



MINISTRY OF TRANSPORT

**REVIEW OF CITYRAIL
REGULATORY FRAMEWORK**

SUBMISSION TO:

**INDEPENDENT PRICING AND
REGULATORY TRIBUNAL OF NEW
SOUTH WALES**

New South Wales Ministry of Transport
Review of the CityRail Regulatory Framework

Submission to:

Independent Pricing and Regulatory Tribunal

for

Review of the CityRail Regulatory Framework

Contents

- PART 1. PRELIMINARY** 2
 - 1. Introduction..... 2
 - 2. Background 2
 - 3. Outline of Submission 2

- PART 2. OPERATING CONTEXT** 2
 - 4. RailCorp and CityRail 2
 - 5. CityRail’s Role in the Transport Task..... 3
 - 5.1 Governance 3
 - 5.2 Regulation..... 4
 - 5.3 Funding 4
 - 6. The Policy Environment 4
 - 6.1 The State Plan 5
 - 6.2 Urban Transport Statement 5
 - 6.3 Dealing with capacity constraints..... 6
 - 6.4 Customer Satisfaction..... 6
 - 6.5 Service Delivery – Customer Service Improvement Programme 8
 - 6.6 Other Issues Including National Developments..... 8

- PART 3. REGULATORY FRAMEWORK** 9
 - 7. Options for the Regulatory Framework 9
 - 7.1 Incentives for CityRail Efficiency Gains and Service Improvements 10
 - 7.2 The Principles of Best Practice Regulation 10
 - 7.3 Revenue Requirements 11
 - 7.4 Compatibility with the Nature of CityRail Services..... 11
 - 8. Regulatory Period..... 12

- PART 4. GOVERNMENT SERVICE STANDARDS FOR CITYRAIL**..... 12
 - 9. Needs of Passengers 12
 - 10. Dimension of Service Standards 12

Part 1. Preliminary

1. Introduction

This is a Submission to the Independent Pricing and Regulatory Tribunal (IPART) in connection with its Review of the CityRail Regulatory Framework.

2. Background

On 11 July 2007, the Government gave IPART a reference for the conduct of a review of the CityRail regulatory framework, and to recommend a regulatory framework which will provide CityRail with the incentives to provide efficient railway passenger services.

On 18 February 2008, the Government amended that reference, noting that the Government's submission to the Review, incorporating advice on the early results of RailCorp's Customer Service Improvement Programme for CityRail (CSIP), will be provided on 9 May 2008. IPART was informed of the need to consider, as part of the Review, the impact of the Programme on CityRail services.

The CSIP is a three-year strategy and programme of work aimed at addressing current and future customer service challenges to deliver consistent service across the CityRail network.

The purpose of this Submission is to provide to IPART commentary and observations on matters which the Government views as critical to support a full and in-depth consideration of the issues involved. To avoid doubt, but unless the context requires otherwise, in this Submission revenue means revenue derived from any source (e.g. the fare-box and Government funding).

The Government has asked the Ministry of Transport to advise on options for restructuring public transport fares, including CityRail fares. After having considered the Ministry's advice the Government will, in due course, inform IPART of its view as to public transport fare structures to enable that view to be considered in addressing the terms of reference.

3. Outline of Submission

The outline and structure of this Submission are set out as follows:

- Part 2 discusses the context within which CityRail services are operated; including how the relevant priorities and targets of the State Plan apply to that context. Part 2 also deals with CityRail's role in delivering the transport task, and provides background on its key business drivers and performance challenges.
- Part 3 canvasses matters relevant to the establishment of an appropriate regulatory framework, including regulatory arrangements that apply to utilities; for example, electricity and water.
- Part 4 notes observations made on the application of service standards to CityRail, and on a number of issues associated with regulatory mechanisms to improve performance.

Part 2. Operating Context

4. RailCorp and CityRail

CityRail is a business arm of Rail Corporation New South Wales (RailCorp). RailCorp is a statutory state owned corporation constituted under the *Transport Administration Act 1988*, (the TA Act), and subject also to the *State Owned Corporations Act 1989*.

RailCorp has the following two principal objectives, which are set out in the TA Act:

- to deliver safe, and reliable railway passenger services in New South Wales in an efficient, effective, and financially responsible manner; and
- to ensure that the part of the NSW rail network vested in or owned by RailCorp enables safe and reliable railway passenger and freight services to be provided in an efficient, effective, and financially responsible manner.

In addition to the principal statutory objectives of RailCorp, the TA Act also sets out the following subordinate objectives (i.e. the TA Act provides that they are of equal importance but not as important as the principal objectives):

- to maintain reasonable priority and certainty for railway passenger services;
- to promote and facilitate access to the part of the NSW rail network vested in or owned by RailCorp;
- to be a successful business, and, to that end:
 - to operate at least as efficiently as any comparable business, and
 - to maximise the net worth of the State's investment in the Corporation;
- to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates;
- to conduct its operations in compliance with principles of ecologically sustainable development contained in the *Protection of the Environment Administration Act 1991*;
- to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates.

In this submission, the term CityRail refers to RailCorp's CityRail business arm and the services, facilities, infrastructure, personnel and so on deployed by RailCorp in connection with activities carried on by CityRail.

5. CityRail's Role in the Transport Task

CityRail is the provider of railway passenger services in the Sydney, Central Coast, Hunter, Blue Mountains, and Illawarra regions, and is the single largest public transport operation in Australia. The CityRail network is essentially that part of the NSW rail network which is used for the provision of CityRail railway passenger services. It is geographically diverse, encompassing a large urban area stretching from Goulburn and Nowra in the south, Lithgow in the west, and Newcastle, Scone and Dungog in the north. CityRail serves a population of more than 4.5 million people, and delivers over 281 million passenger journeys annually across 304 suburban, intercity, and regional stations.

Each weekday approximately 900,000 journeys are made on CityRail services, of which over 500,000 are to central Sydney. CityRail services carry more central Sydney commuters than all other transport modes combined. CityRail provides 2,546 scheduled railway passenger services every weekday, and 1,655 per day on weekends. In addition, over 100 NightRide bus services are provided every night.

CityRail operates a fleet of 1,531 electric and 48 diesel carriages over 3,236 kilometres of track controlled by over 3,433 signals. Each day CityRail trains deliver in excess of 90,000 service kilometres.

To deliver its services effectively, CityRail employs around 14,000 people, operates infrastructure and rolling-stock assets valued at over \$12.5 billion, and currently invests approximately \$800 million in capital annually.

5.1 Governance

A rail performance agreement (RPA) with the portfolio Minister (the Minister for Transport) is

in place in accordance with the TA Act. The RPA sets out the rail performance benchmarks, which must also be referenced in RailCorp's Statement of Corporate Intent (SCI), and the requirements for performance reporting.

The *State Owned Corporations Act 1989* provides that all decisions relating to the operation of a statutory state owned corporation (e.g. RailCorp) are to be made by or under the authority of the Board. The RailCorp Board is accountable to the Government through two shareholding ministers. RailCorp is also accountable to the Minister for Transport for the operation of its services and for meeting the rail performance benchmarks.

5.2 Regulation

CityRail is subject to the regulatory requirements that commonly apply to any urban railway in Australia; for example, safety, environmental, and competition laws. Rail safety regulation is administered by the Independent Transport Safety and Reliability Regulator (ITSRR). ITSRR is also responsible for reporting on the reliability and sustainability of CityRail operations, and undertakes an annual independent survey of CityRail customers as part of its assessment of performance and customer satisfaction.

Unlike other urban railways, CityRail is subject to regulation of its maximum fares by an economic regulator (i.e. IPART).

5.3 Funding

A funding agreement with the Director-General of the Ministry of Transport provides for a financial contribution from Government to enable RailCorp to deliver CityRail services, provide fare concessions, and undertake capital works as agreed in the SCI.

6. The Policy Environment

CityRail is close to unique in the services it operates, its historic legacy of network design and route infrastructure, and its mixed inner-metropolitan, suburban, and inter-urban heavy rail operating environment. CityRail is also required by Government to deliver services or benefits which otherwise would not be provided by a commercial operator. This makes simple comparisons with other industries or utilities operating on a primarily commercial basis difficult.

Further, the Government has implemented a number of substantial policy initiatives which affect the cost base of rail services in NSW. Many of these may raise the cost of delivering services. However, they are vital to securing safe and reliable railway passenger services which are necessary to cater for future patronage growth and to generate the required mode shift to public transport sought by Government in support of long-term sustainable urban communities.

Since the establishment of RailCorp in 2004, it has become clear that its efficiency objectives need to be more closely aligned with the Government's expectations of service and infrastructure, and that the alignment needs to be defined more clearly. To that end, the Government has decided to define expectations which represent RailCorp's service delivery task.

The expectations for RailCorp agreed to by the Government and RailCorp establish the services that RailCorp is to provide, and the requirements applying to the provision of those services; for example, the rail performance benchmarks. Essentially, it describes the Government's and RailCorp's agreed view on the key customer service requirements which in turn must inform RailCorp's operating and financial planning. It follows, therefore, that in assessing the efficient costs of providing CityRail services, it is imperative to recognise the costs that are necessary to deliver the agreed improvements. No direct consideration of or regard for notional productive efficiencies associated with or based on alternative service

levels is necessary.

More broadly, the review of the CityRail Regulatory framework needs to consider the Government's policy commitment to improve the capacity and reliability of public transport systems over the next decade.

As outlined above, the delivery of safe and reliable railway passenger services is RailCorp's principal objective. Since September 2005, there has been significant and sustained improvement of CityRail's service reliability, on-time running, and the provision of passenger information.

It is a priority for Government that CityRail provide a safe and secure environment for its customers, staff, and the general public. Significant investment continues to be made in improving safety across the CityRail network and in the workplace. RailCorp has been responsive to the findings of the Waterfall Special Commission of Inquiry, having implemented 99 of its 103 recommendations to date. This has been reinforced by the development of a more focused and workable *safety management system* for the effective handling of safety incidents.

Security on trains and stations is managed through a network of 600 transit officers, 6,400 CCTV cameras, and 700 emergency help points. Since the introduction of transit officers in 2003, crime on the CityRail network has reduced significantly and is below the general crime rate in NSW.

Recent additional improvements have included the installation of high resolution CCTV cameras at major city stations to provide additional protection and response capability against terrorism, the upgrading of security fencing, and the installation of anti-throw screens at high risk locations on the rail network.

Government has set clear expectations for CityRail's role in delivering the transport task. Patronage targets have been set in the State Plan, and the Urban Transport Statement's aim is to have the total number of daily trips on public transport increase by over 25 per cent by 2022. The overarching policy directions for public transport reflected in the State Plan, the Urban Transport Statement, the Metropolitan Strategy, and the State Infrastructure Statement require significant investment in CityRail if the challenges they establish are to be met. This is an essential consideration in the development of the CityRail regulatory framework.

6.1 The State Plan

The State Plan sets out the priorities of the Government for the delivery of quality public transport. A key objective of the Plan is to increase the share of peak period journeys undertaken on a safe and reliable rail system. The specific targets of the State Plan for which CityRail has a responsibility are:

- increase to 75 per cent the public transport share of trips made to and from the Sydney CBD;
- increase to 25 per cent by 2016 journeys to work by public transport in the Sydney metropolitan region;
- consistently meet public transport reliability targets for all forms of public transport; and
- measure, report, and improve customer satisfaction with Government services.

6.2 Urban Transport Statement

The Premier's Urban Transport Statement is a strategic response to the challenge of accommodating growth in the greater Sydney metropolitan area. It establishes as a priority increasing the number of daily trips on public transport, with the aim of having total daily trips

increase by over 25 per cent by 2022. The Statement confirms a \$20 billion commitment over the next decade which includes Government funding to:

- maintain public transport systems at high levels of reliability as a precondition of greater patronage;
- provide balanced investment to both road and rail;
- commit to the implementation of the Metropolitan Rail Expansion Programme (MREP), now modified with the South West Rail Link and the SydLink Metro;
- extend the Rail Clearways Plan to include duplication of the Richmond line; and
- expand commuter car parking.

6.3 Dealing with capacity constraints

The State Plan targets require CityRail patronage growth of 2.5 per cent per annum and reliability of services will need to consistently meet the 92 per cent target.

Patronage during peak periods is currently growing at over 6 per cent per annum. This is stretching available capacity to meet peak customer demand and is resulting in increased crowding on some lines. Crowding is the key area of CityRail's performance that, for an increasing number of passengers, is not being met. CityRail will need to optimise existing capacity as a matter of priority to manage increased crowding.

The following projects are planned or already being implemented to increase capacity:

- *rail clearways plan* will provide additional capacity and reliability by simplifying the operation of the CityRail network and supplying the infrastructure required to sectorise rail operations. This includes the construction of additional platforms, turn-backs, stabling facilities and line duplications;
- *Epping – Chatswood Rail Link* will provide access to the growing technology belt and generate additional capacity for train movements along the western corridor.
- *South West Rail Link* to Leppington will be completed by 2012;
- *122 Oscar carriages* and new air-conditioned PPP fleet which includes 100 growth carriages;
- *traction power supply capacity* to be upgraded to meet the demands of the current and future fleet electrical demands (and improve reliability); and
- *station redevelopments* to provide increased capacity and safe, efficient access.

These growth projects are being undertaken in three stages:

- *Stage 1—by 2009*: Epping – Chatswood Rail Link; Clearways I projects; Delivery of 122 Oscar carriages.
- *Stage 2—by 2012*: Clearways II projects, South West Rail Link to Leppington and delivery of new air-conditioned PPP fleet. At this point, line capacity within the CBD will be at maximum level.
- *Stage 3—by 2017*: Major station upgrades at Town Hall, Wynyard, Redfern, and Burwood.

The three stages will progressively deliver more peak hour services on each of three sectors of the CityRail network. Stage 1 and 2 projects will deliver a 26 per cent growth in network service capacity for the two hours of the AM peak by 2012.

6.4 Customer Satisfaction

Although critical to achieving customer satisfaction, service reliability alone will not guarantee sustained levels of customer satisfaction. The following projects are aimed improving customer satisfaction:

- building stronger relationships with passengers, including the introduction of customer service standards to set out CityRail’s service commitment;
- transitioning to a service and performance culture which builds on the strong operating and safety culture already in place;
- enhancing real time passenger information systems;
- streamlining ticketing arrangements to reduce waiting time for passengers and provide more flexible payment options;
- improving training of customer service staff to ensure that they have the necessary competence to deliver quality customer service;
- refurbishing and renewing the fleet, and re-engineering maintenance processes to maximise fleet availability; and
- introducing new timetables to increase robustness and capacity following commissioning of the Epping – Chatswood Rail Link, Clearways Stage 1 projects and new Oscar trains. This will ensure that on-time running continues to meet the 92 per cent performance benchmark. The new timetable will help to improve performance; particularly on the Northern, North Shore, and Western lines, which are not achieving the on-time running performance of other lines.

Table 6.1 below sets out the estimated capital expenditure for CityRail maintenance and capital for the next five years.

Table 6.1: Maintenance and Capital Expenditure (nominal \$)

Year	RM and MPM	Capital
2007/08	\$770.4 million	\$936.2 million
2008/09	\$815.2 million	\$950.9 million
2009/10	\$924.4 million	\$1034.1 million
2010/11	\$940.3 million	\$933.2 million
2011/12	\$940.6 million	\$796.6 million

Figure 6.1 illustrates CityRail operating expenditure to 2011/12, and Figure 6.2, CityRail capital expenditure to 2012/13 (Projections are as at November 2007).

Figure 6.1: CityRail Operating Expenditure (nominal \$)

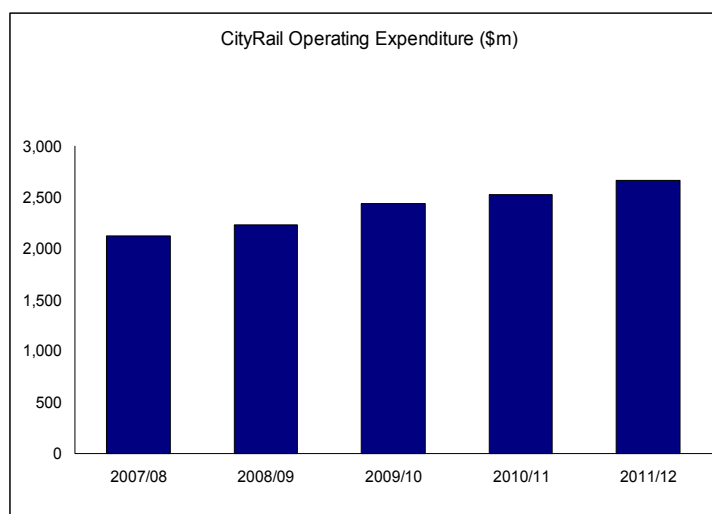
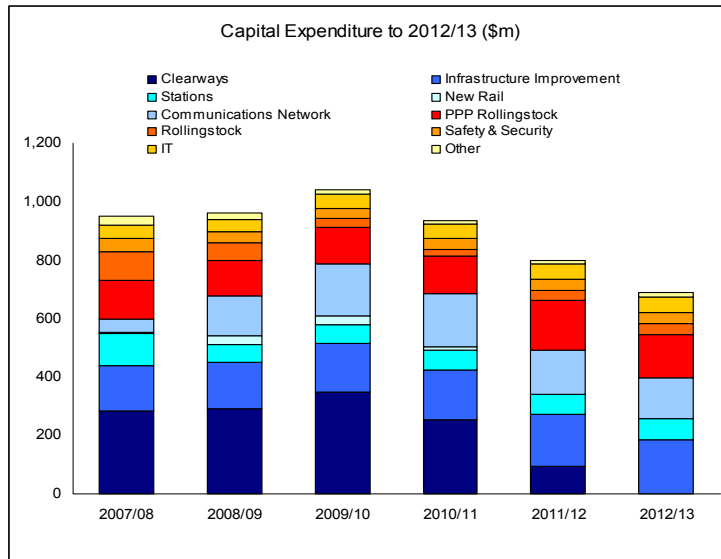


Figure 6.2: CityRail Capital Expenditure



6.5 Service Delivery – Customer Service Improvement Programme

CityRail has undergone significant change since the Waterfall accident especially in organisational and safety reforms. As noted above, the introduction of the 2005 and 2006 timetables has improved on-time running and customer satisfaction. In addition, demand for CityRail services is increasing well in excess of the targets set out in the State Plan. This is a considerable challenge for CityRail, particularly in relation to its ability to deliver consistent, quality service.

In October 2007, the Government initiated the development of a three-year Customer Service Improvement Programme for CityRail (CSIP), and engaged Boston Consulting Group to assist with its development. The CSIP is intended to address the major customer service challenges, improve CityRail’s day-to-day operations, and increase RailCorp’s effectiveness at delivering services.

The CSIP and early results from the CSIP are to be provided to IPART shortly.

6.6 Other Issues Including National Developments

Initiatives of the Council of Australian Governments (COAG) and the Australian Transport Council (ATC) are expected to pose further challenges for CityRail.

The Commonwealth is developing a national emissions trading scheme to address the primary market failure of uncapped greenhouse gas emissions, and to encourage activities and investments to reduce emissions generated by transport. The scheme is expected to commence by the end of 2010.

In April 2007, Australian State and Territory Governments commissioned the Garnaut Climate Change Review. The participation of the Commonwealth Government in the Review has since been confirmed. The Garnaut Review will examine the impacts of climate change on the Australian economy, and recommend medium to long-term policies and policy frameworks to improve the prospects for sustainable prosperity.

Fuel use in transport is a substantial source of greenhouse gas emissions, and is expected to account for 14 per cent of Australia’s emissions in 2051; emissions are growing rapidly with a projected increase of 67 per cent over 1990 levels by 2020. Emissions from cars account for 54 per cent of Australia’s total domestic transport emissions, and are projected to increase by 40 per cent between 1990 and 2020.

In addition to COAG initiatives, the ATC is developing a National Transport Policy Framework which has a number of relevant work streams. One work stream involves the proposed development of an economic framework for both passenger and freight transport which will involve the development of policy proposals for the creation of a national pricing and regulatory framework designed to achieve efficient transport outcomes. Other relevant issues being advanced as part of the national Framework include: urban congestion, infrastructure, climate-change and environment.

Although there is still some time before the firm policy directions from these projects and their implications for public transport become clear, it is expected that their net effect will be to require a much increased share of the passenger transport task to be carried by agencies like CityRail.

Part 3. Regulatory Framework

7. Options for the Regulatory Framework

The regulatory framework for setting CityRail fares should provide adequate revenue to enable RailCorp to maintain a sustainable CityRail service that meets the needs of passengers, and is consistent with the agreed reforms. It is also important that the framework reflects the role and functions of CityRail and the nature of its services, particularly taking into account the social benefits that CityRail's services provide.

The objective of IPART's Review is to recommend a regulatory framework that will provide CityRail with better incentives to improve both the quality of its railway passenger services and the *productive* (or *technical*) efficiency of providing those services. The framework should also promote *allocative* efficiency. For example, by ensuring that projects are the subject of economic as well as financial evaluation, and that pricing plays a role in rationing limited capacity and ameliorating excessive congestion. Hence, each regulatory option should be assessed in terms of its ability to deliver both technical and allocative efficiency gains whilst generating additional value for customers.

It is appropriate for IPART to also consider other objectives including: consumer protection, environmental protection, and financial viability. It is important the regulatory framework provide a transparent mechanism by which IPART can align these objectives and its overarching aim of economic efficiency.

A regulatory regime that builds in financial incentives to improve service delivery has the potential to improve outcomes for customers. However, there would need to be a thorough examination of how a regime can be applied to RailCorp, which is substantially funded by Government. Greater reliance may need to be placed on the public disclosure of performance. Further, the delivery of government funding may need to be modified so it too is aligned with operating performance. For example, by splitting funding between a subsidy for RailCorp (based on efficient cost) and a "below the line" deficit funding.

At its most basic level, an incentive regulatory regime could establish transparent productive efficiency improvement targets for a given level of service quality. However, careful design of the regulatory framework is necessary to deliver improved service quality and to avoid disincentives.

Consideration should also be given to the regulatory framework providing for incentives in the form of price increases in response to demonstrated service improvements.

Similarly, there should not be any disincentives that inhibit RailCorp from expanding its business by attracting new customers and increasing patronage if that is in the interests of the broader community or consistent with Government policy, such as the State Plan objectives. For instance, CityRail sees an opportunity to develop markets outside peak periods when it has significant spare capacity and growth in that market can be achieved at

low marginal cost.

IPART has identified three broad options for the regulatory framework:

- the building block approach, currently used to regulate other industries such as energy and water;
- an operating and maintenance cost approach; and
- a long run marginal cost approach.

There are strengths and weaknesses associated with each of these options and there is no single model that is clearly superior in terms of the incentives it provides to improve the cost effectiveness of service delivery, or best meets the needs of customers and the wider community. These options are discussed as follows:

7.1 Incentives for CityRail Efficiency Gains and Service Improvements

The *building blocks approach* includes all the operating and capital costs required to provide CityRail Services. The incentive for productivity gains under this approach is more comprehensive than the other models, as it would require assessment of the efficiency of capital costs with more rigorous and transparent investment appraisal.

The *operating and maintenance approach* has the advantage of covering those costs over which RailCorp has more direct control. While it makes no allowance for targeting efficiency gains for capital costs, it does provide scope for recognition of cost increases relating to service improvement.

The *long run marginal cost approach* promotes economic efficiency because, theoretically, customers compare the benefit they receive from consumption of an additional unit of a good and service with a price that reflects the cost of producing it; although similar incentives could be provided to consumers under both other options, for instance through differential pricing to reflect capacity.

A key consideration for IPART in determining an appropriate regulatory framework is the means by which incentive mechanisms can best be applied to RailCorp, which does not pay a dividend and will always be substantially funded by Government.

7.2 The Principles of Best Practice Regulation

The principles of good regulation identified in IPART's Issues Paper include providing a framework that is practical, well-targeted, proportionate to the identified problem, and contributes to accountability, transparency, consistency, and simplicity.

The *building blocks approach* provides strong incentives to operate in an accountable and transparent way. However, it is a relatively intensive form of regulation and is the most costly in terms of its resource requirements for RailCorp and for IPART. In addition to an assessment of efficient operating costs, it requires regular reviews of strategic planning, asset management, capital procurement, and service quality outcomes in order to enable the assessment of overall efficiency.

While the principles of the *building blocks approach* may be proportionate to the need to encourage prudent investment decisions, if it is unable to influence the adequacy of investment appraisals (its key benefit), and CityRail continues to have a low level of cost recovery (reducing incentives to reduce costs), its ability to achieve capital cost efficiencies may be compromised and the net impact could be negative.

Building blocks may be less amenable to utilities with overriding equity objectives and social benefits. Railway passenger services have a range of social benefits attached to them, which accrue to both passengers and to the broader community. Hence usage is

encouraged despite the additional costs imposed. This is unlike water and energy businesses where environmental considerations favour demand management and the efficient use of scarce resources.

7.3 Revenue Requirements

The required revenue under the *building blocks approach* is substantial and would have to be satisfied by a combination of fare box and government contributions. Rail capital costs are large and lumpy which could still see cash requirements (for operations and investment) relative to approved revenue fluctuate substantially over several regulatory periods. This will inevitably mean that Government would need to provide some additional funding for capital costs between years, and/or for RailCorp to have significant borrowings, and that CityRail's level of overall cost recovery could fluctuate over time. This may dilute the effectiveness of the regulatory "price signal" that CityRail may face over that period.

Under the *operating and maintenance approach*, regulated revenues would be directly targeted at costs over which CityRail has day to day control, and for which its responsibility is clear. This approach is not as complex as the alternatives, and would be relatively easy for stakeholders to understand and comply with. While the exclusion of capital costs from this approach means it excludes a significant component of the cost of providing railway passenger services, the less "lumpy" profile of operating and maintenance costs would produce a consistent growth in required revenue and CityRail's cost recovery levels.

Conceptually, the *long run marginal cost approach* is the least volatile of the three methodologies, as long term augmentations and lumpy investments would be factored into the calculation of required revenue. However, it may be difficult to estimate *long run marginal cost approach* revenue with precision, potentially creating regulatory uncertainty and potentially compromising the effectiveness of the regime. The practical difficulties of the approach would be exacerbated in the CityRail context of a network business with emerging capacity constraints and significant capital expenditure requirements.

7.4 Compatibility with the Nature of CityRail Services

The regulatory regime must be compatible with, and recognise, the distinct nature of CityRail's services and the policy directions of Government which underpin its current operations and plans for improvement and growth.

Consumption of CityRail services produces more extensive positive externalities than other businesses regulated by means of building blocks approaches (e.g. water and energy). These include positive environmental benefits, including lower greenhouse emissions and reduced air pollution compared with cars, the development of highly concentrated, productive business centres (which by their nature are inaccessible by car for most workers) and social cohesion (by giving access to all to employment, education and social centres). Conversely, road-based modes may generate negative externalities through congestion and local pollution.

Further, road-based transport modes are not subject to proper price signals that encompass both the negative externalities created by congestion and pollution and the value of the road infrastructure utilised; particularly in urban areas. This has partly vitiated the case for rail price reform in the absence of reform of all transport pricing. Cost recovery is also low (irrespective of individual fare levels), because of the large geographic spread of the CityRail network and the relatively low population density of the communities through which the lines run, and the concentration of demand in peak periods resulting in significant excess capacity for most of the day.

Given the inclusion of all cost components, building blocks approaches are well suited to sectors for which it is increasingly important that consumers face the true and full cost of their consumption, due to its scarcity and the negative externalities associated with marginal

consumption (e.g. water and energy). This makes building blocks approaches well aligned with businesses for which marginal use of outputs imposes negative externalities. This is not the case for CityRail.

8. Regulatory Period

The timing of the IPART Review finds CityRail involved in major transition, requiring significant cultural change and capital investment. The Review is an opportunity to:

- develop a better fare adjustment mechanism to formalise CityRail revenue requirements, and
- set out a clearer rationale for fare adjustments aligned to improvements in service delivery, capacity, and customer satisfaction.

Ideally, the regulatory period should align with the 3-year SCI process to provide RailCorp with greater funding certainty and scope to focus on its statutory objectives, and other corporate objectives agreed with Government through that process. In addition, a long-term price path would be useful in meeting the challenge of planning for the growth of the network to meet State Plan targets. Much of the expenditure required for this task will need to be contracted over a longer period than three years; \$4.7 billion in capital infrastructure is planned for the next five years.

Some initiatives, such as the introduction of new rollingstock, require significant capital investments over the period, and will deliver tangible benefits toward the end of the regulatory period. Regardless of the regulatory model adopted, a longer term price path would also allow for a more integrated assessment of capital investments and consequential changes in operating and maintenance costs.

A longer regulatory period will also provide greater funding certainty for RailCorp management, and support a greater focus on longer-term strategic decision-making and planning. It will provide greater clarity to the process of allocating Government funding, and encourage alignment of that process with the timeframe of the price path.

Part 4. Government Service Standards for CityRail

9. Needs of Passengers

Effective metropolitan railway passenger services are crucial to the effective functioning of the Sydney CBD. The central feature of RailCorp's functions is the day to day operation of its CityRail services. This function can be best described as *the carriage of passengers to their intended destinations*, and it is the one and only reason for operating railway passenger services. This translates to the principal performance outcome that must be achieved; that is, "effectiveness".

Ideally, standards against which RailCorp's performance would be measured should support the assessment of RailCorp's effectiveness. Therefore, the test for whether a particular aspect of performance should be assessed will be whether it informs decisions about RailCorp's effectiveness. Interpreting effectiveness would involve identifying the passengers who need to travel (defining the customer base), and the intended destinations of those passengers (defining the transport task).

10. Dimension of Service Standards

The IPART service standards paper discusses the dimensions or framework within which rail service standards could be set, and the matters for or with respect to which service standards could be made. These encompass a range of outcomes which Government and passengers expect from RailCorp; including, for example: amenity, punctuality, effectiveness, and so on. The Paper sets out a table showing the results of research (2004 to 2007) carried

out by ITSRR which ranks the opinions of passengers of the relative importance of various aspects of CityRail services.

These are fundamental considerations for the determination of the dimensions of rail service standards. Moreover, they relate directly to the focus and purposes of the RPA and the rail performance benchmarks which must be derived from the RPA, and which by law must deal with both rail services and rail infrastructure facilities.

It is important to ensure that the development of a service standards regime be done in the context of the tasks that are to be carried out, and in the case of RailCorp such tasks are negotiable periodically; for example, through the SCI process or other processes such as the CSIP. The service standards would need to have regard for:

- the dimensions or framework within which standards can be devised and applied,
- the matters for which standards are required, categorised according to the aspects of service outcomes on which standards would be focused,
- the expectations of passengers in relation to service delivery outcomes,
- the specification of performance benchmarks for the delivery of railway passenger services and the provision of rail infrastructure facilities,
- the means by which service performance might best be measured to determine the extent to which performance exceeds or falls short of the benchmarks.