ICRC

INDEPENDENT COMPETITION AND REGULATORY COMMISSION

DRAFT DETERMINATION

ACTION PRICING FOR THE PERIOD 1 JULY 2001 TO 30 JUNE 2004

February 2001

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1. INTRODUCTION

The Independent Competition and Regulatory Commission (ICRC) is conducting an investigation into the determination of prices for public transport bus services provided by ACTION within the Australian Capital Territory from 1 July 2001. The terms of reference for the investigation are included as Attachment 1.

The terms of reference establish the tasks to be undertaken by the Commission for this investigation and the various matters that are to be considered by the Commission in making the price direction.

The following requirements are specified in the terms of reference in relation to the conduct of the investigation:

> *The Commission in conducting its investigation into the determination of prices shall determine a price path capable of being applied over a period of 3 years* [from 1 July 2001 to 30 June 2004].
>
> *The Determination should consider current and projected patronage trends and any other noticeable trends flowing from the previous 1 July 2000 fare increase. This analysis should include a consideration of probable impact on, and adequacy of, fare box recovery levels.*
>
> *The Commissioner shall also examine and provide advice upon the current CSO funding model.*

All communication with the Commission in relation to this investigation should be directed to:

Independent Competition and Regulatory Commission
PO Box 975
Civic Square ACT 2608

Telephone: (02) 6205 0799
Fax: (02) 6207 5887

This document is the draft price direction on which comment is sought from interested parties.

2. INVESTIGATION PROCESS

The release of this draft report represents the first stage in a process which is established under the provisions of the Independent Competition and Regulatory Commission Act 1997. The draft report is made available for public comment. The timing for the finalisation of this inquiry is set out below:

	Date
Draft Direction	19 February 2001
Deadline for comments on Draft Direction	23 March 2001
Possible Public Hearing	2 April 2001
Final Direction	18 May 2001

Submissions on this draft report should be forwarded to:

Senior Commissioner
Independent Competition and Regulatory Commission
PO Box 975
Civic Square ACT 2608

Telephone: (02) 6205 0799
Fax: (02) 6207 5887
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3. DRAFT PRICE DIRECTION

Following the previous annual price directions, the Commission has been requested on this occasion to establish a price direction for the next three years. This presents the Commission with a dilemma as to how to ensure that its price directions are consistent with policy and operational changes affecting ACTION. This dilemma manifests itself in two areas. Firstly, the Commission has found that, while ACTION has made some progress towards improved efficiency, there is a considerable way still to go and, more importantly, the systems which would facilitate an audit of those improvements, such as the route profitability model, are still not in place. Secondly, the Commission acknowledges that ACTION is operating in an environment where the policy objectives are somewhat less than explicit. Moves towards instituting a formal service level agreement between the Department and ACTION are certainly in the right direction, but the purchaser-provider arrangement effectively endorses whatever is undertaken and does not provide sufficient discipline on either party. In essence, government funding constitutes deficit financing, and there is not accountability by all parties. The move towards establishing ACTION as a statutory authority would materially assist in implementing a more commercially focused process and where there would be greater transparency in nominating and funding services which were deemed socially desirable but were uncommercial.

Having said that, the Commission acknowledges that the current fare levels, even with marginal adjustments, will never make large inroads into ACTION's farebox cost-recovery position. Indeed, the Commission indicated last year that the overall policy setting for ACTION's role should be developed in the context of a wider integrated transport strategy. The Commission notes that little progress appears to have been made in this area.

Consequently, ACTION's finances continue to be run essentially in terms of crisis management. Best endeavours are claimed each year towards lower costs and higher revenues, but when optimistic outcomes are clearly not going to be achieved, ACTION calls upon the Department to provide additional assistance. There are clearly some issues which lie outside ACTION's management discretion - in particular, the recent strong increases in fuel prices as well as some whole-of-government obligations in the area of IT and workers' compensation – but the effective funding mechanism is deficit financing.

The Commission had expected that, while these problems would not have necessarily been resolved over the past year, a new organisational structure for ACTION, as a statutory authority, would have provided a more accountable managerial team at greater arm's length from government. Even though ACTION would have still required government funding to continue its activities, there would have been more effective institutional arrangements to ensure ongoing accountability.

Within this context, the Commission does not believe that the collapsing of the current range of CSO payments into one such figure sends the right signals either to

ACTION management or to the wider community. While it accepts that there is a degree of imprecision in the calculations of the existing CSO figures, the Commission is strongly of the view that the solution is to undertake more detailed work on the accuracy of these components rather than to jettison the whole approach.

The Commission believes, therefore, that there remains considerable work to be done by both the Department and ACTION before the community can have confidence that the pricing and funding of bus operations in Canberra are being undertaken in the most effective and efficient manner. Such action should be pursued with rigour and expeditiously.

Within this context, the Commission is conscious of the initial requirement to provide ACTION with a medium-term price path for the next three years. Patronage evidence suggests substantially low price elasticities, with shifts predominantly in the sales of different ticket types as the relativities of ticket prices has moved within the overall price cap. It appears to the Commission that explicit social objectives would still permit a narrowing of the discounts available to concession travellers without materially and adversely compromising those objectives.

The Commission also notes that ACTION is proposing a fleet replacement program be funded, starting within the next year or so. Given ACTION's difficulty to balance its cash books, it would be unlikely that it can access funds for capital expenditure without a direct injection of funds from government.

Essentially, the Commission has two alternatives available to it. On the one hand, it can issue a medium-term price path, which would have the advantage of providing some degree of farebox revenue certainty over the next three years. The Commission believes that there is a compelling case to increase the real level of fares as a means of providing better signals to the community about the costs of providing bus services. Given the apparent low price elasticities and the continuation of discounts in excess of policy guidelines and the objective of maximising revenue yields, the Commission considers that there is a case for instituting a significant real price increase to prevail over the three-year period, in the order of 2% per annum. There may be grounds for suggesting that such real price increases would need to be higher because there would be no annual scrutiny of the outstanding issues covered in this report, and therefore no ability to exercise any moral suasion on the major parties involved in the process.

However, the Commission is aware of the risk that, by providing such increases in farebox revenue with the commensurate increase in demonstrated cost-recovery, this may reduce the pressure on ACTION and the Department, and the government at large, to resolve the major outstanding issues which represent the greater part of the funding requirements.

The alternative is for the Commission is to adopt the same approach as in the two previous reviews and only issue an annual price direction, with the hope that the

outstanding issues would be resolved within the following 12 months. While the Commission has no jurisdiction to compel any results, an annual pricing review does provide an external audit on the whole process and provides the Commission with the option of endorsing different price outcomes if it believes that progress has been slower than it believes it should have been. The major disadvantage is that the same review process would be undertaken again next year, with no certainty of the outcomes. In this case, the Commission would still recommend a 2% real increase in fares be applicable for the year beginning 1 July.

Associated with either approach, the Commission recommends the associated action:

- Detailed independent scrutiny of ACTION's costs should be undertaken and the route profitability model completed.
- Detailed formal benchmarking of ACTION's costs should be undertaken.
- A review of ACTION's pricing strategy should be undertaken, to increase its revenue yield:
    - Further reductions in discounts for both adult and concession tickets to correspond with government policy
    - Review of the number of zones and the role of the shared zones.
    - As part of this approach, some up-to-date market research to establish firm price elasticities would inform the process and provide solid evidence for the Commission's future deliberations.

In order for it to determine which option to adopt, the Commission invites submissions on the merits of both options, with particular emphasis on which option is likely to provide the more efficient and equitable outcome. Ultimately, the resolution of the outstanding issues between ACTION, the Department and Treasury will have a greater bearing on the funding profile of ACTION than relatively small, albeit real, increases in bus fares, endorsed by the Commission. However, the Commission believes that it can have a significant role in promoting a more efficient and equitable outcome for ACTION through the price review process, and submissions from stakeholders on their views on this matter would be welcome.

4. INDEPENDENT COMPETITION AND REGULATORY COMMISSION

The Independent Pricing and Regulatory Commission (IPARC) was established in late 1997 by the ACT Government. The functions and powers of IPARC are set out in the IPARC Act 1997. In setting prices,

> *…the Commission shall decide on the level of prices for services…and give a price direction accordingly to each person providing regulated services.*
>
> A price direction may specify, in relation to the supply of a regulated service, any or all of the following:
>
> *a. a price;*
> *b. a maximum price;*
> *c a maximum price and a minimum price;*
> *d. a formula for calculating a price referred to in a paragraph a,b or c;*
> *e. a method, by reference to price indices or otherwise, by which a price referred to in paragraph a, b or c is to be ascertained;*
> *f. a period or periods during which the direction, or any provision of the direction, is to apply.*

Under the ICRC Act, the Commission is required to consider a number of issues in making its pricing decision. These include:

> *the protection of consumers from the abuse of monopoly power…*
>
> *standards of quality, reliability and safety…*
>
> *the need for greater efficiency…*
>
> *an appropriate rate of return…*
>
> *the cost of providing the regulated service…*
>
> *the principles of ecologically sustainable development…*
>
> *the borrowing, capital and cash flow requirements…*
>
> *the effect on general price inflation over the medium term; and*
>
> *any arrangement that a person providing regulated services has entered into for the exercise of its functions by some other person.*

5. ACTION

The Australian Capital Territory Internal Omnibus Network (ACTION) is an ACT Government owned enterprise supplying bus services throughout the ACT.

ACTION had 694 full time equivalent employees in 1999-2000, and incurs annual operating costs of $71 million with revenue derived from operations of around $18 million and explicit government contributions of $48 million to maintain the current level of service, as shown in the 1999-2000 budget.

ACTION has two depots, from which its fleet provides services. These are located at Belconnen and Tuggeranong. The operational fleet status as at December 2000 totalled 347 buses, with an average age of just over eight years. The fleet requirements are determined by significant peak periods.

ACTION and the ACT government have established an ownership agreement, which sets guidelines and performance requirements which are intended to ensure the government receives the best possible return through efficient operation and professional management of ACTION. The agreement has been determined through consultation with the Minister for Urban Services, the Minister for Health and Community Care and the Minister for Education and Training. The ownership agreement covers efficient management of finances, assets and staff, in line with the policy goals of the ACT government and in light of ACTION's past performance. One significant aim of the ownership agreement is to quantify appropriate minimum service level requirements between the Department of Urban Services as purchaser and ACTION as provider.

According to the ownership agreement, ACTION's mission is to provide the ACT community with an efficient, effective and accessible passenger transport service. This is achieved by:

- improved customer service;
- increased people involvement;
- creation of a positive community profile; and
- increased commerciality with the ultimate aim of providing the owner with a commercial rate of return on its equity in the business.

The major corporate objectives of ACTION are as follows:

- subject to the requirements of government policy and legislation, to operate as a customer service oriented entity along business like lines;

- to use benchmarking to operate at least as efficiently as alternative service providers and to provide quality, value for money services in all aspects of ACTION's operations;

- to use financial practices and maintain accounts and records which satisfy the requirements of the Financial Management Act 1996, including the associated ACT Accounting Policy Manual modelled on the requirements of the Australian Accounting Standards, and which fairly present ACTION's financial position and operational cashflow results for planning and reporting purposes;

- to adopt high standard operating practices to safeguard the environment and health and safety of staff; and

- to provide a productive and satisfying work environment for staff, and a commitment to high standards of human resource management based on equal employment opportunity.

6. ISSUES CONSIDERED BY THE COMMISSION

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a Determination is required to consider a number of factors and indicate what regard it has had to each factor. The Commission's assessment of each of the Part IV factors is detailed below.

6.1 Costs and Efficiencies

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a Determination is required to consider cost and efficiency factors, as detailed below:

- *the cost of providing the regulated services (Part IV 20.(2e);*
- *the need for greater efficiency in the supply of regulated services to reduce costs to consumers and producers (Part IV 20.(2c); and*
- *any arrangements that a person providing the regulated services has entered into for the exercise of its functions by some other person (Part IV 20.(2k).*

6.1.1 Operating Costs

ACTION's financial statements indicate that the organisation recovers significantly less than the accrual-based costs of providing the services. Over the past six years, farebox cost recovery has fallen within the range of 22.7% to 24.7%. The results are illustrated in Table 6.1.

Table 6.1: Operating costs ('000)

	1994-95	1995-96	1996-97	1997-98	1998-99	1999-2000
Employee costs	39,099	38,414	42,473	42,658	46,280	44,635
Administrative expenses						
- Bus running & maintenance	7,289	7,240	7,149	7,356	8,068	9,784
- Other	6,188	7,139	7,781	6,568	6,959	7,444
Depreciation & amortisation	7,496	7,467	7,368	7,041	6,418	5,181
Interest	8,345	6,851	6,381	3,441	2,428	2,154
Other expenses	-	-	-	-	1,519	1,634
TOTAL	68,417	67,111	71,152	67,064	71,672	70,832
Fares revenue	16,429	15,676	17,235	16,583	16,266	16,617
Farebox (cost recovery)	**24.0%**	**23.4%**	**24.2%**	**24.7%**	**22.7%**	**23.5%**

Source: ACTION

As can be discerned from Table 6.1, total operating costs in 1999-2000 fell slightly, relative to 1998-99. Employee costs fell in line with staff reductions (full time equivalent ACTION staff fell from 712 in 1998-99 to 694 in 1999-2000.) There were also large reductions in depreciation and amortisation expenses, together with lower

interest payments – a combined reduction of 17% in 1999-2000. The reduction in depreciation costs in 1999-2000 is largely attributable to ACTION's decision to extend bus life from 15 to 20 years. The fall in interest costs is associated with the ageing of ACTION's fleet.

It is worthwhile comparing ACTION's *actual* 1999-2000 results with previously *budgeted* 1999-2000 results. On this basis, actual operating costs were over 10% higher than budgeted operating costs for 1999-2000 as at April 1999, as indicated in Table 6.2 below:

Table 6.2: ACTION's budgeted and actual 1999-2000 operating costs ($'000)

	1999-2000: Budgeted	1999-2000: Actual	Difference
Employee costs	39,521	44,635	5,114
Administrative expenses	12,893	17,228	4,335
Depreciation and amortisation	5,720	5,181	(539)
Interest	2,114	2,154	40
Other expenses	3,607	1,634	(1,973)
TOTAL	63,855	70,832	6,977

Source: ACTION

Although actual employee costs decreased by some $1.6 million in 1999-2000, relative to 1998-99, they were still $5.1 million higher than originally budgeted for.

ACTION indicated that $0.5 million of this difference was due to a rise in workers compensation premiums. Another $1.5 million was due to an unexpectedly high level of absenteeism: 14 days per employee per year rather than the anticipated 5. ACTION's current performance is significantly above that of comparable operators. By way of comparison, publicly available data from the STA indicate that absenteeism on Sydney Buses ranged from 11.5 to 11.8 days per annum between 1990/91 and 1993/94 and fell to only 7 days per annum in 1994/95.

ACTION indicates that a further $2.4 million in higher employee costs was due to the higher than anticipated costs of implementing Network 99 in 1999-2000. Some 125,000 additional hours were put into the new network (at an average cost of $20.20 per hour). The remaining $0.7 million in higher costs was attributable to delays in realising EBA objectives relating to enterprise bargaining and the implementation of Network 99.

Higher than anticipated fuel costs in 1999-2000 were largely responsible for $1.7 million of the $4.3 million blow-out in administrative expenses. The average cost of fuel in 1999-2000 was $0.83 per litre, compared with $0.63 per litre in 1998-99. In addition, an extra $0.6 million in expenses was incurred due to an increase in fuel consumption because of higher bus kilometres associated with new network services.

Other factors responsible for the increase in administrative expenses include higher than expected Network 99 publicity costs, mandatory IT modernisation, funding of legal settlements from accidents and increased communication costs (each

accounting for $0.5 million). The Commission acknowledges that ACTION's ability to affect some of these imposts (such as mandatory IT modernisation) is limited.

Relatively low wholesale sales tax costs were largely responsible for the smaller than expected "other expenses" figure.

While the Commission acknowledges that some cost components may lie largely outside ACTION's control, it is nevertheless concerned at the extent of the cost overruns which the implementation of Network 99 appears to have produced in both 1998-99 and 1999-2000. In the March 2000 direction, the Commission noted that the total additional costs of implementing Network 99 in 1998-99 were estimated as $4.5 million higher than previously estimated by ACTION , to which the abovementioned $2.4 million in unanticipated employee costs alone has been added in 1999-2000.

As noted in the previous price direction, this confirms the need for ACTION to be more conscious of the nature of its cost structure in making expenditure forecasts. The Commission previously emphasised the need to develop a route profitability model as one step which would assist in cost planning. However, as noted in Section 6.1.3, ACTION's progress toward development of such a model has been slow.

6.1.2 Efficiency

ACTION's December 2000 submission indicates that it continues to make progress towards implementing its Enterprise Bargaining Agreement (EBA). According to ACTION, some $9.5 million of the estimated $10.5 million in annual savings had been achieved by the end of 2000. Table 6.3 indicates ACTION's progress towards implementation of its savings and efficiency goals.

Table 6.3: ACTION reform savings

	EBA Target	Progress	Comments
Cash Savings			
		$ '000	
Fully implemented			
Transport Officers - reduction in staff	892	892	Fully achieved
Transport Officers - saving in support vehicles	15	15	Fully achieved
Drivers - on bus ticket sales	20	20	Implemented in January 1999
Drivers – mealing	199	199	Implemented in January 1999
Drivers - trainee rates	160	160	Implemented in January 1999
Workers Comp Savings due to income protection	100	100	Implemented in January 1999
Additional savings from Feb '98 agreement	350	350	Implemented in January 1999
Drivers - late night running/area services	250	250	Implemented in Jan 2000.
Review of Cleaning, Fuelling and Clippies – SNT			Implemented July 1999
Drivers - casual spares	280	280	Implemented January 2000
Drivers - saving in bus numbers	385	385	Implemented Jan 2000
Drivers - reduction in numbers	250	250	Implemented Jan 2000.
Drivers - school bus review	250	250	Implemented Jan 2000.
sub-total	*3,201*	*3,201*	
Partially implemented			
Workshops - reduction of 19 indirect staff	985	885	Further staff reductions to be negotiated
Administration – reduction of 24 staff	1,265	1,165	Mostly Implemented
Workshops - transfer of 28 multiskilled drivers	681	600	4 Yet to transfer
Workshops - reduction of 14 direct staff	681	600	Further staff reductions to be negotiated during 2000/01
sub-total	*3,612*	*3,250*	
Not yet implemented			
Drivers - reduction in absenteeism	300	-	Strategies being implemented
Drivers - satellite depots	100	-	Under investigation
Drivers - additional part time broken shifts	200	-	Under investigation
Drivers - sign times	200	-	Now Considered Unachievable
Review of Disciplinary Procedures	100	-	Agreement reached
sub-total	*900*	-	
Total Cash Savings	***7,713***	***6,451***	
New Measures (replacing unachievable savings)			
Uniforms		100	Implemented July 2000
Tyre Management		100	Implemented July 2000
sub-total		200	
Service Improvements - must be paid for by increased revenue			
Fully implemented			
Drivers - increased productive hours	1,448	1,448	Implemented in January 1999
Drivers - on bus ticket sales	15	15	Implemented in January 1999
Transport Officers – after hours ticket sales	20	20	Implemented in January 1999
Total Service Improvements	***1,483***	***1,483***	
Reduction in Wage Increase previously proposed	*1,323*	1,323	Implemented in January 1999
Total Identified Benefits from Reforms	**10,519**	**9,457**	

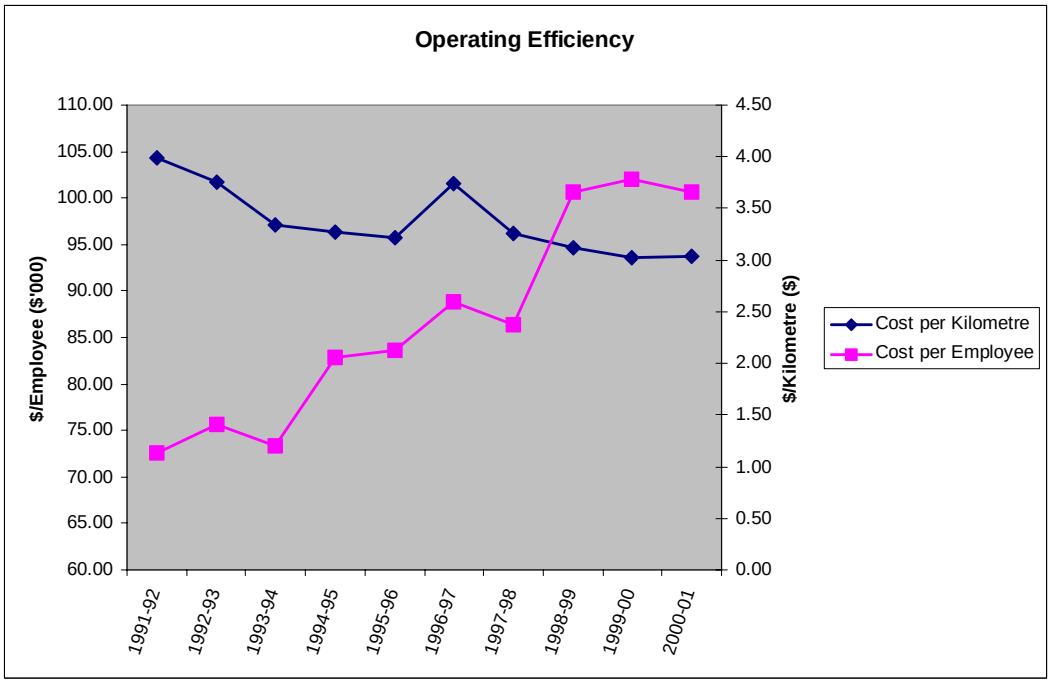
Source: ACTION

ACTION's progress towards implementation of EBA objectives to date has been substantial and is worthy of note. However, given the somewhat uncertain status of the as yet unachieved savings, the Commission would appreciate further details on when ACTION anticipates the remaining $1 million in efficiency improvements will be achieved.

The Commission also notes that the number of full time equivalent employees continued to fall, from 712 in 1998-99 to 692 in 1999-2000. ACTION's bus kilometres in 1999-2000 totalled around 23.4 million - slightly higher than in the previous year. Bus kilometres are anticipated to fall in 2000-01 to around 22.5 million, as the full year effect of modifications to Network 99 takes effect.

Figure 6.1 indicates recent trends in ACTION's performance and particularly illustrates the effects of ACTION's progress towards implementation of the EBA.

Figure 6.1: Operating Efficiency



Source: ACTION

As noted in the last price direction, the large increase in costs per employee in 1998-99 was associated with the implementation of Network 99 and a decrease in staff numbers. However, the above chart also suggests that the impact of these effects had stabilised in 1999-2000.

In the previous price direction, the Commission pointed out that, after excluding increased costs associated with tax equivalent adjustments, costs per employee still increased by 9% in 1998-99 on the previous year. While data for 1999-2000 indicates that costs appear to have levelled off in real terms, it remains to be seen if this will continue in 2000-01. As indicated in the above chart, ACTION suggests that costs per employee will fall in 2000-01. Given the history of the last decade when apparent cost stabilisation has been followed by marked increases, the Commission expects that ACTION's forecast of a unit reduction would occur, given that the full year effects of the modifications to Network 99 will be felt by then, and will be closely monitoring this indicator.

ACTION has made some progress in reducing costs per kilometre, which fell from $3.12 in 1998-99 to $3.03 in 1999-2000. This represents a 3% decline in year on year

terms though, as the above graph indicates, the trend towards cost reductions has flattened out in recent years. Such progress is especially notable in view of the fact that it was achieved in a situation where diesel prices (which made up some 12% of ACTION's operating costs in 1999-2000) rose from $0.63 per litre in 1998-99 to $0.83 per litre in 1999-2000. This is suggestive of some gains in network efficiency terms, and would appear to be associated with falling employee numbers (and costs) while system kilometres increased under Network 99. However, the Commission notes that the outcome is heavily influenced by the reduction in depreciation and amortisation costs as a contribution to total costs.

In spite of rising parts costs, ACTION's maintenance costs have also declined – from $0.29 per kilometre in 1998-99 to $0.27 per kilometre in 1999-2000, as indicated in Table 6.4. Total costs have declined by some 5.5%. This has been driven in large part by a fall in workshop staff numbers, although the Commission also acknowledges that ACTION's relatively low costs in this area are probably associated with the relatively young age of its fleet[1]. At the same time the Commission notes that maintaining such a young fleet may not be optimal and that maintenance costs must be balanced against replacement costs. The issue of optimal fleet replacement strategy is further discussed in Section 6.3.3.

Table 6.4: ACTION's maintenance costs

	1991-92	1992-93	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00	Est. 2000-01
Maintenance Costs:										
. parts	5,449	1,166	2,544	2,151	1859	1784	2029	2371	2883	2900
. mechanics wages	6,010	5,704	4,859	4,854	3991	3847	3857	3664	2538	2665
. apprentices	622	496	365	227	146	66	45	95	164	194
. cleaners/ fuellers	637	694	643	317	335	343	309	496	676	602
Total	**12,718**	**8,060**	**8,411**	**7,549**	**6,331**	**6,040**	**6,240**	**6,626**	**6,261**	**6,361**
Maint/per Kilometre	**0.67**	**0.40**	**0.40**	**0.36**	**0.30**	**0.32**	**0.30**	**0.29**	**0.27**	**0.28**

Source: ACTION

Although the fall in costs during 1999-2000 is a significant accomplishment, the Commission also notes that costs are anticipated to rise in 2000-01, mainly driven by an anticipated increase in the mechanics wage bill.

Overall, ACTION appears to have made considerable progress in implementing the objectives of the EBA. However, the Commission is not clear whether greater efficiencies could have been achieved. The Commission notes the INDEC 1998 Efficient Costing Report which suggested that, based on 1996-97 actual costs, ACTION could have achieved a cost outcome around 26% lower than these actuals

[1] Last years determination cited a range of $0.21 to $0.44 for per kilometre for public sector bus maintenance costs by various operators. See above

and that an efficient cost outcome could lower costs by between 33% and 40% depending on whether a profit margin was taken into account.

These differences represented significant implications for ACTION. INDEC were subsequently commissioned by ACTION in 2000 to update the 1998 report to reflect the changes which had taken place over the intervening years, particularly the introduction of Network 99 and the EBAs. Comparisons between the two reports are somewhat complicated, not least because some of the original 1998 savings estimated by INDEC appear to have been varied by ACTION at the time. The 2000 report notes that the previous INDEC estimate of achievable costs of $51.4 million in 1996-97 prices should be updated to $63.7 million in 1999-2000 prices. This figure was compared with projected 1999-2000 total operating expenses of $70.2 million. The difference is now $6.5 million or around 9% of actual costs, compared with the previous 26%, indicating apparently good progress towards meeting achievable costs. However, it appears that some of ACTION's real unit cost increases over the period have been added into the achievable cost target, which overstates ACTION's performance.

The Commission would be concerned if ACTION took the findings of the latest INDEC report to assume that they had largely maximised their efficiency improvements as there aappear to be reservations about the appropriateness of some of the assumptions. Indeed the Commission believes that, despite acknowledged improvements, there remains scope for more to be done.

6.1.3 Forecast Costs and Efficiency

Table 6.5 provides ACTION's estimates for operating costs over the next four years, made in November 2000.

Table 6.5: ACTION's Forecast Operating Costs ($'000) – as at November 2000

	1999-00 Actual	2000-01 Budget	2000-01 Expected	2001-02 Estimate	2002-03 Estimate	2003-04 Estimate	2004-05 Estimate
Employee Costs	44,635	42,150	42,920	42,939	44,113	45,356	46,637
Administrative Expenses	17,228	15,360	17,341	17,443	17,717	17,998	18,287
Depreciation and Amortisation	5,181	4,740	4,760	4,790	4,790	4,790	4,790
Interest	2,154	1,800	1,800	1,485	1,172	857	814
Other Expenses	1,634	2,560	2,000	2,161	2,161	2,220	2,275
TOTAL	**70,832**	**66,610**	**68,821**	**68,818**	**69,953**	**71,221**	**72,803**

Source: ACTION

ACTION's forecast employee costs are expected to decline from their 1999-2000 levels in 2000-01 before rising again in future years. ACTION has indicated that a fall in workers' compensation claims in 2000-01 is part of the reason for the short term decline in employee costs. However, ACTION has identified increased workers' compensation claims due to the ageing of its workforce as a potential source of cost pressure and has projected forward an annual workers' compensation premium of $2 million in future years.

Total estimated employee costs between 2000-01 and 2002-03 are some $4-5 million higher than those provided in ACTION's April 1999 forecasts, presented in the March 2000 Price Direction. ACTION indicates that one reason for this discrepancy is that the April 1999 forecasts did not allow for CPI adjustments, which have typically been written into enterprise agreements.

While the November 2000 forecasts allow for CPI adjustments of some 3% per annum and increased workers' compensation costs of $0.5 million per annum, this would not seem sufficient to explain this discrepancy. The Commission estimates that between $1.3 million and $2.5 million in additional costs remain unaccounted for even if the April 1999 estimates are indexed at 3% per annum and an allowance is made for rises in workers' compensation expenses. This analysis implies that some of the unanticipated costs experienced in 1999-2000 (such as higher absenteeism and Network 99 running costs) have, to some extent, been built into future estimates.

As previously noted, ACTION's current rate of absenteeism is 14 days per employee - well above that of the previously estimated 5 days per employee. ACTION have now set a target of 10 days absenteeism per employee, which is estimated to yield savings of $0.3 million per annum.

The Commission is concerned that such a target would still seem to allow for a relatively high level of absenteeism and notes that such savings are still well below the amount of unexpected costs ($1.5 million) experienced due to absenteeism in 1999-2000. From advice to the Commission quoted in section 6.1.1, ACTION indicated that the higher-than-expected absenteeism had cost it an additional $1.5 million in 1999-2000. The Commission would like clarification as to why a halving of the estimate of absenteeism is only expected to reduce costs by $0.3 million rather than a figure of around $0.6-0.8 million.

As indicated previously, ACTION 's fuel costs rose from a budgeted $0.63 per litre to $0.83 per litre during 1999-2000. Diesel fuel costs continued to rise during 2000-01, reaching a peak of $0.99 a litre in late 2000. ACTION has indicated that diesel costs of $0.90 have been built into its forward estimates.

Fuel costs are effectively outside ACTION's control. The Commission notes, however, that while fuel prices remain volatile, more recent evidence suggests that the cost pressures cited by ACTION may ease in the medium term. In particular, signs of a slowdown in global economic activity already appear to have contributed to a recent fall in fuel prices, and as a consequence it may not be reasonable to assume that fuel prices will remain at their current levels throughout the forecast period.

Additional IT expenses also contributed to higher costs faced by ACTION in 1999-2000. ACTION has continued to implement an IT modernisation program, as mandated by the ACT government, resulting in $0.5 million in unexpected costs in 1999-2000.

ACTION has also cited CPI and interest rate increases and adverse currency movements as offsetting the impact of the removal of wholesale sales tax and contributing to higher maintenance costs. The Commission notes, however, that ACTION's fleet is relatively young and could be expected to be less affected by such factors than many other bus operators[2]. As noted above, interest payments are forecast to decline over time, with the ageing of ACTION's fleet. Depreciation is relatively stable in future years, reflecting the application of straight line methodology to the fleet.

Estimates developed by ACTION, and reported in the March 2000 Price Direction, suggested that refinements to Network 99 would yield cost savings of some $3 million. ACTION also stated that, after such modifications, service levels would be reduced but would still be 7% higher than pre-Network 99 levels.

It is worth comparing these estimates with subsequent developments. ACTION indicates that, after the initial introduction of the new network, it made downward revisions to its service levels in September 1999, January 2000 and September 2000. These reductions amounted to a total cut of some 66,000 hours from the initial service levels introduced in January 1999, and would appear to allow for annual savings of $1.6 million in 2000-01. ACTION's December 2000 submission to the Commission indicates that, after these reductions, service levels will be 10% above what they were prior to the introduction of Network 99.

Thus, the final Network 99 service levels appear to be slightly higher than those proposed at the time of the previous price direction. Moreover, whilst it is understood that some savings referred to by ACTION in the previous price direction would have been made within the 1999-2000 financial year, it is unclear to the Commission whether or not the target of $3 million in cost savings, referred to last year, will be fully realised.

The Commission has previously expressed its concerns over the need for effective cost controls over the network. At the time of the last price direction, ACTION indicated that it would have a route profitability model developed during the first half of 2000, and the Commission suggested that this work be undertaken as a matter of urgency. ACTION's December 2000 submission, however, indicates that the route profitability model developed was overly complex and resource intensive, and that a revised, simpler model will be available shortly.

Whilst the Commission appreciates ACTION's continuing efforts to develop such a model, it is disturbed at the apparent delay of a year in doing so. This is particularly the case given the lack of knowledge surrounding the route profitability issue and its centrality in explaining ACTION's overall financial performance.

As the preceding analysis suggests, the Commission remains concerned that each new set of future estimates would appear to set operating costs at higher levels than

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[2] ACTION's average fleet age was 8.36 years in 1999-2000. This compares with the STA's average age of 11.8 years in 1999-2000.

previously. The high levels of unanticipated expenditure would suggest the need for improved systems of cost monitoring and control.

6.1.4 Contracting Out

The Commission expressed concern in previous price directions that ACTION had undertaken little investigation of potential outsourcing activities. The March 2000 Price Direction made particular note of ACTION's proposed outsourcing of bus refuelling and cleaning. The Commission expressed the view that not enough had been done by ACTION in the past to achieve non-core savings and indicated that if marked progress had not been made by the time of the current Price Direction, then an investigation of the contracting out of maintenance functions should be undertaken.

During the course of 1999-2000 ACTION conducted a review of its bus cleaning and refuelling arrangements. It was decided to opt for an internal restructure rather than contracting these activities out. ACTION indicates, on the basis of current costs, that the new arrangements will reduce expenditure in this area from $860,000 per annum to an estimated $602,000 per annum in 2000-01. This is equivalent to a cost per bus of $1,734 per annum – or a 26.5% reduction over the previous year's costs. ACTION has now also fully outsourced the provision of tyres, which it expects will return savings of $100,000 per annum.

If this is achieved this progress will be worthy of note, although previous studies suggest that there may still be a gap between the cleaning and refuelling costs currently achieved by ACTION and those which would be achieved by a private operator.

As noted previously, total maintenance costs fell by some 5.5% between 1998-99 and 1999-2000, but an increase of some 1.6% is anticipated for 2000-01. ACTION's maintenance costs of $0.27 per kilometre for 1999-2000 compares to estimates cited in last year's review of $0.21 to $0.44 per kilometre for other public bus operators. Allowing for both inflation and the current, relatively young age of ACTION's fleet, this suggests that ACTION is still not operating at best practice levels.

The Commission is therefore of the opinion that, while progress has been made in the areas such as maintenance, there is still room for further improvement and continued investigation of the possibilities offered by outsourcing. ACTION has indicated that reviews of the stores and maintenance areas will be conducted over the next six months. The Commission will closely monitor the outcome of these reviews.

6.2 Consumer Protection

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a determination is required to consider the consumer protection factors, as detailed below:

- *the protection of consumers from abuses of monopoly power in terms of prices, pricing policies and standard of regulated services (Part IV 20.(2a));*
- *standards of quality, reliability and safety of the regulated services (Part IV 20.(2b));*
- *the social impacts of the decision (Part IV 20.(2g));*
- *the effect on general price inflation over the medium term (Part IV 20.(2j)).*

6.2.1 Pricing

In its last determination, the Commission provided for ACTION to raise its average fares for 2000-01 in line with the growth in the Canberra Consumer Price Index for the 21 month period ending December 1999, plus one percentage point. This produced an average increase in the order of 3.6%. A further net 8% increase was applied across all fares to reflect the net impact of the GST, yielding a total average price increase of 11.6%.

ACTION data available for July-October 2000 indicates that overall passenger boardings decreased by 4% compared to the corresponding period in 1999-2000. The data suggest a continuation of the basic trend towards the purchase of discounted adult periodical tickets.

Table 6.6 compares 1999-2000 fares with those introduced after the last price direction:

Table 6.6: 1999-2000 and 2000-01 fares

	One Zone		All Zones	
	1999-2000	2000-01	1999-2000	2000-01
Adult				
Cash				
Single Trip	$ 2.00	$ 2.30	$ 4.00	$ 4.40
Shopper's Off Peak Daily	n.a.	n.a.	$ 4.00	$ 4.40
Daily	n.a.	n.a.	$ 7.00	$ 8.40
Non-cash				
Faresaver 10	$ 17.00	$ 18.40	$ 34.00	$ 36.80
Weekly	$ 17.00	$ 19.80	$ 34.00	$ 38.00
Monthly	$ 55.00	$ 65.00	$ 110.00	$ 120.00
Concession and School Student				
Cash				
Single Trip	$ 1.00	$ 1.20	$ 2.00	$ 2.20
Pensioner Off Peak Daily	n.a.	n.a.	$ 1.00	$ 1.20
Daily	n.a.	n.a.	$ 3.50	$ 4.20
Non-cash				
Faresaver 10	$ 8.50	$ 9.20	$ 17.00	$ 18.40
Weekly	$ 8.50	$ 9.90	$ 17.00	$ 19.00
Monthly	$ 27.50	$ 32.50	$ 55.00	$ 60.00
School Student Faresaver 10	$ 6.00	$ 6.50	$ 12.00	$ 13.00
School Term	$ 45.00	$ 49.50	$ 90.00	$ 99.00

Notes:
1. If an Adult Single Trip ticket is issued, a 1 hour transfer ticket is available on request at no extra charge.
2. Off Peak = Weekdays 9am-4.30pm and after 6pm and all day weekends and public holidays.
3. Students are not eligible to use the Pensioner Off Peak Daily tickets.
4. The All Zone Concession School Term Ticket may be available to students of families on a low income.
5. Adult Shoppers Off Peak Daily and Adult Daily and Pensioner Off Peak Daily and Pensioner Daily tickets are sold on the bus by the driver in All Zone format only.
6. n.a. = not applicable
7. 1999-2000 fare structure was actually introduced in January 1999. 2000-01 fares reflect price increases implemented on 1 July, 2000.
Source: ACTION

The Commission also notes the ACTION observation that some confusion still exists within the community regarding the operation of the zonal fare structure. The Commission would appreciate further advice from ACTION regarding the specific aspects of the new zonal fare structure which are the source of community confusion. The Commission recommends that ACTION develop a cost effective strategy to improve the understanding of current and potential customers regarding the zonal fare structure, particularly given its perceived implications in terms of overriding and ticket misuse.

6.2.2 Revenue Implications

ACTION indicate that overall patronage is some 4% lower for July-October 2000 than in the corresponding period of the previous year. ACTION suggest that the last round of fare increases would have been responsible for a decline in revenue, had it

not been for revenue protection initiatives. However, later ACTION data indicate that passenger boardings in July-November 2000 were 2.8% lower than for the same period in the previous year, suggesting that the impacts were not as great as first thought. Moreover, as discussed below, it is apparent that much of the decline can be explained by a fall in student boardings during the Sydney Olympic Games.

ACTION still believes that it represents around 5.25% of all passenger trips around Canberra – the same figure as reported in last year's Price Direction. However, as noted in the previous Price Direction, Network 99 was initially intended to raise ACTION's passenger trip share to 6%.

Examining the boardings data for the period more closely, it is evident that developments in the adult, concessions and student market differed. Adult boardings during this period actually increased by 3.1%, while concessions fell by 2.3%, student boardings decreased by 12.1% and miscellaneous ticket boardings fell by 20.6%.

Much of the fall in student boardings was, in fact, associated with the conduct of the Sydney Olympic Games in September 2000, which reduced the third school term by two weeks. It should also be noted that miscellaneous tickets include free passes provided to Inspectors and other ACTION staff. Thus, some boarding variations in this category may not relate directly to pricing or revenue considerations.[3]

It is therefore instructive to exclude student and miscellaneous boardings and to examine adult and concession boardings alone (roughly 70% of total boardings). This indicates that boardings for these two groups combined dropped by only 0.03% during the period. While incomplete, these data suggest that, in broad terms, boardings were not unduly affected by the last round of fare rises. Table 6.7 summarises these changes:

Table 6.7: Comparison of July-October 1999 and 2000 boardings

	July-October 1999	July-October 2000	Change	Percentage change
Adult	1,590,801	1,640,544	49,743	3.1%
Concession	2,181,085	2,130,168	-50,917	-2.3%
Sub-total	3,771,886	3,770,712	-1,174	-0.03%
Student	1,699,288	1,493,268	-206,020	-12.1%
Miscellaneous	79,326	63,001	-16,325	-20.6%
Total	**5,550,500**	**5,326,981**	**-223,519**	**-4.0%**

Source: ACTION

At the time of writing, ACTION data relating to actual revenue by ticket type were incomplete. Available data do, however, permit a comparison by ticket revenue for a number of non-cash adult and concession fares between September and November

[3] In fact "Miscellaneous free passes" boardings dropped by nearly 9,000 during the period in question.

1999 and the corresponding period in 2000[4]. This comparison is made in Table 6.8, below:

Table 6.8: Comparison of available September-November 1999 and 2000 revenues

	September-November 1999	September-November 2000	Change	Percentage change
Adult				
--Faresaver 10	$ 725,883	$ 783,895	$ 58,012	8.0%
-Weekly	$ 170,884	$ 158,387	-$ 12,497	-7.3%
-Monthly	$ 287,430	$ 347,260	$ 59,830	20.8%
Total	**$ 1,184,197**	**$ 1,289,543**	**$ 105,346**	**8.9%**
Concession				
--Faresaver 10	$ 161,381	$ 148,810	-$ 12,571	-7.8%
-Weekly	$ 67,031	$ 58,495	-$ 8,536	-12.7%
-Monthly	$ 86,543	$ 109,108	$ 22,565	26.1%
Total	**$ 314,955**	**$ 316,412**	**$ 1,458**	**0.5%**
Total Adults and Concessions	**$ 1,499,152**	**$ 1,605,955**	**106,803**	**7.1%**

Source: ACTION

The available data indicate that overall adult and concession non-cash revenue increased by roughly 7.1% ($107,000) during this period. Adult ticket revenue rose by $105,000 (8.9%), while concession revenue rose by 0.5%.

Breakdowns for adult tickets indicate that weekly ticket revenues fell by 7.3% during the period, but that revenue for faresaver and monthly tickets rose by 8% ($58,000) and 20.8% ($60,000) respectively. Concession weekly ticket revenues also fell (by 12.7%), as did concession faresaver revenues (down 7.8%). However, a rise in concession monthly revenues (by 26.1%) more than compensated for these falls.

While the above analysis excludes adult and concession daily tickets and adult and pensioner off-peak tickets, a comparison of boardings for July-October 1999 and 2000 indicates that usage of all of these tickets increased (with the exception of concession daily tickets). Assuming rides per ticket were constant over time and taken together with the post July 2000 fare increases, this suggests that combined revenues for these ticket types should be higher than in the same period during the previous year. While data on cash fares were not directly available, an analysis comparing boardings data in July-October 1999 with the same period in 2000 suggests that adult cash fare revenue increased by $22,000 (2.3%) while concession fare revenue increased by $38,000 (5.7%).

The Commission acknowledges that some of the increase in revenue collections for certain ticket types may have been due to the impact of more vigilant revenue

[4] The ticket types excluded from this analysis were: adult daily, concession daily, adult shopper off-peak and pensioner off-peak daily. Student tickets were excluded due to volatility associated with the change in school term starting times and the staging of the Sydney Olympic Games.

protection and public education measures and, as indicated below, it supports the further development of such efforts. However, it is not clear that such measures are solely responsible for revenue increases, as implied by ACTION.

While data limitations and substitution effects inhibit comparisons, in some cases, such as adult faresaver tickets, there appears to have been limited change in boardings between the two years but a marked change in revenues[5]. This suggests a relatively inelastic response to fare changes among adult faresaver patrons. It should be noted that adult faresaver patrons make up a significant passenger market: ACTION data for July-October 2000 suggest that they accounted for roughly one third of all adult boardings during this period.

Thus, taken together, the above analysis suggests that, once the volatility associated with one-off events such as the Olympics has been allowed for, the July 2000 fare increases have contributed to an increase in farebox revenue while having relatively little effect on boardings. However, analysis of both revenue and boardings data suggests a drift from weekly to (relatively cheaper) monthly tickets. As discussed below, this suggests the need to reduce the discount on monthly tickets to improve passenger yield.

The Commission remains concerned about the relatively low level of farebox revenue projected by ACTION itself for 2001-02 and thereafter. ACTION's November 2000 forecasts, reproduced in Table 6.9, suggest that although revenues between 2001-02 and 2003-04 are projected to increase on present levels, they will still be lower than the December 1999 forecasts presented in the last price direction. This is despite that fact that the most recent forecasts include an allowance for annual revenue increases in line with changes in the CPI, whereas previous ones did not.

The capacity to increase farebox revenue via patronage growth would appear very limited. ACTION's own farebox revenue projections provide for patronage growth of 1% per annum. However, the Commission continues to be of the view that it is unrealistic to embark on a pricing path which assumes future patronage growth. As suggested in the March 2000 price direction, even growth of 1% per annum tied to underlying ACT population growth will be difficult to achieve within a cost-effective network.

Accordingly, the Commission believes that ACTION should review a number of aspects of its pricing strategy with a view to increasing average passenger yields over and above any general increase in fare levels.

On both efficiency and equity grounds, a key objective associated with the January 1999 introduction of the zonal fare structure was to improve the relationship between the fare paid and distance travelled, relative to the former flat fare

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[5] Available boardings and revenue data differ somewhat in the scope of their coverage, and ACTION data comparing July-October 1999 and 2000 suggest that adult faresaver boardings increased by 1.4%.. ACTION data for the July-November period suggest moderate change (a 3.3% increase) in adult faresaver boardings.

structure. Data for July-October 2000 provided by ACTION reveals that 81% of adult faresaver tickets and 88% of concession faresaver tickets sold are one zone tickets. Similarly, 92% of adult cash tickets and 94% of concession cash tickets sold in the same period were one zone tickets. This suggests that the new fare structure has largely failed to establish a relationship between the fare paid and distance travelled.

This outcome is tied to the number of zones, associated zonal boundaries, the basis of the fare calculation and the level of fare evasion (specifically overriding). The Commission suggests that ACTION review the potential of the following fare system changes to improve the relationship between the fare paid and distance travelled and/or improve average passenger yields:

- Review the revenue dilution impact of the shared fare zones around the Belconnen and Woden town centres;

- Assess the merits of replacing the existing 'all zones' fares by specific two and three zone fares; and

- Review the relationship between one, two and potentially three zone fares to ensure that it is optimal in terms of maximising farebox revenue.

Last year's price direction included an estimate by ACTION that revenue protection measures could recover between $200,000 to $350,000 per annum at a cost of $80,000. ACTION indicates that these expectations have been met. Four revenue protection officers were appointed at a cost of $80,000 in March 2000 and cash fares are projected to be $300,000 above budget.

While ACTION's progress in farebox revenue protection measures is notable, it may prove cost-effective to further increase the level of enforcement, particularly in the short-term, to reduce the level of over-riding. For example, an analysis of the ACTION passenger origin-destination survey undertaken prior to the introduction of the new zonal fare structure suggested that 75% of single trip (i.e. cash) tickets purchased should be one zone tickets (before allowance is made for the shared zones). Analysis of boardings data provided by ACTION for July-October 2000 implies that 93% of total actual cash boardings (or 92% of adult cash boardings) used one zone tickets, a difference of 18%. If, in fact, the proportion of adult one zone trips tickets fell to (say) 80% (i.e. making a notional allowance for the impact of shared zones), annual farebox revenue would increase by around $100,000, everything else being equal.

The Commission would also encourage ACTION to conduct a review of its product range, specifically the potential to withdraw or re-position low yielding products. The Commission notes that Brisbane Transport recently withdrew its weekly and monthly tickets, which it is understood has increased farebox revenue without adversely impacting on patronage. There would appear to be merit in ACTION reviewing the Brisbane Transport experience.

In the event that ACTION concludes that weekly and monthly tickets should be retained and in the light of recent patronage data, the Commission is of the view that the effective discounts offered on these tickets, relative to the single trip ticket, should be around 20%. The effective discounts afforded by both weekly tickets and monthly tickets both lie well outside the range. Effective adult discounts, relative to one-zone single trip tickets, are estimated at 28% (weekly tickets) and 34% to 37% (monthly tickets).

The higher relative discount enjoyed by adult monthly ticket purchasers may partly explain the apparent drift from adult weekly tickets to monthlies. Adult weekly boardings for July-October 2000 were 16.5% lower than for the corresponding period in 1999, while boardings using monthly tickets increased by 17.9%[6]. Reducing the discount on monthly tickets, in particular, would help improve passenger yield.

The Commission also notes that the effective discount offered by the FareSaver 10 has increased from 15% to 20%. The Commission believes that this discount should be reduced to 15%. Given the apparently inelastic demand for adult faresaver tickets, referred to earlier, and the prominence of this ticket within the adult market, the Commission feels that reduction of this discount should be a priority.

The ACTION submission notes that use of the 'transfer ticket' is increasing and '… may need to be reviewed if it continues to erode the single cash fare revenue.' The Commission is not convinced that any justification exists for the withdrawal of the transfer ticket. Implicitly, ACTION customers needing to transfer between services to complete their journey receive a lower quality of service relative to those who are able to complete their journeys on a single vehicle. It would therefore seem illogical for those customers who need to transfer to pay a higher fare (i.e. second single fare) relative to those completing their journey on a single vehicle.

In addition to potential fare system re-structuring and increased farebox revenue protection measures, the Commission believes that there is scope to raise the general level of ACTION fares as a means of contributing to an improvement in farebox cost recovery.

As suggested in previous price directions, the demand for ACTION services is understood to be highly inelastic. Previous ACTION demand modelling has used fare elasticities for individual products ranging from –0.15 to –0.25, consistent with an overall average of –0.2. This implies that, other things being equal, each 1% increase in real fares would only be expected to reduce ACTION patronage by around 0.2%. This is relatively low by interstate and international standards and reflects the fact that the 'captive' bus user is dominant in the overall ACTION customer profile.

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[6] Boardings figures are for adult one zone and all zones tickets combined. A similar trend was observed for concession fare boardings, with weeklies down 26.7%, but boardings using the monthly, tickets increasing by 2.2%.

Further support for the conclusion that the demand for ACTION services is highly inelastic is provided in the Department's submission, which cited results of the *2000 Survey of ACTION Services* and findings of Bureau of Transport Economics (2000).

The 2000 Survey of ACTION Services reported that:

- 54% of non-users would only contemplate public transport if they lost their private transport or ability to drive

- 79% of non-users stated that they did not use bus services because they were too inconvenient or because they had their own private vehicle.

BTE (2000) reviewed national and international experience regarding the capacity to effect mode shifts. It was concluded that there is a natural tendency for persons to travel independently (generally for convenience reasons) and for this tendency to increase with income. As suggested by the Department , the dispersed nature of Canberra suburbs, high private motor vehicle ownership rates and relatively high income levels would seem to support this view.

Notwithstanding the available evidence, the Commission notes the concern expressed by ACTION regarding the capacity to retain its market in the event that fares are increased beyond CPI (i.e. real fare increases). Although the Commission believes that there is a strong body of evidence that points towards the demand for ACTION services being highly inelastic, it is suggested that ACTION undertake market research directed at providing robust fare elasticity estimates for the ACTION market. The results of this research can then be applied to the modelling of future ACTION fare changes.

6.2.3 Student Fares

The Commission has previously noted that reviews of student fares should be connected with studies of alternative fare and zonal structures. This is due to the fact that the issue of student fares is inter-related with that of zonal anomalies. In its last direction the Commission supported the speedy introduction of improved ticketing technology so as to assist in resolution of zone boundary problems.

As part of the previous direction the Commission also suggested that school students should be differentiated from those attending tertiary institutions. This would assist in determining which groups should benefit from student discounts and in resolving difficulties which arose when tickets structured around school terms were used by tertiary students.

It is not clear to the Commission that there has been much progress on either of these two issues over the past year. It is understood that work continues towards the introduction of a "Smartcard" which may, among other things, alleviate some of the current problems surrounding boundary anomalies. However, at present, it is not anticipated that Smartcard rollout will occur before the end of 2001.

The Commission is advised that ACTION has modified some school bus routes in response to demand changes. However, the details and results of these modifications were not discussed in ACTION's December 2000 submission to the Commission.

In addition, no progress has been made in determining whether tertiary students should continue to benefit from the same level of discounts afforded to school students. Whilst this is an issue which needs to be resolved at a government policy level, the Commission is disappointed at the lack of development in this area.

In the last review the Commission found that discounts applicable to student term fares exceeded that mandated by government policy, i.e. 35% of the adult cash fare on a per ride basis. Accordingly, the Commission directed that student tickets be set at 35% of the full adult equivalent ticket.

While there has been some increase in student zone and all zone tickets since the Commission's last price direction, the increases (10%) have not been sufficient to achieve the government's policy ticket of 35% of the full adult equivalent ticket. This is in part because the full equivalent ticket fares were increased at the same time. Based on average ride data supplied to the Commission during the course of the last review and current prices, student one zone and all zone term tickets both currently appear to offer prices which are roughly 30% of the equivalent adult tickets on a per ride basis. This suggests that another increase in term tickets – in the order of 15% - is warranted.

In short, the Commission would welcome further information on this issue.

6.2.4 Social Impacts

In analysing the social impact of price and policy changes, the Commission has previously noted that ACTION has an extensive system of concession fares, applying to pensioners, students and the disabled. In fact, student and concession boardings accounted for nearly 70% of total boardings during July-October 2000. In addition, CSO payments, excluding general deficit funding payments, continue to account, at $42.6 million, for over 70% of ACTION's total operating revenue.

As was the case in past years, many passengers appear to have benefited from a move towards periodical tickets, such as monthlies, over the past year. In addition, some concession fares continue to be offered at heavily discounted rates relative to their adult equivalents.

For example, combining the latest available average ride data with current fares suggests that the average fare per ride of a pensioner off-peak daily ticket is approximately one third that of an adult off peak daily. In addition, the concession daily, concession weekly (one zone and all zone) and adult monthly one zone tickets would all appear to cost less than 50% of their adult equivalents on an average fare

per ride basis, although the extent of discounting is not as great as for pensioner off-peak daily tickets.

The particularly heavy discounting applied to pensioner off peak weekly tickets also appears to have had impacts *within* the concession market. While pensioner off-peak boardings were up by 8.6% during July-October 2000 compared to the same period in the previous year, sales of concession daily tickets fell by some 7.5%. As concession daily tickets appear to cost some 43% of their adult equivalents – compared to 33% for off-peak daily tickets - there is an obvious incentive to switch to pensioner off-peak daily tickets, which, in turn, erodes yields.

In the previous price direction, the Commission indicated that, if the 50% threshold were to apply to the $1 pensioner concession, the fare should be raised to $1.50 under the then prevailing fare structure. In the event, the fare was raised only to $1.20 at a time when other fares were also raised. As a consequence, this ticket still represents a concession well in excess of 50%.

As a result, the Commission again suggests that pensioner off peak daily tickets be set at 50% of the equivalent adult ticket price (on an average per ride basis) and that care should also be taken to maintain the same 50% concession benchmark against adult fares for all other ticket types. Whilst this may imply an increase in the cost for some concession fares, such changes are likely to be small and would only be restoring fares to levels set by previous policy benchmarks.

Considering the extent of the current discounting and the limited impact of the suggested adjustments, the Commission remains of the opinion that such price and policy changes will not have any major adverse social impacts on ACTION's customers.

6.3 Financial Viability

Under Part IV of the Independent Pricing and Regulatory Commission Act, 1997, the Commission, in completing a determination, is required to consider the financial viability factors, as detailed below:

- *an appropriate rate of return on any investment in the regulated industry (Part IV 20.(2d));*

- *the borrowing, capital and cash flow requirements of persons providing regulated services and the need to renew or increase relevant assets in the regulated industry (Part IV 20.(2i)).*

6.3.1 Government Contribution to ACTION/CSO Funding

Table 6.9 details ACTION's forecast November 2000 operating statement and future estimates:

Table 6.9: Forecasted Operating Statement ($'000) – November 2000

	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Expenditure	(71,672)	(70,832)	(68,812)	(68,809)	(69,942)	(71,211)	(72,793)
Revenue	17,478	17,702	18,883	18,019	18,729	19,466	19,466
Government Contributions	39,295	42,631	42,675	43,672	44,428	42,805	43,526
Other	166	93					
Operating Deficit/Surplus	**(14,733)**	**(10,406)**	**(7,254)**	**(7,118)**	**(6,785)**	**(8,940)**	**(9,801)**
Operating Injection	2,326	5,241	3,624	4,398	4,093	4,093	4,093
Abnormal Items		825					
Operating Deficit/Surplus after abnormal and extraordinary items	**(12,407)**	**(4,340)**	**(3,630)**	**(2,720)**	**(2,692)**	**(4,847)**	**(5,708)**
Capital Contribution from Government		2,826					
Accumulated Funds at the end	**36,953**	**35,441**	**31,811**	**29,091**	**26,399**	**21,552**	**15,844**

Source: ACTION

The last two price directions expressed concern about the forecast rundown in accumulated funds due to continued ACTION deficits in future years. Current ACTION forecasts indicate that the situation continues to deteriorate. The forecasts in Table 6.7 generally show higher expenditure, lower revenues and larger operating deficits for 2000-01 and the forward years, than was the case for the estimates made in December 1999 and presented in the March 2000 Price Direction. As a consequence, forecast accumulated funds for the years after 2000-01 are even lower than last year's estimates.

As previously noted, part of the reason for the higher results on the expenditure side is that indexation of some 3% has been applied to employee costs. In addition, allowance has been made for an increase in workers compensation costs of some $0.5 million per year after 2000-01 and higher fuel prices. It is not completely clear to the Commission, however, that the impact of these effects is sufficient to explain why forecast expenditure levels are still above those predicted in December 1999.

Moreover, it is understood that revenues have also been subject to CPI indexation. Thus, the deterioration in accumulated funds would not appear to be a product of inconsistent indexation. Rather, the Commission has been advised that the farebox revenue forecasts provided in the previous price direction were overly optimistic.

While recent expenditure and revenue initiatives taken by ACTION have been noted in previous sections, these results suggest that costs will be higher and revenue lower than previously estimated.

As was reported in the March 2000 Price Direction, government contributions are the major means through which ACTION's accumulated savings are protected.

Government contributions actually increased markedly in 1999-2000, as indicated in Table 6.10.

Table 6.10: Government Contribution ($'000)

	1996-97	1997-98	1998-99	1999-00
Pricing CSO	16,340	13,376	14,189	17,839
General Route Off-Peak Services CSO	9,038	7,779	9,455	9,262
School Services CSO	9,387	9,684	9,780	9,592
Concessional Travel Payments	3,501	3,606	4,159	4,301
Special Needs Transport	1,022	1,922	1,712	1,637
Resources Provided Free of Charge	-	31	-	-
Sub-total	39,288	36,398	39,295	42,631
General Subsidy/Injection for OR	3,000	1,000	2,326	5,241
Total	**42,288**	**37,398**	**41,621**	**47,872**

Source: ACTION

Information provided by the Department as a part of its December 2000 submission indicates that CSO payments for 2000-01 are some $40.8 million , with an additional $3.6 million operating injection. ACTION's forecasts, however, indicate CSO payments of $42.7 million in 2000-01, with a $3.6 million operating injection.

The Department's December 2000 submission to the Commission also suggests that CSO figures no longer accurately reflect actual services delivered to market segments and that the division of CSO components is largely notional. The Department suggests that CSO divisions be removed from the 2001/02 Budget Papers and replaced with a single funding figure in line with the Service Level Agreement (SLA) indicating the Department as the purchaser and ACTION as the provider.

The Commission is concerned at these suggestions, as it has previously called for greater transparency in the reporting and allocation of CSO payments in previous price directions. Indeed, in the March 2000 price direction, the Commission expressed its concern that the calculation of CSO payments may not fully represent the value of services which ACTION provides and stated its expectation that clearer and more justifiable CSO payments were necessary as part of the conversion process to a statutory authority.

The Commission also noted that the Department's suggestion for abandoning the current reporting of CSOs is based on its interpretation of a Commonwealth Grants Commission (CGC) paper: *Urban Transit - A Concessions and Other Payments Approach*. However, the issue in this paper is that the CGC has difficulties in comparing CSO payments as a basis for grants equalisation because such payments are structured differently across jurisdictions. The Commission does not believe that this should be taken as support for a claim that reporting of CSO payments be abolished. On the contrary, the Commission believes that, for the purposes of

determining government policy in terms of funding requirements for ACTION, there is a need to ensure that CSO payments are appropriately defined, measured and accounted for.

This is critically important for the Commission's price setting role, in which it needs to take account of:

- Commercial fare levels and hence any net cost difference resulting from the current fares relative to commercial fares (i.e. pricing and concession fare CSOs)

- Minimum service levels (specified by the Department) and hence any incremental net costs for providing actual service levels relative to MSLs (i.e. service level CSOs)

- Best practice cost levels and hence any net cost difference between actual costs and best practice cost levels, for the current level of service (i.e. "cost inefficiency" CSOs)

Providing this information requires a breakdown of ACTION's financial performance (i.e. its "deficit") broadly along the lines currently adopted (although there is no specific "cost inefficiency" CSO in the current framework).

A further breakdown of these factors for different types of specific groups of services (such as school or general route services) would have the following merits:

- avoiding setting fares that produce unintended cross subsidies between different service types

- if services such as school transport need to be funded from a separate source (or not), making transparent the costs of school services.

Therefore, the Commission is strongly of the view that ACTION's deficit should continue to be broken down into separate CSO payments for transparency and management control purposes, particularly as the current SLA represents the purchase of all provided services by ACTION, rather than a series of defined services which explicitly distinguish between commercial and non-commercial services.

In the March 2000 price direction, the Commission noted that government funding support (in total) for ACTION was at a higher level than previously projected. However, forecasts prepared in November 2000 indicate that government funding support *again* exceeds the (already higher) levels projected in the last price direction. The size of these increases is indicated in Table 6.11. According to ACTION's figures, total government support for ACTION in 1999-2000 and the following four years will be between $1.3 million and $4.6 million higher than estimated in December 1999:

Table 6.11: ACTION Additional Government Funding Requirement ($'000)

1999-2000	2000-01	2001-02	2002-03	2003-04
2,757	1,321	2,582	3,751	4,681

NB Figures include Government Operating Injection.
Source: ACTION

The reason behind such increases is not clear to the Commission and it remains concerned at ACTION's continued heavy reliance on government support. The Commission, in fact, is concerned that government contributions are essentially deficit financing and that any attempts to aggregate those payments only reinforces the funding difficulties.

6.3.2 Cost Recovery

Cost recovery for 2000-01 is forecast by ACTION to be 24.1%, as shown in Table 6.12, below.

Table 6.12: Cost Recovery Trend

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Fares	16,583	16,266	16,617	16,600	16,877	17,553	18,254	18,254
Operating Costs	67,064	71,672	70,832	68,821	68,818	69,953	71,221	72,803
Farebox Cost Recovery	**24.7%**	**22.7%**	**23.5%**	**24.1%**	**24.5%**	**25.1%**	**25.6%**	**25.1%**

Source: ACTION

The Commission notes that farebox cost recovery was higher in 1999-00 than in the preceding year. However, forecast farebox cost recovery levels are below those reported in the last price direction. This is a consequence of ACTION's revised expenditure and revenue expectations.

Table 6.13 compares ACTION's recent farebox cost recovery performance with two other operators:

Table 6.13 Farebox Cost Recovery

Public Bus Operators	Cost Recovery
ACTION	23.5% (1999-2000)
Sydney Buses	59.3% (1999-2000)
Newcastle services	21.4% (1999-2000)

Source: ACTION and STA

Although this table represents a very limited sample, it suggests that, despite the modest improvement of the past year, ACTION remains at the lower end of the cost recovery range.

The Commission is disturbed at the lack of substantive progress in improving ACTION's cost recovery rate. Despite modifications, higher than anticipated costs associated with the introduction of Network 99 continued to have an impact in the

1999-2000 financial year. At the same time, the movement towards periodical tickets (such as monthlies) has eroded yields.

The Commission believes that the fare increases initiated on 1 July 2000 will assist in improving farebox recovery in the 2000-01 financial year. It suggests that a further round of fare increases, in combination with changing ticket price relativities and expenditure restraint, would seem to be necessary to ensure an improved farebox recovery performance in future years.

Failure to improve farebox revenue implies that ACTION will continue to receive high levels of government support into the future. This, in turn, implies a large ongoing subsidy from ACT taxpayers to ACTION users. The Commission believes that a more efficient level of operations, combined with a more appropriate fares policy, will help to reduce the level of community subsidy and to help ensure that bus users' transport decisions are more accurately priced.

6.3.3 Rate of Return

The Commission acknowledges that assessment of a "rate of return" for businesses such as the provision of public transport can present special difficulties. This is because such businesses, as a whole, are typically loss making and require government support to balance their books. However, acknowledgement of this fact does not preclude the need for public transport providers to establish clear investment guidelines for asset acquisition and replacement.

In its last price direction the Commission expressed concerns about several aspects of ACTION's proposed fleet replacement plan. The Commission's concerns included:

- the lack of any assessment of new investments according to prescribed rate of return criteria, or of any clear investment guidelines for bus acquisition and replacement, consistent with commercial practice;

- an average fleet age (8.4 years) below that of the cited optimal age (10 years) and that of operators such as the STA, raising questions over the need for major expenditure on replacements;

- a "lumpy" age profile for the current fleet which seemed to imply excess capacity before 2007-08 and a shortfall in capacity between 2007-08 and 2015-16;

- the appropriateness of an 18 year age limit for ACTION buses given the problem of a shortfall in capacity;

- the choice of bus types and sizes; and

- the budgetary impacts and benefits of smoothing out funding peaks.

ACTION have indicated that a review of the fleet replacement plan has been undertaken. At present, this is still in draft form and full details have not been released to the Commission.

However, ACTION's December 2000 submission indicates that the new fleet replacement plan proposes an average bus life of 12 years (rather than the previous optimum of 10 years), a maximum life of 20 or 21 years and the evaluation of extra maintenance costs against the cost of purchasing new buses. The Commission has previously suggested that ACTION's fleet is quite young when compared to operators such as the STA. The average age of ACTION buses in 1999-2000 was 8.36 years, while that of STA buses was 11.8 years – suggesting that there may be some leeway for ACTION in allowing for a slightly older fleet if this is deemed optimal.

While the details are not yet available, these proposals would appear to go some way to addressing the Commission's previous concerns about the extent of proposed fleet replacement given the relatively young age of ACTION's existing fleet. In addition, as the Commission previously suggested, and ACTION have recognised, extending the maximum age limit of buses from 18 to 20 or 21 years would, in principle, assist in resolving the problem of fleet lumpiness and a future shortfall in capacity. However, it is not yet clear to the Commission how the proposed replacement program relates to forecast network requirements.

At the same time, both ACTION and the Commission have recognised the impact which implementation of the Commonwealth's *Disability Discrimination Act* (1992) (DDA) will have on the replacement of its fleet. As ACTION is required to have at least 25% of its fleet accessible by 1 July 2005, this would seem to necessitate initiation of a fleet replacement program sooner rather than later.

It should be noted that, even allowing for the mandatory requirements of the DDA, ACTION's revised purchasing schedule calls for the purchases of 20 new buses per year, in comparison with the 25 suggested in the past. Whilst the Commission is not in possession of the details behind these figures, this suggests that ACTION may have made some progress in balancing the requirements of the DDA with the need for financial prudence.

The Commission awaits receipt of ACTION's new draft fleet replacement plan before making further comment. The Commission will be paying close attention, in particular, to any rate of return or other investment criteria upon which the draft plan is based.

6.3.4 Minimum Service Levels

As a part of its last price direction the Commission estimated that the net cost of service provision would be reduced by $11.5 million if ACTION were to operate to

Minimum Service Levels (MSL) only. The Commission has since re-examined its estimate of the net cost savings of operating at MSL. The reasoning behind – and impact of - this re-evaluation is given in Table 6.14:

Table 6.14: Impact of re-estimation of MSL

Factor	Estimate in March 2000 price direction	Estimate for current price direction	Impact on previous estimate of net costs	Reasoning
Variable cost rate	$2.17 per revenue kilometre	$2.50-$3.00 per revenue kilometre	Increase in avoidable costs by $4.6-$7.9m	An allowance should be made for factors such as medium term efficiency measures and the differentiation between variable costs for peak and off-peak services. As many avoidable services occur during off-peak periods, this would seem a relevant issue. ACTION's own recent reform measures suggest that a significant quantum of costs could be considered variable in the medium term. The previous variable cost rate therefore appears too low to reflect medium run cost changes.
Service level elasticity	0.5	0.25	Reduction of revenue loss by $1.2m	The previous estimate of elasticity of 0.5 appears higher than most other Australian and international evidence would suggest. In addition any service reductions would occur to lesser used services, and would have less of a patronage impact than if applied across the board. Evidence presented by ACTION as part of their December 2000 submission suggests that Network 99 produced a 5% increase in patronage for a 20% increase in service. This suggests a service level elasticity of 0.25.
ACTION service level changes (Jan and Sept. 2000)	Network operates as at August 1999	Network operates at 2000-01 service levels	Fall in net costs of $1.2m	ACTION has refined and scaled back Network 99 since the time the last estimates of operating at MSL were made. Current operating levels therefore reduce the potential for cost savings.
Total impact			**$13.7-17million**	

Source: Booz Allen & Hamilton analysis

Thus, this revised analysis suggests that savings of some $13.7-$17 million per annum could be obtained if ACTION were to operate at MSL only. This is an aggregate result. The Commission acknowledges (as it has in the past) that some individual routes, which are above MSL, may be worth operating if revenues exceed costs.

ACTION's willingness to substantially modify its service levels after the introduction of Network 99 is also acknowledged as a positive step by the Commission. As noted above, steps undertaken after the time of writing of the last price direction have effectively moved ACTION closer to MSL operations.

The Commission would expect that ACTION's modifications to route and service structures in the wake of Network 99 have allowed for a clearer understanding of which services have previously operated, and/or continue to operate above MSL requirements. It would also expect that the analysis associated with such network changes would serve as the basis for the determination of route CSO payments. As yet, however, the Commission has not seen any systematic evidence that this is indeed the case.

Given the ambiguities which surround this issue, the Commission feels that there is a clear need for better definition and quantification of MSLs. It has previously urged ACTION to develop a route profitability model, which would assist in such quantification. ACTION have, however, indicated that the full implementation of such a model has been delayed until later this year.

The Commission suggests that such modelling, and other steps in support of the quantification of MSLs, be undertaken as a matter of urgency.

It should be noted, however, that the Department's December 2000 submission equates ACTION's required level of service to its current level. By this interpretation, the Department is purchasing the services constituting Network 99 as modified, not a defined set of MSL services. All ACTION services offered are effectively seen as being undertaken at the request of government, with none being provided on a commercial basis. On this basis there is little to be gained at the present time from assessing the cost implications of operating beyond ACTION's nominal MSL standards.

The Commission does not feel that such a position is tenable. It believes that commercial considerations form a part of service level decision-making. It is worth noting that the introduction of Network 99 represented a 20% increase on previous service levels, but that subsequent service reductions reduced this to a 10% increase. This would suggest that the given level of ACTION service at any one time cannot simply be taken as a "de-facto MSL", but that service level decisions should be, and are, subject to commercial considerations.

The Commission has also re-examined the issue of assessing the "best practice commercial price" for the services ACTION currently operates. In the March 2000 price direction, the cost for an efficient private operator to run ACTION's existing network in 2000/01 was given as $63 million (including a profit margin of $5 million), while ACTION's expected costs were $66.3 million.

The figure for efficient private operations included an estimate of operating expenditure of $58 million. This, in turn, was reliant on a figure of $102.59 per

service hour (for 565,000 hours) which ACTION indicated was derived from INDEC 1998's report, *ACTION Review of CSO Framework and Efficient Cost for CSO Services*.

The Commission notes that INDEC's July 2000 report *Operating Cost Savings at ACTION* attempts to update INDEC's 1998 report. However, there is little discussion of how the efficient costs target should be updated. The Commission suggests that, based on the earlier INDEC report, an updated efficient cost figure for 1999-2000 might be in the order of $54 million.

INDEC's review of achievable costs is complicated by changes in service levels and EBAs as well as cost savings. In addition, it would appear that some of ACTION's real cost increases over the period have been inappropriately added into the achievable cost target. Thus, while INDEC estimates that ACTION's achievable costs are now some $63.7 million (in 1999-2000 prices). There is clearly some uncertainty as to what distinguishes achievable from efficient costs, and more detailed analysis is required in this area.

In the light of the above, a review of benchmark data suggests that the original figure of $102.59 per service hour, which probably included some of ACTION's real cost increases, is an over-estimate and that an efficient private operator would experience costs more in the order of $70-$80 per service hour. Because the original figure used was an aggregate figure, the Commission has not been able to establish the major reasons for the wide disparity.

Based on the above benchmarking analysis, the Commission suggests that the current gap between ACTION's costs and those of an efficient private operator is probably at least $10 million, rather than the $3.3 million previously suggested. As a result, the Commission recommends that a detailed review of such costs be undertaken as a matter of urgency so that the development of more explicit MSLs, as part of an enhanced service level agreement between the Department and ACTION, can be completed.

6.4 Environmental Issues

- *The principles of ecologically sustainable development referred to in subsection 7 (2) of the Territory Owned Corporations Act 1990, as modified by virtue of subsection 4(1) of that Act (Part IV 20.(2f)).*

- *Considerations of demand management and least cost planning (part IV 20.(2h)).*

6.4.1 Ecologically Sustainable Development

In its last price direction, the Commission acknowledged the importance of ecologically sustainable development (ESD) and the need for improved pricing and valuation of environmental resources. The Commission acknowledged – and continues to acknowledge – that major price rises could result in customers switching to other forms of transport, such as cars, which have higher environmental

costs. However, given the low elasticity figures, it is unlikely that modest price rises will have a materially adverse effect on modal split.

In the last two price directions, the Commission has expressed its disappointment with the lack of progress ACTION had made in introducing CNG or other low emission buses. The introduction of such buses with improved environmental technology would increase the externality benefits of ACT public transport.

The Commission awaits the details of ACTION's fleet replacement plan to see whether alternative bus technology has been evaluated.

As noted in the March 2000 price direction, the ACT government has issued a Greenhouse Strategy and a discussion paper on integrated land use and transport planning. ACTION have indicated that an inter-departmental committee is continuing to examine the issues and is yet to make any recommendations. The Commission accepts that integrated transport planning is a lengthy process and that such deliberations may go on for such time.

As it has in the past, the Commission accepts the need to balance revenue expectations and financial imperatives for ACTION with environmental considerations and the maintenance of public transport patronage. The Commission remains of the view that its price direction does not unduly impact on the usage of public transport in the ACT and thus does not inhibit the realisation of broader environmental objectives[7]. Accordingly, it does not believe that the proposed fare increases in this year's price direction will have a major effect on future patronage growth.

The Department has reiterated the point , made many times in the past, that Canberra's high income levels, dispersed nature and high car ownership rate, makes it difficult to achieve environmental objectives through attracting people onto public transport. The Department have also noted that underutilised public transport can have a more deleterious effect on the environment (in terms of greenhouse gases) than private vehicles.

The Commission acknowledges these difficulties. However, as the Department itself points out, the issue of underutilised public transport is, in a large sense, a supply side rather than a pricing matter. The Commission agrees with the Department's suggestion that the most appropriate way to tackle this issue is through the setting of appropriate MSLs and the rationalisation of schedules.

6.4.2 Demand Management

ACTION's December 1999 submission did not discuss demand management issues in detail. In the previous price direction, however, the Commission noted that there

[7] As already noted, evidence for this can be found in the very small overall decline (0.03%) in combined adult and concession patronage in July-October 2000 compared to the same period in the previous year, despite the fare increases.

was scope for improved demand management in areas such as weekend services (which carried about 8% of weekly patronage and consumed 12% of resources) and night services (which carried 2.5% of passengers and consumed 10% of resources). The Commission also expressed concern about the level of increase in services during off peak periods and called for close attention to be paid to route patronage

ACTION indicated at the time of the last price direction that it would re-examine the issue of demand management in the context of modifications to Network 99. In particular, evening service frequencies were to be relaxed from 60 to 90 minutes, while service frequencies would be relaxed from 30 to 40 minutes on low patronage daytime routes. In addition, selected school and non-school routes were to be amalgamated.

The Commission notes that the specification of Minimum Service Level (MSL) standards for 2000-01 calls for evening service frequencies of 90 minutes on all routes, with more frequent services on higher patronage/major routes, particularly on Friday and Saturday nights. Therefore, if ACTION has implemented its proposals, many of its night time routes would be running at or near MSL. ACTION have estimated that overall service levels have been reduced from 20% above pre-Network 99 levels in January 1999 to 10% above such levels at present. ACTION have indicated that, as a part of recent modifications to Network 99, number of school and non-school routes have been amalgamated. Others have been withdrawn in areas of poor patronage and transferred to areas of high demand.

However, the Commission is also informed that ACTION's evening services are typically running on an hourly basis. In fact, were ACTION to run its evening services on a 90 minute basis, as originally suggested, it would be operating at the minimum service levels specified in the current (2000-01) MSL agreement. This suggests that there has been little change in evening service frequency since the last price direction and that misallocation of resources in this area may still pose a problem.

While the Commission is of the understanding that many cutbacks have occurred in low patronage and/or evening services it is not possible to assess any improvement in ACTION's demand management without more detailed information.

ACTION has indicated that it continues to face strong competition in the school charter area. Last years price direction noted that ACTION's spare capacity had been reduced with the introduction of Network 99, thus limiting the opportunities for charter work. ACTION argues that, as a consequence, its charter revenue is projected to remain at around the $500,000 mark in 2000-01 – similar to the figure of $530,000 recorded in 1998-99 and considerably lower than the figure of $626,000 recorded in 1997-98.

On an a priori basis, however, it could be expected that the modifications to Network 99 would have freed up some bus capacity. The Commission would appreciate clarification as to whether this is the case and why such capacity could not be employed in charter-related work.

ACTION received a one-off benefit from Olympic-related work in both Sydney and Canberra during September 2000. Net revenue from such activity is estimated to have been some $250,000-$300,000.

6.5 Alternative Fare Adjustments 2000-01 to 2003-04

In considering a medium-term price path, the Commission is mindful that the last price direction included a relatively large increase associated with the implementation of the goods and service tax (GST). However, it is also mindful that a number of issues discussed in the previous price direction have still not been resolved. For example, ACTION is still not a statutory authority, and there appears to be a continuing and increasing call by ACTION on government funds just to balance its cash books, without consideration of the funding of the proposed fleet replacement plan. Furthermore, despite discussions about the need to make the purchaser-provider arrangements more explicit, with particular regard to minimum service levels, the Commission has been informed that there are moves towards collapsing the different CSO payments into an aggregate payment, principally because of the difficulties of accurate measurement of the component parts.

The Commission is concerned about any moves which would dilute the transparency of CSO payments to ACTION as this would reduce the effectiveness of determining appropriate price levels. However, the Commission is conscious of the need to provide sufficient time for substantive changes to take place and that uncertainty about future years' price directions may cloud the decision-making process.

On this basis, the Commission essentially has two options. On the one hand, it can make a three-year price direction or it can recommend only a one-year price direction. In both cases, the Commission believes that there is a compelling case to move towards higher real fares because of the low elasticities and the need to shift more of the recovery of ACTION's costs on to the users and away from the taxpayers. The Commission believes that a real increase in fares of 2% per annum is warranted and is likely to be the only way that forecast increases in fares revenue can be achieved. The issue is whether the Commission applies such an increase for each of the three years.

There are a number of disadvantages of this approach. Principally, the Commission would have no further involvement in ensuring that the improvements which it

wishes to encourage actually take place. Based on past performance, the Commission is concerned that there is a real risk that the underlying problems associated with the funding and sustainability of ACTION may remain unresolved when it would be due to undertake its next review in three years' time.

On the other hand, the Commission can take the view that the substantive issues which prevailed last year and which militated against establishing a medium-term price path at that time are no less urgent now and that there needs to be more convincing progress by all major stakeholders towards resolving those issues before the Commission can be persuaded that anything more than a one-year interim price direction can be justified.

In particular, ACTION and the Department need to finalise an effective service level agreement which explicitly defines the minimum services which the government wishes to underwrite in the light of an integrated transport strategy. ACTION and the Department should also complete more detailed analysis to specify appropriate and targeted CSO payments commensurate with government objectives and the need for greater transparency and accountability.

In any event, a real price increase of around 2% is proposed from July 2001. The Commission would be interested in submissions which discuss the perceived benefits of these alternative approaches – a one-year or a three-year determination.