

WORKING PARTY Nº 2 ON COMPETITION AND REGULATION

METHODS FOR ALLOCATING CONTRACTS FOR THE PROVISION OF LOCAL AND REGIONAL BUS SERVICES Contribution from Peru

1. Description of the industry and regulatory framework

In the early nineties, Peru underwent a process of institutional modernization and economic reforms. In the case of public transportation, these reforms included the establishment of free competition for the determination of prices and free temporary access of natural or legal persons as service providers^{1,2}, as well as the importation of used vehicles.

The main business model developed in this sector is one based on private firms which have a license for a particular route and contract individual operators who provide the service, often driving their own vehicles.³

According to a report by the Peruvian Ombudsmen⁴, as a result of the above mentioned conditions and a weak regulation in the sector, nowadays urban transportation services in Peru and, particularly, in Lima is characterized by the following:

- Transport supply has exceeded demand.
- Given that there are more vehicles than needed; operators violently dispute passengers, which increases the risk of traffic accidents.
- No operator can increase prices since there is always another one that may undercut him. Therefore, revenues are insufficient to cover the costs of operation and maintenance and operators cannot invest in the renewal of their units.
- Employment conditions are bad, operators usually work shifts of more than 12 hours.
- Congestion.

In this context, the Metropolitan Municipality of Lima (MML)⁵ is currently implementing a plan to reorder the urban transportation system. The plan includes granting authorizations in unsaturated routes (traditional system) and

¹ Legislative Decree Nº 651, given on 24th July 1991.

² According to Law Nº 27181, General Law on Land Transportation and Traffic, in unsaturated areas, a firm must have an authorization in order to provide local and/or urban transportation services. In the case of saturated areas, a concession is granted for the provision of transportation services.

³ World Bank (2006). *Perú: La oportunidad de un país diferente, próspero, equitativo y gobernable*. Washington D.C. Cited in: Defensoría del Pueblo (2008). *El Transporte Urbano en Lima Metropolitana: Un desafío en defensa de la vida*. Available in: <http://ditoe.minedu.gob.pe/Materiales%20DITOE/B14.pdf>

⁴ Defensoría del Pueblo (2008). Op. cit.

⁵ The MML is the local government of Lima, the Peruvian capital. However, according to the Decentralization Law (Law Nº 27783), the MML has political, economic and administrative autonomy, as well as powers of a regional government within the province.

granting concessions through public tenders in saturated routes. The area within MML which is directly involved in this process is the Urban Transport Management. Furthermore, MML has two decentralized entities with administrative autonomy which are also involved in the regulation of urban transportation services: Protransporte Metropolitan Institute (Protransporte) and the Metropolitan Investment Fund (Invermet).

The main reform under implementation is the Integrated Public Transport System (ITS), which is characterized by the physical and operational integration of payment methods and rates.

ITS has four components: (i) the high capacity segregated corridors system, also known as Cosac; (ii) the railway transportation system⁶; (iii) the complementary corridors system⁷, and (iv) regular transportation services (via authorizations). The latter component is provided via authorizations, while the other three are provided via authorizations or concessions.⁸

The implementation of Cosac I (also called Metropolitano), is one of the most important reforms implemented in the urban transportation system in Lima in the last years. It aims at providing transportation services in high capacity buses within a corridor that crosses the city of Lima from north to south, crossing 16 of the 43 districts of Lima. Furthermore, the MML is developing investment studies for Cosac II, which will cross the city of Lima from east to west.

Cosac I consists of four management units:

- The **Management and Control Center** is responsible for planning, managing and controlling the system operation. In other words, it sets out buses requirements in corridors and determines the frequencies and average speed of the buses, taking into account the demand for the service. This unit is currently administered by Protransporte.⁹
- The **Passenger Transport Unit** is responsible for the acquisition and operation of buses. These functions are currently delegated to four private firms: Consorcio Lima Bus Internacional, Lima Vías Express S.A., Consorcio Grupo Plaza de Inversiones S.A. - Consorcio Grupo Empresarial 9 and Consorcio Perú Masivo.
- The **Collection Unit** is responsible for the sale, recharge, distribution and validation of the means of access to the system. It is also in charge of the

⁶ It is worth mentioning that the railway transportation system is currently under the administration of Autonomous Authority of the Electrical System of Mass Transportation in Lima and Callao, which belongs to the Ministry of Transport and Communications.

⁷ Nowadays, the bidding process for the complementary corridors systems is being organized. However, some authorizations for urban transportation services remain valid.

⁸ Source: Ordinance N° 1613 of MML.

⁹ It should be mentioned that activities related to overseeing the functioning of buses are coordinated with Invermet.

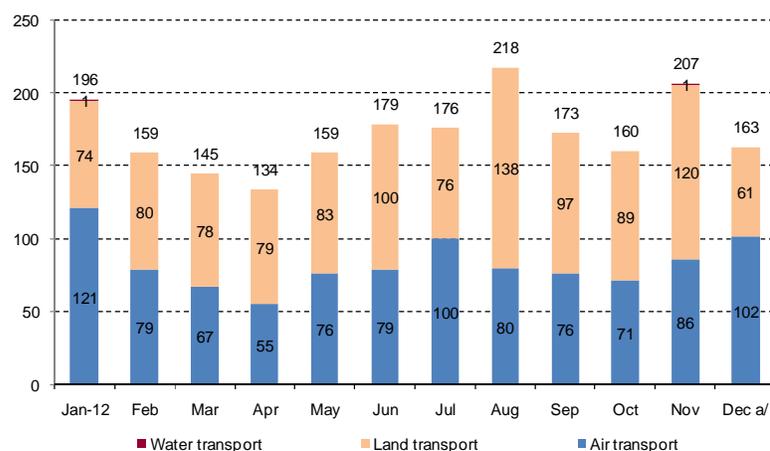
management and custody of revenues until their delivery to the Trust. This unit is currently granted to a private firm (ACS Solutions Perú S.A.).

- The **Trust** is comprised of the assets acquired thanks to the sale of the means of access to the system. The trustee in charge of its administration is Cofide, a mixed economy company¹⁰ which currently operates as a second-tier development bank.

There are several ways in which complaints for bad services in the sector can be handled. If the complaint is related to the traditional transport system, it can be handled by the Transport Regulation Sub Management (a unit within the Urban Transport Management). If the complaint is related to the service provided by Cosac I, it can be handled by Protransporte. Additionally, MML also has a Citizen Defense Management, which tracks and channels the complaints of citizens to the organs, decentralized organizations and companies of MML.

Furthermore, Indecopi, as the national consumption authority, is in charge of enforcing the Consumer Protection Act (Law N° 29571) and other laws that protect consumers from unsuitable goods and services, from deficiencies or lack of information and for consumption discrimination. Graph 1 presents the claims associated to transport services that were received in the Citizen Service of Indecopi¹¹ in 2012. As we can see, in the last year, 1 224 claims were related to land transport.

Graph 1
CLAIMS ASSOCIATED TO TRANSPORT SERVICES RECEIVED IN THE
CITIZEN SERVICE OF INDECOPI, 2012



a/ Preliminary.

Source: Citizen Service of Indecopi.

¹⁰ 98,7% of Cofide's capital is owned by the Peruvian State, while the other 1,3% belongs to the Andean Development Corporation (CAF).

¹¹ The Citizen Service of Indecopi is responsible for channeling and integrating the services of functional and administrative areas, providing information on procedures and requirements for accessing services provided by all the areas of the institution, as well as resolving consumption controversies through conciliations, by means of the delegation of functions on the part of the Consumer Protection Commission.

2. Tendering process

As we mentioned before, under the traditional system, authorizations are given to firms that wish to provide urban transport services. Nonetheless, MML is currently implementing a plan to reorder the urban transportation system, which included the concession to private firms of two management units of Cosac I, the Passenger Transport Unit and the Collection Unit. The tendering process for both of these units was in charge of Protransporte.

The tendering process for the Passenger Transport Unit included awarding the operation of four sets of buses (Table 1 presents the requirement of buses for each operating area¹²) and consisted of two phases. In the first phase, potential bidders had to demonstrate compliance with certain requirements, such as experience in the operation of similar systems and the existence of a social capital of USD 1,5 millions, among other legal requirements.

Table 1
NUMBER OF BUSES REQUIRED IN THE TENDERING PROCESS FOR THE PASSENGER TRANSPORT UNIT OF COSAC I

Set	Operating area	Articulated bus		Conventional bus 12 m		Conventional bus 8,5 m	
		Minimum	Maximum	Minimum	Maximum	Minimum	Maximum
1	South	75	90	38	57	-	40
2	North 1	75	90	38	57	-	27
3	North 1B	75	90	19	29	54	81
4	North 2	75	90	73	110	-	19
	Total	300	360	168	253	54	167

Source: Concession contract for the Transport Service of Cosac I.

In the second phase, bidders that met the requirements of the first phase were qualified according to a formula that combines the following elements:

- A factor that measures how much the firm has been affected by the rearrangement of routes implemented due to the implementation of Cosac I (*A*).
- The tendered value per kilometer in the main route (*TM*)
- The tendered value per kilometer in feeder routes (*TF*).¹³

¹² Upon the end of the franchise, the buses acquired and operated by the service providers will be given to Protransporte, who will organize a new tendering process and award the buses and the operation of the system.

¹³ The formula for the determination of the score of each bidder is:

$$Score_i = (0,93*FTM_i + 0,07*FA_i)*0,75 + 0,25*FTF_i$$

Where: $FTM_i = (TM \text{ of the lowest bid}) / TM_i$

$FA_i = (A \text{ of the lowest bid}) / A_i$

$FTF_i = (TF \text{ of the lowest bid}) / TF_i$

Furthermore, according to what is established in Law N° 28242, National Productive Development Promotion Act, additional points were awarded to bidders who committed to carry out works and buy goods produced in the country.

As we mentioned before, the franchise was awarded to four private firms: Consorcio Lima Bus Internacional, Lima Vías Express S.A., Consorcio Grupo Plaza de Inversiones S.A. - Consorcio Grupo Empresarial 9 and Consorcio Perú Masivo.

Unlike the traditional system in which prices for transport services are determined in the market, prices in Cosac I are determined by the Coordinator Consortium¹⁴, according to the formulas included in the annex of the concession contract. In case there is no agreement among the members of the Coordinator Consortium, Protransporte can set the price of tickets in Cosac I, without appeal. Nowadays, the price for the service provided in the main route of Cosac I is PEN 2,00¹⁵ (regardless of the firm providing the service or the distance traveled), while the average price of urban transport services under the traditional system is PEN 1,28.¹⁶

3. Nature of the contracts awarded

Cosac I connects 16 districts of Lima using two route groups, the main route and feeder routes. The main route is an exclusive corridor that runs from south to north and vice versa, and is composed of three sections (south, central and north). The feeder routes are routes that are designed to transport users from remote terminals to the main route through transfer operations.

In the main route, regular and nonstop services are provided. The four operators of the Passenger Transport Unit provide all the services under an equitable allocation based on the number of buses owned by each operator.

On the contrary, feeder routes are distributed among the operators: Lima Vías Express S.A. is in charge of the four feeder routes located in the south of the city; while the 16 feeder routes located in the north of the city are distributed among the other three operators (see Graph 2).

¹⁴ The Coordinating Consortium is made up of representatives of each one of the operators of the Passenger Transport Unit and the Collection Unit.

¹⁵ Approximately, USD 0,78.

¹⁶ Approximately, USD 0,50.

Graph 2
DISTRIBUTION OF COSAC OPERATORS IN FEEDER ROUTES IN THE NORTH OF LIMA



Source: Protransporte.

Protransporte is in charge of the allocation of routes, frequencies, etc., in coordination with the operators and taking into account the demand of the service.

According to the concession contract, the duration of the grant is 12 years since the beginning of the operations of each firm. The contract also states that the grant can be extended, if requested by the operator at least one year before the expiration of the contract and after the evaluation of Protransporte.

The concession contract also states that both the grantor and the operators have a mutually beneficial financial relationship. Nonetheless, it provides that both are entitled to a reestablishment of this equilibrium when any of the following events occurs as a result of a legislative change¹⁷:

- The total annual costs of the operator increase or decrease in more than 10% with respect to the previous year.
- The total annual revenues of the operator increase or decrease in more than 10% with respect to the previous year.

¹⁷ This includes a change in the interpretation of relevant laws.

- The combined effect of changes in total costs or revenues is higher than 10% with respect to the previous year.

Regarding the quality of the service, the concession contract states that the operators are obliged to comply with technical requirements and minimum quality standards specified in the annexes of the contract. Furthermore, they must provide the service without discrimination, pay for any damage and establish a telephone hotline for inquiries and complaints.

Finally, it should be mentioned that with the implementation of Cosac I, a group of bus transport providers under the traditional system was retired. The concession contract establishes that at least 25% of the workers hired by the operators must be workers who lost their jobs due to the implementation of Cosac I.

4. Execution of the contracts

The concession contract of Cosac I states that Protransporte is entitled to inspect or arrange inspections by technical auditors and/or accountants to the facilities, equipment, files and other data from the operators, without hindering the provision of the service. Supervision activities are performed in coordination with Invermet¹⁸.

The contract also states that Protransporte can impose sanctions and penalties for infringements, which are defined as any act or omission which affects the system operation, the appropriate formation of prices, equality and opportunity in access to information, protection to users, transparency in the system, the orderly development of the market and, in general, any violation of relevant laws and regulations. Sanctions depend on the gravity of the infringement¹⁹ and may include both fines and the suspension or disqualification of the driver or person responsible for the infraction.

5. Outcome

To date, there has only been one tendering process for Cosac I. Six bidders were qualified to pass the first stage of the process and four of them were chosen for the provision of transport services in Cosac I.

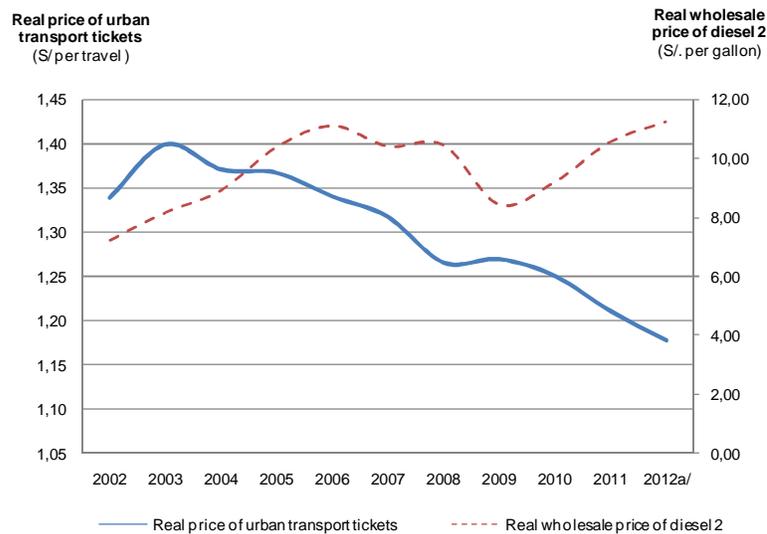
The impact of the implementation of Cosac I on prices, costs, quality and safety of the services provided by the licensees has not been evaluated yet. Nonetheless, the operation of Cosac I constitutes an improvement in the quality of life of the citizens of Lima.

¹⁸ Invermet is in charge of monitoring compliance with the obligations established in the concession contract, its Regulations and other relevant laws, either directly or through third parties.

¹⁹ Minor infringements receive a fine of 0,5 to one tax unit (approximately, USD 720 to 1 439); serious infringements receive a fine of two to five tax units (approximately, USD 2 878 to 7 195) and very serious infringements receive a fine of six to 10 tax units (approximately, USD 8 634 to 14 391).

As we mentioned before, the characteristics of the operation of the traditional transport system in Lima had resulted in low quality of service, basically because revenues are insufficient to cover the costs of operation and maintenance. In fact, as can be seen in Graph 3, between 2003 and 2012, the real wholesale price of diesel 2 (one of the most widely used fuels in buses that operate in Lima under the traditional system) has increased in 4,54% per year, on average; while the real price of urban transport tickets has decreased in 1,28% per year, on average.

Graph 3
REAL PRICE OF URBAN TRANSPORT TICKETS AND REAL WHOLESALE PRICE OF DIESEL 2



Source: National Institute of Statistics and Informatics.

In comparison, Cosac I offers a higher quality service in an exclusive corridor (main route), it has a speed controlled system, pilots are trained professionals and stations are equipped with a camera surveillance system and security personnel.