

SUSTAINABLE CROATIAN RAILWAYS IN EUROPE

Terms of Reference for the Comprehensive Audit of Contract No 1/2019/DP-HPP on Public Services for Services of General Economic Interest in Public Passenger Rail Transport in the Republic of Croatia

Reference No.: SUCRE HR-HZI-177343-CS-FBS

JULY 20, 2020

TABLE OF CONTENTS

	Page
I. Background	3
II. Objectives of the assignment.....	4
III. Detailed task description	4
A. <i>Task 1: analysis of actual reporting and validation processes.....</i>	<i>4</i>
B. <i>Task 2: legal assessment of PSC obligations and compliance by the signatories.....</i>	<i>5</i>
C. <i>Task 3: cost audit and proposed modifications to compensation methodologies.....</i>	<i>6</i>
D. <i>Task 4: draft updates to the PSC and workshop with the Signatories.....</i>	<i>7</i>
IV. Milestones and invoicing	7
V. Management and reporting	8
VI. Qualifications.....	8
VII. Administrative provisions	9
A. <i>Data ownership</i>	<i>9</i>
B. <i>Language of reports and data.....</i>	<i>9</i>

SUSTAINABLE CROATIAN RAILWAYS IN EUROPE

Terms of Reference for the Comprehensive Audit of Contract No 1/2019/DP-HPP on Public Services for Services of General Economic Interest in Public Passenger Rail Transport in the Republic of Croatia

I. BACKGROUND

1. The Ministry of the Sea, Transport and Infrastructure (MSTI) and Hrvatske Željeznice Putnički Prijevoz (HŽPP)¹ signed a Public Service Contract (PSC) on December 21, 2019 for delivery of public passenger rail services in the Republic of Croatia. The PSC covers the period from January 1, 2019 to December 31, 2028. The value of the PSC is HRK 4.62 billion. The contact was awarded according to article 5, paragraph 4a, of EU Regulation 1370/2007 (as amended by article 1, regulation 2338/2016). The PSC's development was supported by a World Bank-financed technical assistance activity which included scope of services, calculation scheme, penalties scheme, vehicle specifications, marketing requirements, KPI report structure, passenger survey and incentive scheme. The PSC contact is currently providing the institutional basis for deploying European Union funds to procure new rolling stock for passenger rail service delivery in Croatia.

2. The PSC defines the scope of services that HZPP is obliged to perform in exchange for financial compensation from MSTI. It includes 8 annexes that are meant to govern payment, level of service, quality, marketing and customer outreach, and a system of penalties. These include:

- Appendix 1: Scope of services;
- Appendix 2: Calculation scheme;
- Appendix 3: System of penalties for non-fulfilment of contracts;
- Appendix 4: Specification of vehicles in use;
- Appendix 5: Marketing requirements;
- Annex 6: Structure of the report on key indicators;
- Annex 7: Passenger survey; and
- Annex 8: Revenue Increase Incentive Scheme.

3. The operationalization of the Public Service Contract has proceeded since its signing under a transitional period. There is accordingly a need to take stock of lessons learned and to make appropriate adjustments to enhance the PSC's effectiveness. An approach to incremental assessment and improvement is provided for under the chapter II of the PSC's "*Standard Terms of Contract*" which includes:

- *Point 4 "General obligations-fulfilment by the service provider"*: under (j) defines that the parties may propose amendments to Annex 3 which contains the system of penalties for non-performance of the contract. In the event that both Contracting Parties cannot agree on the amended parameters, the qualified independent body engaged by the MSTI will carry out the amendments.

¹ Together referred to as "the Signatories"

- *Point 5 "Amendment of the request"*: under (b) The Contracting Parties agreed to review the key indicators and extensions of parameters specified in the PSC and its annexes.
 - *Point 5 "Amendment of the request"*: under (d) defines that, after a transitional period of one year, both parties agree with the annual revision of the PSC to verify quality standards, the structure of remuneration, the absence of overcompensation, compliance of all contractual obligations and to ensure that the service provider continuously improves its business and financial output.
4. Part I (a) of the PSC provides for a comprehensive analysis of key indicators and other parameters specified in annexes every two years. This is to be carried out by a qualified independent auditor engaged by the MSTI. These terms of reference define the scope of work for the Consultant (hereafter the “Service Provider”) to undertake the first review of the PSC now that its initial transitional period is concluding.

II. OBJECTIVES OF THE ASSIGNMENT

- Support MSTI and HZPP with moving the PSC beyond its transitional period;
- Provide a legal opinion on the PSC’s actual functioning and each party’s compliance with PSC provisions to date;
- Identify and recommend solutions to key bottlenecks in the PSC’s implementation that have been encountered to date; and
- Support MSTI and HZPP to improve the governing framework for the PSC’s implementation in subsequent years. The Consultant shall analyse the flow of funds between MSTI and HZPP and make suggestions for its improvements. This should include, but not be limited to, better supervision of the use of funds by HZPP, approval mechanism for the use of funds, and HZPP reporting to MSTI (and MoF). The Consultant should review and improve monitoring tools for MSTI that should simplify and digitalize the above procedure. The tools should enable MSTI to have a better insight into operational and financial performance of HZPP at any given time and in any required form. The monitoring tools should also include KPIs that will be improved if needed and included in the Public Service Contract.

III. DETAILED TASK DESCRIPTION

A. Task 1: analysis of actual reporting and validation processes

5. The purpose of this task will be to objectively define a “*state of play*” for the PSC’s current implementation that can inform all future tasks. To achieve this, the Service Provider will undertake process mapping, critical path analysis, and a gap assessment of the PSC relative to initial technical work undertaken to prepare contract terms. The Service Provider’s activities will include:

- Detailed review of the technical study used to prepare the PSC contracts terms and of the current form of the PSC, to understand the architecture for the PSC’s provisions;
- Revision of the current form of the PSC vis-à-vis of the existing EU regulations and identification of any deviations from the EU requirements, in order to avoid any further complaint or corrections from the relevant EU institutions;

- Assessment of the structure and content of the Appendix 2 to the PSC, which is the key element of the contract and identification of the elements for improving it by comparing the current form of the Appendix 2 with the form (Appendix 3) recommended by the previous consultancy study on PSC;
 - Assessment of in-practice functioning of all PSC terms and identification of the nature of the bottle necks. The interviews with HZPP and MSTI staff and other tools used for this assessment shall include both junior and senior level staff involved in different stages of execution of the current PSC;
 - Development of an improved Appendix 2 including the process maps and a critical path of task dependencies for payment periods showing information flow and the order of tasks involved in data collection, compilation of PSC indicator reports, payment requests, validation of data by MSTI, and payment processing. This should include the specific procedure for data / invoice submission and payment procedures;
 - Elaborate the methodologies to be used by the HZPP and by the MSTI for data collection, transmission, and processing for the execution of the PSC, including the data description, the deadlines for each activity, and the persons (staff position) at HZPP and MSTI in charge with each activity;
 - Analyse PSC contract terms, develop a summary table of specific obligations that apply to MSTI and HZPP, and prepare amended clauses as needed for an updated PSC. The updated PSC should clearly establish the obligation of parties and their respective roles in obtaining necessary governmental approvals (e.g. decision of the MoF or other arms of Government) in relation to the methodologies used by the HZPP and the MSTI for data collection, transmission, and processing during execution of the PSC. This should also include mandatory pre-conditions for establishing the validity of the updated PSC;
 - Undertake analysis of actual performance of each counterparty during the PSC's first year of implementation relative to the obligations identified.
6. *The outputs of this task will include* an interim report that includes: (i) identification of the dysfunctions of the current form of the PSC vis-à-vis of EU regulations or resulted from the execution of the current PSC during 2019, (ii) improved form of Appendix 2, (iii) the methodologies elaborated for data collection, transmission, and processing for the execution of the PSC, and (iv) process maps and the critical path of tasks required for each PSC payment period.

B. Task 2: legal assessment of PSC obligations and compliance by the signatories

7. The objective of this task is to analyze the contractual obligations created under the PSC and to assess compliance of each party with its respective obligations. The Service Provider will accordingly:

- Provide a legal opinion for each obligation regarding whether each party has met or breached specific obligations;
- Provide recommendations for any breaches identified regarding how the parties should proceed in the future to comply with PSC obligations;

- Identify areas of ambiguity within the PSC contract where obligations are unclear or expected to be met by third parties that are not signatory to the PSC. The Service Provider should accordingly recommend new or modified PSC clauses to rectify ambiguity or omissions.
8. ***The output of this task will include*** a second interim report containing: (i) improved form of the PSC including the recommended modifications to PSC clauses (or new clauses) needed to address areas of ambiguity.

C. Task 3: cost audit and proposed modifications to compensation methodologies

9. A key aim of the Public Service Contract is to achieve fair compensation to HZPP that covers the full cost of services requested by MSTI but does not provide for over compensation. The Service Provider will accordingly undertake a cost audit to assess whether the PSC's compensation framework achieves that by undertaking a cost audit of HZPP. The Service Provider's analysis will consider:

- The cost allocation mechanism (on 27 elements of costs, further consolidated) developed by the consultant which developed the study for the elaboration of the current PSC;
- The evolution of costs vis-à-vis of the cost allocation mechanisms, during the execution of the contract in 2019, including expenditures such as fuel / electricity, Track Access Charge and other infrastructure related charges, routine maintenance, wages, rental expense, interest expense, sales and marketing expenses, etc.; and
- Capital costs as needed to support renewals and enhancements of HZPP's asset base and provide return on any capital that the Company itself uses for investment (i.e. not including assets directly funded by government).

10. The consultant shall propose potential improvements of the cost allocation developed by the previous study on the SC and a formula for annual cost adjustment considering the KPI's for improvement of the operational and financial performance of the HZPP as well as the increases of costs independent of the HZPP (e.g. energy, fuel, track access charge, etc.) and will formulate the new clauses in the PSC for the annual correction of costs and compensation.

11. For the purpose of the cost audit, the Service Provider will develop basic financial analysis that reflects HZPP's cost structure for the 2019 calendar year, the costing correction formula due to external factors, which shall be used for costing and compensation projection forward for subsequent years covered by the PSC.

12. Based on the findings on the costing audit, the Service Provider will develop amendments to existing annexes (or one or more new annexes) as needed to bring the PSC's level of compensation into balance and improve its incentive framework.

13. ***The outputs of this task will include:*** an interim report that includes: (i) the assessment of the mode of utilization of the cost allocation methodology during 2019, (ii) the results of the revision of the cost allocation methodology elaborated formula for the annual adjustment of cost due to external factors; and (iii) the financial analysis developed for the PSC cost audit.

D. Task 4: draft updates to the PSC and workshop with the Signatories

14. The Service Provider will compile all recommended amendments and new annexes and will compile a modified draft of the PSC. This should include all changes clearly shown in a tracked changes or red-lined version of the document(s).

15. The Service Provider will submit the modified PSC draft to MSTI for comment and circulation to HZPP and other Government of Croatia institutions. After receiving feedback on this submission (within approximately 1 month), the Service Provider will conduct a two-day workshop in Zagreb with the Signatories and other representatives from the Government of Croatia. This will include:

- A summary presentation on all work and main findings under the assignment;
- Explanation of all proposed amendments to the PSC and its annexes to obtain broad feedback; and
- Demonstration of proposed process enhancements to measurement of PSC indicators and execution of periodic compensation cycles.

16. For the avoidance of doubt, MSTI will provide the workshop venue and the cost of refreshments for workshop attendees. Following the workshop, the Service Provider will compile feedback and will make amendments as needed to the PSC draft as instructed by MSTI.

17. *The output of this task will include* a final draft of the modified PSC and its annexes.

IV. MILESTONES AND INVOICING

18. The Service Provider will invoice at each task milestone according to the fractions of total contract value indicated below. The Service Provider's contract will be inclusive of all expenses (i.e. lump sum). The Service Provider should complete all work no later end October 2020.

19. The fixed budget for this assignment is EUR 150,000.00 (not including VAT).

20. Facilities for workshops and meetings with MSTI / HZPP representatives will be provided by MSTI and or HZPP.

<i>Task</i>	<i>Title</i>	<i>% of contract value</i>	<i>Indicative completion (weeks from mobilization)</i>
I	Task 1: analysis of actual reporting and validation processes	20	4
II	Task 2: legal assessment of PSC obligations and compliance by the signatories	30	6
III	Task 3: cost audit and proposed modifications to compensation methodologies	20	10
IV	Task 4: draft updates to the PSC and workshop with the Signatories	30	12
Total		100	

V. MANAGEMENT AND REPORTING

21. The Service Provider will report directly to Head of Sector for Railway and Intermodal transport and will work in close consultation with other members of MSTI's sector team and representatives of the World Bank Group.

22. Copies of all reports of the consultant shall be shared with the World Bank team, which will support the MSTI and the HZPP in the revision of the documents.

VI. QUALIFICATIONS

23. The Service Provider's team should possess the following qualifications:

a) Project manager

- The Project manager will have the overall responsibility for work and all the deliverables.
- He/She will act as a focal point on behalf of his team with the client.
- The Project manager shall not be changed without good reason and without the approval of the client.
- Preferable experience in railway sector, contracting PSO and Croatian language.
- Experience in railway restructuring is desirable.
- Experience in development of the market driven services and marketing strategies in public transport services is desirable.

- Knowledge in negotiating PSC between state/government and transport services provider is desirable.

b) Expert for PSC contracting and analysis

- He/She will be responsible for railway passenger transport demand, quality of delivered service and reporting analysis.
- Minimum 5 years of experience in travel demand analyses, travel demand surveys, modeling and quality of delivered service.

- Desirable experience in railway sector PSO contracting.

- Experience in implementation of the information systems in railway passenger transport is desirable.

c) Costing expert

- He/She will be responsible for railway passenger transport costing / accounting regarding PSO contracts and analysis of earmarked spending
- Certified auditor
- Experience in railway public transport and costing / accounting regarding PSO contracts.
- Experience in programs for reducing the transport costs and in railway restructuring is desirable.
- Experience in implementing the measures for reducing costs in public transport, costing information systems in the railways, is desirable.
- Experience in calculation of the operating costs in passenger transport, minimum 3 projects.

d) Croatian Legal Expert

- Experience with a public service contracts and good knowledge of the related EU regulation.
- Minimum 10 years of experience in railway sector is desirable.
- He/She will be responsible for a legal review of the contract and its annexes and harmonization of the PSC in line with the EU regulation.

24. The Service Provider will need to meet eligibility requirements for employment as a consultant under World Bank Group financed projects under “*Guidelines on Selection and Employment of Consultants Under IBRD Loans and IDA Credits & Grants by World Bank Borrowers – January 2011 (revised July 2014)*”.²

VII. ADMINISTRATIVE PROVISIONS

A. Data ownership

25. MSTI will own all right, title and interest, including all intellectual property rights, in and to any reports, document, computer software (in source code and object code form), or other deliverable (whether in hard-copy, electro-magnetic, or machine-readable format) created or used under this assignment. The Service Provider will submit additional soft copies of all data in Microsoft Excel or Access formats. All analysis should be replicable after completion of the assignment without requiring any additional data sources.

B. Language of reports and data

26. The Service Provider will submit all reports, presentations, and data sets in well written Croatian and English language. All written materials should be packaged concisely with graphics, figures, and tables as required to facilitate communications. All data files should include annotations in Croatian or English that will enable MSTI or different partners to retrace analytical steps and make future use of all data and analysis.

² See:

<http://pubdocs.worldbank.org/en/894361459190142673/ProcurementConsultantHiringGuidelinesEngJuly2014.pdf>