amendments added to the initial contractual agreements in some French UPT networks, the terms of the contracts are frequently renegotiated (CERTU 1996, Cour des Comptes 2005).

These frequent renegotiations might indicate that operators face numerous hazards and therefore that initial contractual terms really need to be modified. However, given the short duration of UPT contracts and the various adaptation clauses they contain, this interpretation does not seem to be very relevant. In our view, the numerous amendments to the initial contracts are rather an illustration of the high discretionary power of local authorities and/or a consequence of the franchisees' opportunism. To disentangle this indeterminacy, it would be very fruitful to know whether renegotiations are mostly authorities-led or rather operators-led (Guasch, Laffont & Straub 2003, 2005). Unfortunately, such information is not available. We must content ourselves with conjectures and the assumption we consider as the most realistic is that contracts renegotiations are outward signs of franchisees' opportunistic behavior. Since operators have more information than authorities and since the low capacity of expertise of the latter does not allow reducing these informational asymmetries, renegotiations are more likely to turn to the franchisees' advantage. Once again, if local authorities had the capacity to control and monitor the franchisees, they could detect opportunistic behaviors more easily, promote efficient adaptation and mitigate haggling expenses.

#### *4.4. Refranchising: the first mover advantage problem*

The last fundamental problem associated with franchise bidding schemes according to transaction cost economics is the lack of bidding parity at the time of recontracting (Zupan 1989). Williamson indeed argues that winners of the original competition enjoy substantial incumbency advantages over non winners so that no real competition can take place at contract renewal interval (Williamson 1976, p. 83). He attributes this partly to the fact that on-the-job experience provides incumbents with information not available to other (new) bidders, and partly to the difficulties to determine unambiguous rules for valuing the assets to be transferred.

In the case of the French UPT franchise contracts, investments in physical assets (infrastructure, equipments, rolling stock) are made by the local authorities who own them. Moreover, regulation requires that staff should transfer on the same terms of employment. Contracts stipulate that, when the undertaking changes hands, employees automatically become employees of the new franchisee on the same terms and conditions. These characteristics, combined with the short duration of contracts, reduce the incumbents' advantage at contract renewal (Littlechild 2002).

However, there is still a lack of bidding parity because incumbents are better informed over assets quality and demand characteristics than their rivals and, above all, than the franchisors. Due to the local authorities' lack of expertise and control and to the lack of reliable data, only incumbents are able to evaluate properly the depreciation of physical assets, which gives them a crucial advantage over potential entrants. Moreover, as underlined by Williamson (1976, p.88), incumbents may benefit from their better knowledge of communication idiosyncracies (information channels, procedural routines, codes, "red tape") and may be more familiar with the particularities of the bureaucratic procedures associated with competitive bidding in the city he operates.

## **5. Conclusion**

Our objective in this paper was to contribute to the discussions on the limitations of franchise bidding and assess to what extent the problems envisaged in the literature arise in the French urban public transport sector.

Many European urban public transport systems are now subjected to competitive tendering, which is perceived as a threat, and partially as a chance to make systematic improvements and to develop high environmental and social standards. Some experiences in Sweden and Denmark for instance indicate that competitive tendering can lead to increased efficiency together with high procurement standards resulting in a better quality and cheaper public transport services (SIPTRAM 2003). But the appraisal, in France, is far from being as satisfactory. Indeed, the introduction of franchise bidding mechanisms to allocate the right to provide urban transport services did not have the same positive impact. The empirical evidences we provide in this paper clearly reveal that competition has not been fostered and that performance indicators are still mediocre, not to mention the fact that collusion still exists.

But that franchise bidding is not efficient in the French UPT sector does not mean, according to us, that this mechanism of coordination could not yield positive results and has to be abandoned. What we intended to highlight in this paper is that competitive tendering cannot be beneficial if certain conditions are not respected. More particularly, as long as the French local authorities will not have a real capacity of expertise and control, it is illusory to think that franchising UPT services in France could result in improved performances.

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