ICRC

independent competition and regulatory commission

DRAFT DETERMINATION

ACTION PRICING FOR THE PERIOD FROM 1 JULY 2003 TO 30 JUNE 2006

MARCH 2003

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Paul Baxter, Senior Commissioner
Robin Creyke, Commissioner
Peter McGhie, Commissioner

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FOREWORD

This is the Commission's draft determination of prices for public transport bus services provided by ACTION in the ACT for the three-year period from 1 July 2003.

This draft report is issued as required by the *Independent Competition and Regulatory Commission Act 1997*. There will now follow a period of public consultation including, if necessary, a public hearing.

Extensive consultation, involving both written and oral submissions, will be undertaken with ACTION, government agencies, community groups and individuals. The deadline for comments on this draft direction is 24 April 2003, after which the Commission will publish its Final Direction on 16 May 2003.

Under the terms of reference for this investigation, the Commission is considering current and projected patronage trends, as well as any other noticeable trends flowing from the previous fares increase in July 2001 and the more recent introduction of single zone flat fares.

The Commission notes that the environment in which ACTION – now a statutory authority – operates has changed since the last price determination in 2002. The Commission also notes that over the past two years ACTION has made progress in its levels of operating efficiency and deficit financing.

It should also be noted, however, that ACTION has continued to operate in the absence of an overarching public transport strategy, though current ACT Government initiatives are being undertaken to redress this deficiency. In this respect the Commission has been conscious of its duty to strengthen, even in the short term, the building blocks of such a public transport strategy.

I encourage all interested parties to make submissions to the Commission about this draft determination.

PAUL BAXTER
Senior Commissioner
24 March 2003

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 2003. 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 2003 to 30 June 2006].
>
> *The Determination should consider current and projected patronage trends and any other noticeable trends flowing from the previous 1 July 2002 fare increase and the introduction of single zone flat fares.*

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:

Draft Direction	24 March 2003
Possible Public Hearing	April 2003
Deadline for comments on Draft Direction	24 April 2003
Final Direction	16 May 2003

Submissions on this draft report should be forwarded to:

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3. DRAFT PRICE DIRECTION

This is the fourth price determination which the Commission has made on ACTION bus fares. Since the first determination in 1999, the environment in which ACTION operates has changed. In particular, ACTION is now a statutory authority, with an independent Board, rather than an agency within the Department of Urban Services (DUS). ACTION now has a formal contract with DUS to provide agreed bus services until December 2006. More recently, the government has created a single zone fare structure for all ACTION services.

In its previous price directions, the Commission identified three major areas which were of concern, as they impacted on ACTION's performance and the environment in which price determinations were being made:

- ACTION's level of operating efficiency;
- the funding of ACTION's services by way of deficit financing [1]; and
- the absence of any overarching strategy for public transport in the ACT.

Operating efficiencies

The Commission is pleased to note that progress has been made over the last two years in all of these areas. ACTION has recorded falls in both operating costs per employee and per bus kilometre over the last two years. Having said that, the Commission notes that ACTION claims that there are now only very limited opportunities for it to achieve any further efficiency improvements. Out of a total annual expenditure budget of some $68 million, ACTION has argued that it would only be able to achieve further efficiency gains in the order of $2.6 million. Its claim is largely dependent on the definition of input inefficiencies and the costs which ACTION must necessarily incur as a result of its being in government ownership. There appears to be a considerable difference of opinion between ACTION and the findings of the Commission of Audit[2] which suggested that ACTION should view some $9 million of its annual costs as being potentially reducible with increased efficiencies.

The Commission is not in a position to adjudicate on these different claims. It acknowledges that a number of areas which the Commission of Audit identified would present challenges to management and perhaps require the Government to make explicit its position on certain industrial matters. Nonetheless, the Commission believes that management should not only strive for continuing operating efficiencies but also develop appropriate strategies to pursue ongoing efficiencies, which may exceed the one-off figure of $2.6 million. In the Commission's opinion, the next three years will be critical in determining the future profile and performance of ACTION. Its current contract with DUS expires at the end of 2006, and decisions about how bus services in the ACT should be provided after that date will be

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[1] *The term 'deficit financing' is used to refer to additional top up finding that is provided above funding received by ACTION under the Government's CSO (Community Service Obligation) funding arrangements for public transport and the fare box revenue*

[2] *ACT Commission of Audit. Report (No.2) on the State of the Territory's Finances: ACT Forests, ACTION and Australian, International Hotel School (December 2002).*

critically influenced by how much ACTION has ensured that its services are provided as efficiently as possible.

Deficit financing

With regard to deficit financing, this has been an inevitable consequence of the funding model used for ACTION and the fact that public transport systems such as that operated by ACTION are not commercial enterprises. Despite the way in which CSO payments have been recorded, these have not been based on sound explicit requirements, and have not been sufficient to match the shortfall between farebox revenue and operating expenses. The Commission is concerned that, according to the 2002-03 Budget Papers and despite revised government contributions over the next three years, the operating position will still be in deficit.

Over the past year, all parties have acknowledged that the current model for government funding is inadequate as it provides no signals to ACTION or the community about how to judge its performance on any reasonable financial basis, nor does it provide government with budget certainty. ACTION, DUS and Treasury are currently in discussions on an alternative funding model which should provide greater certainty as well as greater obligations on all parties to ensure that ACTION provides value for money and is directly responsible for that outcome. The Commission hopes that, within a short time, this model will be in operation and transparent signals will be in place.

Transport strategy

The third area of concern was the absence of an integrated land use transport strategy for the ACT and the inherent difficulties in assessing the performance of the public transport operator under these circumstances. ACTION's patronage represents only around 5-6% of the total trips undertaken in the ACT, which is a heavily car-dependent community. Thus, there have been limitations on the capacity of ACTION to increase its market share. In a community where historically car use has been so dominant and relatively cheap, the major users of public transport have tended to be those without access to cars. While adult journey-to-work trips are not insignificant (29.2%), the majority of bus users are students or concession ticket holders who would tend to be lower income residents.

A recent elasticity study has confirmed the expectation that current users of ACTION buses are relatively uninfluenced by the level of fares. Adults who use the bus to travel to and from work are more price inelastic than other users, but all categories demonstrate low elasticities. All users who travel by bus do so largely because they would appear to have little alternative.

The Government is currently undertaking a major review of land use and transport policies and strategies in the ACT. From this work is expected to emerge some clearly articulated targets for public transport's share of transport trips. To achieve any substantive shift away from private car to public transport will require actions on both modes. While car parking availability and prices have little impact on choice, the prospect of encouraging journey-to-work trips to shift to public transport

will be difficult. Public transport has to provide a convenient and comfortable service which minimises the waiting and access time penalties which are a disincentive to its use.

The Commission is well aware of the difficulties of effecting a material shift to public transport in the ACT. Transport users' responses to alternative modes are affected by perceived costs as much as by real costs - the cost of a single, short car trip would be seen at most to be the petrol cost, and perhaps a parking fee. The task of encouraging public transport is a formidable one, and one which will require significant service, price and marketing actions if it is to be even modestly successful. Public transport, however, is not just ACTION buses. Taxis are also an integral contributor and the total provision of public transport services throughout the ACT requires well-constructed strategies, targeting user demands in the most cost-effective way.

Environmental advantages

Probably, one of the major tactics for a successful campaign will be identifying the environmental advantages of any new public transport strategy. In terms of minimising air pollution and reducing greenhouse gas emissions, public transport can make a major contribution to greater community amenity, on the proviso that such a strategy does not lead just to large empty buses plying the streets at all hours. The Commission suggests that the ACT community would view favourably persuasive environmental arguments in favour of public transport if these were accompanied by manifest service enhancements, associated with appropriate price signals.

In the light of all these considerations, the Commission was confronted with making a pricing decision for ACTION buses at a critical time. In fulfilling its legislative remit it is required to take into account a wide range of social, economic, environmental, operational and financial considerations in its price determinations. In doing so it must weigh up the competing influences which each of these may have on any pricing decisions.

In previous determinations the Commission awarded fare increases to ACTION, largely on the basis that it was of the view that such pricing signals were required to provide both the community and the Government with some additional revenue to match more closely the costs of providing bus services in the ACT. However, the Commission is aware that no acceptable fare increase is going to make a substantive difference to the level of farebox revenue (that is, in simplest terms, revenue from ticket sales) in the light of ACTION's existing share of the transport market.

Pricing options

On this occasion, the Commission has considered a range of pricing options: namely:

- increasing fares by CPI,
- increasing fares at the same rate as unit costs,
- increasing fares on a CPI minus X basis, or
- increasing fares based on CPI plus X, where X represents cost increases above CPI which are outside ACTION's control.

The Commission notes that any fare change at this time would constitute the fourth change in four years. Given that one of the fare changes substantially reflected the GST impact and that the most recent change has reflected the introduction of a single zone system, the Commission believes that another fare change in such a short time may not be well received by the travelling public. The key to future change should be in *increasing revenue through higher patronage rather than higher fares.*

The Commission has indicated that the key to a sustainable future for ACTION is also based on other, non-price decisions which have to be made. The Commission notes that the government at large and the specific parties involved in ACTION's performance and oversight have already embarked on these processes but have not yet finalised them. The Commission is aware that these deliberations take time and that they involve community consultation.

In the light of these considerations, the Commission is of the view that the largest fare increase which it might have considered would have been in line with the CPI. On an annual basis, this would only have increased ACTION's farebox revenue by around $300,000, taking account of the elasticity effect and the administrative costs (including changes to printed materials and advertising) of introducing a fare change. Such a change would not materially shift the cost-recovery level in an annual budget of $68 million, but it would have kept fares reasonably in line with real changes in costs. However, in the absence of any changes in the costs of other transport services, particularly car parking, such an increase could be seen as a disincentive to increasing bus transport usage despite any forthcoming government strategies promoting a public transport image. Overall farebox revenue can potentially be increased by an increase in patronage at existing fare levels. In the context of the forthcoming strategic reforms in public transport policy in the ACT, greater patronage of ACTION's buses would be more beneficial from an overall transport planning and farebox revenue perspective at this time than simply increasing fare levels.

As a result, the Commission considers that the most appropriate action which it can take at this time is not to grant any fare increases in the short term. This will assist in providing one of the building blocks for a public transport strategy - a relative price incentive to use buses. As stated above, the Commission believes that the next three years are critical in determining the future of public transport services in the ACT. However, in adjudicating on the broader financial implications on ACTION, the Commission believes that some fare increase over the next three years is warranted.

Proposed price determination

To this end, the Commission proposes no change to the weighted average price cap for the next two years (2003 and 2004), but that from 1 July 2005 the weighted average price cap is increased by the extent to which the Canberra-based CPI will increase for the twelve months ending March 2005. (See Attachment 2)

The Commission believes that a moratorium on changes to the weighted average price cap for two years should contribute to building support for the government's

public transport strategy. When the Commission next comes to review fares in 2006, it expects to have the benefit of a clear policy direction for public transport and a greater ability to assess ACTION's performance in satisfying the demand for public transport services. It will also be in a good position to assess the extent to which ACTION farebox revenue can be increased because of higher patronage engendered through the public transport strategy.

In the meantime, the Commission expects that ACTION will again address its levels of operating efficiency, particularly as any changes to the wider transport strategy for the ACT could be expected to lead to changes in services. Under these conditions, and given the pressures which would attend the expiry of the current contract at the end of 2006 and the prospect of greater competitive service provision thereafter, the Commission believes that ACTION's Board will be obliged to ensure that the authority's operating and maintenance services are provided as efficiently as possible.

The Commission also anticipates that a more appropriate funding model will have been implemented by the time of the next price review and that it will offer more effective financial controls and incentives for ACTION's operations and greater certainty for Government's planning.

4. INDEPENDENT COMPETITION AND REGULATORY COMMISSION

The Commission was initially established as the Independent Pricing and Regulatory Commission (IPARC) under the *Independent Pricing and Regulatory Commission Act 1997* (ICRC Act). The functions of the Commission are set out in section 8 of the ICRC Act. In setting prices, the Commission is directed by section 20(1) to make a price direction at the end of each investigation under a reference, as follows:

> *…the Commission shall decide on the level of prices for services…and give a price direction accordingly to each person providing regulated services.*

In section 20(A), a price direction must include a direction about the pricing of regulated services in the form of either or both of the following:

> *(a) a price, a maximum price or both a minimum and a maximum price for each regulated service;*
> *(b) a maximum total amount (revenue cap) that may be earned by a person providing regulated services from the provision of those services.*

Section 20(2) of the Act provides that the Commission consider a number of issues in making its pricing decision. These include, inter alia:

> *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 social impacts of the decision*
>
> *considerations of demand management and least cost planning*
>
> *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

In January 2002, the Australian Capital Territory Internal Omnibus Network (ACTION) was established as a statutory authority and was from then subject to the corporate governance requirements of the *ACTION Authority Act 2001*. Under this legislation, the ACTION Authority took over all the operations and responsibilities of the former ACTION, which had previously operated as part of the Department of Urban Services.

According to ACTION Authority's *2001-02 Annual Report*, the key benefits of this organisational change include:

- A Board comprised of industry, business and community members
- Clarification of commercial and social objectives
- Alignment of the ACTION Authority with other publicly owned transport providers
- A five-year contract for provision of services, giving employment security to staff

The ACTION Authority is accountable to the Minister for Planning.

The Authority is contracted to provide Canberra's public timetabled and school bus services. The current five-year contract expires in December 2006. In addition, it provides charter bus services, essentially using available staff and vehicles during down time. The Authority also provides special needs transport to a variety of agencies in Canberra.

At 30 June 2002, the major features of ACTION's operations were:

- 679 full-time equivalent employees;
- annual operating costs for 2001-02 of $67.3 million, of which $14.4 million was recovered through the fare box;
- two depots (Belconnen and Tuggeranong); and
- an operational fleet of 347 buses.

Under the *ACTION Authority Act 2001*, ACTION's functions are:

(a) to provide an effective, affordable and accessible public transport network within its area of operation; and
(b) without prejudice to paragraph (a), to operate on a sound commercial basis; and
(c) to maximise the sustainable return to the Territory on its investment in the authority; and
(d) to perform services to the community in accordance with any agreement with the Minister; and
(e) to advise the Minister on all significant issues relating to the authority and its activities; and
(f) to implement any directions from the Minister under this Act; and
(g) to exercise any other function given to it under this Act or another Territory law; and

(h) to carry out activities incidental to its other functions.

According to ACTION's *2001-02 Annual Report*, the Authority is committed to:

- Excellence in customer service
- Delivering value for money
- Transparency and accountability
- Innovation
- Sustainable outcomes
- A performance and achievement orientation.

The Authority aims to demonstrate this commitment through:

- Excellent customer service
- Effective staff
- Enhancement of processes and systems
- Exploring business development opportunities
- Ensuring front line innovation.

In April 1999, the Commission, in its first price determination on ACTION fares, directed that the average fare prices for 1999-2000 should not exceed the Canberra CPI for the 12-month period ending March 1999. At that time, ACTION chose not to change its fares, principally because it had only recently made changes to the fare structure in January 1999 with the introduction of a new network of services and because very small increases would have resulted in implementation problems. In March 2000, the Commission determined that an average fare price increase for 2000-01 should not exceed the Canberra CPI for the 21 month period ending December 1999, excluding the GST, plus one percentage point. This produced an average increase in the order of 3.6% plus an additional 8% to reflect the impact of the GST.

The Commission's May 2001 Price Determination directed that a real price increase of 2% be applied to ACTION's average annual fares as from July 2001, followed by a CPI adjusted price increase to take effect from July 2002. This led to variable fare increases for cash and non-cash fares from July 2001, while major changes to the fare structure took place in July 2002 with the removal of a multi-zone ticketing system and the introduction of a single zone system.

Since the time of the May 2001 Price Determination, a number of other developments impacting on ACTION services have occurred, including:

- The introduction of the School Student Transport Scheme (SSTS) in September 2001 and its withdrawal in December 2001. The SSTS provided for free transport to many school students.
- The introduction of the Road Transport (Public Passenger Services) Act 2001 which required ACTION to be accredited by the Road Transport Authority and pay for items such as bus registration fees.

- Finalisation of a contract between ACTION and the Department of Urban Services (DUS) on the provision of agreed bus services over the five years from December 2001.
- Discussions on a new funding model for ACTION services
- The development of integrated transport planning initiatives, such as that pursued by Planning and Land Management (PALM), an arm of DUS.

Since the Commission's first price determination in 1999, ACTION's farebox cost recovery level has not experienced any material increase as a result of fare increases, as discussed in section 6.3.2 below. Changes in cost recovery have been more affected by changes in costs and efficiencies and by Government decisions on issues such as school fare subsidies and the introduction of a single zone fare structure. In fact, ACTION's current cost-recovery level is lower than it was in 1999. This highlights the fact that increasing fare levels does not automatically result in an increase in the proportion of total operating costs which are recovered through the fare box.

6. ISSUES CONSIDERED BY THE COMMISSION

Under Part IV of the *Independent Competition 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.

Several developments have occurred since the last price determination. The *ACTION Authority Act 2001* was passed in August 2001 and ACTION became a statutory authority on 1 January 2002. The ACT Government subsequently required a Commission of Audit to provide an opinion on the state of ACTION and in particular,

> *…an assessment of operational and financial performance, efficient costs, additional costs associated with government ownership, a broad identification of the level of inefficiencies, and an assessment of the proposed funding model.*[3]

The Commission of Audit's report (delivered in December 2002) constituted a detailed review of costs and funding issues affecting ACTION. A number of the issues raised in the report are relevant to the current fare determination process and have been taken up in this draft Determination.

6.1 Costs and Efficiencies

Under Part IV of the *Independent Competition 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 Recent Operating Costs

Table 6.1 below illustrates the operating costs incurred by ACTION over recent years.

The Commission notes the following:

- Overall, ACTION's operating costs in 2001-02 were some $912,000 below budget forecasts (but were some $664,000 higher than operating costs in the previous year).
- ACTION's total operating costs for 2000-01 were only some $4,000 above 2000-01 budget forecasts.

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[3] *ACT Commission of Audit: Report (No.2) on the State of the Territory's Finances: ACT Forests, ACTION and Australian International Hotel School (December 2002), p.10*

- The main driver of ACTION's higher total operating costs in 2001-02 was higher employee costs – which rose by some $1.2 million.
- This rise was partly offset by falls in administrative expenses ($250,000) and interest ($350,000).
- Farebox cost recovery fell significantly in 2001-02, although this would largely appear to be due to the impact of the (temporary) introduction of free travel to many school students under the School Student Transport Scheme (SSTS).

Table 6.1: Operating Costs ($'000)

	1996-97	1997-98	1998-99	1999-2000	2000-01	2001-02 Actual	2001-02 Budget
Employee costs*	42,473	42,658	46,280	44,635	41,382	42,575	40,916
Administrative expenses							
- Bus running & maintenance	*7,149*	*7,356*	*8,068*	*9,784*	*9,898*	*10,023*	*n.a.*
- Other	*7,781*	*6,568*	*6,959*	*7,264*	*7,557*	*7,182*	*n.a.*
- Subtotal	14,930	13,924	15,027	17,048	17,455	17,205	19,369
Depreciation & amortisation	7,368	7,041	6,418	5,181	4,719	4,734	4,756
Interest	6,381	3,441	2,428	2,334	1,950	1,602	1,485
Other expenses	-	-	1,519	1,634	1,108	1,163	1,665
Total	**71,152**	**67,064**	**71,672**	**70,832**	**66,615**	**67,279**	**68,191**
Fares revenue	17,235	16,583	16,266	16,617	16,455	14,434	n.a.
Farebox cost recovery	**24.2%**	**24.7%**	**22.7%**	**23.5%**	**24.7%**	**21.5%**	**n.a.**

Source: ACTION
* Includes superannuation
n.a. = Not available

As changes in operating costs may simply reflect changes in budgetary priorities, the most useful approach is to compare ACTION's budgeted operating costs for 2001-02 with its actual results for that year:

Employee expenses - $1.7 million higher than forecast in the 2001-02 Budget.

ACTION indicated in the 2002-03 Budget Papers that major reasons for the over-run were:

- unbudgeted hiring of permanent staff for the School Student Transport Scheme (SSTS);
- additional (i.e. unexpected) Comcare charges; and
- costs of inoperatives and long-term staff absences due to illness and injuries, particularly among drivers.

Administrative expenses - $2.2 million lower than forecast.

ACTION indicated in the 2002-03 Budget Papers that cost savings of $1.8 million were due to the hiring of permanent staff (rather than contractors) for the SSTS. Other ACTION data suggest that reduced fuel costs and administrative overheads may also have been responsible for the below-budget result in this category.

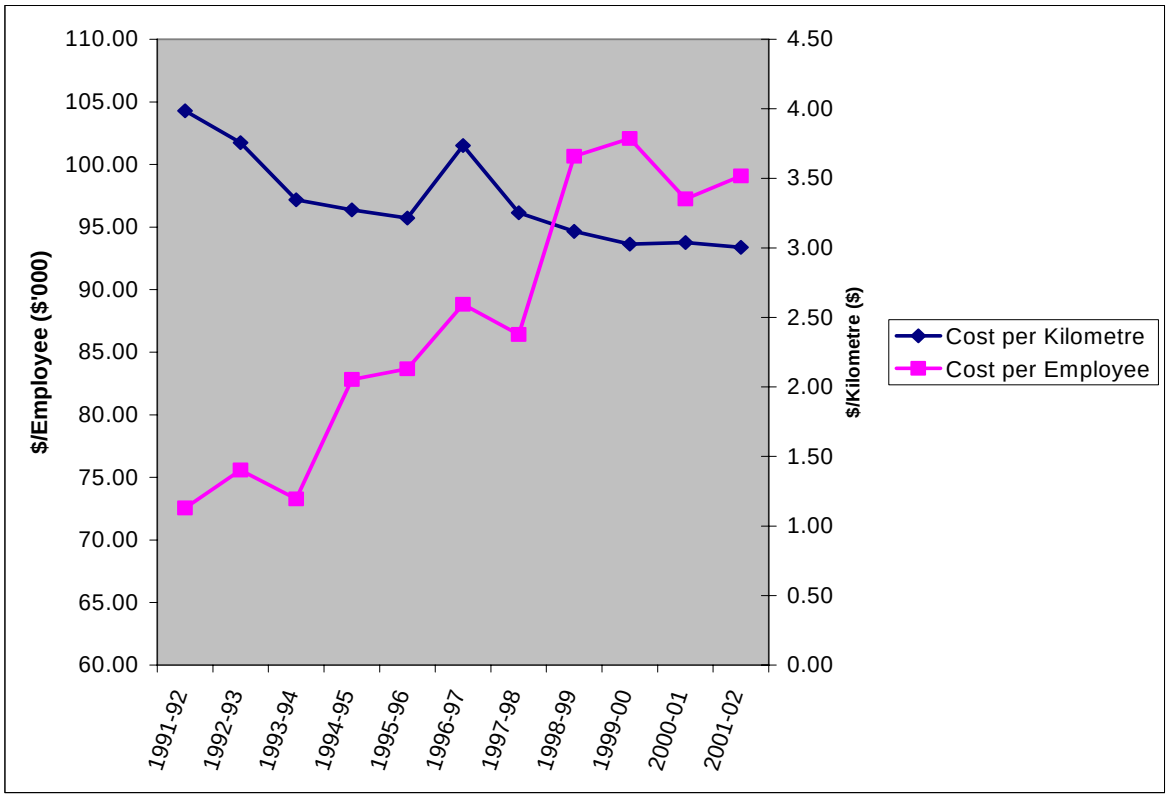
Interest expenses - some $0.1 million higher than previous budget estimates.
This outcome compares with ACTION's comments in the 2002-03 Budget Papers which indicated that the result would be $0.3 million lower than budgeted.

Other expenses - $0.5 million lower than forecast.
ACTION's comments in the 2002-03 Budget Papers indicate that this was largely due to savings in bus leasing charges for the SSTS, with some contribution from reduced taxes and tariffs.

Operating efficiency

Operating efficiency (as measured by operating costs per employee and per kilometre travelled) was examined by the Commission in its previous price direction. An updated chart is provided in Figure 6.1 below (measurement is in nominal dollars, consistent with previous price directions).

Figure 6.1: Operating Efficiency



Source: ACTION

Operating costs per employee

- The May 2001 Price Direction reported that ACTION's operating cost per employee was forecast to drop to $100.59 in 2000-01. In fact, it fell to $97.25 in 2000-01, but rose to $99.08 in 2001-02.
- Decreases in costs per employee in 2000-01 appear to reflect falling employee numbers and associated cost reductions in the post-

Network 99 period. Employee numbers fell from 693 in 1999-2000 to 685 in 2000-01 and to 679 in 2001-02.

- The rise in operating costs per employee by 1.9% in 2001-02 exceeded the overall rise in operating costs of 1.0% in 2001-02.
- As increases in total operating costs in 2001-02 were largely driven by rises in employee costs, it appears that cost savings due to falling staff numbers were more than offset by higher payments to remaining employees.

Operating costs per kilometre

- The last price direction indicated that ACTION's operating costs were forecast to be $3.04 per total kilometre travelled in 2001-02.
- Operating cost data supplied by ACTION indicate that costs actually fell to $3.00 per kilometre in 2001-02, even as total operating costs rose, which appears to reflect improved network efficiencies on the part of ACTION.

The Commission notes that, if measured in real terms (i.e. 2001-02 dollars), ACTION's operating costs per employee fell from $111.47 in 1999-2000 to $99.08 in 2001-02. Likewise, real operating costs per kilometre fell from $4.41 in 1999-2000 to $4.02 in 2001-02. Overall, this represents a notable improvement.

Taken together, these operating cost and efficiency indicators demonstrate that ACTION has made progress in containing costs since the last pricing review. Although changes in government policy regarding the SSTS affected outcomes in 2001-02, ACTION's operating cost results over the last two years have been close to (or below) budget forecasts - in contrast to results in earlier years.

6.1.2 Forecast Operating Costs

Table 6.2 below indicates projected operating costs for ACTION as indicated in the latest Budget papers.

Table 6.2: Forecast Operating Costs ($'000) – 2002/03 Budget

	2002-03	2003-04	2004-05	2005-06
Employee costs*	43,281	43,447	43,251	43,277
Administrative expenses	17,736	18,320	18,772	19,390
Depreciation & amortisation	4,875	4,928	5,011	5,038
Interest	1,172	857	814	771
Other expenses	1,255	1,314	1,369	1,424
Total	**68,319**	**68,866**	**69,217**	**69,900**

*Including superannuation
Source: ACTION

The January 2002 *INDEC Report* indicated that Achievable Savings (i.e. efficiencies) of some $2.6 million (2000-01 dollars) could be obtained by ACTION in future years. This report suggested a two year plan (the "Transition Plan") to achieve these savings, as indicated in Table 6.3, below.

Table 6.3: Suggested Approach to Achievable Savings:
***January 2002 INDEC Report*[3]**

Item	Year 1 ($'000)	Year 2 ($'000)	Totals ($'000)
Wages (drivers)	278	139	417
Cleaners	9	5	14
Redeployees	55	27	82
Redundancies	10	5	15
Bus running	0	0	0
Maintenance	963	481	1,444
Admin salaries	136	68	204
Transport officers	258	129	387
Communication and IT	0	0	0
Debt servicing	0	0	0
Corporate overheads	0	0	0
General overheads	34	17	52
Depreciation	0	0	0
Abnormal Items	0	0	0
Totals	**1,743**	**871**	**2,614**

Source: INDEC

ACTION's *Annual Report 2001-02* indicated that savings of $2.6 million were incorporated into the 2002-03 Budget Paper's forward estimates (reported in Table 6.2 above) in accordance with the findings of the January 2002 *INDEC Report* and that ACTION was capable of achieving such economies.

Thus, while the 2002-03 Budget Paper's forward estimates reflect a rise in *total* operating costs in future years, the Commission infers that operating costs would have been even higher had the Transition Plan not been implemented. In fact, information supplied by ACTION in November 2002 and in subsequent discussions indicates that the 2002-03 Budget Paper's forward estimates incorporate the following:

> *Employee costs* - indexation of 1.3% p.a., offset by savings of $0.375 million (2003-04) and cumulative savings of $1.125 million (2004-05)
> *Administrative Costs* - indexation of 2.5%, offset by savings of $0.125 million (2003-04) and cumulative savings of $0.375 million (2004-05).
> *Borrowing costs* - These reflect a reduced loan balance
> *Other expenses* - "allowable indexing".

Thus, cumulative savings will total some $1.5 million by the end of 2004-05. ACTION have also indicated that further savings of $1.1 million will be achieved by the end of 2005-06, allowing the target of $2.6 million in savings to be achieved over three years, rather than the suggested two year approach under the original Transition Plan. (The Commission notes, however, that ACTION's January 2003

3 *These figures are in 2001-02 dollars. The Commission notes that the January 2003 INDEC Report indexes the figure of $ 2.614m to 2002-03 dollars by applying an escalator of 2.5% p.a. (i.e. $2.746m). The original figure of $2.614m is used in this report for consistency.*

Submission also refers to a "three year savings plan" (p.3) as does the January 2003 *INDEC Report* (p.4)[4].)

The higher cost profile is evidenced from a comparison of the 2002/03 forward estimates (Table 6.2) with those made the year before (Table 6.4).

Table 6.4: Forecast Operating Costs ($'000) – 2001/02 Budget

	2002-03	2003-04	2004-05
Employee costs	40,788	40,790	41,377
Administrative expenses	17,369	17,418	17,917
Depreciation & amortisation	4,768	4,774	4,780
Interest	1,172	857	814
Other expenses	1,255	1,314	1,369
Total	**65,352**	**65,153**	**66,257**

Sources: ACTION, ACT 2001-02 Budget Paper No. 4
NB: Employee costs include superannuation expenses

The Commission notes the following in respect of this table:

- Despite partial implementation of Transition Plan savings, the 2002-03 forward estimates for ACTION for 2002-03 to 2004-05 (inclusive), are between $3 million and $3.7 million *higher* than estimated in the 2001-02 Budget.
- The major drivers of higher operating cost forecasts in the 2002-03 Budget Papers (compared to 2001-02 forecasts) are increases in employee costs and administrative expenses.
- Forward estimates for interest and other expenses are identical in both the 2001-02 and 2002-03 Budget Papers and only small differences exist in the forward estimates for Depreciation and Amortisation.

ACTION's January 2003 submission indicates that the current forward estimates incorporate increases other than "normal Budget CPI" in areas such as insurance costs, the introduction of bus registration fees for buses, payments to Centrelink for issuing concession charges and increases in the cost of parts due to currency fluctuations. These factors are likely to contribute to the recurrent cost increases in the Employee Expenses and Administrative Cost categories.

The Commission acknowledges that some recurrent cost increases may be explained by new budget initiatives. These impact on both capital and recurrent costs. The 2002-03 Budget provided $43 million of extra expenditure for ACTION over the four years from June 2002. The 2002-03 Budget Papers and ACTION's *Annual Report 2001-02* both indicate that ACTION will be continuing to expand bus services, focussing on improving customer service, implementing a new communications system, continuing its bus replacement program and undertaking a bus door safety project.

[4]*Note that the January 2003 INDEC Report is a follow up to the January 2002 INDEC Report.*

Figures derived from the Commission of Audit indicate that the $43 million will be allocated as follows:

- $16 million for capital funding, of which:
  - $13.2 million for bus replacement[5];
  - $1.5 million for the new communications system; and
  - $1.3 million for modifications to bus doors.
- A recurrent funding increase of $26.3 million, composed of:
  - $8.8 million to finance the move to single zone fares;
  - $17.5 million for "increased base funding" (covering rising insurance costs, higher spare parts costs and the introduction of bus registration costs).

ACTION's *Annual Report 2001-02* also notes a 15% increase in service levels in the Gungahlin area, commencing in May 2002, while the 2002-03 Budget Papers refer to new bus services to South Tuggeranong and West Belconnen. This increase in service offerings could be expected to impact on ACTION's recurrent costs in future years.

However, increases in recurrent funding under the 2002-03 budget measures appear to be effectively "netted out" by savings in recurrent funding, arising from the withdrawal of 2001-02 budget initiatives, such as the SSTS. If any operating cost savings arising from the cessation of the SSTS are simply counterbalanced by new costs, such as increased service provision, then the 2002-03 budget initiatives, by themselves, do not explain the increases in recurrent costs since the 2001-02 budget.

Despite recent productivity improvements recorded, future cost increases continue to be higher than earlier forecasts.

6.1.3 Cost of Government Ownership

ACTION's position as expressed to the Commission of Audit was that further efficiency improvement only amounted to $2.6 million. That represents around 16% of the difference between actual and efficient costs, estimated in 2000-01 at around $15-16 million. The January 2003 *INDEC Report* reaffirmed this position, stating that:

> *INDEC Consulting formed the view that a savings target above this amount [$2.6m] was not realistic, given current award conditions, public sector employee expectations, cost reductions achieved by ACTION and its staff, and policy settings*[6].

This implies that the unavoidable costs associated with government ownership are some $12.4 million (2000-01 dollars).

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[5] *ACTION's January 2003 submission refers to a $17.2 million program of bus replacement. This would appear to include a $4 million allocation in 2001-02. Likewise, the Commission of Audit refers to a five year bus replacement program, although figures it presents for 2002-03 to 2005-06 inclusive only total $13.2 million.*

[6] *The January 2003 INDEC Report provides a revised figure of the cost of government ownership of approximately $15m in 2000-01 dollars.*

By comparison, the Commission of Audit assessed the cost of government ownership as only $6 million in 2000-01 and found that the remaining $9 million of residual "input inefficiencies" constituted potentially achievable savings. Significantly, those inefficiencies were estimated to increase to over $13 million by 2005-06.

These differences are substantial and provide a clear focus on ACTION's management of its operating costs. Essentially, the Commission of Audit contested the proposition that previous employment and management arrangements are necessarily defined as "legacy" costs and cannot be challenged, re-assessed and reduced.

In Section 4.4.2 of its report, the Commission of Audit discussed 13 specific areas of ACTION's costs. It considered that the identified costs of these areas were costs of government ownership but that the costs of two of these items (administration and inoperatives) could be substantially reduced. Moreover, it claimed that costs associated with maintenance, leisure leave, additional wage rate and transport officers, were not attributable to government ownership. Somewhat offsetting this, the Commission of Audit introduced a depreciation expense associated with the Tuggeranong depot as an appropriate cost of government ownership.

The Commission of Audit claimed that ACTION should attempt to reduce its actual costs by some $9 million (in 2000-01 dollars and using a 2000-01 base) rather than the $2.6 million claimed by ACTION and INDEC. The Commission of Audit did not claim that the task would be easy and that in practice some aspects might not be achieved. However, it suggested that, under its more commercial charter, ACTION management could and should address this range of issues which have for so long remained unchallenged.

The Commission notes that both the January 2003 *INDEC Report* and the January 2003 ACTION submission dispute the Commission of Audit's conclusions on the cost of government ownership.

In fact, both documents reiterate that ACTION's achievable savings are only in the order of $2.6 million. ACTION has stated that the areas in which the Commission of Audit identified savings are those which are covered by whole of government working arrangements or those which would require a payout to be applied to ACTION staff.

Among other points, the January 2003 *INDEC Report* notes the following:

> *"(a) ACTION drivers who constitute the majority of ACTION staff, are currently absent for 15 days on sick leave or worker's compensation a year on average. Sick leave of up to 15 days per annum is an entitlement under current award conditions.*
>
> *(b) Superannuation is approximately 20% compared to the SGC superannuation of 9% (8% in 2000/01) typically paid by private operators.*
>
> *(c) ACTION carried approximately 65 long-term inoperatives and*

redeployees on light duties (10% of the workforce) in 2001/02, and current legislation prevents ACTION management of [sic] *dealing with this problem efficiently and from removing the associated cost imposts.*

(d) The April 2001-02 EBA included a 4% wage rise back dated to 1 January 2002, which was to be entirely offset by productivity improvements.

(e) Long service leave and personal leave in the current award are more generous than those of private operator awards.

(f) Award conditions are costly to remove and ACTION staff are considered public servants covered by the Public Sector Management Act and share the expectations of other ACT public servants.

(g) The trend of wage increases for ACT Government employees in certain sectors has been in excess of wage rises awarded to ACTION employees in recent years.

(h) A number of whole of ACT Government policies impact on ACTION's costs. An example of such cost imposts is in the area of IT/communications estimated by Indec Consulting to cost ACTION $1 million more than IT/communication costs incurred by an average private operator.

(i) ACTION employed approximately 30 Transport Officers and Ticket Inspectors who provide a service not typically provided by an average private bus operator. However, because of community expectations, particularly with regard to passenger security at interchanges, any reduction or removal of this service is clearly subject to Government approval.

(j) ACTION is Government-owned and has a number of onerous liaison and reporting requirements leading to servicing cost imposts and additional costs associated with complex public sector budgeting and human resources policy and practice."

INDEC also claimed that meeting the Commission of Audit's savings target would require:

(i) Reduction of staff numbers by a total of 130 FTE staff

(ii) To maintain output with reduced staff levels, would require

- Restriction of wages and salaries growth to 1.3% unless offset by cash savings not including the savings target of $8.952 million
- Reduction in sick leave provisions to 8 days per annum
- Elimination of leisure leave provisions.
- Introduction of greater flexibility in processing workers compensation cases for long-term operatives and redeployees

(iii) Implementing annual savings of approximately $1 million in non- labour expenditure.

The Commission notes that there is a significant difference between the Commission of Audit's position on "input inefficiencies" (almost $9 million) and that of ACTION with INDEC ($2.6 million) - almost $6.5 million.

The Commission is not in a position to adjudicate on these numbers. However, given the earlier discussion on the increases in total costs in the latest forward estimates, and despite some recent progress on productivity improvements, the Commission is mindful of the need for ACTION to challenge previous positions, particularly in the light of the upcoming new EBA.

Many of the arguments which ACTION has applied to its alleged inability to tackle some of the areas outlined by the Commission of Audit hinge on views about community expectations and established practice which do not necessarily have any legislative force.

The Commission is sceptical that no more than $2.6 million can be achieved through ongoing efficiency savings. This implies that, if achieved, ACTION has reached its peak efficiency position and that there is no more opportunity for any further efficiency improvements. The Commission believes that the major areas which the Commission of Audit identified as candidates for further savings should be seriously pursued over the next three years, particularly the areas of "inoperatives", "transport officers", "additional wage rate", "leisure leave" and "maintenance". Clearly, not all will be amenable to immediate change, but the Commission believes that ACTION's independent Board will be obliged to ensure that these are addressed during the currency of its current contract with DUS, which expires at the end of 2006.

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 March 2000 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%.

In its last determination, the Commission provided for a real price increase of 2% from July 2001, followed by a CPI indexed increase to take effect from July 2002. As a result, individual non-cash fares were increased by between 6% and 17% on 1 July 2001[7]. Changes to individual cash fares ranged from no price rise (adult and

[7] *School student fares – when applicable during the year – were an exception to this due to the change to a single zone for school students on 23 July 2001. Single zone school students experienced no fare increase while all zones students experienced a 50% fall.*

concession singles and pensioner off-peak daily) to a 23% increase (shoppers off peak daily).

ACTION introduced a single zone, flat fare structure on 1 July 2002. Table 6.5 compares ACTION's 2000-01, 2001-02 and 2002-03 fares.

Table 6.5: ACTION fares

	One Zone		All Zones		Single Zone
	2000-01	2001-02	2000-01	2001-02	2002-03
Adult					
Cash					
Single Trip	$2.30	$2.30	$4.40	$4.40	$2.40
Shopper's Off Peak Daily	n.a.	na	$4.40	$5.40	$3.50
Daily	n.a.	na	$8.40	$9.40	$6.00
Non-cash					
Faresaver 10	$18.40	$19.80	$36.80	$39.00	$21.00
Weekly	$19.80	$22.00	$38.00	$43.00	$23.50
Monthly	$65.00	$76.00	$120.00	$136.00	$80.50
Concession and School Student					
Cash					
Single Trip	$1.20	$1.20	$2.20	$2.20	$1.30
Pensioner Off Peak Daily	n.a.	na	$1.20	$1.20	$1.30
Daily	n.a.	na	$4.20	$4.70	$3.00
Non-cash					
Faresaver 10	$9.20	$9.90	$18.40	$19.50	$10.50
Weekly	$9.90	$11.00	$19.00	$21.50	$11.75
Monthly	$32.50	$38.00	$60.00	$68.00	$40.20
School Student Faresaver 10	$6.50	$6.50	$13.00	$6.50	$7.50
School Term	$49.50	$49.50	$99.00	$49.50	$55.00

Source: ACTION

The fare schedules in Table 6.5 indicate the following outcomes for 2002-03:

- the shift to single zone ticketing was accompanied by an increase in fares for former one zone users (the majority of passengers) and a fall in fares for former all zones users[8];
- fare increases for single zone passengers were modest ranging from 4% (single adult cash tickets) to 8% (single trip concession holders);
- single fare users also benefited from an effective product improvement (i.e. ability to travel 56 kilometres from one end of Canberra to the other); and
- fare changes for all zones users ranged from an 8% rise for Pensioner Off Peak Daily users to a 46% fall for Adult Faresaver 10 users[9].

8 *Patronage data for 2001-02 indicate that 72% of ACTION's adult and concession users were single zone travellers, although this figure would include passengers who over-ride.*

9 *These figures exclude those applying to school students, as they had been covered by a single zone ticket structure since July 2001. The fare changes introduced on 1 July 2002 increased the cost of School Term tickets by 11% and School Student Faresaver 10 tickets by 15%.*

In order to relate these price changes to patronage, ACTION boardings data from 1999-2000, 2000-01 and 2001-02 are indicated in Table 6.6, below.

Table 6.6: Comparison of ACTION boardings: 1999-2000 to 2001-02

	Boardings ('000)				
	1999-2000	**2000-01**	**2001-02**	**Change 1999-2000 to 2000-01**	**Change 2000-01 to 2001-02**
Adult	4,816	4,892	4,613	76	(279)
Concession	6,323	6,213	5,779	(110)	(434)
Sub-total Adults and Concessions	*11,139*	*11,105*	*10,392*	*(34)*	*(713)*
School Student	4,756	4,541	5,397	*(215)*	856
Total	**15,895**	**15,646**	**15,789**	**(249)**	**143**

Source: ACTION

The passenger boardings data indicate the following points:

- The rise in student boardings in 2001-02 of 856,000 can be explained by free travel for many students during September-December 2001 under the SSTS and the change to single zone school ticketing during the remainder of 2001-02.
- In isolation, adult and concession boardings data do not provide evidence that previous changes in fare levels *per se* have had major direct impacts on patronage.
- While prices increased in real terms in *both* years, adult and concessions boardings in 2000-01 were only 34,000 lower than in the previous year, although boardings fell by 713,000 in 2001-02. However, since the average real price applied in 2001-02 was little different from that applied in 2000-01, it is unlikely that increased fares alone could explain the fall-off in boardings in 2001-02.

ACTION's January 2003 submission also indicates that the introduction of a single zone fare structure has been accompanied by an increase in Adult and Concession patronage over the six months from 1 July 2002. Data subsequently provided by ACTION for the period July to December 2002 indicate that combined adult and concession boardings were some 224,000 (or 4.3%) higher than for the corresponding period in 2001. (ACTION have indicated that this higher demand is, in part, being met in the short term by delaying the sale of some older buses.)

Table 6.7 indicates the change in boardings between July-December 2001 and July-December 2002.

Table 6.7: Comparison of ACTION boardings: July-December 2001 to July-December 2002*

	Boardings ('000)			
	July-December 2001	**July-December 2002**	**Change: 2001 to 2002**	**Percentage change: 2001 to 2002 (%)**
Adult	2,284	2,454	170	7.4
Concession	2,908	2,962	54	1.9
Sub-total Adults and Concessions	*5,192*	*5,416*	*224*	*4.3*
School Student	*2,740*	2,748	8	0.3
Total	**7,932**	**8,164**	**232**	**2.9**

Source: ACTION
*Excludes free travel

The Commission notes that adult and concession patronage rose in spite of the fact that most patrons would have experienced a (modest) fare increase. A possible explanation is that former single zone ticket holders were being offered a changed product while many all zones ticket holders received a very substantial price cut. ACTION has, indeed, indicated that the move to a single zone system was a major factor in the rise in boardings over July-December 2002.

The Commission notes that some of the rise in adult patronage in July-December 2002 could result from the recent expansion of ACTION's services (such as the 205 new services in the Gungahlin area, introduced in May 2002.) Adult and concession boardings in Gungahlin for July-December 2002 were up by 65,000 over the previous year. This is equivalent to a sizeable proportion (around 29%) of the rise in total adult and concession patronage.

The Commission also acknowledges ACTION's comments in its January 2003 submission that changes to network structure over time may make it difficult to compare boardings between years (by, in some cases, producing the appearance of *falling* patronage):

> *Patronage is also difficult to compare between years, as network changes have meant that fewer people are required to change buses to complete their journeys. The traditional measure of patronage has been "boardings". Positive network changes that provide improved through services may consequentially provide reduced boarding figures.*

Such changes also present difficulties when simply comparing boardings and revenues, as discussed below.

Aside from changes to network structure, ACTION has also suggested that the rise in boardings over the July-December 2002 period may have resulted from the following factors:

- A rise in fuel prices faced by motorists
- Rising car registration and parking costs
- The general rise in car prices after the "one-off" fall associated with the introduction of the GST on 1 July 2000

The Commission has also investigated the issue of whether population changes have impacted boardings, but any such impact is likely to be very marginal. Canberra's estimated population grew by some 2,200 (from 313,000 to 315,200) between 2001 and 2002 - or less than 1%.

It is for reasons such as those cited above (which drive a wedge between revenue changes and changes in observed boardings) and in order to resolve long standing debates about the price responsiveness of the Canberra bus transport market, that the results of a recent fare elasticities study, undertaken on behalf of the Department of Urban Services (DUS), are of particular interest to the Commission. The summary results of this study are examined in the following section.

6.2.2 Fare Elasticities

In previous determinations, the Commission indicated that it would welcome some documented evidence on likely fare elasticities in the ACTION bus market, particularly as it received conflicting signals as to how responsive bus passengers were to fare changes.

A recent study of the price elasticity of demand in the Canberra bus market, undertaken by Booz Allen Hamilton on behalf of DUS, indicates that the overall bus market in Canberra is relatively price inelastic. The overall elasticity is around -0.2, which means that for every 10% increase in fares, bus patronage falls by 2%; conversely, a 10% reduction in fares would only lead to an increase of 2% in patronage. Table 6.8 indicates the results of this elasticity study, broken up by time of day and trip purpose.

Table 6.8: Elasticities by time of day and purpose

	Trip Purpose			
Time of day	**Work**	**Student**	**Other**	**All**
Peak	-0.13	-0.16	-0.28	-0.18
Off Peak	-0.14	-0.16	-0.32	-0.21
All	-0.14	-0.16	-0.29	-0.20

Source: Booz Allen Hamilton estimates

Notes:
Peak refers to 7am – 9am and 4pm to 6 pm
Students include both university and school students

It should also be noted that, while the categories used in this study do not correspond precisely to ACTION ticket types, it is likely that "work" trips would be largely undertaken by adult fare holders, while "other" trips would typically correspond to concession ticket holders. "Student", as defined here, includes both school and university students.

In general, these elasticities confirm that the Canberra bus market is relatively unresponsive to changes in bus fares. In large part, this is because the share of transport trips performed by bus is small, only around 5%, which suggests that only those who have little choice but to use the bus are the dominant users. (However, not all of these users are concession users, and by inference relatively disadvantaged.)

Not surprisingly, off-peak usage is more inelastic than peak travel (for non-student travel, by up to 40-50% more inelastic), and "work" is more inelastic than "other" (for non-student travel, by 50%). Even the relatively more elastic "other" category produces an elasticity result which is at the lower end of other jurisdictions' generally observed elasticities.

Any fare changes based on time-of-day or full fare-concession differential would suggest that any small loss of patronage would be more than offset by increased farebox revenue. This is not inconsistent with the Commission's previous directions to reduce the period discounts, which would be more used by regular passengers, particularly for work trips.

6.2.3 Revenue Implications

The Commission notes that ACTION's revenues in 2001-02 were impacted by the introduction and subsequent withdrawal of the SSTS, complicating comparisons with past years. In addition, the student market was affected by one-off changes due to the Sydney Olympic Games in the 2000-01 financial year.

Table 6.9 illustrates the changes in adult, concession and student revenues and boardings in recent years.

Table 6.9: Comparison of ACTION fare revenues: 1999-2000 to 2001-02

	Revenues ($000)				
	1999-2000	**2000-01**	**2001-02**	**Change 1999-2000 to 2000-01**	**Change 2000-01 to 2001-02**
Adult	8,620	8,683	8,613	63	(70)
Concession	4,622	4,693	4,428	70	(264)
Sub-total	*13,243*	*13,376*	*13,041*	*133*	*(334)*
Student	3,258	3,153	2,229	(104)	(924)
Total	16,501	16,530	15,271	28	(1,259)
	Boardings ('000)				
	1999-2000	**2000-01**	**2001-02**	**Change 1999-00 /2000-01**	**Change 2000-01 /2001-02**
Adult	4,816	4,892	4,613	76	(279)
Concession	6,323	6,213	5,779	(110)	(434)
Sub-total	*11,139*	*11,105*	*10,392*	*(34)*	*(713)*
Student	4,756	4,541	5,397	*(215)*	856
Total	15,895	15,646	15,789	(249)	143

Source: ACTION

In assessing Table 6.9, the Commission notes the following:

- Falls in adult and concession revenues occurred in 2001-02, a year in which prices rose in real terms. However, as already acknowledged, boardings and revenues may also have been impacted by non-price factors (e.g. changes in route or network structures and in service provision).
- A previous round of fare increases, set under the March 2000

Price Determination, were applied on 1 July 2000. Individual fares rose between 8% and 20%. However, compared to 1999-2000, combined adult and concession boardings fell only marginally in 2000-01, while combined revenues *increased.*

A separate comparison of July-October 2001 and 2002 data indicated that:

- Combined adult and concession revenues fell by some $321,000 (falls in adult revenue accounted for $283,000)
- Boardings rose by 72,000
- As is the case for the yearly data, the combined impact of fare price changes, fare structure changes and network service changes makes it difficult to isolate the impact of any single factor on revenues.

Taken together, the evidence suggests that while patronage is price inelastic, overall fare revenues (and boardings) will clearly be impacted by factors other than fares themselves.

6.2.4 Student Fares

The impact on ACTION's boardings and revenues associated with the introduction of the SSTS on 1 September 2001 and its subsequent withdrawal after 31 December 2001 has been noted above. ACTION has stated that school student patronage remains strong even after the withdrawal of the SSTS and the reintroduction of student fares.

A review of ACTION patronage data for July-December 2002 indicates that student patronage is 8,000 higher than for the equivalent period in 2001, which overlapped with the introduction of the SSTS. This is despite the fact that (based on 2000-01 boardings data) some 78% of school students previously used one zone fares and that many of these would have experienced both the reintroduction of fares (in January 2002) and a price rise of $1 to $7.50 in July 2002[10].

The introduction of single zone ticketing (on 23 July 2001 in the case of student fares) would appear to have effectively removed previous community concerns raised with the Commission relating to student fares and zonal anomalies.

However, the Commission understands that full time University and CIT students are still entitled to travel at school fare (rather than concession) prices. This represents an anomaly which the Commission has raised in the past and which it still believes should be addressed.

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10 *Under the SSTS, free transport was provided to school students between 7.30 am and 5.30 pm, provided they lived outside of a specified radius from Canberra schools. This radius was defined as being at least 1.6 kilometres from a primary school and at least 2.0 kilometres from a high school. In addition, all Kindergarten to Year 2 students were permitted to travel free, regardless of distance.*

6.2.5 Social Impacts

The Commission notes that, according to the elasticity study, the "other" category is relatively more elastic than "work" trips. It would appear that the "other" category would consist substantially of concession ticket holders. In total, concession ticket holders dominate ACTION's patronage profile. Within that category, the Pensioner Off-Peak ticket is the most widely used concession ticket by a wide margin, accounting for about 40% of all concession patronage between July and October 2002.

The Commission has indicated in previous price directions that the level of discounting on concession tickets should not exceed 50% of the equivalent adult fare, consistent with government policy. Based on currently available average fares data, concession tickets would roughly correspond to this benchmark (with the exception of the Pensioner Off Peak ticket which, on average, costs some 43% of its adult equivalent).

In considering the social impacts of any pricing decision, the Commission is concerned to ensure that there should be no increase in the discounting margin for concession tickets. However, it does not wish to adopt an outcome which would have deleterious social impacts by introducing fare increases which would materially impede the access to public transport of those most socially disadvantaged.

6.2.6 Effects on Cost of Living

The Australian Bureau of Statistics conducts a Household Expenditure Survey covering all States and Territories. The most recent Survey dates from 1998-99. Bus transport charges are estimated to comprise around 0.3% of an average Canberra household's weekly expenditure (ABS Cat. No. 6535.0, 1998-99).

The maintenance of existing fare levels for the next two years, followed by a CPI adjusted fare in the third year, would have no adverse impact on Canberra's CPI for 2003-04, 2004-05 and 2005-06.

6.2.7 Quality and Safety Standards

The *Road Transport (Public Passenger Services) Act 2001* requires public transport operators such as ACTION to be accredited by the Road Transport Authority. Accreditation sets standards for service, safety, maintenance, management and accountability. It also involves an initial audit and assessment, followed by reassessment every two years.

ACTION's Annual Report 2001-02 states that:

- a formal application for accreditation was to be lodged in September 2002;
- ACTION's fleet will be required to undergo vehicle registration inspections for the first time in September 2002; and

- ACTION is working towards accreditation as a provider of heavy vehicle inspection services to allow for in-house inspections.

The Commission acknowledges that the accreditation process has imposed a number of costs on ACTION (such as the need to pay for bus registration costs) and that ACTION has received increased funding to meet these costs. Capital funding for the modification of bus doors ($1.3 million) and for a new radio communications system ($1.5 million) partly reflects the need to meet accreditation standards as, presumably, does some element of the "increased base funding", referred to below, for recurrent operations.

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

Table 6.10 indicates ACTION's operating results for 2001-02 and forecast results for the following three years.

Table 6.10: Forecasted Operating Statement ($'000) – November 2002

	2001-02	2002-03	2003-04	2004-05
Expenditure	(67,279)	(68,319)	(68,866)	(69,217)
Non ACT Govt. Revenue*	15,943	15,710	16,084	16,468
ACT Government Contributions	46,538	50,663	48,737	48,411
Operating Deficit/Surplus	(4,798)	(1,946)	(4,045)	(4,338)
Operating Injection	4,398	0	0	0
Abnormal Items	0	0	0	0
Operating Deficit/Surplus after Abnormal and extraordinary items	(400)	(1,946)	(4,045)	(4,338)
Capital Contribution from Government	5,650	1,550	5,600	3,600
Total equity at end of period	45,893	45,497	47,052	46,314

Sources: ACT 2002-03 Budget Paper No. 4, ACTION Annual Report 2001-02 and ACTION supplementary data November 2002
*Includes fares, other revenue, grants from the Commonwealth, profit on asset sales and interest.

ACTION's operating results for 2001-02 represent an improvement on those forecast in the 2001-02 budget:

- ACT government contributions are some $1 million less than anticipated;
- expenditures are some $0.9 million less than budgeted; and
- non-ACT government revenues are some $1.6 million more than anticipated.

However, much of this would appear to be a reflection of the withdrawal of the SSTS.

It is also of concern to the Commission that the reduction in ACT Government Contributions would have been some $0.5 million greater had it not been for an increase in funding to meet costs relating to long term staff absences from illness and injury.

This issue is interrelated with those of sick leave entitlements and current Comcare arrangements. The Commission notes that ACTION has identified the age profile of its drivers and Comcare premiums as a risk in its *2001-02 Annual Report.* ACTION needs to ensure that it has appropriate strategies in place in order to manage this risk.

In referring to ACT Government Contributions, the 2002-03 Budget Papers state that:

> *The increase of $3.848m in the 2002-03 Budget from the 2001-02 estimated outcome is due to the reclassification of $4.093m injection for operations as Service Purchase Payment, additional funding of $2.2m associated with the introduction of a single zone for all fare categories, and additional base funding of $4.071m. These are offset by reductions in funding on the cessation of the free school bus services, totalled $4.023m and the previously budgeted base funding reduction of $2.493m.*

Thus, excluding the Service Purchase Payment reclassification, these particular shifts in funding programs and priorities largely cancelled each other out in 2002-03, leaving little net change in ACT Government Contributions when compared to 2001-02.

However, it is instructive to compare the forward estimates for ACT Government Contributions reported in the 2002-03 Budget Papers with *previously budgeted* ones. The Commission notes that projected ACT Government Contributions in the 2002-03 Budget Papers appear to exceed 2001-02 Budget Paper forward estimates by between $2 million and $3.2 million for the period 2002-03 to 2004-05 inclusive.[11]

Much of this increase in ACT Government Contributions appears to be driven by the need to service ACTION's increasing employee expenditures, discussed previously. In addition, the Commission of Audit indicated that the heading of "base funding" relates to funding to provide for current budget pressures faced by ACTION such as

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11 *These estimates exclude the Service Purchase Payment for comparability with ACT government contributions estimates made in 2001-02.*

increasing insurance premiums, the (new) requirement to pay for bus registration and the rising cost of spare parts.

The Commission remains concerned at the level of deficit financing such large government contributions imply. As indicated previously, the Commission believes that there may be scope for further efficiency gains beyond the $2.6 million in savings identified by INDEC.

Moreover, these forecasts indicate that operating deficits will continue into the future, reaching some $4.3 million in 2004-05. The Commission does not believe that, if the total quantum of CSO requirements is known in advance and accurately estimated, there should continue to be a need to budget for operating deficits.

The Commission is also concerned at the internal allocation of ACTION's CSO payments. ACTION's January 2003 submission indicates a rise in the "Pricing CSO" of some $8.1 million between 2001-02 and 2002-03 (see Table 6.11). While the Commission would expect an increase in the Pricing CSO (reflecting the introduction of single zone ticketing), this rise would seem to imply that the Operating Injection (or Service Purchase Payment) has been subsumed within the Pricing CSO, along with the (net) increase in "base funding", suggested above.

Table 6.11: Government Contributions ($'000)

	1996-97 Actual	**1997-98 Actual**	**1998-99 Actual**	**1999-00 Actual**	**2000-01 Actual**	**2001-02 Actual**	**2002-03 Budget**	**2003-4 Budget**	**2004-05 Budget**
Pricing CSO	16,340	13,376	14,189	17,839	15,782	15,817	23,913	23,695	22,887
General Route Off-Peak Services CSO	9,038	7,779	9,455	9,262	10,180	9,948	9,441	8,527	8,686
School Services CSO	9,387	9,684	9,780	9,592	10,544	14,328	10,728	9,779	9,944
Concessional Travel Payments	3,501	3,606	4,159	4,301	4,383	4,912	4,912	5,025	5,140
Special Needs Transport	1,022	1,922	1,712	1,637	1,842	1,533	1,669	1,711	1,754
Resources Provided Free of Charge	-	31	-	-	-	-	-	-	-
Sub-total	**39,288**	**36,398**	**39,295**	**42,631**	**42,731**	**46,538**	**50,663**	**48,737**	**48,411**
General Subsidy/Injection for Operations	3,000	1,000	2,326	5,241	3,624	4,398	-	-	-
Total	**42,288**	**37,398**	**41,621**	**47,872**	**46,355**	**50,936**	**50,663**	**48,737**	**48,411**

Source: ACTION (January 2003 submission used for estimates for 1999-2000 and after)

The Commission has previously noted that the division of CSO components in reported ACTION data is largely notional. Past price directions have called for greater transparency in the allocation of CSO payments and noted that clearer and more justifiable CSO payments were necessary as a part of ACTION's conversion process to a statutory authority. In the last price direction, the Commission noted ACTION's comments that CSO payments should provide an explicit and legitimate reflection of government policy and that ACTION had commissioned a report into the appropriate level of such funding.

Nonetheless, ACTION's breakdown of CSO payments continue to be based on an arbitrary division of government funding. The Commission of Audit noted its dissatisfaction with this approach and with other elements of the current funding model and examined principles for alternative funding models. More discussion on funding models is given in section 6.3.4 below.

6.3.2 Cost Recovery

Table 6.12 indicates ACTION's farebox cost recovery in recent years and provides projections for several future years.

Table 6.12: Cost Recovery Trend

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03 (est)	2003-04 (est)	2004-05 (est)
Fares ($m)	16.6	16.3	16.6	16.5	14.4	14.7	15.0	15.4
Operating Costs ($m)	67.1	71.7	70.8	66.6	67.7	68.3	68.9	69.2
Farebox Cost Recovery	**24.7%**	**22.7%**	**23.5%**	**24.7%**	**21.5%**	**21.5%**	**21.8%**	**22.3%**

Source: ACTION

ACTION's level of cost recovery for 2001-02 was markedly lower than in previous years, as a result of changes involving the introduction and withdrawal of the SSTS and the extension of concession travel to holders of Health Care Cards.

Projected farebox cost recovery levels for 2002-03 to 2004-05 are similar to levels forecast in the last price direction, despite the withdrawal of the SSTS and a more restricted application of concession fares to Health Care Card recipients, and largely stem from the continuing increase in ACTION's operating costs in future years.

ACTION's forecasts for 2003-04 and 2004-05 reflect indexation of 2002-03 revenue estimates by estimated CPI (i.e. 2.5%). However, the 2002-03 figures themselves may be understated, as ACTION has indicated that the patronage response to single zone ticketing has been unexpectedly strong.

ACTION's January 2003 Submission to the Commission argues that government priorities have shifted from farebox recovery to "affordable fares" and that the ACT government is willing to provide a significant subsidy to public transport users in order to achieve sustainable outcomes.

While ACTION states that "in the past there has been a focus on farebox recovery and a target of achieving 30%", it has also implied that this is no longer an objective. ACTION argues that sudden government policy shifts, such as the introduction of the SSTS and the Health Care Card concession schemes (which have had major impacts on its farebox cost recovery), have demonstrated the change in government perspective to favour affordable fares over farebox recovery.

The Commission notes that, while Part 2 (5) (a) of the *ACTION Authority Act*

2001 states that the Authority is to provide an "affordable" service, Part 2 (5) (c) indicates that the authority is required "to maximise the sustainable return to the Territory on its investment in the authority". In addition, as indicated in previous price directions, failure to improve farebox revenues implies a willingness to tolerate an ongoing subsidy from ACT taxpayers to ACTION users.

The Commission acknowledges that any changes to overall fare structure and levels are likely to have modest revenue implications. In contrast to this, the data in Table 6.12 above provides some support to the argument that sudden government policy shifts can have major impacts on farebox revenue.

In the past, the Commission has indicated that there is no single correct answer to the question of an appropriate farebox cost recovery rate for ACTION. At the same time, the Commission has previously pointed to the need to balance user contributions with community underwriting of ACTION. Part 2 of the *ACTION Authority Act 2001* would also appear to recognise the need to achieve this balance. This implies that the issue of farebox revenue should not simply be ignored but should form part of a wider strategy and be explicitly treated.

6.3.3 Rate of Return

In the past, the Commission acknowledged the difficulties inherent in estimating a "rate of return" for a (loss making) public transport business while noting that this does not negate the need for transport providers to establish clear investment guidelines for asset acquisition and replacement.

In addition, Part 2 (5) (c) of the *ACTION Authority Act 2001* states that the Authority is required "to maximise the sustainable return to the Territory on its investment in the Authority".

The March 2000 price direction noted a number of concerns about ACTION's proposed fleet replacement program at that time, including:

- 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 in 1999) 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.

These points were reiterated in the May 2001 price direction. The Commission also notes the Commission of Audit's conclusion that the current funding model does not encourage the effective stewardship of assets.

ACTION's *2001-02 Annual Report* indicates that negotiations leading to the finalisation and implementation of a bus replacement program were undertaken during 2001-02. The program addresses issues such as the age of ACTION's fleet and the need to meet the requirements of the Commonwealth's *Disability Discrimination Act* (1992) (DDA).

ACTION's *2001-02 Annual Report* states that 32 buses (9% of the fleet) are now DDA compliant and that 45 vehicles will be purchased over the next four years, while the Commission of Audit refers to the allocation of $17.2 million for 44 vehicles to be purchased over five years, at an average cost of almost $400,000 per bus[12].
The Commission believes that the determination of an effective forward planning investment program for bus acquisition should be linked to the establishment of an appropriate funding model.

6.3.4 Alternative Funding Models

For some time, the ACT Government has been concerned about what appears to be the open-ended funding arrangements for ACTION. Although the accounts indicate explicit payments for particular types of community service obligations (CSOs), there has been no effective measurement and control of those payments and therefore no real test as to whether they reasonably reflect payments for non-commercial service provision.

Previous Commission determinations discussed the merits of identifying a series of minimum service levels (MSLs) which the Government would require of ACTION as a basis for assessing the worth of those CSO payments. However, the five-year contract between DUS and ACTION (agreed to in December 2001) is for a fixed set of routes and services as agreed and the discussion about MSLs has not progressed.

In addition, in examining the current funding model, the Commission of Audit found that:

- it was not aligned with the requirement for ACTION to operate on a 'sound commercial basis' as per the *ACTION Authority Act 2001;*
- it did not encourage long-term planning or the effective stewardship of assets;
- the current presentation of CSOs was largely notional and, as such, did not assist the process of determining the true costs, or value, delivered by these activities; and
- current funding mechanisms did not address the expansion of ACTION services to meet the needs of new and developing areas or permit the assessment of funding implications.

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12 *The reference to a five year replacement plan given in the Commission of Audit is more consistent with the 2002-03 Budget Paper forecasts. Note that the Commission of Audit's figures actually imply a cost per bus of approximately $391,000.*

In the light of this, DUS sought to redefine the way in which government funding should be provided to ACTION by developing a revised funding model. The Commission of Audit previously assessed this model and recommended a number of modifications. The Commission of Audit also suggested that this Commission could provide a role in assisting in the development and implementation of an appropriate funding model.

Discussions are currently underway between ACTION, Treasury and DUS, with the assistance of the Commission, on an appropriately structured funding model which should provide a transparent mechanism for strategic decisions for public transport in Canberra to be funded and should lead to the following outcomes:

- ACTION should not be penalised for improved efficiency, but neither should it be reimbursed if it does not achieve designated efficiency.
- Treasury should identify defined funding commitment, rather than continue "drip feeding".
- A three-year guarantee of government revenue should be provided once the agreed cost elements are in place.
- An incentive should exist for ACTION to improve efficiency measures by retaining pre-agreed government payments.
- Changes to the scope of services, due to policy shifts, should be paid for at net incremental efficient cost.

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 Integrated Land Use and Transport Strategy

The Commission's discussion above notes the need to balance issues such as cost recovery and the level of government contributions with the broader concerns which would be incorporated in any integrated land use and transport strategy. ACTION's services account for only some 5% of total transport trips within the ACT and the Commission acknowledges that ACTION's ability to materially affect patronage levels is limited, given the predominance of private vehicles within Canberra. The results of the recent elasticity study conducted for DUS only serve to reinforce this point.

The Commission noted in previous price directions that there are more substantive policy issues driving the objectives which public transport, including ACTION, should pursue.

The Commission notes that Planning and Land Management (PALM), within DUS, is developing a Canberra-wide planning framework to provide the basis of strategic decisions for the next 25-30 years. The framework is called The Canberra Plan and comprises three parts: The Canberra Spatial Plan, The Canberra Economic White Paper and The Canberra Social Plan.

As part of this planning framework, the Commission understands that studies are being undertaken to investigate the future of public transport, car parking charges, the costs of private and public transport as well as the recent fare elasticity study. The Commission also understands that the work is focusing on the desirability of setting public transport targets for Canberra and identifying appropriate strategies to achieve those targets.

The Commission suggests that this work should include an examination of the possible impacts of Canberra transport cross-elasticities, particularly drawing on the elasticity work already undertaken. For example, the impact of increases in car parking and other car travel costs on ACTION's patronage should be examined as a part of this study. Other issues to be covered as part of a wider integrated transport study would be whether low patronage or off-peak bus services should be replaced by taxi services in certain circumstances.

To this end, the Commission believes that an examination of the feasibility of using taxi services in place of buses during periods of very low patronage should be conducted by DUS. This issue should be examined, along with the broader question of ACTION's role as a service provider, as a part of the integrated transport approach for Canberra being developed by PALM.

The Commission believes that the development and implementation of an effective integrated land use transport strategy forms a necessary input into resolving long-running issues such as the appropriate level of government contributions to ACTION and the transport context within which ACTION is expected to provide services.

6.4.2 Ecologically Sustainable Development

The Commission accepts the importance of ecologically sustainable development (ESD) and the need to price environmental resources. It also acknowledges that the operating efficiency and revenue concerns, cited above, must be balanced against other issues such as the need to implement an integrated transport approach and environmental considerations.

The Commission has previously acknowledged that public transport fare rises could result in ACTION users switching to more (environmentally) costly forms of transport such as private cars. The Commission notes, however, that this issue is inter-related with that of integrated land use and transport strategy and that ACTION's role within ESD should be more clearly defined in the future.

In previous price directions, the Commission has expressed its disappointment at ACTION's lack of progress in introducing CNG or other low emission buses.

ACTION's January 2003 Submission does not address this issue. However, the *2001-02 Annual Report* states that it is now ACTION's intention to purchase CNG or fuel-efficient diesel powered vehicles in the future and that both of these vehicle types will meet Euro III emission standards.

The Commission also notes that running buses on routes which are only lightly patronised can have deleterious ecological effects. To satisfy ESD concerns, a holistic approach to transport provision is required – and this is currently being addressed.

6.4.3 Demand management

The Commission has examined the issue of the effective demand management of ACTION services in past price directions and, in a broader sense, the Commission acknowledges that ACTION services constitute only a part of a total demand management strategy for transport within the ACT. Thus, the Commission believes that the wider issue of total transport demand management should also be addressed by DUS and as a part of the integrated transport strategy being developed by PALM.

The Commission notes that:

- ACTION's *Annual Report* 2001-02 states that new timetables were introduced in May 2002;
- the Commission also notes that ACTION increased its level of service provision in May 2002 with the introduction of 205 extra services per week to Gungahlin; and
- new services are also planned for South Tuggeranong and West Belconnen.

The Commission has previously expressed broader concerns about the utility of running buses on off-peak or other services which attract very few or no passengers. The Commission assumes that any new services which are introduced are justified in the light of expected patronage levels.

6.4.4 Pricing Options

The Commission is aware that there have been significant changes to the institutional and operational environment in which ACTION operates since the last determination.

Within this context, the Commission is confronted with a range of pricing options:

1. The Commission could determine that fares will increase by the CPI. This would seek to maintain fares at real levels and might even contribute to a very modest increase in farebox cost recovery, if cost increases were constrained. The major advantage of this option is that it would not be unexpected and would signal that the Commission does not expect ACTION's

financial situation to deteriorate. The disadvantage of this option is that it essentially endorses the status quo and does not represent a proactive signal to encourage bus patronage or to increase operating efficiency.

2. The Commission could determine that fares will increase at the same rate as the expected increase in ACTION's unit costs. The advantage of this approach is that the index would be more closely aligned with the changes in costs which drive the resultant cost recovery outcome. If the CPI understates ACTION's cost increases, a CPI adjusted fare determination will not maintain current cost recovery outcomes. The disadvantage of this approach is that the Commission could appear to endorse ACTION's cost profiles when it has already indicated concerns about the future cost estimates and potential efficiencies.

3. The Commission could determine a fare increase on a CPI minus X basis, which seeks to encourage ACTION to make further efficiency improvements to ensure that its financial position does not deteriorate. However, the Commission is aware that such a mechanism would not, of itself, provide an incentive for ACTION to rein in costs. As indicated above, the current funding model provides whatever deficit financing ACTION requires to balance its books. The Commission believes a more effective mechanism in encouraging greater efficiency by ACTION is through an appropriate funding model.

4. The Commission could determine a fare increase on a CPI plus X, where X represents explicit compensation for cost increases outside its control which are in excess of CPl. The difficulty with this approach is for the Commission to determine what is an appropriate X. Again, this is linked to the funding model and the determination by ACTION, DUS and Treasury on the definition of input inefficiencies and strategies to reduce them. The Commission believes again that the key lies in implementing an appropriate funding model.

A separate issue relates to whether, for any of the above options, the Commission should use:

- an average annual fare approach (which it has done in the past), or
- a fare cap for each type of fare charged by ACTION, or
- a revenue cap for the total farebox recovery by ACTION.

An average annual fare cap allows ACTION greater flexibility in the fares that it charges for different services and customer groups. A fare cap on individual type of fare category basis removes this flexibility. A farebox revenue cap would provide a greater degree of certainty as to the level of revenue that ACTION could expect to recover from passengers, but would do so in a way that would potentially require further fare increases should the revenue cap not be achieved.

Given that the Commission is required to establish a three-year price path, decisions on all of these options would also involve whether the same increases would apply for each of the years.

There is, however, a fifth option available to the Commission, i.e. that there is no increase in fares for some or all of the three-year period. The Commission is concerned that any fare increases which it might determine along the lines above would in fact make little difference to ACTION's overall financial outcome.

On the basis of the elasticity study, a 3% increase in average fares on a current farebox revenue base of around $15 million would only amount to around $350,000 in additional gross revenue, which does not materially shift the cost-recovery level. Moreover, ACTION has indicated to the Commission that estimated additional administrative and advertising costs associated with the introduction of a fare change are upwards of $50,000. Thus, the net revenue gain from a 3% average fare rise would be $300,000 at most. At the same time, any fare increases in excess of this could be interpreted as sending the wrong signals to the public in terms of the use of public transport, but even modest CPI adjustments in the absence of a co-ordinated public transport strategy may not encourage increased public transport usage.

The Commission has noted in previous determinations that the resolution of ACTION's financial position is dependent on clearly articulated objectives and associated strategies for public transport with commensurate funding arrangements being put in place.

Since the last determination, progress has been made on both counts. The broader public transport strategy is considering pricing for cars, including parking charges. Future land use decisions as well as competitive transport modes need to be viewed within the wider land use transport context.

The Commission is concerned that its price determinations do not impede the outcome of both developments. However, it acknowledges that these processes are complex and may take a few years to implement. From ACTION's point of view, both issues need to be resolved within the next three years before the current contract with DUS expires at the end of 2006.

At the same time, the Commission is mindful that pursuing a “no fare change” option may result in a “price shock” when fares are reviewed in the next price determination, in three years time.

Thus, the Commission proposes at this stage to direct that the *weighted average fares* remain at their current levels for the next two years and that, for the third year covered by this price determination (i.e. 2005-06), they be indexed to the change in the All Groups Canberra CPI over the previous year (i.e. for the year ending in the March 2005 quarter) . This should give sufficient time for the imminent public transport strategy to take effect and for the public to have confidence that fare levels have not been set as a disincentive to public transport usage. At the same time, this

approach will help avoid the possibility of an induced price shock when fares are reviewed in the Commission's next price determination.

This approach does not preclude ACTION from adjusting *individual* fares at any time over the next two years, so long as the average annual fare level remains unchanged. The average annual fare represents the average of individual fares, weighted by passenger boardings for each fare type. Thus ACTION is not precluded from increasing fares for some fare types over the next two years, so long as it offsets this by fare reductions for other fare types *and* ensures that the *weighted average* of all ACTION fares remains the same.

However, in this regard the Commission points out that if ACTION were to adjust the relativities between the various fares, it would to a large extent nullify the objective of demonstrating to the community that bus fares can remain stable, and would lead to the increase in administrative costs which the Commission's decision is designed to avoid.

In the case of the final year (i.e. 2005-06) the average annual fare will be indexed by the change in the All Groups Canberra CPI over the previous year. Thus, in the final year covered by this determination, ACTION is required to ensure that any individual fare changes must produce a result such that the weighted average of these individual fares is consistent with the change in Canberra CPI.

In making this determination, the Commission believes that this will increase the onus on ACTION to adopt a more proactive approach to pursuing further internal efficiencies on the cost side. In the light of possible changes to services which might emanate from the new public transport strategy, ACTION must seriously address the areas which have been highlighted as input inefficiencies, within the context of the proposed discussions on the funding model.

When the Commission undertakes its next review of ACTION's fares in three years' time, it would expect to see that ACTION has achieved not only increased patronage but also greater efficiencies.

ATTACHMENT 1

Australian Capital Territory

Independent Competition and Regulatory Commission (Reference for Investigation) 2002

Notifiable instrument NI2002 -

made under the

Independent Competition and Regulatory Commission Act 1997, s15 (Nature of industry references)

TERMS OF REFERENCE

for an Investigation into public bus passenger service fares

Regulated industries under Section 4

Pursuant to subsection 4(1) of the Act, the Minister for Urban Services in December 1999 declared the public transport bus services provided by ACTION within the ACT, to be a regulated industry.

Reference for Investigation Under Section 15

Pursuant to subsection 15(1) of the Act, I refer to the Commission the matter of an investigation into the determination of prices for public passenger bus services provided by ACTION within the Territory from 1 July 2003.

Specified Requirements in Relation to Investigation Under Section 16

Pursuant to subsection 16(1) of the Act, I specify the following requirements in relation to the conduct of the investigation:

(a). The final report is to be provided to the Minister for Urban Services in relation to determined public passenger bus service prices for the period from 1 July 2003 to 30 June 2006, by 16 May 2003;

(b). A draft report in relation to determined public bus passenger service prices for the period from 1 July 2003 to 30 June 2006 is to be provided to the Minister for Urban Services and be made available for public examination and consultation in accordance with Section 18 of the Act.

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.

The Determination should consider current and projected patronage trends and any other noticeable trends flowing from the previous 1 July 2002 fare increase and the introduction of single zone flat fares.

Dated this 11th day of September 2002.

Bill Wood

Minister for Urban Services

ATTACHMENT 2

Draft Price Determination Methodology

In its draft determination, the Commission proposes that there be no change to the weighted average price cap for ACTION bus fares for the next two years (2003 and 2004) but that from July 2005 the weighted average price cap should be increased by the CPI (see *Proposed price direction* at p.6). The Commission considers that the following calculation would derive weighted average fare levels that would conform to the Determination. In detail this means:

- in each of the first two years of the determination, that is from 1 July 2003 to 30 June 2004 and from 1 July 2004 to 30 June 2005, the weighted average fare level should remain unchanged from the weighted average fare levels applying at 24 March 2003;

- for the 12 months commencing 1 July 2005, the weighted average fare level would be allowed to increase by the movement in the ACT CPI (all groups) between the following two periods: the 12 months period from 1 April 2004 to 31 March 2005 and the preceding 12 months period from 1 April 2003 to 31 March 2004;

- the movement in the ACT CPI for the 2003/04 (April to March) and 2004/05 (April to March) years would be calculated by averaging the Canberra CPI for each of the four quarters in the year concerned. The average for the year 2004/05 would be divided by the average for the year 2003/04 in order to determine the movement in the CPI over the 2005/05 April to March period for purposes of adjusting the weighted average fare level to apply from 1 July 2005; and

- the weighted average fare levels should be calculated using the fare categories existing at 24 March 2003, and weighted for the 2003/04 year by the patronage levels on ACTION buses for the 12 months to 31 May 2003; the weighting for the 2004/05 year to be the patronage levels for the 12 months to 31 May 2004 using the fare categories in use as at 31 May 2004; and the weighting for the 2005/06 year to be the patronage levels for the 12 months to 31 May 2005, using the fare categories in use as at 31 May 2005.

The Commission has outlined the steps it considers necessary to derive the weighted average fare levels for the final year of this Determination. However, while the Commission has outlined the method to be used to arrive at the average weighted fare levels for 2005/06, the Commission requires ACTION to provide to the Commission its calculation of the fares that it proposes to apply so that the Commission can confirmation that ACTION's proposed fares meet the Determination requirements.
