ACTION'S BUS FARES FOR 2000/2001

DRAFT PRICE DIRECTION

DECEMBER 1999

INDEPENDENT PRICING AND REGULATORY COMMISSION

FOREWORD

The ACT Internal Omnibus Network (ACTION) has been the subject of extensive discussion and debate within the ACT community. Announcements of a new network and fare structure earlier this year (Network 99) brought forward a mixed response from the wider community. It was clear that the changes then proposed would improve services offered to many ACTION customers and potential customers. However, there was a strong reaction from those within the community who found that they were required to pay more for the services that they used.

Network 99 has now been in operation for around 12 months and there has been an opportunity to review various aspects of its effectiveness and the community's response to the revised services and prices that have applied. The Commission requested in its Final Price Direction in April 1999 that various studies be undertaken to provide a guide not only to the further improvement of the services by ACTION but also to what action the Commission should take to meet the requirements of its legislation when reviewing prices for 2000/01. Details of these studies are provided in this Draft Price Direction, and form an important component of the Commission's deliberations on future prices to apply to ACTION.

It is evident from the results of the studies that have been undertaken over recent months and the community's response to the revised services provided under Network 99 that there has been a favourable reaction to many of the changes that have been made. However, there is also a need for some further refinement of the bus network. To this end, ACTION has foreshadowed that details of a number of changes will be announced over the coming weeks. It is not unexpected that further refinement of the network will be required over time, especially as the community's needs change in response to the availability of public transport and the prices regime that applies.

Of greater concern however, has been the apparent difficulty encountered by ACTION in achieving all of the cost savings that had originally been predicted following the negotiation of a new Enterprise Bargaining Agreement (EBA) and the development and implementation of the Network 99 strategy. To the extent that ACTION has been unable to capture the anticipated cost saving benefits, the gap between the cost of delivering the public bus network in the ACT and the revenue from fares has not been significantly reduced. As a consequence, the Commission faces the task of both assessing the overall efficiency of the bus network and services provided against current cost outcomes, and the extent to which increases in prices should be contemplated as a means of recovering the gap between present prices and efficient operating costs.

In this Draft Prices Direction, the Commission has proposed a prices strategy that will effectively limit the growth in cash fares from 1 July 2000, but allow for some reductions in the level of concessions offered for certain types of fare options. In this way the Commission is seeking to maintain a balance between maintaining patronage levels while at the same time increasing the fare revenue in areas where a further contribution towards meeting the cost of providing the transport service could reasonably be expected.

At the same time, the Commission has sought to highlight the extent to which ACTION costs have exceeded what might be termed as being a 'commercial price'. For example, it appears from the Commission's analysis that the additional costs incurred by ACTION in providing services above the Minimum Service Levels (MSL) agreed with the ACT Government could account for around $11.5 million in additional cost annually. On current projections, this is more than the projection of shortfall in ACTION's current recovery from fares and direct CSO payments agreed with the Government. To the extent that additional services above the MSL are fully recovered from fares collected from users of that service, then it would be appropriate for ACTION to continue to operate above the MSL. But, to the extent that fare revenue for these services does not cover the additional cost, the overall financial efficiency of ACTION is adversely affected. The Commission will be interested in comment and discussion on the provision of services above the MSL as part of the response to this Draft Prices Direction.

In releasing the Draft Prices Direction, the Commission is seeking comments from the various stakeholders and the community at large on the current findings of the Commission and the draft recommendations for bus fares for 2000/01. Public submissions are invited and a public hearing will be held in February.

The Commission would welcome the views of the wider community on this complex issue. Ultimately the Commission will need to determine the prices to apply from 1 July 2000. However, to the extent that these prices do not fully recover costs and the costs are beyond what might be construed as efficient costs, the ACT community is ultimately asked to wear a bigger financial burden in order to maintain the operation of ACTION in its present form. These are matters that are of importance to every member of the Canberra community.

Paul Baxter
Commissioner
23 December 1999

CONTENTS

1. INTRODUCTION

The Independent Pricing and Regulatory Commission (IPARC) is conducting an investigation into fares for bus services supplied by the Australian Capital Territory Internal Omnibus Network (ACTION), which should apply for the period from 1 July 2000 until 30 June 2001. The terms of reference for the investigation are included as Attachment 1.

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

> *The Commission is to review and report on appropriate pricing and pricing methodology for the following:*
>
> - *the regulated bus services provided by ACTION for the period from 1 July 2000 until 30 June 2001.*

In addition, the Commission shall:

> *specifically determine a price path based on best practice "commercial price". This will be done using best practice cost benchmarks taking into account potential patronage in the Territory and the service levels specified by the Department of Urban Services as the purchaser on behalf of the Territory Government.*

This document is a draft price direction, on which the Commission invites submissions prior to the public hearing. After this, the Commission will issue a final price direction.

2. INVESTIGATION PROCESS

The release of the draft price direction represents the first stage in the public process for determining prices. This report follows on the previous price direction issued by the Commission in March 1999, which referred to a price path for 1999-2000. In preparing this report, the Commission has reviewed various studies of ACTION's operations that have been commissioned by ACTION and the Department of Urban Services (DUS) since the previous direction. These are referred to, as appropriate, in this report.

The Commission now seeks broader community input into the price setting process. The Commission is calling for submissions in response to the draft price direction by 1 February 2000 and will hold a public hearing in the Legislative Assembly Building on a date to be announced in February. It is proposed to release the final price direction by 10 March 2000.

Activity	Due Date
Release of Draft Price Direction	23 December 1999
Public Submissions (including ACTION's)	1 February 2000
Public Hearing	February 2000 (TBA)
Release of Final Price Direction	10 March 2000

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

Independent Pricing and Regulatory Commission
GPO Box 447
Canberra City ACT 2601

Telephone: (02) 6273 0655
Facsimile: (02) 6273 0654
E-mail: paul.baxter@au.pwcglobal.com

Public submissions received by the Commission and transcripts of the public hearings can be obtained by contacting the Commission at the above address.

3. SUMMARY OF DRAFT PRICE DIRECTION

The principal features of the Commission's draft price direction for ACTION for 2000/01 are as follows:

- the increase in average fare prices for the financial year 2000-01 should not exceed the increase in the consumer price index for all groups for Canberra for the 24-month period ending March 2000;
- no increases in cash fares should be made;
- given the size of the discounts available for the purchase of periodical tickets, the allowable increase in the average fare should be made by way of reducing the discounts on periodical tickets, to being no greater than 15% on the cash fares;
- within this overall cap, no increases in student fares on average should be made, while the highest student fare is not permitted to increase over the existing level;
- despite the Commission's intention expressed in the previous determination, this direction is made for one year only.

The Commission estimates that the fare price increase permitted under this direction, in conjunction with further proposed operating cost changes, should assist in raising the cost-recovery level, from 24.4% in 1998/99 to about 29.4% in 2000/01.

As public transport charges are estimated to comprise only around 0.4% of an average household's weekly expenditure, the Commission believes that the effect of this price direction on the CPI will be negligible, ie. less than 0.1%.

The Commission acknowledges that the implementation of the Goods and Services Tax (GST) will take effect from the beginning of 2000/01. ACTION will be obliged to pass on the effects of the GST, but at this stage it is not clear what the net effect, after reductions in cost inputs, will be. Further work is currently being undertaken in this area, and a clearer picture should have emerged for the Commission to incorporate in the final price direction in March 2000.

The implementation of the new enterprise bargaining agreement in early 1999, in conjunction with the new Network 99, was designed to indicate that ACTION was becoming a more commercial organisation. However, the cost reductions and the expected revenue increase from higher patronage forecasts have not yet led to significant financial improvements. As a result, a continuation of ACTION's current performance is unlikely to lead to a material reduction in government subsidy. In order to assist with greater commercialisation, the government has proposed to establish ACTION as a statutory authority from July 2000. The board of the new authority will be responsible for the operator's performance, which, in association with the more formal purchaser/provider model, should provide a more arm's length management from government.

While the Commission had hoped to be able to make a longer-term price direction on this occasion, the proposal to establish ACTION as a statutory authority was not known at the time of the previous determination. Consequently, the Commission is concerned that its direction does not unduly impede the future directions of the authority, given the current ongoing budgetary difficulties affecting ACTION. Hence, it has only provided a price direction for one year.

The Commission is concerned that the earlier optimistic expectations about improved efficiencies and higher patronage have not been fully achieved. In fact, ACTION acknowledged that the Network 99 services and the new enterprise bargaining agreement were not sufficient to increase revenue and reduce costs to set the operator on a path to improved financial sustainability. As a result, all services have been subsequently reviewed by ACTION in a move to reflect a more commercial balance between the patronage and revenue opportunities and the costs of the services, and some services have been rationalised to reduce the prospect of continually widening deficits, and further adjustments are planned to be put in place from the beginning of February 2000.

This review considered the details of the recently instituted service agreement between ACTION and the purchaser, the Department of Urban Services, and sought to identify a clearer understanding of the minimum service levels which the Department required. ACTION acknowledged that a number of its services exceeded the minimum service levels required under the agreement, and that some of those represented a non-commercial outcome, ie. costs exceeded revenues. On the other hand, the Commission acknowledges that the determination of a "commercial" service network involves an assessment of the overall integrity of the services provided. However, the Commission has assessed that the provision of services corresponding to a minimum service level (MSL) network could lead to a net reduction in costs to ACTION of around $11 million. Thus, in a commercial environment, no services provided in excess of the MSL should lead to a financial outcome worse than this.

While the Commission believes that the moves already undertaken to develop more explicit and transparent service decisions are in the right direction, it is concerned that the process of establishing the costs and revenues for different services has moved too slowly. The new formal purchaser-provider arrangements provide a more focused approach to establishing ACTION in a more commercial environment. The Commission hopes that by the time ACTION is established as a statutory authority there is a clearer picture of the financial implications of service operations.

While the Commission believes that more can be achieved in terms of operating costs, it also believes that the average fares, for the distance travelled, are lower than reasonable commercial comparators. As a result, despite concerns about cost levels, the Commission is of the view that there are grounds for increasing fares. Significant government contributions will still be required over the next few years to support ACTION's financial position.

4. INDEPENDENT PRICING AND REGULATORY COMMISSION

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

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

The legislation establishing the Commission lists a number of matters the Commission must consider in making its decision. These include:

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

Submissions to the Commission may address any of these matters.

5. ACTION

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

ACTION has 712 full time equivalent employees, as at 1 July 1999, and incurs annual operating costs of $72 million with revenue derived from operations of around $17.5 million and explicit government contributions of $39 million to maintain the current level of service, as shown in the 1998/99 budget.

ACTION has two depots, from which its fleet provides services. These are located at Belconnen and Tuggeranong. The operational fleet status as at October 1999 totalled 385 buses (21 of which are Special Needs Transport buses) with an average age of just over eight years. The fleet requirements are determined by significant peak demands.

From July 1999, ACTION and the ACT government have established an ownership agreement, which sets guidelines and performance requirements to ensure the government receives the best possible return through efficient operation and professional management of ACTION. The agreement has been determined through consultation with the Minister for Urban Services, the Minister for Health and Community Care and the Minister for Education and Training. The ownership agreement covers efficient management of finances, assets and staff, in line with the policy goals of the ACT government and in the light of ACTION's past performance. One significant aim of the ownership agreement is to quantify appropriate minimum service level requirements between the Department of Urban Services as purchaser and ACTION as provider.

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

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

The major corporate objectives of ACTION are as follows:

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

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

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

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

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

As further indications of the changes to ACTION's commercial environment, the ACT Government is preparing legislation to establish ACTION as a statutory authority. It is expected that this will take effect from mid 2000.

In addition, a new regulatory framework is being prepared (Public Passenger Transport Bill) which will regulate all bus service providers (both ACTION and private operators).

6. ISSUES CONSIDERED BY THE COMMISSION

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

6.1 Costs and Efficiencies

Under Part IV of the Independent Pricing and Regulatory Commission Act 1997, the Commission in completing a determination is required to consider the 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))*
- *any arrangements that a person providing the regulated services has entered into for the exercise of its functions by some other person (Part IV 20.(2k))*

6.1.1 Operating Costs

ACTION's financial statements indicate that the organisation recovers significantly less than the accrual-based costs of providing the services. Over the past six years, farebox cost recovery has fallen within the range of 22.1% to 24.7%. The results are illustrated in Table 6.1.

Table 6.1: Operating Costs ($'000)

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99
Employee Costs	40,920	39,099	38,414	42,473	42,658	46,280
Administrative Expenses						
Bus Running and Maintenance	8,044	7,289	7,290	7,149	7,356	8,068
Other	5,347	6,188	7,139	7,781	6,568	6,959
Depreciation and Amortisation	7,404	7,496	7,467	7,368	7,041	6,418
Interest	8,554	8,345	6,851	6,381	3,441	2,428
Other Expenses	-	-	-	-	-	1,519
TOTAL	70,269	68,417	67,111	71,152	67,064	71,672
Revenue (Fares)	15,527	16,429	15,676	17,235	16,583	16,266
Farebox Cost Recovery	22.1%	24.0%	23.4%	24.2%	24.7%	22.7%

In Table 6.1, farebox cost recovery only covers revenue received from passenger fares as a proportion of operating expenses. For the rest of the price determination, the Commission compares cost recovery rates, which is all non-government revenue as a proportion of operating expenses.

As indicated in last year's price determination, costs for 1998-99 and beyond were expected to be higher than those for 1997-98 because the ACT Government had introduced an equivalent tax regime for its utilities, which imposed payroll tax, sales tax, insurance and increases in superannuation costs. Last year, these were estimated to amount to around $6.5 million per annum for ACTION.

A review of 1998-99 financial statements suggest that payroll tax amounted to $2.668 million, insurance $952,000, sales tax $422,000, income protection $322,000, and other ACT taxes and charges $122,000. Together, these add up to almost $4.5 million worth of increased charges that ACTION has not previously faced.

Over 55% of the increase in employee costs in 1998-99 is accounted for by an increase of almost $2 million in redundancy payments during the year. In fact, the sum of the redundancy payments and the payroll tax are greater than the aggregate increase in employee costs. The major offsetting item was the reduction in salaries of $1.3 million or almost 20%, representing a reduction in administrative staff.

Interest payments have continued to fall in the financial statements, but the further reduction in 1998-99 was offset by a new item, Other Expenses. This represents a change in the way that lease payments are reported in the financial records. Lease payments for buses were previously reported as interest payments, but are now included as Other Expenses.

"Other" administrative expenses increased by 6%. While most areas within this category actually fell, these reductions were more than offset by a substantial increase in advertising and promotional expenditure in support of the introduction of Network 99. This expenditure rose from $806,000 in 1997-98 to $1.414 million in 1998-99. Had this item remained unchanged, the total of these "other" expenses would have fallen to just over $6.35 million or a 3.3% reduction. While there may be ongoing promotional expenditure in support of the new network services, the Commission would expect that next year's budget in this area would be significantly reduced on the 1998-99 figure.

Nevertheless, as was acknowledged in last year's price determination, the new services under Network 99 are expected to lead to increases in costs with higher service hours, which will only in part be offset by increased driver productivity through the recently negotiated Enterprise Bargaining Agreement (EBA). Bus running costs and maintenance costs in 1998-99 increased by 10%, largely as a result of the increases in bus kilometres travelled and higher than expected fuel prices under Network 99.

6.1.2 Efficiency

The major change affecting ACTION's efficiency which occurred last year was the new enterprise bargaining agreement (EBA). When it was introduced, ACTION claimed that it would achieve annual total savings of $10.5 million, of which $7.7

million were seen as cash savings and the remaining $2.8 million represented service improvements, particularly increased driver productive hours, and forgone wage increases. At the time of the previous price determination, ACTION estimated that $7 million of these savings had been achieved by March 1999. The remaining $3.5 million savings were to come from additional efficiency improvements in administration, workshop and driver operations over the 1999 and 2000 calendar years. The Commission stated in its previous determination that progress towards realising those remaining savings would be taken into account in the current price determination.

ACTION advised the Commission that, as at November 1999, almost $7.28 million of the savings had already been achieved, including all of the service improvements and other items introduced in conjunction with Network 99. This left a further $3.24 million of annual savings still to be achieved.

The following table indicates ACTION's expectations about achieving these savings as at November 1999.

Table 6.2: Outstanding Savings under EBA ($000)

	Amount to be Achieved	To be Achieved 1999-2000 on annualised basis	To be Achieved post July 2000 on annualised basis	Not Achievable
Administration	165	165	-	-
Workshops	897	816	-	81
Drivers	2,075	1,390	585	100
Other	100	-	-	100
TOTAL	3,237	2,371	585	281

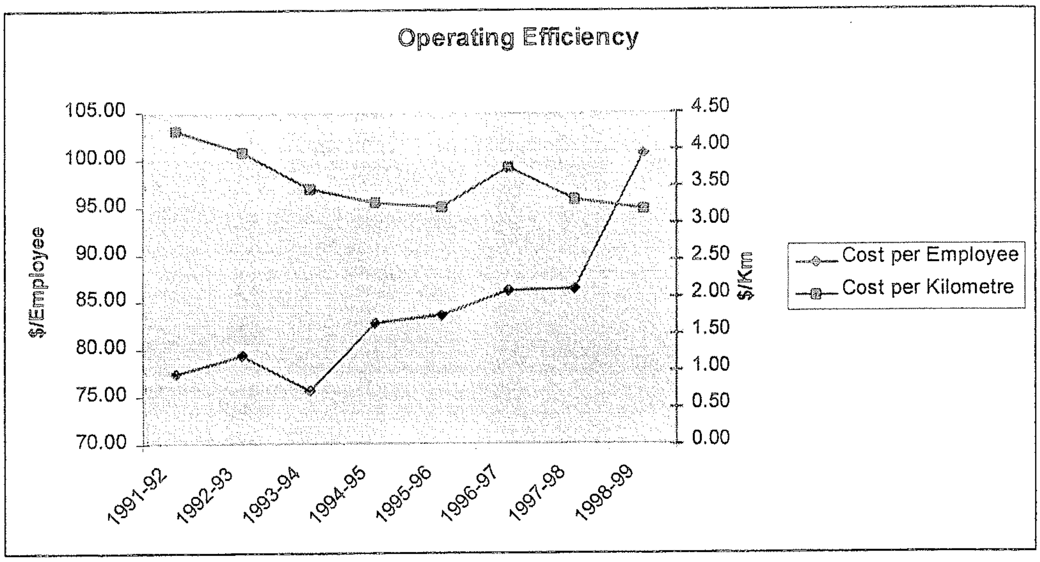
ACTION expects to have achieved over 70% of the outstanding efficiency savings ($2.4 million on an annualised basis) by the end of 1999-2000. While these savings would have been signed off progressively during the year, they will not be taken up in 1999-2000 on a full year basis. Therefore, a full year's benefit of these savings will not be reflected in the 1999-2000 accounts.

Clearly, these efficiency improvements are in the right direction although less progress has been made than was previously expected. The Commission acknowledges that there are often practical difficulties which impede the speedy implementation of efficiency improvements which involve industrial arrangements, although it remains concerned that 9% of the outstanding savings are now not expected to be achieved at all while the other 18% have been put back to subsequent years. There is always the risk that the deferral of efficiency improvements leads to their eventual abandonment, as the difficulties justifying their initial postponement become too entrenched.

Certainly, these improvements will go some way to reduce the adverse margin between ACTION's average costs by comparison with average public and private bus operators, discussed in the previous determination. There, the evidence of other consultants' reports suggested that ACTION's overall costs ranged between 10% and 20% higher than other public bus operators, and significantly more against private operators. More discussion of this is contained in section 6.3.4 in determining the "best" commercial price.

Figure 6.1 illustrates recent trends in ACTION's performance and particularly indicates the effects of the 1998-99 year when the EBA was negotiated.

Figure 6.1: Operating Efficiency



The number of full time equivalent employees continued to decline in 1998-99, falling to 712 from 776 in the previous year and from 1,050 in 1991-92. The number of bus kilometres is estimated by ACTION at around 22.5 million for 1998-99, slightly higher than the range of 19-21 million which has prevailed since 1991-92, and can be attributed to the increased service levels of Network 99.

ACTION's operating costs increased in 1998-99 because only some of the efficiency savings were achieved during the year, because of the incorporation of a number of adjustments for amounts previously excluded, and because the additional costs associated with the new network had been underestimated by ACTION. In fact, ACTION have now determined that the costs of introducing Network 99 and the associated 7-day week timetable are about $4.5 million higher than anticipated. As a result of this increase in the aggregate cost figure, the cost per employee in 1998-99 has increased significantly from over $86 per employee in 1997-98 to over $100 per employee, an increase of more than 16%. The major explanation of this large increase in per employee cost is the decrease in staff numbers, with an increase in operating costs. In order to compare like with like, the cost per employee without incorporating the $4.5 million of taxation equivalent adjustments only rises to over $94. This is nevertheless an underlying increase of over 9% in one year, and underscores the Commission's concern about the capture of efficiency savings by remaining staff rather than those savings being used to reduce the deficit and therefore taxpayer subsidy.

ACTION is an urban bus operator with a cost, operational and demand profile similar to that observed in other Australian capital cities. That is not to say that ACTION's costs are directly comparable with other urban bus operators. There are significant differences between the market served by ACTION and the other urban bus operators in Australia. There are also differences in the level of service provided, fares structure and availability of concessions. Consequently, when considering these benchmarking comparisons, it is important to be aware of the different market characteristics.

Demand for ACTION bus services shows a typical urban public transport peaked profile. The Network 99 service pattern shows that the weekday peak periods (in terms of buses in service) are each less than 30 minutes long and coincide with the school rather than commuter travel periods. Some 10% of the standard sized buses deployed to serve the peak periods are in service for less than three hours in the day. The articulated bus fleet is now almost entirely allocated to school operations. Only eight of the 31 articulated buses are utilised for more than four hours per day and none is used on Saturdays, Sundays or school holidays.

This peakiness in the service profile limits the potential for maximising the efficient rostering of drivers to vehicles. Inevitably, many drivers will only be productive for a short period of paid duty time given that the industrial agreement provides for a minimum payment of three hours in any half shift. After allowing for shift penalties, leave allowances and scheduling inefficiencies, ACTION pays for the equivalent of 2 driver hours at the basic rate per bus hour operated. Although not outside the range for the data available on other operators, this factor is at the top end of the range (~1.3 to 2). For each bus hour in revenue service (ie discounting time spent driving between the depot and termini and other non-revenue trips), ACTION pays for almost 2.4 driver hours. This factor is also at the top end of the range for comparator operations.

Maintenance costs for ACTION operations equate to $0.37 per bus kilometre. For public sector operators, a range of $0.21 to $0.44 has been observed. The $0.44 figure refers to Sydney Buses and was identified as an area for potential cost reduction of 10% in a study by IPART. Sydney Buses fleet has a higher average age than ACTION's which would lead to higher unit maintenance costs in Sydney.

The cost per kilometre in 1998-99 was $3.19, which is a 4% decrease on the 1997-98 figure. This continues the downward trend evident earlier in the decade although, allowing for the 1996-97 result, it appears that the unit cost per kilometre may have largely flattened out.

6.1.3 Forecast Costs and Efficiency

Table 6.3 provides ACTION's estimates for operating costs over the next four years, made in April 1999.

Table 6.3: ACTION's Forecast Operating Costs ($'000) – April 1999

	1998-99 Actual[a]	1998-99 Expected April 1999	1999-00 Budget April 1999	2000-01 Estimate April 1999	2001-02 Estimate April 1999	2002-03 Estimate April 1999
Employee Costs	46,280	45,129	39,521	38,671	38,654	38,654
Administrative Expenses	15,027	13,873	12,893	13,059	13,321	13,321
Depreciation and Amortisation	6,418	6,017	5,720	5,720	5,720	5,720
Interest	2,428	2,429	2,114	1,800	1,485	1,171
Other Expenses	1,519	3,558	3,607	3,656	3,707	3,707
TOTAL	71,672	71,006	63,855	62,906	62,887	62,573

Source: Department of Urban Services, ACTION Ownership Agreement, April 1999

(a) Actual figure is taken from the 1998/99 ACTION Financial Statements

The aggregate 1998-99 outturn was broadly in line with earlier expectations although there were some major variations between categories. Assuming some adjustments between "other expenses" and "administrative expenses", the principal area where operating costs were expected to come down was in employee costs, with a reduction of around 15% in 1999-2000 (over $6.7 million) and a further 2% in 2000-01 (around $850,000).

In the previous determination, the Commission expressed concern that past efficiency improvements appear to have been absorbed by increases in wages and expressed a desire to see the effects of the new EBA and subsequent efficiency improvements leading to lower requirements for taxpayer subsidy. Of particular concern to the Commission is the possibility that the EBA has encouraged full-time drivers to take redundancy payments and then become re-employed as casuals on penalty rates, which are high compared with rates for casual bus drivers in other states. As a result, this has contributed to the costs associated with Network 99 being greater than ACTION originally expected.

ACTION acknowledged in November 1999 that they had under-estimated the costs associated with Network 99 by around $ 4.5 million. Most of the increase reflects the increased traffic task associated with the new network which has not been offset by efficiency improvements in the EBA. Some of this increase was attributed to increased staff turnover, recruitment and training. However, such costs could be expected to be one-off expenses which should not be continued. ACTION also faced increased costs which lie more outside ACTION's control, eg. recent increases in diesel fuel prices and IT modernisation costs. A continuation of higher diesel prices is expected to increase ACTION's bus running costs by around $600,000 on an annual basis, while the additional IT costs are estimated at around $500,000. These IT costs are associated with an ACT government decision to standardise the computer systems within all government agencies and departments. ACTION also faces an extra $0.5 million in Comcare premiums, which has meant that, although ACTION have lower levels of staff, their workers compensation payments have increased.

There is a dispute about the valuation of the Belconnen and Tuggeranong depots and the resultant depreciation that should be taken up in ACTION's accounts. Different approaches to asset valuation have been used: replacement cost and existing use, based on the type of facility which a private operator would require to undertake the services currently provided by ACTION. This issue has yet to be finally resolved. In the meantime, ACTION has proposed to reinstate the original asset valuation, which involves an increase in depreciation and interest costs of $740,000 in 1999-2000, increasing to over $830,000 in 2003-04. The Commission is of the view that a final outcome is likely to involve a somewhat lower depreciation expense than this, and that it may not be appropriate to endorse these numbers at this time.

ACTION also reassessed their revenue forecasts in line with reduced patronage estimates for the future. ACTION had over estimated the level of patronage demand that would occur due to the new network in future years.

Since the introduction of Network 99, ACTION have made a number of refinements, in May and September 1999. However, because of the significant cost overruns, ACTION is now proposing a further series of adjustments to the network to take effect from the beginning of February 2000. These reductions are expected to reduce the cost overrun from $4.5 million to $1.5 million, and ACTION have informed the Commission that the changes will involve the following:

- Service frequencies to be relaxed from 30 to 40 minutes on low patronage daytime routes and from 60 to 90 minutes in the evening
- Selected routes will be amalgamated and connections strengthened
- Low patronage school services will be amalgamated – changes have already been agreed with Schools Transport Advisory Committee and affected schools
- Changes represent a decline of about 2 million service kilometres and affect about 10% of the existing network
- Adjusted services are above minimum service standards and are still 7% above those offered prior to the introduction of Network 99
- Zone structure and 7-day network features are retained.

The effect on the network of these changes will be a 14% decrease in services on Monday to Friday, and an 8% decrease on the weekends, relative to the original service level of Network 99.

The implications of these changes are summarised in Table 6.4.

Table 6.4: Forecasted Operating Costs ($'000)

	April 1999	November 1999 (with May/Sept changes)	December 1999 (with February 2000 Changes)
1998-99	71,672	71,672	71,672
1999-00	71,006	67,844	67,195
2000-01	63,855	67,093	65,449
2001-02	62,906	66,074	64,570
2002-03	62,887	65,810	64,346
2003-04	62,573	65,548	65,270

ACTION claim that the adjusted figures take account of the $3 million per annum savings due to changes in service levels, as well as increased expenses due to factors discussed above.

The overall position over the next five years varies for ACTION. Further revisions to the services provided need to be considered, in addition to the changes effective from February 2000. The Commission understands that significant reviews of both school services and non-school route services are currently being undertaken to establish a better match between demand for services and their provision. This involves looking at services which are in excess of the minimum service levels contracted by DUS and assessing how to rationalise poorly patronised services. ACTION proposes that these form the basis for further changes to be effective from the beginning of 2000-01.

The Commission acknowledges the moves towards more effective cost controls on ACTION's network and understands that ACTION is developing a route profitability model which should inform the evaluation process. ACTION has advised the Commission that the model should be effective in the first half of 2000, at which time responsibility for performance accountability will rest with the new Board. It is to be expected that, at that stage, more reliable indications of cost will be forthcoming from ACTION. Given the past performance of ACTION's financial forecasts, the Commission believes that the route profitability model be enhanced as a matter of urgency. Without such specification, the Commission is concerned that these more recent revised cost estimates will have no more validity than their predecessors.

6.1.4 Contracting Out

In the previous price determination, the Commission expressed concern that little effective investigation of potential outsourcing opportunities appeared to have been undertaken by ACTION. Given the increasing trend in other jurisdictions to outsource non-core functions and the increasing pressure on ACTION to reduce costs, the Commission was of the view that further opportunities needed to be assessed.

The EBA includes provision for reviewing business activities with a view to reforming them or, if they cannot be reformed to competitive cost levels, to contracting them out. To date, ACTION has undertaken a review of bus refuelling and bus cleaning processes in conjunction with external consultants. The costs associated with bus cleaning and refuelling were estimated to be around $860,000 per annum; for 364 buses, this constituted an annual average cost of $2,360 per bus. The review found that ACTION's current practices led to significantly higher costs than comparable public and private bus operators. The two comparators (State Transit Authority of NSW (STA) and Surfside Bus Lines on the Gold Coast) indicated that ACTION's cleaning and refuelling costs were higher: between 33% (STA - $1,775 per bus) and 100% (Surfside - $1,200 per bus). The review also noted that the STA estimates were not necessarily consistent with best practice as evidenced by a consultant report to IPART that further savings could be achieved by STA in these areas. This would suggest that the margin between ACTION and a more efficient public bus operator could be even greater.

ACTION acknowledged that substantial improvements in bus cleaning and refuelling were necessary, particularly as the review suggested that contracting out of non-core business, covering these particular services, can usually offer significant savings, in the order of 20%. However, a preliminary estimate from a facilities management company on the likely costs to outsource these services was given in May 1999 as $800,000, which is only 7% lower than ACTION's assessed costs. The Commission notes that the estimate was given as a "worst case estimate" and was not an expression of interest or a response to a tendering process. In fact, the contractor was of the view that "once work schedules are fine tuned and productivity is maximised, there is a strong possibility of further cost savings".

Although ACTION's own internal review suggests that its costs are at least 33% higher than they need be (and probably even more), the Commission is concerned that, given the without prejudice response from a contractor, suggesting an improvement of only 7%, ACTION may adopt more modest ambitions at achieving efficiencies. If the internal benchmarking analysis were valid, the Commission would expect that contractors, under an open competitive tendering process, would offer far greater savings. If those savings were of the order of 20-25%, this would amount to an annual saving of around $200,000, and the cost per bus would still be above STA's current cost. It appears that ACTION has only planned around $50,000 worth of annual savings from this area, and the Commission expresses concern that not enough is being done to achieve savings in these non-core areas.

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 previous determination, the Commission provided for ACTION to increase the average fare prices for 1999-2000 by no more than the consumer price index. It also allowed ACTION some flexibility in adjusting its fare structure provided that the effect of any fare increases did not lead to an increase in its average fare prices weighted by the expected patronage in excess of the price cap.

ACTION chose not to change any of its fares, principally because it had only recently made changes to the fare structure in January 1999 with the introduction of Network 99 and because very small increases would have resulted in implementation problems. Furthermore, ACTION argued that, at that time, it expected reasonably strong patronage growth as a result of the new network and had expected that this would translate into correspondingly strong revenue growth. Unfortunately, while market analysis undertaken tends to confirm some increase in patronage, revenue growth has been less than originally forecast, in part because of a shift to periodical tickets which represent a lower price per journey. ACTION also claim that, with the new zonal fare structure, some passengers are over-riding and this constitutes a loss of revenue.

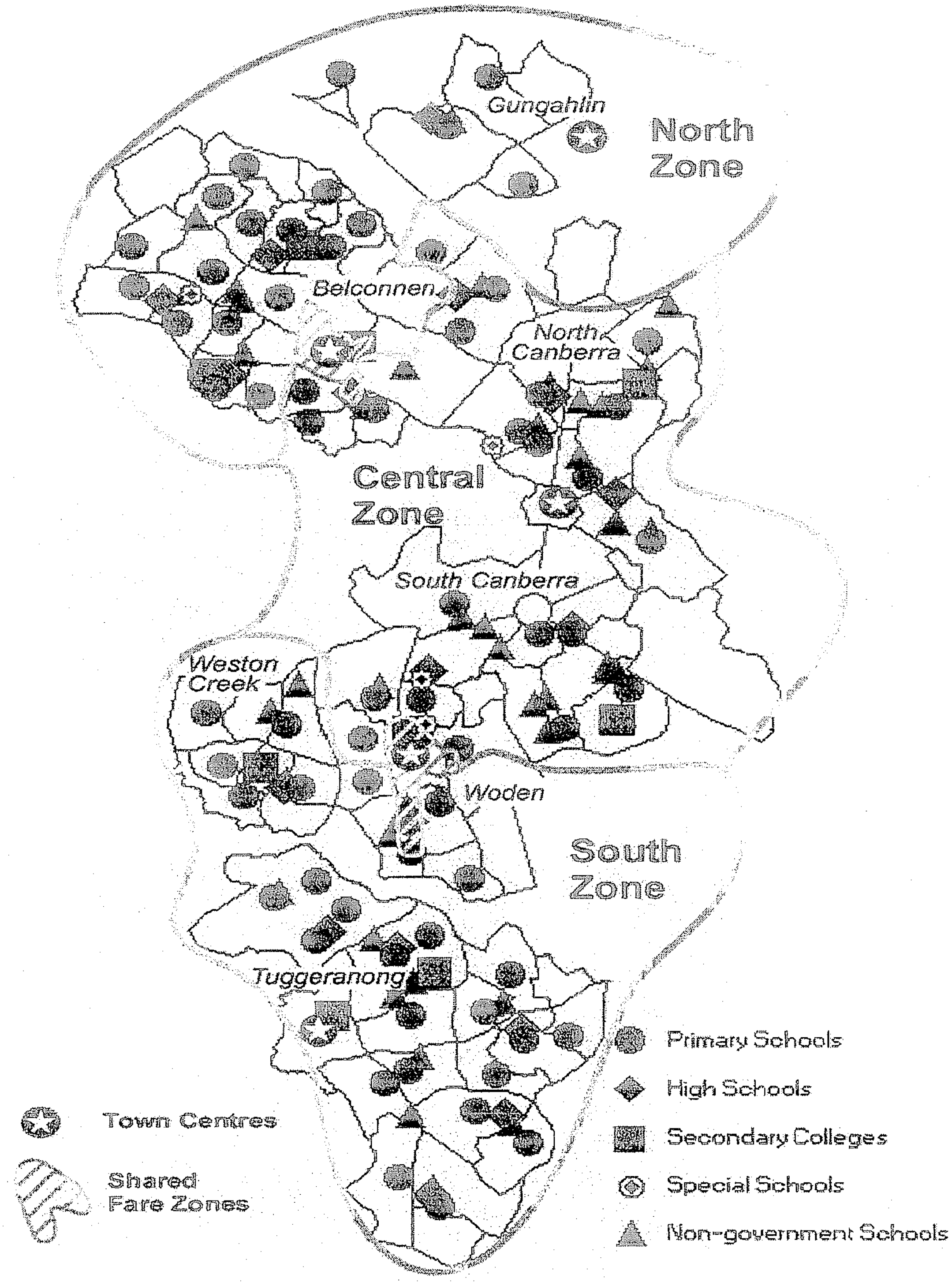
The specific fares available under Network 99 are given in the following table, which compares those fares with the pre-Network 99 fares.

Table 6.5: Pre and Post Network 99 Structures

Fare Types	Pre 1 Vehicle	Pre- 2 Vehicles (1 Interchange)	Pre- 3 Vehicles (2 Interchanges)	Post Zone 1	Post Zone 2	Post Zone 3
FareGo 4	1.80	3.60	5.40	1.80	3.60	3.60
Cash	2.00	4.00	6.00	2.00	4.00	4.00
Adult Daily	6.70	6.70	6.70	7.00	7.00	7.00
FareGo 10	1.70	3.40	5.10	1.70	3.40	3.40
Adult Monthly	109.00	109.00	109.00	55.00	110.00	110.00
Shoppers Off-peak Daily	4.00	4.00	4.00	4.00	4.00	4.00
Adult Weekly	29.00	29.00	29.00	17.00	34.00	34.00
Conc FareGo 4	0.70	1.40	2.10	0.85	1.70	1.70
Conc Cash	1.00	2.00	3.00	1.00	2.00	2.00
Conc Daily	2.70	2.70	2.70	3.50	3.50	3.50
Conc FareGo 10	0.70	1.40	2.10	0.85	1.70	1.70
Conc Monthly	45.00	45.00	45.00	27.00	55.00	55.00
Pensioner Off-peak	1.00	2.00	3.00	1.00	1.00	1.00
Conc Quarterly	105.00	105.00	105.00	n.a.	n.a.	n.a.
Conc Weekly	12.00	12.00	12.00	8.50	17.00	17.00
Student FareGo 4	0.45	0.90	1.35	0.60	1.20	1.20
Student Cash	1.00	2.00	3.00	1.00	2.00	2.00
Student FareGo 10	0.45	0.90	1.35	0.60	1.20	1.20
School Term	68.00	68.00	68.00	45.00	90.00	90.00

Figure 6.2 illustrates the three-zone structure of Network 99.

Figure 6.2: Zonal Structure (Network 99)



Source: ACTION

As a result of the previous determination, the Commission raised a number of issues which it would take into account in this price determination. These cover patronage response to Network 99 and the revenue implications. In particular, the Commission recommended that ACTION undertake a survey of passenger responses.

6.2.2 Survey Responses

ACTION commissioned a survey of community and customer attitudes towards the bus service, which was undertaken in June 1999. ACTION also commissioned a profile of the current market, drawing on an analysis of ticket usage patterns and a customer travel diary survey.

The main points which emerged from the surveys were as follows:

- Patronage growth increased for the five months to June 1999 by around 6-6.5% on the same period last year. There were difficulties in measuring patronage because of the nature of boardings and the changed ticketing arrangements.
- The majority of passengers are travelling one zone or between a shared and adjacent zone and have shifted towards a greater use of monthly tickets which offer savings over previous corresponding tickets.
- The market is dominated by concession and student passengers, with the former estimated to have increased by almost 20% over the past year. The student market represents around 60% of total passengers.
- There has been a marked shift by students in the use of term tickets away from Faresaver (Farego) tickets, reflecting the dominance of single zone student movements.
- Overall, single zone journeys comprise 68% of total journeys.
- 62% of journeys are undertaken during the AM and PM weekday peak periods.
- The perception that ACTION is providing a valuable community service increased from 79% in 1997 to 87% in 1999.
- A decline in community perception as to whether ACTION's fares represent value for money was recorded – in 1995, 58%; in 1996, 53%; in 1999, 44%.
- The main reasons cited for people not using ACTION buses were greater flexibility with their own cars; bus trips were longer than car trips; cars required during the day; bus frequency did not permit flexible travel; work timing was inconvenient for bus travel; and services did not go where wanted.
- The main reasons cited by ex-users were car purchase; change of job or house; need to drop off family members; and walking or cycling. These reasons do not reflect substantive dissatisfaction with ACTION.

6.2.3 Revenue Implications

On the basis of these findings, the Commission considers that ACTION will experience difficulty in maintaining strong passenger growth. The recent increase has resulted from the new network despite the changed fare structure. While some further increase may still come through, it is unlikely that it will be substantial. It appears that ACTION no longer subscribes to the view that the farebox revenue will increase by 1999-2000 in the order of $1.8-$2.4 million. In fact, according to the most recent advice from ACTION, the Commission understands that ACTION expects that its fare revenues for 1999-2000 will be around $1.5 million less than originally budgeted.

With future years unlikely to see any substantive patronage growth for the reasons found in the survey, future revenue shortfalls from original budgets also increase, up to almost $3.7 million in 2001-02 although the shortfall is expected to narrow by 2003-04 to $2.2 million. This includes ACTION's estimate of lost revenue (around $500,000) through over-riding. It believes that, through revenue protection measures, between $200,000 and $350,000 per annum of this revenue can be recovered, at a recovery cost of around $80,000.

On the basis of past performance, the Commission is concerned that ACTION's presentation of future revenues assumes an initial deterioration on what was previously forecast followed by a modest narrowing of the gap by 2003-04. Given that ACTION is probably close to its patronage ceiling for all the reasons discussed above, the Commission believes that it is unrealistic to embark on a price path which assumes future growth. Even a 1% per annum growth in patronage in the light of overall population growth is going to be difficult to achieve within a cost-effective network.

However, ACTION's fare elasticity estimates, outlined in the previous determination, indicated generally low elasticities, ranging for different class of tickets from zero to a maximum of –0.25. This compares with a general industry expectation of public transport fare elasticity of –0.3. This would suggest that Canberra's bus passengers are more price inelastic than others. Such a conclusion is supported by the survey data which indicated that bus passengers are broadly those who do not have access to private vehicles. From an efficiency and revenue maximising position, there are grounds for raising ACTION's fares.

There are of course equity considerations, particularly when a large number of bus passengers are concession travellers. Nevertheless, recent data suggests that the same passengers have responded to the new network and fare structure by changing their ticket purchases, from Faresaver to periodical tickets. If the previous fares were considered broadly acceptable on equity grounds, any move towards recovering more revenue from those passengers who have transferred their ticket purchases to cheaper fares could not reasonably be considered to be inequitable, particularly as one of the largest shifts has occurred in the single zone monthly which, at $55, represents an almost 50% reduction on the previous one vehicle monthly. On the contrary, the Commission believes that such a move to raise fare for these passengers to levels prevailing before the new structure was put in place could certainly be seen as reflecting a more efficient and equitable outcome.

Probably, the most effective way to achieve this adjustment in the first instance is to reduce the discounts for periodical tickets. Currently, these discounts amount to around 20% off the standard single zone Faresaver ticket. The Commission noted in its previous determination that multi-ride ticket users are more likely to be in full-time employment and tend to be more affluent than cash fare payers (IPART 1998 Determination for STA, page 17) and that ACTION had reduced its previous discounts, which were around 50% in the early 1990s, to around 15% before the new fare structures were put in place. The Commission believes that it would be appropriate for ACTION to reduce the current discounts from around 20% to no more than 15% and perhaps even less, subject to a rounding up or down of fare values.

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)).*

In addition, the Commission has been requested to consider ACTION's financial viability in the light of best practice "commercial price", taking account of cost benchmarks and potential patronage and service levels.

6.3.1 Government Contributions to ACTION

The following table details ACTION's November operating statement and future estimates prior to the latest financial reviews.

Table 6.6: Updated Forecasted Operating Statement ($'000) - November 1999

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Expenditure	(67,064)	(71,672)	(67,844)	(67,093)	(66,074)	(65,810)	(65,548)
Revenue	17,871	17,478	17,891	18,705	19,395	20,113	20,859
Government Contribution	37,398	39,295	39,047	37,082	35,427	35,732	35,732
Other	780	166	7	0	0	0	0
Operating Deficit/Surplus	(11,015)	(14,733)	(10,899)	(11,306)	(11,252)	(9,965)	(8,957)
Operating Injection		2,326	1,943	2,569	4,398	4,093	4,093
Operating Deficit/Surplus after abnormal and extraordinary items	(11,015)	(12,407)	(8,956)	(8,737)	(6,854)	(5,872)	(4,864)
Accumulated Funds	52,578	36,953	27,997	19,260	12,406	6,534	1,670

Source: ACTION and DUS, November 1999.

The following table details ACTION's December operating statement from 1997-98 with forecasts from 1999-00. These estimates take account of the proposed service changes from February 2000.

Table 6.7 : Forecasted Operating Statement, with February 2000 service changes ($'000) - December 1999

	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04
Expenditure	(67,064)	(71,672)	(67,195)	(65,449)	(64,570)	(64,346)	(65,270)
Revenue	17,871	17,478	17,891	18,705	19,395	20,113	21,435
Government Contribution	37,398	39,295	43,172	42,409	41,090	40,677	38,124
Other	780	166	0	0	0	0	0
Operating Deficit/Surplus	(11,015)	(14,733)	(6,132)	(4,335)	(4,085)	(3,556)	(5,711)
Operating Injection		2,326	1,943	2,569	4,398	4,093	4,093
Operating Deficit/Surplus after abnormal and extraordinary items	(11,015)	(12,407)	(4,189)	(1,766)	313	537	(1,618)
Accumulated Funds	52,578	36,953	32,764	30,998	31,311	31,848	30,230

Source: ACTION and the Department of Urban Services.

As can be seen from the above tables, ACTION is forecasting continued deficits in the future years. The consequence of this is that again ACTION must fund the deficit using accumulated funds. The Commission expressed concern about this continued decline in accumulated funds in the previous price determination. The predictions for future years show a small reduction in the operating deficits for ACTION based on decreases in employee expenses, administration expenses and the continued operation of Network 99, but these are much smaller savings than ACTION initially believed would be made. Given that half of the 1998-99 financial figures were achieved under Network 99 and took into account savings due to the first stages of the EBA, it seems unlikely that there will be further significant reductions in the operating expenses of ACTION without further revisions to services and operating practices.

The major difference between the two positions involves a significant increase in government contributions throughout the period, which appears to be the only means by which ACTION's accumulated savings can be protected.

A detailed breakdown of the government's contribution is shown for the last three years:

Table 6.8: Government's Contribution ($'000)

	1996-97	1997-98	1998-99
Pricing CSO	16,340	13,376	14,189
General Route Off Peak Services CSO	9,038	7,779	9,455
School Services CSO/ School Transport Services	9,387	9,684	9,780
General Subsidy/Injection for Operating Requirements[(a)]	3,000	1,000	2,326
Concessional travel payments (Dept of Education and Community Services)	3,501	3,606	4,159
Special Needs Transport	1,022	1,922	1,712
Resources Provided free of Charge	-	31	-
TOTAL	**42,288**	**37,398**	**41,621**

(a) In 1998-99 the General Subsidy category of government payments is now reported as an injection for Operating Requirements, in a separate section of the financial reports.

Before 1996 Government contributions were treated differently, and therefore there can be no direct comparison between the years before this and the figures since 1996-97. There has also been a change in the way in which government contributions are included in financial statements due to the ownership agreement. The government component of ACTION's revenue is no longer considered a contribution but a charge. The government is charged for services that ACTION must provide.

The three major areas of government support in 1998-99 were in:

- pricing CSOs, which represent reimbursement for offering fares below a commercial level;
- school transport services, which is the estimated cost of subsidised travel for both tertiary and school students;
- general route off peak service CSOs, which represent reimbursement for providing non-commercial off peak services.

The recent trend to reduce explicit government CSO payments reflects a growing concern that this may not be an effective means of allocating taxpayers' funds. As mentioned in the Commission's last price determination, pricing bus services below their efficient costs results in bus users not bearing the full cost of their transport decisions. Theoretically, under open market conditions, a subsidy that lowers the price of public transport should result in travel mode shifts toward it. But this may not be the case in public transport if alternative modes are inappropriately priced, for example, if the cost of a road vehicle use does not adequately reflect environmental or congestion costs that such use may incur on the community, or if the price elasticities are very low.

However, in saying the CSO payment is trending down because the government may feel this is not an efficient way to allocate funds, the CSO payment is expected by ACTION to be $43.172 million in 1999-2000, which is a large increase on last year's results.

The Commission reaffirms the need for greater transparency in the allocation of CSO payments. The previous price determination indicated that the Department of Urban Services (DUS) must specify the minimum service requirements of ACTION, in order that CSO's be apportioned on the basis of these requirements. As part of the ownership agreement, a minimum service level agreement was developed between DUS and ACTION for 1999-2000, which sets out time bands for feeder, primary and trunk routes. These standards are very supply side orientated with little concern for patronage demand. The minimum service agreement also sets out a reliability objective of 99.8% of all scheduled services that operate each day. Any variations to ACTION's services, greater than 1% of the network, must be agreed upon with DUS.

The Commission also reaffirms its concern that government funding support in total for ACTION continues to increase. The magnitude of these increases is indicated in Table 6.9, where total government support required for the next five years is expected in December 1999 to be between $4.8 million and $6.4 million higher than previously expected.

Table 6.9 : ACTION additional funding requirement from Government ($'000)

1999/2000	2000/2001	2001/2002	2002/2003	2003/2004
4,865	6,114	6,400	5,732	5,036

Source: Department of Urban Affairs

6.3.2 Cost Recovery

As a proportion of total costs, ACTION received 58% (1998-99) as explicit government contributions including concessionary fares' reimbursements. (This left a shortfall of 18% of costs a deficit which was funded from reserves.) This Government contribution proportion has fallen from 82% in 1993-94. Cost recovery for 1999-2000 is forecast by ACTION to be 26.6%, as shown in Table 6.10 below.

Table 6.10: Cost Recovery Trend

	1997-98	1998-99	1999-00[a]	2000-01[a]	2001-2002[a]	2002-2003[a]	2003-2004[a]
Non-government revenue	16,583	17,478	17,891	18,705	19,395	20,113	21,435
Operating Cost (Total Expenses)	67,064	71,672	67,195	65,449	64,570	64,346	65,270
Cost Recovery	**26.6%**	**24.4%**	**26.6%**	**28.6%**	**30.0%**	**31.3%**	**32.8%**

(a) ACTION and DUS forecasts (December 1999), Includes February service level changes.

Table 6.11 compares ACTION's recent cost-recovery performance with two other operators.

Table 6.11 : Cost Recovery

Public Bus Operators	Cost Recovery
ACTION	24.4% (1998-99)
Metrobus (Tasmania)	28.4% (1998-99)
Sydney Buses	55.8% (1998-99)

This table reflects fewer examples than that given in the Commission's previous determination because of reporting changes in other jurisdictions which do not facilitate direct comparison. Nevertheless, the Commission considers that there has been no material change in the relativities and that ACTION remains at the lower end of the cost recovery range.

Cost recovery is affected by changes to either costs or non-government revenue. Given the earlier discussion on efficiency, the Commission would want to ensure that strenuous measures are put in place to effect substantial improvements in operating efficiency, so that such low cost recovery levels are not maintained through excessive cost structures. On the other hand, a cost recovery outcome also reflects particular fare structures, which may be unrealistically low in commercial terms but which may be endorsed by government for broader social policy reasons.

There was an expectation that Network 99 would lead to broadly similar cost recovery levels as seen over recent years. This expectation was based on expected fare revenue increases, associated with increases in patronage, being offset by higher costs due to service level increases, higher statutory taxation and charges applied to ACTION. However, 1998/99 cost recovery fell by 2%. Patronage did in fact rise around 5% according to the recent market analysis document, but because of costs and ticketing distribution there was a fall in cost recovery. ACTION's actual costs were higher than predicted in 1998/99, due to the operation of Network 99. The reasons for this have been discussed earlier in the report. Another unexpected outcome associated with the operation of Network 99 and the zonal ticketing system has been a shift from Faresaver to periodical tickets. The purchase of Faresaver tickets declined by 7% in the first five months of Network 99 and ACTION believes that patrons have shifted towards monthly periodical tickets that include a discount of at least 20% on a single zone fare saver ticket.

From Table 6.10 above, it can be seen that ACTION is predicting an improvement in cost recovery based on a reduction in costs associated with a reduction in service levels from those initially introduced as part of the new network. These reductions affect low patronaged services although the level of service nowhere falls below the minimum service level agreement with DUS. The effects of the changes to both costs and revenues are expected to increase cost recovery, to around 28.6% in 2000/01.

6.3.3 Rate of Return

The Commission indicated in its previous determination that it had cited little evidence that ACTION had applied a rigorous assessment of new investments in terms of prescribed rate of return criteria. It also stated that ACTION needed to establish clear investment guidelines for capital decisions, for bus acquisition and replacement, consistent with accepted commercial practice.

The Commission has been provided with information on ACTION's proposed bus fleet replacement program. ACTION has recently extended the useful economic life of its buses from 15 to 18 years, based on other operators' practices, ACTION's bus kilometres travelled, the state of the ACT road network and the value of the second-hand bus market. ACTION stated that an average age of 10 years was considered optimal, although no supporting evidence was given. The Commission notes that the average age of the STA fleet in Sydney is not allowed to exceed 12 years, not 10 years.

According to ACTION, the weighted average age of its bus fleet in 1998 was 7.7 years. In 1999, the average age has increased to 8.4 years. Both of these numbers are less than ACTION's optimal figure of 10 years, which implies that ACTION can allow its fleet on average to age further before expending major funds on replacement.

ACTION claim that there are advantages in aggregating annual bus replacement expenditures to ensure smoother contractual arrangements and probably being able to negotiate a more competitive price. However, in terms of like-for-like replacement, the Commission does not believe that a program of 25 new buses per year starting in 2001 is necessary to ensure that the average age of buses meets these criteria, particularly as there are currently four different bus types in operation. Almost 80% of the fleet are rigid buses, while a further 9% are articulated buses which are now used only during the peak periods and only for school transport. The most recently acquired 25 midi buses are used for all forms of service, while the 21 mini buses are used for special needs transport (SNT).

Thus, the economies of scale associated with more consistent bus purchases may not be as great as ACTION suggests. Secondly, the limited application of articulated buses suggest that their capacity would likely be replaced by rigid buses. Furthermore, the proposed schedule for replacement, representing 25 new buses annually, appears to lead to a significant reduction in capacity between 2007-08 and 2015-16. In the first six years from 2001-02, the number of new buses coming onstream cumulatively exceeds the number of buses being retired because of expiry of their commercial lives. For the next eight years, the total number of buses in the fleet would be much lower than the current numbers - the difference peaks in 2011-12 by which time 344 buses would have been retired and replaced by only 275 new buses.

While longer-term decisions about bus replacement may be better made closer to the time in the light of potential changes to market conditions, the Commission is concerned that ACTION is proposing a replacement schedule which appears to leave a significant shortfall of required bus capacity towards the end of the next decade. Clearly, this could be overcome by retaining the older buses in service for longer than 18 years, but there is no suggestion in ACTION's statements to suggest that this will be the case. On the other hand, if there is no expectation about excess demand, the Commission is concerned that this implies that there is currently excess capacity, ie. that there are more buses in service than are required.

However, the acquisition of new buses is affected not only by economic imperatives of a generally ageing fleet with associated increases in maintenance costs and reductions in service reliability and quality. It is also affected by exogenous factors such as the type of buses which is driven by environmental concerns and by social requirements such as disability criteria. If more serious consideration is given to the acquisition of CNG buses and of buses with appropriate disability access, to comply with the Commonwealth Government's *Disability Discrimination Act* (1992), the Commission would expect that these would contribute to the need for earlier rather than later acquisition of new buses.

The Commission notes that ACTION is not proposing to endorse a bus replacement program in the current financial year but is looking for ratification of its proposal for 2000-01. In the light of the above comments, the Commission believes that not enough detailed analysis has yet been undertaken to develop an optimal bus replacement program. Such analysis should take account of the following:

- the implications of the lumpiness of the ageing profile of the current fleet;
- to what extent the commercial lives of buses will need to be extended beyond 18 years for a given annual intake of new buses;
- the advantages and disadvantages of acquiring CNG buses;
- the choice of bus types and sizes; and
- annual budgetary impacts and the benefits of "smoothing" out funding peaks.

6.3.4 Best Practice 'Commercial Price'

The average fares revenue per passenger boarding for ACTION bus services is currently \$1.08. After adjustment for discounted tickets, concession usage and schoolchildren, this is equivalent to an average adult single fare of \$2.15. Because a zonal fares structure applies in the ACT, it is not possible to estimate the average passenger journey length.

An adult single fare of \$2.15 is equivalent to a journey length of 5.8 kilometres if the NSW private bus operator urban fare scale is applied. The Commission understands that the private operators serving outer Sydney receive no direct operating subsidies although they are compensated for revenue forgone for the carriage of concession passengers and schoolchildren. The NSW private bus operator fare scale is therefore a reasonable proxy for a commercial price for bus travel. Given the geographical distribution of the ACT population, an average journey distance of 5.8 kilometres would appear to be at the low end of the expected range. This suggests that the base ACTION fares are also low in comparison with commercial bus fares in similar urban operating environments. However, this comparison provides an indication only since there are other factors which would influence the level of commercial fares including the passenger demand profile, spread of service, availability of alternative modes and bus journey speeds.

The service levels currently operated by ACTION are between 30% and 50% higher than the specified Minimum Service Levels (MSL). The operation of services above the MSL is a commercial decision on the part of ACTION. It would be expected that these additional services produce fares revenue income which exceeds the marginal cost of operation. Given the deficit incurred by ACTION, it is appropriate to review the net revenue benefit due to the services operated in excess of the MSL.

The Commission has reviewed some of the performance indicators derived from data provided by ACTION to support this analysis. Overall, there are 0.72 passenger boardings per bus revenue kilometre on the current ACTION service levels. This is equivalent to \$0.57 fares receipts per revenue kilometre.

As indicated, ACTION has made a commercial decision to operate services additional to the MSL requirements. The Commission has estimated the potential impact on revenues and costs of operating only the MSL services. For this estimate, an overall elasticity of demand to service changes of 0.5 has been used. It is recognised that a marginal rate can only give an indication of the impact of such a large change in the level of service, and therefore, a more detailed study would be required to determine the exact impact of a large service change.

On the cost side, the Commission has separated the fixed and variable costs of bus operation and has included cost savings from the variable measures only. The current distribution of costs is 41% fixed costs and 59% variable costs. Fixed costs include administration, marketing and bus leasing costs. Variable costs include bus operating costs, such as drivers, and bus running costs as well as maintenance costs. The variable costs are calculated to be $2.27 per revenue kilometre.

The MSL network would increase the passenger boarding rate from 0.72 to 0.93 boardings per kilometre. At current fares levels, revenue would be about 17% lower overall due to the patronage reduction in response to the lower service levels. Costs would fall by 20%. In a full year, the net cost of service provision would be reduced by $11.5 million if ACTION were to operate to MSL only. This figure is higher than the predicted annual deficit assuming current service levels are retained.

ACTION is moving towards the adoption of lower service levels with a proposed service change to be introduced in February 2000. This approach is sound in that it allows the operator to monitor the impact on demand and revenue of adjusting the service frequency on the poorest performing routes operated above the MSL requirements. The data required for such an analysis was not available to the Commission and would require a detailed assessment which, it is expected, ACTION will undertake prior to introducing any timetable changes.

The data available to the Commission indicates that the supplementary routes, which are services that are entirely above the MSL requirements, do not show particularly high boarding rates. In reality, some journeys may be worth operating if fares revenue is high or costs are low when assessed at an individual journey level. If individual supplementary services were run, the net financial position for ACTION in comparison to the MSL network would be further improved, as the services would not be run, in a commercial operating environment, if the revenue gained from the supplementary services was not greater than the costs incurred.

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(I) of that Act (Part IV 20.(2f)).*

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

6.4.1 Ecologically Sustainable Development

Ecologically sustainable development (ESD) requires the implementation of improved valuation and pricing of environmental resources. Urban public transport is a critical component of government initiatives to reduce air pollution. ACTION has the potential to remove up to 80 private cars from the road per journey, which provides improvement in air quality. In the absence of a road pricing regime, incorporating higher parking charges, the Commission realises that significant price rises could result in customers switching to alternative modes of transport, mainly cars, which have higher environmental costs.

As indicated in the previous price determination, the Commission questions ACTION's continued lack of CNG buses. CNG powered buses have significantly lower emission levels compared to diesel buses. If ACTION were to increase the number of CNG buses, the externality benefits, in terms of environmental savings, of ACT public transport would further increase.

ACTION currently has two re-engined CNG buses which they claim are unreliable and costly to maintain. The experience of other public bus companies is that re-engined buses do tend to be unreliable, but new CNG buses tend to work suitably. The Tuggeranong bus depot is fully equipped with CNG fuelling capabilities, and ACTION should look to obtaining CNG buses as part of their bus replacement program. The view of ACTION is that CNG buses will be considered when evaluating new bus acquisitions, and the decision on whether CNG buses are purchased will be guided by technical and operational performance, financial analysis of costs and benefits and government policy directives.

In attempting to satisfy the principles of ESD, the Commission understands the need to balance the requirement for government support for higher bus patronage outcomes and the payments by users. However, the Commission cannot change the road infrastructure network or car parking levels, both of which, due to their abundance, have significant impact on transport users' choice of mode in the ACT environment.

6.4.2 Demand Management

ACTION's improved fleet management has resulted in the utilisation of almost all available vehicles in the morning and afternoon peak (333 of 364 buses not including Special Needs Transportation). It is these morning and afternoon peaks which determine fleet size and constrain any reduction in bus numbers. The Commission is pleased to note that since 1991 the proportion of buses in excess of maximum daily demand has fallen by nearly 50% from 16.6% to 9%.

For ACTION, weekday journeys comprise nearly 90% of all journeys. With the morning and evening peaks constituting approximately 40% of weekday services, this percentage does not appear to be high given Sydney Buses weekday peak period journeys comprise approximately 45% of all journeys. ACTION has significant lulls on weekend and night services that receive disproportionate amounts of resources. Weekend services carry around 8% of weekly patronage and consume about 12% of resources, while night services carry only 2.5% of passengers and around 10% of resources. Demand management within given minimum service levels may allow ACTION to reduce the level of resources used in these areas. The Commission has already noted that ACTION is planning to make modifications to services to reflect this.

The introduction of Network 99 brought with it increased through routing and extended services to developing areas of the ACT such as Gungahlin. This equates to an increase of around 20% in scheduled services without increasing the size of the bus fleet. The increase in service has mainly occurred in off peak periods. Management of the Network 99 routes is necessary if ACTION is to achieve efficient operating levels. Review of the patronage levels on routes, and the bus supply to these routes, must be an on going process. As already discussed, in September 1999, ACTION undertook a review of routes which led to the removal of service along some routes and changes to the timing of other routes, and further changes will be implemented in February 2000.

ACTION's charter service revenue has fallen in 1998-99 to $530,000. This is a significant change in trend from previous years given that between 1993-94 and 1997-98 charter service revenue had grown from $552,000 to $626,000. The reasons for this decline are due to the introduction of Network 99. ACTION has more timetabled requirements for its bus fleet and does not have the same level of spares to use as charter services. Also, there has been a fall off in demand, with reduced school charters because of lower budgets and an increase in competition for such services from other operators. ACTION forecasts a similar level of charter service revenue in 1999-2000, around $500,000.

Attachment 1: Terms of Reference

Australian Capital Territory

Independent Pricing and Regulatory Commission Act 1997

Declaration of Regulated Industries Under Section 4
and
Reference for Investigation Under Section 15
and
Specified Requirements in Relation to Investigation Under Section 16

Instrument No 202 of 1999

Reference for Investigation Under Section 15

Pursuant to subsection 15(1) of the Independent Pricing and Regulatory Commission Act, I refer to the Independent Pricing and Regulatory Commission (the 'Commission') the matter of an investigation into the determination of prices for public transport bus services supplied by ACTION within the Territory for the period from 1 July 2000 until 30 June 2001.

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 of Urban Services in relation to determined public transport prices for the period from 1 July 2000 to 30 June 2001 and the determination of the best practice 'commercial price' (specified below) – by 10 March 2000;

(b) A draft report in relation to determined public transport prices for the period from 1 July 2000 to 30 June 2001 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 – by 13 December 1999;

The Commission in conducting its investigation into the determination of prices shall specifically determine a price path based on best practice 'commercial price'. This will be done using best practice cost benchmarks taking into account potential patronage in the Territory and the service levels specified by the Department of Urban Services as the purchaser on behalf of the Territory Government.

Dated this twelfth day of August 1999

BRENDAN SMYTH
MINISTER FOR URBAN SERVICES