IPART
New South Wales

Independent Pricing and Regulatory Tribunal

Review of the CityRail regulatory framework

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1 Introduction

CityRail provides passenger rail services within the Greater Sydney region. CityRail is a division of RailCorp, which was established by the NSW Government as a Statutory State Owned Corporation (SSOC). The Independent Pricing and Regulatory Tribunal of NSW (IPART) regulates the fares CityRail can charge its customers for these services. IPART considers that it is time to implement a more comprehensive and robust regulatory framework.

In response to this concern, the NSW Government has asked IPART to undertake a review and recommend a regulatory framework that will provide CityRail with better incentives to provide passenger rail services at efficient cost levels. (See Appendix 1 for the terms of reference.)

1.1 Purpose of the review

Regulation of CityRail's fares should aim to create incentives for CityRail to increase its operational efficiency and improve its service standards. IPART considers that a more comprehensive regulatory framework will provide CityRail with better incentives. One of the main problems IPART faces in its regulation of CityRail is that, unlike other regulated industries (such as electricity or water), CityRail does not generate sufficient revenue to recover the cost of providing its services. For example in 2006/07 revenue from ticket sales was around $529 million while CityRail's expenses, including depreciation, were $2.1 billion. NSW Taxpayers are effectively providing a subsidy to CityRail of $1.9 billion per annum — or $15 per week per household.

IPART intends to develop a regulatory framework that offers CityRail the best incentives to improve its efficiency and service standards by:

- Establish the appropriate allocation of costs between the government and users and ensuring that CityRail has sufficient revenue (including government contributions) to meet the cost of providing its services. This is complicated because both passengers and taxpayers contribute to providing CityRail's revenue. Fare regulation should ensure that each group provides its fair share. Over the last few years, the trend has been for passengers to contribute less and taxpayers to pay more.
- Establish CityRail's efficient level of costs and encourage CityRail to increase its efficiency. Therefore, regulation should provide incentives for CityRail to increase its efficiency in supplying its services, which will reduce its costs for the benefit of both passengers and taxpayers.

IPART considers that an important way of creating incentives is to improve the level of transparency in CityRail's operations and funding arrangements. This transparency would increase confidence in IPART's fare decisions and allow CityRail and other stakeholders to have more certainty about fare outcomes. It would also enable CityRail to better plan for its future operational needs.

It is also important to ensure that CityRail is held accountable for its performance. Improvements in the economic regulatory framework developed by IPART can be reinforced by and improve the broader regulatory framework governing CityRail; for example, by improving RailCorp's Statement of Corporate Intent (which is a performance-based contract between the management of RailCorp and the government) by providing clearer targets and benchmarks for its managers to achieve.

1.2 Process for the review

As part of this review, IPART will undertake public consultation. IPART invites all interested parties to make submissions to this review. It will also hold a public roundtable discussion, to provide stakeholders with a further opportunity to contribute their views. In addition, it will engage consultants to assist it in estimating the efficient costs of providing CityRail's services, the allocation of costs between government and users, and the price-elasticity of fares.

IPART intends to release a draft report and recommendations and invite comments from interested parties. After considering these comments, it will provide its final report and fare determination to the Premier.

The proposed timetable for the review is provided on Table 1.1.

Table 1.1 Timetable for review

Action	Timetable
Release issues paper and invite submissions	October 2007
RailCorp response to the issues paper due	30 January 2008
Public submissions on issues paper and RailCorp's response close	29 February 2008
Make consultant's draft reports available for public comment	February/March 2008
Hold public roundtable discussion	April 2008
Release draft report and recommendations and invite submissions	July 2008
Provide final report and determination	October/November 2008

IPART's issues paper is the commencement of the public consultation process for the review. IPART is calling for stakeholder submissions on both its issues paper and RailCorp's response to the issues paper by **29 February 2008**. To make it easier for stakeholders to respond, IPART is requesting that submissions cover both its issues paper and RailCorp's response. Details on how to make a submission can be found at the front of IPART's issues paper.

:osts and cost efficiency

In other industries IPART regulates, users contribute only to the efficient costs of providing the regulated service. That is, IPART sets the level of fares or prices so that they will recover only the efficient economic costs of providing services. In the public transport industry, the revenue service providers earn from fares is not enough to cover costs and so the government also contributes to the cost of providing passenger services.

IPART has previously indicated that it considers it 'unlikely that CityRail is operating at the lowest possible cost'.[1] One of IPART's key concerns in this review is to obtain a clear picture of CityRail's costs, including the drivers of these costs, and the efficiency of these costs. This will help it to understand the extent to which CityRail can be provided with incentives to reduce its costs by operating more efficiently.

IPART has engaged an independent consultant to undertake a total cost review of CityRail's operations. The consultant will estimate the efficient cost of providing CityRail's regular passenger services taking account any potential efficiency improvements for each of the next five years. IPART will release the consultant's draft report for public comment before the consultant provides its final report.

3 Service standards

Linking CityRail's fare increases to the service standards it provides will be an important element of any new regulatory approach that IPART considers. There are multiple dimensions to service standards for metropolitan rail services – for example, the punctuality of services, the adequacy of the timetable, safety, crowding, comfort, and the provision of information. This means that any measure of service standards must be carefully constructed.

On-time running – which indicates the punctuality of services by comparing their actual running time to the timetable – is a commonly used measure of service standards. CityRail currently reports on-time running in peak hours on its website and it has made clear improvements in on-time running since 2004. However, there remains much dissatisfaction with the standard of CityRail's services, as illustrated by poor press coverage, letters to the press and submissions to IPART's 2007 review of CityRail fares. IPART wants to broaden and improve the measures of service standards used as part of its regulatory framework review.

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1 IPART, *Review of fares for CityRail in NSW 2006 - Determinations and Report*, June 2006, p 11.

One of the central issues related to incorporating service standards into the regulatory framework is to decide which aspects of service should be considered. Ideally, service standards should reflect passengers' views of what is important, be quantifiable and, for benchmarking purposes, be comparable with other jurisdictions. Of course, if CityRail is expected to improve its service standards, the initiatives required to achieve the improvements must be funded. The Independent Transport Safety and Reliability Regulator (ITSRR) undertakes annual surveys of CityRail customers which identify 37 aspects of service and their importance to passengers. As part of this review, IPART will estimate the costs of providing increases in the various aspects of service. This should provide information to all stakeholders, both passengers and government, on the costs of providing service improvements and whether passengers would be willing to pay for these improvements.

There are three major dimensions of service quality that IPART is interested in exploring as part of its review:[2]

- **Operational performance (for example, certainty of service and on-time running).** CityRail currently has targets and reports to the Minister and publicly on some aspects of operational performance, including on-time running in peak hours, peak stops skipped, and peak services cancelled. CityRail also publishes additional information on its website, such as the weekly average duration of delays.
- **Timetable (for example, number of services, frequency of service and transit times).** These aspects of service are not specifically covered under the Rail Performance Agreement, the State Plan or CityRail's Customer Service Commitment. CityRail reports on the number of peak services per day, but does not regularly report publicly on other indicators.
- **Amenities (such as comfort, convenience and security of services).** CityRail has targets under the Rail Performance Agreement for some aspects of amenity (crowding) and monitors and reports publicly on a number of other aspects – for example, offences against people and property; vandalism (including seats and windows replaced, and graffiti removed from trains and trackside); the availability of ticketing systems, lifts and escalators, CCTV and Help points; and customer complaints.

4 Cost sharing and social benefits

At present, most of CityRail's operations are funded by taxpayers via government subsidies. Irrespective of the regulatory framework, the government will continue to contribute to the costs of providing CityRail's services. However, at present, there is little transparency as to which aspects of CityRail's operations are funded by taxpayers.

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2 Independent Transport Safety and Reliability Regulator submission to IPART hearings for determination of CityRail fares for 2007, p 7.

In addition, government funding of CityRail's services has grown significantly over the last seven years. In 2006/07, the $1.9 billion NSW Government subsidy to CityRail represented 4.3 per cent of the NSW Government's total general expenditure. In comparison, in 1999/2000, the subsidy ($859 million) represented 3.3 per cent of general expenditure.

A key issue for this review is who should pay and how much. Some cost sharing between passengers and taxpayers is appropriate, as CityRail's passenger services generate social benefits for the community. For example, these benefits include reducing the negative impacts of road use (such as congestion and pollution) and providing transport options to people unable to travel by car (for example, school students or aged people).

IPART, with the assistance of industry expertise, will develop a framework for assessing the optimal level of government cash contributions to CityRail in light of the social costs and benefits of its services.

It's important to remember that any increase in the level of government funding of CityRail comes at the expense of increased funding for other government services (for example, education and health). In 2007/08, CityRail's expected subsidy ($1.7 billion) is expected to be equal to:

- 17 per cent of the government's spending on education ($10.5 billion), or
- 14 per cent of the government's spending on health ($12.5 billion).[3]

Alternatively, the size of CityRail's subsidy may prevent a reduction in the State's level of taxation.

5 Scope of the new regulatory framework

Potentially, economic regulation of CityRail's passenger services could cover a number of different areas:

1. **Investment** in the network, and in rolling stock, in order to provide an appropriate quality and quantity of train infrastructure, in the right location. Ensuring efficient investment requires an assessment of the social costs and benefits of different options, and would need to include a comparison of different types of transport (such as buses, roads and trains).
2. **Maintenance** of the network and rolling stock, and **operation** of stations and train services. This involves ensuring that services of the required quality are provided at minimum cost.
3. **Use** of the network, including the mix of services provided, and the service schedule. The structure of fares can have a significant impact on the efficient use of the network.

3 NSW Treasury 2007, *Budget Paper no. 2*, NSW Treasury 2007-2008 Budget papers, Sydney.

The regulatory framework adopted may focus to a greater or lesser extent on each of these areas. Furthermore, different forms of regulation may emphasise different objectives for each of these areas. For example, in those areas where RailCorp is not the effective decision-maker, IPART's regulation may focus on increasing transparency in order to improve the accountability of decision-makers. For example, this could apply in the area of network investment, where decisions are made or heavily influenced by government rather than RailCorp. RailCorp has greater discretion over operating and maintenance expenditure, and so IPART's regulatory framework may aim to more directly influence this expenditure, by providing incentives for efficiency.

In the area of fares and network usage, the regulatory framework needs to be mindful of NSW Government policy in addition to economic efficiency. For example, it needs to be consistent with policy objectives to increase patronage and take account of the capacity of users to pay.

IPART has reviewed regulatory approaches used in public transport fare regulation in other states and countries. It found that generally, the form of regulation used is less independent and transparent than that currently used by IPART. Typically, fare regulation is still undertaken by government departments, such as the transport ministry, or by local governments. Similarly, network investment decisions are more frequently the preserve of governments.

The area where the regulation has most often sought to provide incentives for efficiency has been in operating and maintenance expenditure, where the form of regulation has sought to minimise the cost of providing a defined level of services.

IPART has identified three broad options for the regulatory framework:

1. The building block approach used by IPART in the regulation of other industries (for example, energy and water).
2. An operating and maintenance cost approach, which has been used internationally.
3. A long run marginal cost approach, which has been used by some regulators both in Australia and abroad.

IPART is also seeking stakeholders' suggestions on alternatives to these approaches.

Regardless of the regulatory approach adopted, an adjustment path - possibly over many years – may be required if CityRail's current revenue does not meet the revenue (or efficient cost) requirement established under the new regulatory approach.

6 Fares

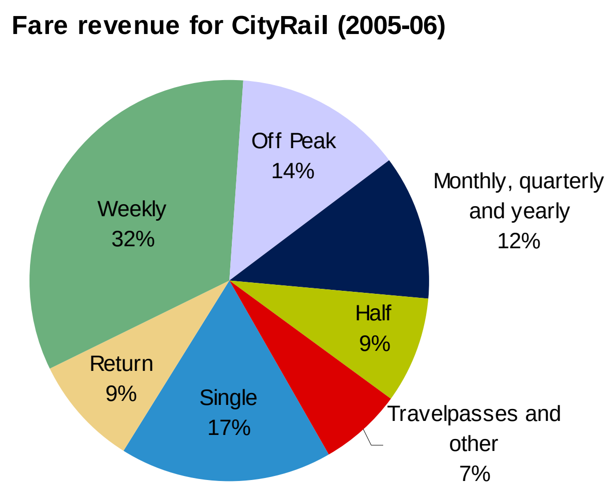
When setting public transport fares, IPART needs to consider both the level of fares and the structure of fares. The Ministry of Transport has been tasked by the NSW

Government to consider options for restructuring and simplifying public transport fares, including CityRail fares. This process is underway and has yet to be presented to the government for consideration. It will be important for IPART, the Ministry and RailCorp to work together to ensure that the outcomes of the respective reviews are consistent and practical.

CityRail's current fare structure is largely distance based (TravelPasses are zonal), with distance categorised into 25 separate distance bands. CityRail offers a range of ticket types – single, off-peak return, weekly, monthly, quarterly and yearly tickets plus a range of TravelPass tickets that also allow travel on bus and ferries.

Currently, CityRail earns a major portion of its revenue (32 per cent) from weekly tickets (Figure 6.1).

Figure 6.1 Revenue by ticket type (2005/06)



In submissions to recent fare reviews, some stakeholders called for fare reform. IPART agrees that a review of fare structures is required. Possible options for fare structures include:

- **Distance based** – fares based on actual distance travelled.
- **Flag fall plus distance based** – fares based on actual distance travelled plus a fixed flag fall per trip.
- **Fixed zones** – defined with reference to a number of geographical zones that remain fixed irrespective of where the ticket is purchased within the zone.
- **Time based** – for example, two-hour interruptible trips at a flat fare.
- **Flat price** – a flat price is charged for a trip irrespective of the distance travelled.

Each of these fare structures has its own strengths and weaknesses, which IPART will explore during this review.

7 List of issues that IPART seeks comments

1 Given the terms of reference, are the following proposed assessment criteria reasonable and balanced? What is the relative importance of each criterion?

- Provides CityRail with the discipline to provide efficient passenger rail services
- Reduces the costs and improves the quality, reliability and safety of passenger rail services for the benefit of consumers and taxpayers
- Promotes economic efficiency of rail services
- Consistent with government policy objectives
- Targeted to and proportionate with the problem
- Promotes clear and appropriate accountabilities
- Increases transparency of decisions
- Consistent
- Practical, pragmatic and feasible
- Simple and understandable

2 Are there any other assessment criteria that IPART should consider?

3 While the regulatory arrangements are different in Victoria, do stakeholders see some benefits in replicating features of the Victorian approach for CityRail? If so which are the features which should be included?

4 How should the NSW Government's public transport policies be reflected in the regulatory framework? For example, under what circumstances should the cost of its public transport policies be fully reflected in fares?

5 Should IPART distinguish between CityRail's suburban, intercity and regional networks and services in setting fares?

6 What indicators of service standards would most effectively reflect the experience of CityRail customers?

7 Is there a useful single indicator of service standards?

8 What relative weights should be given to measures of operational performance (reliability and punctuality), timetable (quantity of timetabled services) and amenity (crowding, comfort, safety, information etc)?

9 How could the current measure of on-time running be improved?

10 How can CityRail's service performance be incorporated into the regulatory approach and fare decisions?

11 To the extent that passengers advocate higher service standards, would they be prepared to accept higher fares for improved service?

12 What is an appropriate framework for determining the share of CityRail's costs between users and the government?

13 Has IPART identified the main social benefits and social costs (that is, externalities) associated with the provision of CityRail's services?

14 How can the social costs and benefits be quantified and what is their likely magnitude?

15 Has the magnitude of social costs and benefits changed over the last ten years?

16 What is the best way to address these social costs and benefits? To what extent do they provide justification for the government to share some of the costs of CityRail's regular passenger services? Alternatively, should more attention be given to other approaches to increasing rail patronage and capturing the net social benefits of rail, such as increased rail service quality and frequency?

17 If a 'line in the sand' approach were adopted by IPART what considerations should influence where the 'line' is drawn?

18 Which approach to fare determination is more appropriate for the regulation of CityRail? Do stakeholders have any other approaches which they consider to be viable alternatives?

19 If a building block approach was adopted how should the RAB be set?

20 What is the appropriate rate of return for CityRail's capital investments?

21 If an operating cost approach was adopted, would stakeholders prefer yearly review based on a fixed formula or longer fare determinations and regulatory periods based on more detailed analysis of CityRail's specific costs?

22 Are there alternative regulatory approaches that could meet IPART's assessment criteria more effectively?

23 Are there any reasons why IPART should use a methodology other than setting individual fares? If so, should IPART determine a weighted average price cap and allow CityRail to set its own fares for individual tickets? Or are there other methodologies for fixing maximum fares that IPART should consider?

24 What is the appropriate regulatory period: three or five years?

25 Over what time period should IPART transition CityRail to the new regulatory framework?

26 Which fare structure or mix of fare structures is most appropriate for CityRail?

27 What is the appropriate difference between peak and off-peak fares?

28 Should IPART consider demand management (that is, encourage patronage to be spread more evenly throughout the day) when determining fares?

29 What other factors should be reflected in differences between peak and off-peak fares?