



INDEPENDENT CONSUMER & COMPETITION COMMISSION

**REVIEW OF CURRENT PRICING ARRANGEMENTS FOR
PUBLIC MOTORS VEHICLE (PMV) FARES**

FINAL REPORT



1st October 2008

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COMMISSIONER'S FOREWORD

The Independent Consumer and Competition Commission (the Commission or ICCC) is a statutory body, established under the provisions of the *Independent Consumer and Competition Commission Act 2002*. The Commission has been given the responsibility in PNG for the promotion of competition and fair trading, the regulation of prices for certain goods and services, and the protection of consumers' interests and other related purposes. As part of its functions, the Commission has the mandate to set fares for Public Motor Vehicles ("PMVs") for various routes throughout the country.

The full Board of the Commission is represented as below:

| | | |
|-------------------------|---|---|
| Thomas Abe | - | Full Time Commissioner & CEO |
| David Dawson | - | Associate Commissioner (Non- Resident); and |
| Dr. Billy Manoka | - | Associate Commissioner (Resident) |

This Review into the current PMV fares is in response to numerous complaints from commuters on unilateral fare increases applied by PMV operators and submissions received by the Commission from various PMV Associations and operators who felt that an adjustment in fares is necessary to allay significant increases in fuel prices since the release of the final Price Determination for PMVs and Taxis in November 2007. In view of the complaints and submissions received, the Commission has out of its own volition, decided to examine more formally whether or not a further price adjustment is necessary, and if so the extent to which the increase can be allowed.

This Review has primarily focused on the recent increases in fuel prices and the impact of these price increases upon the ability of PMV operators to maintain their services. The review is not intended to reopen or reconsider the matters covered more fully in the PMV and Taxi Review released by the Commission in late 2007. There were a wide range of issues raised and considered as part of the 2007 Report, and the Final Determination made by the Commission put into place a price adjustment mechanism that makes allowances for various costs increases, including fuel costs, that PMV and taxi operators face in providing their transport services. The focus of the current review has been upon whether or not it is necessary for the Commission to take action within the terms of the existing Price Determination process to make more regular adjustments to PMV fares at a time when one of the more significant operating cost variables which in this case is fuel, is increasing at a considerable rate.

This review has been undertaken in accordance with Sections 25B and 25C of the *Prices Regulation Act Chapter 320* (hereinafter the "PR Act") in an open and transparent manner with the participation of the general public and stakeholders of the industry at all stages of the review process.

Under the existing pricing arrangements relating to PMV fares as determined by the Commission in 2007, the fare adjustments are driven by a formula which takes into account movement in the underlying costs of operating a PMV business. Essentially, the formula incorporates movements in the Consumer Price Index ("CPI") and a fuel cost index devised by the Commission from movements in the retail price of diesel for Lae. Movement in these cost indices are applied to PMV fares on an annual basis. This review will further consider whether or not there needs to be more frequent adjustments in the fare levels given the volatility of the fuel price index.

The Commission has received a number of submissions from the industry and has considered the relevant arguments which form the basis of this Final Report. The Final Report and the submissions are public documents and are archived in the Commission's office for public viewing unless commercial confidence is sought for certain aspects of the submissions.

Finally, the Commission would like to acknowledge the contribution and participation of the various industry stakeholders including members of the public during the course of this review.

For further information on this Report or any other matters of concern to the Commission, please contact Mr. Stanley Alphonse, Executive Manager for Prices, Regulatory Affairs and Special Project Division on 325 2144 or email him at salphonse@iccc.gov.pg.



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Thomas Abe
Commissioner & CEO

30th September 2008

1 EXECUTIVE SUMMARY

This Review has been undertaken by the Commission at its own volition in accordance with the provisions of Section 25 of the PR Act.

This executive summary provides an overview of the Commission's key findings and its final determinations that will apply to the pricing arrangements of PMV in 2008. These key findings and determinations are based on submissions and comments received by the Commission plus the Commission's own analysis. It is important to note that the Final Determination does not replace the Pricing Determination on PMV Fares issued by the Commission in November 2007. Rather, this Final Decision seeks to address a particular issue, namely the recent significant increase in world prices for fuel and the flow on effects on the PMV industry in PNG.

1.1 Key Findings

The Commission has reviewed the movement in fuel prices and discussed the overall impact of these cost increases on the PMV industry. The Commission has also examined a number of issues in relation to the level of service being provided by the industry, and the ability of the industry, particularly on urban routes to recover the higher fares that the Commission approved last November. The Commission noted that these higher fares were designed to address the need for the industry to have a fare structure that better reflected its need to recover costs given the number of passengers that were being carried and the types of routes being serviced. The failure of the urban PMVs to recover these higher fares raises a concern for the Commission in that by increasing the fares yet again to take into account the higher fuel prices, there is no guarantee that the industry will actually collect the additional revenues that these higher fares would otherwise imply.

The Commission has also received submissions on matters arising out of its November Determination. Submissions received, particularly for non urban routes, have suggested that the Commission should have used as a cost base a higher level of fares than that used in the November decision and the price adjustments that took effect from 1 January 2008 (that is, the then existing level of fares upon which the Commission then allowed an increase based on movements in the general level of inflation and fuel costs—the fare adjustment formula). The Commission has examined these submissions, and notes that they are often based on arguments and evidence which do not support the conclusions that have been reached. In making its November 2007 Determination, the Commission undertook a detailed evaluation of the industry based on operating costs and other materials provided by the industry. Nothing in the new submissions has indicated that the analysis previously undertaken by the Commission was wrong. In fact, the new submissions have tended to support the view that there is a high degree of inefficiency in the way in which the industry operates, and that while local villages and communities may be prepared to 'fund' this inefficiency for the convenience of having their own family group or village owned PMV, this does not mean that fares should be increased so that all commuters pay for that social benefit that is fully appropriated by the village or family group concerned.

However, the Commission has noted that there are a number of omissions in the schedule of fares that it has gazetted, and as a consequence of these omissions being identified, the Commission will make some amendments to the schedule of fares that is gazetted.

The Commission has examined four possible fare adjustment arrangements to take into account the recent rises in fuel costs. Effectively these adjustments work in a manner similar to the existing price adjustment formula, but endeavour to bring forward the fare adjustment in recognition of the significance of the fuel cost increases.

The Commission has examined these options in the context of the requirements that are placed upon it by section 21(2A) of the PR Act. The Commission has concluded that there is justification for some adjustment of fares to take effect immediately, but that this adjustment should apply to non-urban routes only. Urban PMV operators are challenged to find ways to improve their overall recovery of the existing fares, so that more of their customers pay the maximum fares allowed for each customer segment. The Commission is prepared to work with the industry to help to achieve a better fare recovery.

For non-urban routes, the Commission has calculated a fare increase of 9.7% for this Final Determination. This is based on movements in the costs indices up until the end of June 2008. A further fare increase for the non-urban routes would take effect from 15 October 2009 onwards and would take into account the more recent increases in fuel costs and other underlying inflation effects consistent with the fare adjustment mechanism outlined in section 6.3 of this Final Report. For urban routes, the existing determination by the Commission will stand and the next fare adjustment for urban routes would take effect from 1 January 2009 and would take into account the more recent increases in fuel costs and other underlying inflation effects.

The Commission believes that this adjustment best meets its requirements under the PR Act to balance the interests of the industry and consumers, while ensuring that there is continuing improvement in overall efficiency and service delivery.

Following are the Commission's Final Decision on this matter based on the Commission's consideration of all the evidence including the comments received as part of the Review Process.

1.2 Final Determinations

Final Determination 1

The Commission will make amendments to the gazetted fare schedule to include destinations/pick up points that have inadvertently been omitted from its November 2007 decision. Fares for these locations will be determined by the Commission having considered the current fares applying to nearby locations and the route distance to the additional pick up and drop off points. In terms of those locations where there was no listing for the whole route as part of the fare gazettal process, as a general guide, and consistent with what action it has already taken in relation to those non urban routes that have been gazetted, the Commission will use as the starting point the fare rates that have applied in 2007, and make adjustments as appropriate based on the decisions arising from this Report. However, the Commission will reserve the right to amend this arrangement where it is apparent that there has been any attempt to inflate the 2007 fare levels to be used by the Commission or that the fare proposed is inconsistent with fares applying for similar route lengths and under similar conditions in other places.

Final Determination 2

The Commission will apply a one-off adjustment to non-urban fares covering movement in the fare adjustment formula for the nine month period to the end of June 2008. The adjustment will be 9.7%, and the standard rounding rules will apply to the fares calculated using this adjustment factor. The fare adjustment will take effect from 15 October 2008.

Final Determination 3

The fare adjustment from 15 October 2008 will apply on a once only basis. The next adjustment to non-urban fares to take effect from 15 October 2009 will also be based on the movement in the fare adjustment formula for a 12 month period as set out in this Final Report.

2 INTRODUCTION & BACKGROUND

2.1 Overview of Commission & Legislative Arrangements

The Commission is a statutory body, established under the provisions of the *Independent Consumer and Competition Commission Act 2002* ("ICCC Act"), which has been given responsibility for the promotion of competition and fair trading, the regulation of prices for certain goods and services, and the protection of consumers' interests and other related purposes.

The Commission is also responsible for the administration of the Prices Regulation Act ("*PR Act*") relating to the price regulation of certain goods and services declared by the Minister for Treasury for the purposes of this Act. As part of the economic regulatory reforms undertaken in 2002, certain amendments were made to the PR Act which saw the inclusion of certain provisions that effectively allowed the Commission to initiate reviews into the pricing of certain goods or services declared under this Act. The Commission can undertake such a review on its own volition, or upon any written request from the Minister responsible for the Act or the supplier of the declared goods or services concerned.

Under the provisions of Section 25A(6) of the PR Act, the Commission of its own volition may decide to undertake a review of a 'reviewable order' (see Appendix A). A reviewable order under the terms of the PR Act is a pricing order that has been made in accordance with the PR Act. The Commission's determination on PMV prices announced last November has resulted in a reviewable order being issued, namely the price control arrangements that are to apply to PMV fares. This review by the Commissions has been in response to community and industry concern about the pricing of PMV fares in the context of significant increases in fuel prices, and the Commission has exercised its powers under the provisions of Section 25A(6) to undertake a review of the current reviewable order relating to the setting of PMV fares.

In undertaking this review, the Commission has also had regard to other provisions of the PR Act, in particular:

- Sections 10, 20A & 20B and 25B & 25C of the amended PR Act; and
- Confidentiality and public disclosure provisions of the PR Act relating to information received from stakeholders and other interested parties.

2.2 Overview of Review

2.2.1 Background

The regulation of PMV operations in PNG is shared between the Department of Transport (DoT), the National Land Transport Board ("NLTB"), and the Commission. The Commission has recently undertaken a major review of the PMV and taxi industry. The Final Report detailing the current PMV Fare Determination was released on 7th November 2007. Urban PMV fares in Port Moresby were adjusted at that time, and adjustments to fares for other routes across PNG were made to apply from 1 January 2008. The current determination will apply until 31 December 2012.

The current Review has been limited in focus, and has addressed the issue of whether, under the price adjustment mechanism that the Commission has determined, there should be an interim adjustment to fares to take account of the recent price increases in fuel. Thus, the current review sought to address issues raised by PMV operators that the impact of the higher than expected fuel prices have adversely affected their ability to continue to operate without some financial relief by way of a fare increase.

2.2.2 Review Process

The review consisted of the preparation and release of a Draft Report, the taking of submissions and comments on that report from all interested parties, and the preparation and publishing of this Final Report. It was anticipated that should the Commission find that there is a need to make an early adjustment to the fare structure to address the fuel cost increases, the Commission would be able to implement this fare increase under its existing powers and under the current gazetted price determination and price adjustment arrangements.

2.2.3 Review Timeframe

The timeframe for the Review process was as follows:

| Event | Timeframe |
|---|--------------------------------------|
| Release of Draft Report | Wednesday 9 th July 2008 |
| Due date for Receipt of Submission | Wednesday 23 rd July 2008 |
| Release of Final Report and Determination | Wednesday 1st October 2008 |

Copies of submissions received by the Commission (unless treated as being confidential) will be available for public viewing at the Commission's office on a 'Public File' or copies can be obtained from the Commission at a nominal cost for photocopying. The Draft Report and Final Report of the Commission are also public documents and can be obtained from the Commission's office after their release. The Draft Report and Final Report are also published on the Commission's web site at www.iccc.gov.pg.

3 OVERVIEW OF CURRENT PMV PRICING ARRANGEMENTS

3.1 Current Price Determination

In the November 2007 Final Report on the PMV and Taxi Industry, the Commission reports on its comprehensive review of the industry and the form of the price determination that will apply until 31 December 2012. As part of that Review, the Commission needed to determine whether or not to continue price regulation of PMV and Taxi services, and if price regulation was to continue then what form of regulation would be appropriate. Matters that the Commission considered included the extent of competition in the market for these transport services, the existence of potential new competitors, the ability of consumers to exercise some degree of influence on prices that are charged and the opportunity for innovation or changes in the form of transport to limit the market power of existing service providers.

The Commission concluded that the market conditions were not sufficiently competitive to ensure that any market power holders of a PMV or Taxi licence might have is prevented from being exploited. Thus, the Commission determined that there were sufficient grounds for some form of price regulation to apply for both PMVs and Taxis. Accordingly, the Commission determined that both PMV and Taxi Fares were to be subject to price control under the auspices of the Commission.

In determining the appropriate fares that should be applied across the industry, the Commission undertook some financial modelling based on information provided by PMV and Taxi operators. This allowed the Commission to form a view as to what level fares should currently be set after having allowed for PMV and Taxi operators to recover their efficient costs and to make an appropriate return on their investment in the business concerned. For the purposes of forming a view as to the appropriate fare rates, the Commission took into account the particular routes that are being serviced by PMVs in particular, and the cost structure associated with those routes. Thus the fare structure devised by the Commission and gazetted embraced the fares that should apply on both urban and rural routes across the country.

Not only did the Commission need to determine the level of fares to apply immediately, but as part of its decision to set a five year price path, it needed to devise and determine a mechanism whereby fares could be adjusted on a regular basis over the five years of the price determination period. To determine the appropriate fare adjustment mechanism for the regulatory period, the Commission considered the major cost drivers in the operation of PMV and taxi services. From data obtained from the industry and the analysis undertaken by the Commission, the Commission concluded that the most appropriate indicators of movements in cost that could be used to adjust the regulated fares over the next five years were the Consumer Price Index ("CPI") and a fuel price index based on movement in the retail price for diesel in Lae. Based on the relative contribution of fuel and associate fuel based products on the total cost structure of a PMV business, the Commission devised a weighting mechanism whereby movements in the CPI and fuel price index could be combined into a single index which would then be applied to fare levels to calculate revisions to the fare levels at various times over the regulatory period. The Commission decided to make these fare adjustments on an annual basis, reflecting standard regulatory practice for other goods and services for which the Commission determines a price, and also for the practical reason that more regular price adjustments may only result in confusion within the industry and amongst consumers as to what is the current fare level that can be charged.

3.2 Fare Adjustment Mechanism

The price adjustment mechanism devised by the Commission and which is currently in force is applied on an annual basis with new fare rates applying from 1st January each year. The Commission's determination requires that the Commission determine the adjustment to apply from

1st January no later than 7th December each year (or the first business day thereafter). The new fare is to be published by way of the Government Gazette and daily newspapers.

The fare adjustment formula is as follows:

$$\Delta P_{t+1} = \Delta CPI_t * 0.75 + \Delta DFI_t * 0.25$$

where;

ΔP_{t+1} = the percentage increase in fares in the next year t+1

ΔCPI_t = the percentage increase in the CPI (excluding betelnut, alcoholic beverages and tobacco) produced by the National Statistical Office (NSO) and calculated over the four quarters to September in year t over the CPI (excluding betelnut, alcoholic beverages and tobacco) calculated over the four quarters to September in year t-1.

ΔDFI_t = the percentage change in the average monthly price for diesel (including GST) in Lae as published by the ICCC for the period to September in year t over the average monthly price for diesel for the period to September in year t-1

In terms of the calculation of the CPI index, the following formula is used:

$$\left(\frac{Dec\ CPI_{t-1} + March\ CPI_t + June\ CPI_t + Sept\ CPI_t}{Dec\ CPI_{t-2} + March\ CPI_{t-1} + June\ CPI_{t-1} + Sept\ CPI_{t-1}} \right) - 1$$

where;

- Dec, March, June, Sept are the quarterly CPI index numbers
- t, t-1, t-2 refer to years such that t is the current year (the year in which the price adjustment analysis is performed) and t+1 is the next year for which the fare increase is to apply

In terms of the calculation of the ΔDFI_t index, the following formula is used using Lae diesel prices:

$$\left(\frac{12\ month\ average\ monthly\ diesel\ fuel\ price\ to\ September_t}{12\ month\ average\ monthly\ diesel\ fuel\ price\ to\ September_{t-1}} \right) - 1$$

Under a ‘rounding rule”, the fare calculated for individual PMV routes using this annual adjustment formula is adjusted down to the nearest whole number evenly divisible by 10 if the calculated rate is no more than 5 toea greater than the number evenly divisible by 10. If the calculated rate is 6 toea or more above a number evenly divisible by 10 the rate is adjusted up next to the highest level evenly divisible by 10. When the following year’s fare adjustment is calculated for PMVs, the actual (not rounded) fare rate issued as the starting point for purposes of applying the percentage increase to calculate the new fare.

The Commission’s decision also made an allowance for a concession fare to apply on PMV routes. These concession rates apply to children and students. The two concession categories are “School Children”, that is for those in Primary and High School up to and including Grade 10 students, and “Senior and Tertiary Students”, that is for those in High School Grades 11 and 12, and in tertiary institutions (university), technical school and teachers college. The latter group must be able to provide a student identification card to the PMV operator when requested, in order to be eligible for the concession fares.

A uniform concession applies across PNG. For “Senior and Tertiary Students” the concession fare rate is 75% of the full fare and for “School Children” the rate is 50% of the full fare. These

percentages have been applied to the determined fares. The rounding rule also applies to the concession fares.

3.3 Conditions for Granting Fare Certainty to the Industry

As part of its 2007 Report, the Commission gave consideration to the issue of the service standards offered by the PMV industry. The Commission was particularly concerned by clear evidence that not all PMV operators are meeting their obligations in terms of providing safe and reliable transport service to the locations indicated by their PMV licence conditions. Furthermore, the Commission was concerned about apparent public safety issues arising not only from poorly maintained PMVs, but also from some unsavoury and illegal activities perpetrated by some PMV drivers and their offsidiers. While these are matters that should ideally be prosecuted through the enforcement of the licence conditions (and therefore should be enforced through the Department of Transport) or under the existing public law and order legalisation applying in PNG (and therefore enforced by the police), it is clear that the enforcement of these standards is not occurring. Thus, the Commission took the decision to build into its price determination arrangements under the PR Act whereby it can effectively take action under the PR Act to have fines applied to PMV drivers and operators who fail to meet their obligations for service and safety.

In particular, the two conditions that were set by the Commission were:

- a PMV may only charge fares on the condition that it completes its full designated route from one end of the route to the other, on every journey during each day on which it carries passengers; and
- PMVs may not discriminate against concession paying passengers (including school children) in any way or at any time, either by refusing to carry concession fare passengers whenever there is room available on the PMV for them to get on, or by asking or requiring concession fare passengers to get off the PMV before completion of the passenger's journey.

Failure to comply with either of these conditions would place the PMV operator in breach of the PR Act and through the powers given to the Commission action could be taken that would lead to fines and in conjunction with the Department of Transport, potentially the removal of the PMV licence to help enforce these standards. The Commission established a 'complaints line' whereby the public could report instances where PMV drivers fail to meet these requirements. The Commission, by way of its own pricing inspectors will also keep an active look out for PMV operators who are failing to meet their obligations and thereby are breaking the law.

The inclusion of these requirements for the industry to improve its overall image and level of service was a fundamental condition of the decision of the Commission in November 2007 to grant fare increases and to put in place a fare adjustment mechanism which gives PMV operators certainty regarding fare adjustments against cost increases over the next five years. It is important to note this link between the granting of certainty over fares and the requirement that the industry provide a reasonable and safe service. These two issues go hand in hand, and were considered as being part of the trade off in requiring the public to pay higher prices.

4 SUBMISSIONS RECEIVED

The Commission's decision to undertake this Review was in part driven by the number of submissions received regarding the impact of fuel price rises on PMV operators' ability to continue to operate profitably. These submissions are briefly discussed below. A list of submissions received to-date is provided at Appendix B.

4.1 Submissions to the Review

The Commission has received a number of submissions from interested parties (see below). Without repeating the discussions of the initial submissions received which have been outlined in the Draft Report, the Commission has commented below on the additional submissions received after the release of the Draft Report.

The submissions received by the Commission on this inquiry were from the following interested parties:

| | |
|---|--|
| Submissions before Draft Report | Freddie Nanai-Silona –Rigo PMV operator |
| Klinki PMV Association – Lae Wau-Menyama Route | New Ireland Provincial Land Transport Board |
| Rigo Central PMV Association | Madang Urban PMV Association |
| PMV Owners Route 300 – Barakau | Manus Provincial Administration |
| Hoodlagoon PMV Association | West New Britain Land Transport Board |
| Mr. Elim Kiang | ENB Provincial Land Transport Board |
| Submissions to the Draft Report | Klinki PMV Association – Lae-Wau-Menyama Route |
| Milne Bay Provincial Administration | Route 3 PMV Association – Lae to Ramu |
| East Sepik Land Transport Board | Route 4 PMV Association – Lae to Bukawa |
| Milne Bay Provincial Administration | Oro Provincial Administration |
| Eastern Highlands Provincial Land Transport Board | |

The Commission considers these submissions as an important component in reaching a decision on this matter and in identifying and assessing the performance of PMV operations over the last 9 months and in considering appropriate remedial actions.

4.2 Discussion of the Issues

The written submissions received from the operators before the release of the Draft Report primarily focussed on the rising cost of fuel facing the industry. Other issues that have concerned operators are:

- The general rising cost of goods and services;
- Deteriorating road conditions;
- Absence of approved maximum fares for certain rural routes;
- Commuters and travelling passengers paying fares below approved fare levels;
- No fare increases for some routes after the 2007 determination; and
- Delays in obtaining further increases in the level of fares.

Most submissions have argued that fuel prices have risen significantly within a short period of time while fares have remained unchanged meaning PMV operators are providing the services at a loss, as a greater proportion of revenue is spent on fuel costs. The additional fuel costs have also

resulted in inflationary pressures across the country and price increases, particularly on internationally imported goods and services. Ultimately, these additional costs are passed on to consumers and in this instance PMV operators are faced with meeting much higher costs of maintenance and repair on their vehicles.

In addition, some operators claimed that the adjustment granted by the Commission following the release of the November 2007 Report was not sufficient to allow them to earn an appropriate return. They argued that the previous gazetted fares upon which the Commission used to calculate the adjustment to set the current fares had remained unchanged for more than ten (10) years and therefore the level of fare increase granted fell below the change in economic comparators such as CPI, fuel prices, vehicle cost and general cost of maintenance and repairs.

The Commission notes that urban PMV operators have also expressed concern with the issue of underpayment of the PMV fares by the public. Passengers are not paying the higher fares set by the Commission in November 2007, and as a consequence, the PMV operators are running their businesses at a loss and this is further exacerbated by the price increases in fuel costs during the months of January 2008 to July 2008. Operators on some rural routes are arguing that the fares recently announced by the Commission are marginally different to the fares that have applied over the last (10) years, and that with deteriorating road conditions on the rural routes, maintenance costs are now difficult to recover from the fares collected.

Before discussing the issue of fuel costs in more detail, it is worthwhile commenting upon these two major points that have arisen from consideration of the submissions received to-date. Each will be dealt with in turn.

4.2.1 Recent fare Increases from November 2007 Report

The fare adjustments announced by the Commission in its November 2007 Report were determined after an extensive public review process to which the PMV operators, Provincial Land Transport Boards and other stakeholders were invited to submit information on particulars of routes, fares and the costs of operating PMV businesses. As part of this review, the Commission undertook an exercise in data gathering from the industry, and as reported in the November 2007 Report, the Commission received information from operators, both urban and rural from across the country. This information was then used in building a cost based pricing model for the industry which looked at costs on a route by route basis using the information that was obtained from the industry. In addition to the direct costs that the industry provided, the Commission also included an allowance in the cost build up for the depreciation of vehicles (over a standard life of four years) and a return on the investment in the vehicles of 15.8% nominal pre-tax. Thus, the Commission went into some detail to incorporate not only the costs as advised by the industry, but also allowance for a fair return on the investment that had been made in the vehicles and a recovery of the cost of those vehicles over an assumed four year life span.

The Commission therefore can be said to have considered in some detail the cost of operating PMVs in a number of locations across the country. The allowance of the replacement of the vehicle cost over a four year period also allows for considerable wear and tear on the vehicle, due to the condition of the local roads.

When the Commission then considered what fares would be required to allow PMV operators to recover these costs, it noted that on a number of routes, PMV operators were already recovering these costs plus more. However, on other routes, it was noted that there was a need for a fare increase. But in this process, the Commission also had to have regard to the efficiency of the operation of the PMVs involved. As highlighted in the Draft Report, when discussing the Barakau submission, there was evidence of inefficiency in the operation of some PMVs. This was reflected in overcapacity on some routes and the running of PMVs when it was clear that the additional revenue likely to be generated would not meet the additional marginal costs for items such as fuel

and staff wages. Thus in considering the number of passengers carried, while the Commission gave strong consideration to the passenger numbers reported by the industry, where it was apparent that the number of passenger carried was uneconomical, the Commission did not simply increase the fares to a level that would have meant that this small number of passengers would have met all the costs of the PMV.

Thus, the process of setting the fares was not simply one of assessing all the costs and then setting the fares to recover those costs. The Commission had to have regard to the demand for the PMVs and whether or not the additional costs of running PMVs with low patronage was an inefficiency that passengers should not be required to meet by way of fare increases. One approach which could be used to improve efficiency, could be to re-adjust the number of vehicles from one operator travelling a particular route so that more vehicles were on the route during peak travel times and less were deployed during off-peak times. Overall the vehicles deployed would use more of their available seating thus improving the financial performance of the operator. Other approaches could be used for single vehicle operations including advertising departure times and adjusting departure times to periods of highest demand.

The Commission used the existing fare structure as a starting point for its analysis for the November 2007 decision. However, as is demonstrated by the decision that the Commission took with reference to the urban fares, the Commission was not necessarily bound to that structure. Rather, the Commission, having undertaken its detailed route-by-route analysis came to a view that an across the board fare adjustment was justified in this particular situation. In some instances where operators have claimed that fares have not changed from those existing ten years ago, the Commission is aware that on some routes the Land Transport Board prior to 2003 and even since the establishment of the Commission, made what are effectively illegal decisions to increase fares. Again, the Commission's analysis demonstrated that in these instances the increases were not justified, and the Commission believes that the fares that it has determined are appropriate for the routes concerned given the economic and financial analysis undertaken at that time.

Under the provisions of the PR Act, operators have the right to request the Commission to reopen a price determination, but such a reopening cannot occur within 12 months of the Determination being made without the agreement of the Commission. After a 12 month period has elapsed, the Commission is required to reopen a determination if requested by the supplier of a declared good or service. However, the Commission notes that the current determination is for PMV fares across a wide range of routes, and a route-by-route re-examination of the determination would be a very expensive exercise, both for the operators concerned and for the Commission.

The Commission has noted the comments received regarding omission of certain parts of rural PMV routes from the published fare determination. The Commission acknowledges the difficulties encountered in terms of having up-to-date route details, and therefore as discussed below, will take appropriate action to include these omissions in the relevant fare schedule.

4.2.2 Discussions of Submissions on Draft Report

In response to the Draft Report on the apparent omission of the routes not covered in the November 2007 PMV fare determinations, the Commission has received a number of submissions particularly from Provincial Land Transport Boards (PLTBs), Provincial Administrations and PMV Associations.

Among the submissions for consideration of new routes, Oro Provincial Administration submitted the fares for their provincial routes that were not gazetted following the November 2007 Determination. They argued that prices for their routes had been set by the Provincial Land Transport Board in 2007 and that adjustments from 1 January 2008 should have been based on these 2007 fare levels. The issue here is one of lack of available detail to the Commission when it gazetted fares in early 2008. The question that the Commission must address is whether or not to

use the 2007 fare levels set by the PLTB as the starting point for the new fares, if any, to apply in 2008.

The Commission did not approve the fares set by various PLTBs during 2007. In fact, the Commission made it clear to the National Land Transport Board that it had no authority to set fares in 2007, and at that time the Commission was already working on the preparation of what has become known as the November 2007 Determination. However, in setting the rates from 1 January 2008 under the November 2007 Determination, the Commission adopted the then gazetted fares or the fares that had been set by the relevant PLTBs. Thus in these circumstances, what the Commission will do is to take the 2007 fare levels set by the Oro Administration for example, and make adjustments to these to reflect any decision made in this Report on an interim adjustment to account for more recent cost increases. The Commission will adopt a similar approach for other relevant routes where it is demonstrated that the Commission had not had access to their fare levels at the time it gazetted non urban route fares in early 2008.

Other submissions only cited individual routes that were not originally covered in the Commission's 2008 fare determinations. This includes routes that were not known to the Commission and new routes which have been established and which now need to have a fare determined (see submissions from East New Britain Provincial Land Transport Board ("ENBPLTB"), Eastern Highlands Province, East Sepik Provincial Land Transport Board (ESPLTB), West New Britain Provincial Land Transport Board (WNBPLTB), Milne Bay Provincial Land Transport Board (MBPLTB), Eastern Highlands, West New Britain Provincial Land Transport Board (WNBPLTB) and a number of routes in the Morobe Province).

There were other submissions suggesting to the Commission that it consider proposed revised fares as part of this review process and these submissions are particularly from MBPLTB and Madang Urban PMV Association. Submissions from several routes in Morobe Province have quoted their current fares (fares not necessarily set by the Commission) but suggested that these fares should be considered for adjustment in the next fare adjustment review.

The Commission recognises that the list of routes that has been available for gazettal purposes has not been complete. In fact, it has only been as a result of the actions by the Commission to make a determination and enforce that determination that the failures of the previous arrangements whereby the various Land Transport Boards were making the fare decisions have become apparent. It is the Commission's intentions now to fix these failures such that there is a clear listing of all fares, and in due course a clear process whereby new routes can be notified and fares set by the Commission as is required under the PRA.

In the meantime, the Commission will examine each one of the submissions received to determine what fare should apply and will gazette the appropriate fare. As a general guide, and consistent with what action it has already taken in relation to those non urban routes that have been gazetted, the Commission will use as the starting point the fare rates that have applied in 2007, and make adjustments as appropriate based on the decisions arising from this report. However, the Commission will reserve the right to amend this arrangement where it is apparent that there has been any attempt to inflate the 2007 fare levels to be used by the Commission or that the fare proposed is inconsistent with fares applying for similar route lengths and under similar conditions in other places.

The Commission emphasises however, that it will not condone the charging of fares that have not been approved and /or gazetted by the Commission. It will use its enforcement officers to apply the full powers of the PRA to those PMV operators found to be charging fares inconsistent with the fares approved and/or gazetted by the Commission.

4.2.3 Collection and Payment Issues

Collection and payment of the appropriate fare is pertinent to the effective operation of a PMV business. In the November 2007 Final Report, the Commission noted that the manner in which fares are collected is based on “pay as you enter” arrangement whereby the passenger pays before boarding. This type of arrangement is mainly practised on the urban routes. However, this does not seem to be the practice particularly during the peak hours when there is a rush for commuters to either leave for home after work (in the afternoon) or go to work in the morning, thus making it impossible for the crew to collect the fare as people are boarding the PMV. As a consequence, having boarded the PMV, passengers can and do refuse to pay the full fare. As a consequence, and allegedly in response to this practice, PMV operators are shortening their route and demanding that all passengers leave the PMV.

The Commission considers that the onus is on the PMV operators to ensure that they have collected the maximum approved fares. However, if the operators are willing to accept a fare lower than the maximum approved fare then this is a commercial decision made by the PMV operator concerned. A decision by the operator to accept less than full payment should not be used as the basis to shorten the route and offload passengers. The PMV operator has the prerogative to refuse entry or offload the underpaying passenger at the nearest police station.

However, the Commission acknowledges that it can be difficult to take the PMV to the nearest police station to seek help to remove passengers who have not paid the full fare. Such a disruption in the operation of the PMV may be unacceptable to the PMV operator and to the other full paying passengers on the PMV. Thus, some other form of action is required by the PMV operator if they are to ensure full payment of the fares.

It is not possible for the Commission to institute arrangements that would force passengers to make full payment. It can only be the PMV operators themselves who can address this problem. However, their ability to address and resolve the problem may be helped if the industry was to take a common approach to a resolution. For example, while it is currently common practice for passengers to ‘rush’ a PMV at the peak hours and not pay until on board, a concerted action by the industry to refuse entry until the fare is paid would help to address this problem. Thus, if all PMVs adopted the approach whereby passengers must pay before they board and this approach was applied during all hours of the day, there would gradually be an acceptance of the fact that this is the way that the PMVs are going to operate.

Failure to adopt some form of disciplined entry arrangements onto PMVs over a number of years has contributed to the problem that is currently being faced in the urban areas. To a large extent the solution to this problem is in the hands of the PMV operators themselves, and provided that they operate within the law, they are within their rights under the PR Act to refuse entry to someone who does not pay the gazetted fare.

There was no specific response to this suggestion made in the Draft Report notwithstanding the concerns being expressed by the PMV operators that passengers were not paying the full fare. The Commission remains of the view that the solution to this problem is in the hands of the PMV operators themselves and that the Commission can not take any additional action other than support the PMV operators when they are charging the correct approved fare. The Commission is unable to literally police every transaction and PMV trip. Furthermore, the Commission is not willing to increase the fares further to take into account the failure of the PMV operators to collect the fares that they are legally entitled to collect. This would only serve to add a cost burden to those passengers who are doing the correct thing by paying the appropriate fare. It is up to the PMV operators to take action through their association to ensure that fares are paid. The Commission’s suggested approach as outlined in the Draft Report remains on the table as one possible option that the industry could consider.

Some passengers, especially in NCD and Lae, have argued that PMVs do not complete their routes and therefore that provides the justification basis for them to pay less than the maximum approved fares. While the Commission understands the frustration from the commuters, the Commission considers that this is not a proper justification to intentionally pay less than the maximum fares. The Commission further considers that commuter's position will be protected if they can pay the approved fares and should the PMV not complete its route then commuters should quickly provide the details of the PMV to the Commission using the telephone 'hotline' established by the Commission for this purpose. The Commission in conjunction with other relevant authorities will ensure that the operators concerned will be brought to account.

In rural areas, failure to pay fares is not a problem for the operators as passengers tend to pay the required amount and in instances where a passenger cannot pay the full fare, a negotiation between the operator and passenger is made and payments can be made later. Thus the problem is mainly one that is impacting on the urban routes in NCD and Lae.

The consequences of this failure to collect the full fare on urban routes is that PMV operators on these routes are failing to fully recover their costs and make an appropriate return on their investment. This is of concern to the Commission as it lessens the ability of the PMV operators concerned to maintain their vehicles in a safe operating condition, and it implies that the PMV fleet is not being operated in the appropriate manner. At the same time, the solution to this problem in terms of seeking to increase the gross revenue of the PMV operators is not necessarily to increase the PMV fares to compensate for this underpaying. Indeed it is likely that such action will only serve to exacerbate the problem.

As noted by Mr. Kiang in his submission to the Commission, the resolution to the difficulties with the urban transport arrangements requires a multifaceted approach directed at improving the standard of the industry. The focus should not only be on increasing PMV fares as this will not necessarily resolve the immediate on longer term issues facing the industry.

The larger issues of the condition of the roads, the possible need for a distance based urban fare structure, the appropriate training of PMV owners and operators in 'good management' techniques, and the policing of the licence conditions to remove 'rogue' operators from the industry are all longer term matters which the Commission has raised in its November 2007 Report and which it is acting upon through discussions with the relevant authorities. But in the short term, in terms of the underpayment of fares, the potential to do something about this problem is with the industry itself. It needs a concerted and unified approach to the problem. The Commission is willing to work with the industry to ensure that people understand their obligation to pay the gazetted fare and the rights that the PMV operators have to refuse to provide a service to people who will not pay the approved fare.

4.2.4 Discussion of Submissions on Draft Report

Following the release of the Draft Report, there have been a number of discussions on issues at various meetings and workshops held by the Commission to gauge the views of the operators regarding the draft determination. Some of the issues that have been raised relate to longer term issues and are outside of the purview of the Commission. This includes the general condition of the roads and the impact that this has on the operating costs of the operators. The Commission has made allowance for these costs in its November 2007 Determination when it accepted the operating costs advised by the industry in the development of the pricing model used in that Determination.

Amongst other issues that have been raised is the question of setting fares that are expressed in kina and toea terms. Operators have noted that this requires them to have change to handle the payments being made, and in some instances passengers paying the kina amount but not the toea amount. For instance where the maximum fare is K2.20, passengers tend to pay only K2.00 and not the extra twenty toea. Operators requested that fares be rounded to the nearest kina value

and thus avoiding the change giving issue. Considering this issue, the Commission believe that by rounding the fares to the nearest kina will not resolve the issue. The onus is on the operator as part of his management of his PMV business to ensure that passengers pay the full fare and also have enough coinage as change for passengers who pay in whole kina amounts. The Commission has made some concessions in terms of the rounding of the urban fare, but to round the fare when it involves a kina/toea amount would be to introduce anomalies into the fare arrangement which the Commission is not prepared to countenance.

Another issue raised which is not of direct relevance to the issue of fare collection or the rounding of fares, is the allocation of responsibility for the setting of fares. It was proposed by some operators that the Commission should consider separating the determination of fares for urban and non urban routes such that Urban and inter-provincial routes would be controlled by ICCC whilst the remaining non urban routes would be determined by the relevant Provincial Land Transport Board ("PLTB"). This it was argued was supported by the fact that the relevant PLTBs are more familiar with the conditions of all the roads in the province and the difficulties faced by the operators.

The Commission is not convinced by this argument. Indeed, it is clear to the Commission that many of the Provincial Land Transport Boards do not have the expertise or the resources to be able to undertake an independent assessment of fare requirements as is provided for under the PRA. In effect there is a real risk that the interests of consumers will not be appropriately considered and that there will not be transparency in the manner in which fares are set. The question of the different conditions that are faced in different locations across the country is relevant to any inquiry on any product or service that the Commission regulates. It is through the public consultation, Draft Report publication, and interaction with interested stakeholders that the Commission can be informed of specific issues that need to be considered in setting fares or prices for particular areas or PMV routes. It is not an appropriate option to simply delegate the responsibilities of the Commission to other parties who are not bound by the legislative requirements that ensure that the Commission acts in an unbiased and independent manner.

4.3 Fuel Costs

The principle concern raised by the submissions to the Commission and in public comments on this matter is the rising fuel cost. Under the determination made by the Commission in 2004 and embodied in the Petroleum Pricing Review, fuel products in PNG are regulated under Section 10 and 32A of the Prices Regulation Act. The Commission determines the margin that applies on the wholesaling and retailing of fuel and has a close monitoring approach to the freight costs associated with delivering fuel around the country. However, under the terms of the Project Agreement entered into between the Government of PNG and the Napa Napa refinery operator, InterOil, the Commission's role in terms of the ex-refinery price for fuel products is simply to monitor the movement in the price against a formula that has been determined by the Agreement (although this Project Agreement has recently been subject to review by InterOil and the Government). The Commission has given its views on various aspects of this pricing formula, both in terms of the version that exists in the original Project Agreement, interim pricing formula agreed by Government and InterOil and the revisions that have been agreed between InterOil and Government in recent months. However, the formula itself is one that is not of the Commission's making and the Commission does not have any direct power over its structure. The role of the Commission is simply one of checking and confirming that the agreed formula has been applied correctly.

Announcement of fuel prices are made every 8th day of each month. Movements on a month-to-month basis are closely tied to the movement in fuel prices in the Singapore market with adjustments for freight costs to PNG. Currently the adjustment in fuel prices each month is based on the movement in the Singapore price over the previous month adjusted for exchange rate differences and other cost differentials which have been under review by Government. Unlike

Australia where fuel prices can move more frequently and even on a day-to-day basis, the fuel price in PNG is set for the month and no official adjustment is allowed over that month. PNG is a 'price taker' in the world context when it comes to the prices paid for petroleum products, and as a consequence, transport operators including PMV operators are unable to influence the final cost of their fuel bills other than by careful, fuel efficient driving.

In the November 2007 PMV Final Report, the Commission used survey information from the PMV industry to determine the cost build up of the revenue requirements for this industry. This included the cost of fuel at that time, and its relative contribution to the overall cost of operating a PMV service.

In recognition of the importance of fuel costs to the total costs that are incurred by the industry, the Commission also explicitly included movement in a domestic fuel cost index in the price adjustment mechanism that is to apply to PMV fares on an annual basis (see discussion in Section 3 above).

The Commission has examined the movement in fuel costs over several years to assess to what extent the current movement might be regraded as being outside of the normal pattern. The reasoning for this is that under a normal annual price adjustment mechanism of the type that the Commission has established for the PMV industry, adjustment is usually made at the beginning of each calendar year to take into account the movement in costs over the previous 12 months. By providing a greater degree of certainty in making price adjustments (unlike under the previous pricing arrangements in PNG where there was little certainty regarding any adjustment to prices to take into account cost increases) and by developing a model that reflected the underlying costs of the industry and ensuring that revenue generated from expected patronage and the fares set would allow an efficient PMV operator to recover costs and make an appropriate return on investment as well as a recovery of the depreciated value of the vehicle, the Commission sought to establish a fair basis for setting PMV fare rates that balanced the interests of PMV operators and consumers. However, to the extent that underlying costs are growing at an unprecedented rate, and therefore putting the financial viability of the PMV operations at risk, there may be grounds for the Commission to consider whether more frequent fare adjustments are required to allow for the pass through of these more rapid cost escalations.

Analysis of the movement in fuel prices, and in particular diesel fuel prices in Lae since September 2004 indicate that there have been periods where prices have risen rapidly on average over the year (that is, at rates greater than 10% on average, for example 2005 and 2006) and other years when there has been very little change over the year on average (such as 2007) (See Figure 4.1). Since 1st January 2008, the price of diesel has however increased by nearly a third over the average price that applied in 2007. This is shown by the rapidly rising index series shown in Figure 4.1.

Figure 4.1 – Index of Retail Prices for Diesel (Sept 2004 – June 2008): Lae

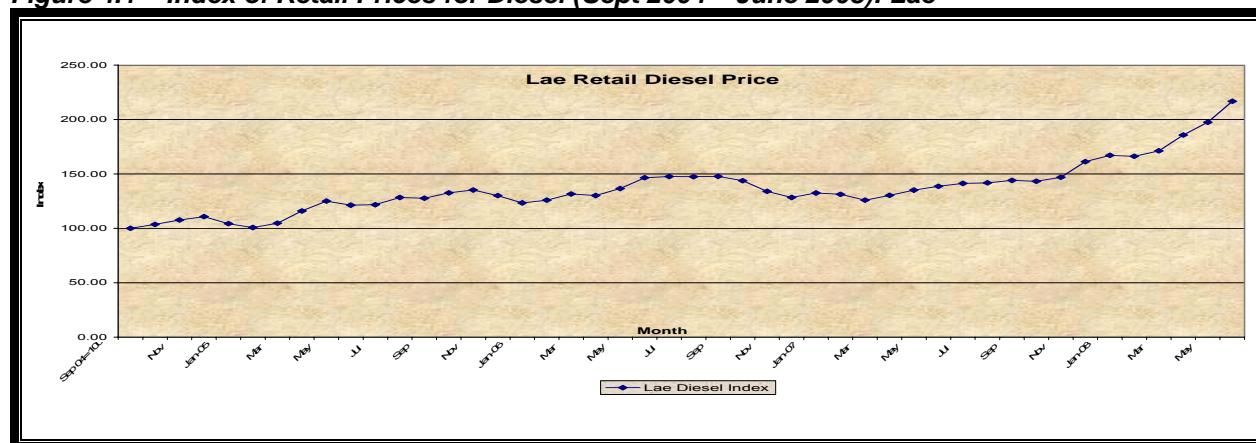


Table 4.1 provides details on the price of diesel in Lae on a monthly basis for the period from October 2006 to June 2008. The price adjustment mechanism that the Commission has established for the PMV industry uses the average movement in the prices for diesel for the 12 months to September each year as the indicator of movement in these prices. The prices in Lae are used because it is a higher price than in Port Moresby and includes the higher costs related to fuel distribution, which are relevant to outlets away from the Napa Napa refinery which is close to Port Moresby.

From Table 4.1 it can be calculated that the movement in the average monthly price for diesel for the period October 2007 to June 2008 by comparison to the average monthly price for the period October 2006 to September 2007 is 27.5%. In the 12 month period to September 2007 over the 12 month period to September 2006, there was a slight reduction in the average monthly price of diesel. This further highlights the fact that prices for diesel fuel in recent months have been rising at a much faster rate than in previous years.

Table 4.1 Retail Diesel Prices:-Lae

| Month | Retail Prices (toea per litre) |
|---------------------|--------------------------------|
| October 2006 | 268.66 |
| November | 250.40 |
| December | 239.95 |
| January 2007 | 247.59 |
| February | 245.31 |
| March | 235.18 |
| April | 243.60 |
| May | 252.41 |
| June | 259.07 |
| July | 263.92 |
| August | 264.91 |
| September | 269.25 |
| October 2007 | 267.70 |
| November | 274.43 |
| December | 310.31 |
| January 2008 | 312.14 |
| February | 310.48 |
| March | 319.94 |
| April | 346.99 |
| May | 368.88 |
| June | 404.98 |

Source: ICCC Fuel Prices Data

To further highlight the significance of the recent price increases, and to provide a comparison with previous years, Table 4.2 summarises the average price for diesel in Lae for the nine months to June each year for the last three years and compares this average with the average price for the previous 12 months ending in September.

Table 4.2 Percentage Change in Average Monthly Price to June - Lae

| Period | Nine Month Average Price to June (toea per litre) | Annual Average Price Previous Year to June ¹ | Price | Percentage change |
|--------|---|---|-------|-------------------|
| 2005 | 206.35 | N/A | | N/A |
| 2006 | 247.44 | 213.57 | | 15.9% |
| 2007 | 249.13 | 254.52 | | -2.1% |
| 2008 | 323.98 | 255.79 | | 26.7% |

¹ The 2004 Annual average price of fuel under Column 3 above cannot be derived as there was a change in the base of price of fuel from landed cost reviews ("LCR") to import parity price ("IPP") due to the commencement of the Napa Napa refinery in September 2004.

It is important to note that while the above table relates to the year to June 2008, since that time the price of fuel has declined following a further increase in July and August. As at September, the price of diesel in Lae is K3.4659, down from a high of K4.24905 in July

However, Table 4.2 highlights the extent to which the average monthly price for fuel in the current year which is used for purpose of the price adjustment mechanism has been growing much faster than in previous years. While there has been some reduction in price in the more recent month, it is not possible to predict accurately how prices may behave over the remainder of 2008. Internationally the price of oil has been falling, but there is also a need to consider the likely behaviour of the K/US\$ exchange rate. For purposes of this current review, and on the basis of the methodology used by the Commission to determine fare levels (which essentially uses the movement in prices over the most recent year to adjust fare levels), the question that the Commission must consider is whether the price increases that have occurred to date have caused hardship to the PMV industry such that an interim fare adjustment is required.

4.3.1 Discussion of Submissions on Draft Report

The issue of the rapid increase in fuel prices has been central to the submissions that have been made to the Commission both prior to and post the release of the Draft Report. There can be no doubt that fuel prices have increased significantly over the last 12 months, and on average have been about a third higher in the 2008 year to date than there were in 2007. It is important to note however, that the price of fuel fell during 2007 by comparison to 2006 and it was only in the last quarter of the year that prices started to rise considerably. Nevertheless, by mid 2008 prices had risen dramatically over the level that had been factored into the price determination made by the Commission in November 2007. Furthermore the price adjustment that was allowed for non urban routes from 1 January 2008 was based on price data for the year to September 2007, and this had not fully captured the price increases in fuel that were then starting to appear and which continued into 2008.

By comparison, while there has been a strong quarterly increase in the CPI in the June 2008 quarter, the average movement in the CPI over the same period has not been as strong as the increase in fuel costs. On a 12 month basis to June, the adjusted CPI series as used by the Commission (that is, excluding betel nut, and beverages prices) had risen by 5.75%, significantly less than the increase in fuel prices.

In its November 2007 Determination, the Commission reported on the modelling it had undertaken of PMV costs based on information provided by the PMV industry. This analysis was then used not only to determine the initial fare levels, but also to determine the methodology for the fare adjustment formula to be used by the Commission. In this formula, fuel costs account for 25% of the weighting of costs adjustments. That means that from a total costs perspective (including an allowance for the depreciation of the vehicles, wage costs, vehicle repair and tyres), fuel costs amount to a quarter of the total costs that a PMV operator will incur. Thus, in the annual price adjustments that the Determination established, the fuel cost increase would make up 25% of any adjustment in future fare levels.

From an annual perspective, this is a fair balancing of the need for the operators to recover costs and for the consumers to be required to pay only a price which reflects the recovery of the efficient total costs of providing the PMV service. However, at a time of rapid changes in costs, where one element of cost in particular is increasing at a rate much higher than other costs, and this element of costs is an 'immediate cash cost' that the operator must incur (as distinct from say depreciation which is a recovery of a capital costs but does not immediately impact on the day to day cash flow of the business), there can be a need to consider some form of adjustment in prices to assist in recovery of the additional costs that require immediate funding by the operator.

Thus, an argument can be made for some interim fare adjustment to address the rapid and unprecedented increase in one significant cash cost element of the operation of the PMVs while at the same time maintaining the integrity of the Price Determination made by the Commission in November 2007 and in which the Commission sought to achieve a balance between the interests of consumers and the industry.

4.4 Other relevant issues

4.4.1 Omissions in the current fare schedule

Some operators particularly in the rural routes have raised concerns that the base fares used by the Commission to set the current fares were incorrect and requested the Commission to correct these anomalies. As discussed in section 4.2.1 above, the Commission has reviewed these submissions and notes that it has used as the base for the adjustment of fares the legally approved fare rate that was applicable on the relevant route. In addition, the Commission has modelled its fare adjustment arrangements on these legally approved fares, and the adjustment that has been made is entirely consistent with the Commission's modelling of an appropriate fare for the individual routes. The issue that the Commission has had to contend with is the extent of patronage on some of these routes and the extent to which the level of demand is over-serviced by the availability of PMVs. It is not the Commission's role to subsidise over-capacity by increasing the fares for those that do use the PMVs. Thus the Commission is not proposing to make any adjustment to these fares in response to this comment.

However, the Commission has acknowledged above that there have been some parts of the routes gazetted that have not been specifically itemised and the fare specified in the gazettal notices. The Commission will rectify this omission upon receipt of submissions and evidence from the PMV operators concerned that there is in fact an omission, and the submission must specify the distance of the omission, the name of the start point and the name of the end point.

Examples of these are the Route 300 where fares were set for Barakau turn-off, Gaire turn-off and Tubuserea turn-off without specific reference to the villages which are located a fair distance from the main highway

Also some parts of Route 400 that goes beyond the Port Moresby to Yule Island Turn-off, adjoining to Nikura, Delena, Poukama and Nabuapaka villages. The Commission set a maximum fare of K10.50 per adult for the POM to Yule Island Turn-off but not the additional fare relating to the extension of the route to the four villages. The Commission is informed that passengers travelling to Nikura are charged K11.00 while those travelling to Delena, Poukama and Nabuapaka villages are charged K13.00 by the PMV operators.

In addition to the omitted routes identified in the Draft Report, the Commission has received a number of submissions detailing the routes which were omitted in the initial fare determinations. These matters are discussed under 4.2.1 above. A number of proposed fare rates have been put forward as part of these submissions. The Commission will examine each of these in the context of the principles outlined in 4.2.1 above.

4.4.2 Discussion on Submissions received on Draft Report

The Commission recognises that these omissions have occurred in the gazetting of fares to date, and notes that it has only been as a result of the public and transparent process adopted by the Commission under its legislation that these anomalies are now being identified and can be addressed and resolved. Accordingly, the Commission will gazette a fare for the specific village as the pick-up and drop-off points based upon information provided to the Commission and after the Commission has scrutinised the facts surrounding each case. In particular, the Commission will be seeking from relevant interested parties advice on the additional distance involved in travelling to

the new drop off or pick up point, the total distance of the route concerned and the proposed fare for travel to the pick up or drop off point. ..

4.4.3 Service Standards

Since the release of the November report on PMVs and the Commission's warning of action that will be taken under the PR Act should PMVs be found to have not met their service obligations, the Commission notes that it has continued to receive complaints that urban PMVs, particularly in NCD, Lae and other main urban centres have not been completing their full designated routes as specified in their licences. By comparison, in the rural routes, most PMVs complete their routes and there is limited evidence of a similar problem.

It has been argued by some operators that this type of behaviour is necessary in order to allow the PMV operator to break even or make a profit. With the significant increases in fares on urban routes made in late 2007, it should be no longer necessary to take such action. Inefficiencies in the operation of the PMV may still encourage some more unscrupulous operators to seek to make up for the extra costs they incur as a result of poor maintenance of their vehicles or poor driving behaviour or by not collecting the approved fare from all passengers, by adopting this practice.

The Commission further urges PMV operators, particularly those in the urban centres of Port Moresby and Lae to complete their designated routes while at the same time ensuring that the maximum fares are collected.

The failure of PMV operators to meet their obligations under their licence conditions adds weight to the argument that the Commission should refrain from making further fare adjustments. Certainly if the industry is to regain the good will and support of the community it needs to recognise that the behaviour of some PMV drivers and operators is unacceptable and is bringing the whole industry into disrepute.

4.4.4 Discussion on submission on Draft Report

The Commission in the Draft Report proposed that there be no adjustment to urban fares until 1 January 2009 as provided for under the November 2007 Determination. In part this view was taken by the Commission as it seemed that in part the industry was failing to collect the higher fares that had already been approved, and there were still instances of PMVs failing to complete the full route for which they have been licensed. The only submission from an urban PMV operator on the Draft Report was from the Madang Urban PMV Association on behalf of its members. This submission proposed a new set of fares for the Madang Urban routes to be considered as part of this review. However, as previously noted, the Commission is not considering altering the November 2007 Determination in terms of the actual level of fares set , but rather in this inquiry has focussed upon the need for an interim adjustment within the spirit of that Determination to take into account recent extraordinary cost increases. To the extent that the Madang PMVs fall into those categories for which an interim adjustment will be made, then there will be an adjustment to their rates as a result of this inquiry. For other routes however, the normal fare adjustment will occur from 1 January 2009.

4.4.5 Monitoring and Policing Aspects

In terms of enforcement arrangements, the Commission's Price Inspectors have been making random checks to ensure that the correct fares are being charged on PMVs and taxis. The Commission has also established a 'telephone complaints line' which can be used by commuters to report instances of overcharging, discrimination against concession paying passengers or lack of completion of licensed routes.

To-date, while the Commission has not issued any fare infringement notices, it has made several warnings to individual PMV drivers concerning their actions. Having given ample warning of its

intentions to take appropriate legal action within its powers, the Commission will now commence taking direct action to prosecute PMV operators who are found to be in breach of the declared pricing and service requirements.

The Commission will also continue to work collaboratively with other relevant organisations and government agencies to further improve the services currently provided by PMV operators.

5 OPTIONS AVAILABLE

The issue before the Commission is what, if any, action it should take to address the rapid increase in fuel prices that has occurred over the last six to nine months. The evidence demonstrates that there has been a strong growth in fuel costs. In addition, the CPI for PNG has risen rapidly (in part reflecting the fuel cost increase within the CPI itself) in response to the growing inflation levels on a worldwide basis, although the annual increase in the CPI has not been as dramatic as that for fuel prices. The Commission has established an automatic annual price adjustment mechanism which is based on movement in the costs of fuel and general inflation levels in PNG. From a practical perspective, because the adjustments are retrospective (that is they are made at the end of the year), the ability of the domestic PMV industry to remain viable over the year while waiting for a price adjustment to take effect on 1 January can prove to be particularly difficult for an industry where the financial resources of the operators are not very high and the cost of fuel in particular represents a cash outlay which must be met daily.

At the same time, the fare increases that have occurred in the last 12 months, particularly for the urban PMV routes have been quite significant and there is already evidence of consumer resistance to these higher prices. If fares are lifted again there is the real possibility that consumers may refuse to pay the higher rates, or forego using PMVs and opt for other forms of transport. In these circumstances (where the elasticity of demand would be said to be high) there is the real risk that in terms of the recovery of sufficient revenue to cover their costs, the PMV operators may find that there is a fall in their total revenue takings notwithstanding that fares have risen, because passengers forego travel or seek other transport options.

The added complication in considering the options available is the apparent failure of some urban PMVs to be providing the full route service that they are required to provide under their licence conditions. This poor performance by some reflects badly on all PMV operators and captures the attention of consumers who are quick to express their dissatisfaction with the whole industry rather than just those few who break the law. Thus, at a time when there are rapid rises in costs elsewhere across the economy, there will be little sympathy for the PMV industry, as is demonstrated by the public calls for the relevant authorities (including the ICCC) to take action to ensure delivery of the service that is required of the PMVs.

5.1 Option A: Adopt a Six Monthly Price Adjustment

In considering the options that it might take, the Commission needs to have regard to a model that best balances the interests of both the operators and the consumers with regard to Section 21 (2A) of the Prices Regulation Act. The Commission's 2007 Determination which currently stands and is not intended to be changed by this current review has been based on an extensive review not only of the cost factors facing the industry, but also of the wider social and economic consequences of the form of fare setting arrangements adopted. If any change is to be made to the fare setting arrangements to take into account the rapid increase in the cost of fuel it needs to be made in the context of not distorting the existing fare adjustment mechanism while at the same time making some adjustment to reflect changed cost parameters.

Under the Commission's annual price adjustment mechanism, the fares for PMVs would next be adjusted from 1 January 2009. However, as outlined in the Draft Report, one option that is open to the Commission is to bring forward an adjustment and base it upon movement in the relevant price series for the six months period to the end of March (the annual adjustment is based on movements in the price series for the 12 month period to September, so the adjustment to March would be a six month adjustment). The Commission would apply the same weighting and other elements of the price adjustment mechanism as specified in its determination announced in November 2007. However, an adjustment would simply take into account the most recent cost movements, and effectively bring forward part of the adjustment that would have occurred from 1

January 2009. The 1 January 2009 adjustment could then be based on the six-month movement in costs for the period to September 2008, or could be based on the twelve-month movement in costs for the period to September 2008 less the adjustment which is allowed as part of the six month interim adjustment envisaged under this option..

One of the advantages of this early adjustment approach is that it would provide a degree of certainty to the industry that prices will be regularly reviewed with a view to adjusting them for changes in underlying costs, and it would represent a more current updating of the fares given the movement in costs. At a time of rapidly increasing costs, this could be advantageous for the operators as it allows them to charge at a rate that reflects the current cost paradigm that they face rather than wait a full twelve months before a price adjustment occurs. Another advantage is that if there are to be price adjustments, then it will mean that these might be smaller individual adjustments rather than larger adjustments that might otherwise occur on an annual basis.

Disadvantages with this early adjustment approach are primarily practical ones in the sense that it requires more administration to calculate the six monthly price increases, and to make the necessary gazettal orders that authorise the new price. From a customer perspective, even though the price adjustments may be smaller, being more frequent may create confusion in consumers' minds about the process and concern about what they may see as constantly changing prices for a service that they normally expect to have reasonably stable prices.

There is also the danger that the use of data for different periods may introduce seasonality problems into the calculations. For example, in the approach outlined here where the six month data to march 2008 is compared to the six month data to September 2007, to the extent that there is any seasonality in the cost series (particularly the CPI which does include prices for goods that have seasonal variations in prices) then this can be confused in the results that are used to adjust the fares. The Commission has a preference for using the four quarterly or annual data for any price series as this to some extent removes any seasonality that might occur over a twelve month period.

The Commission's determination on pricing which allows for a rounding up or down of the price if after the calculation of the change, the price that is calculated for each route needs to be rounded to the nearest price evenly divisible by 10. This has the effect of possibly smoothing out the smaller price movements and then having more noticeable price changes, for example pricings moving from 70 toea to 80 toea rather than going from 70 toea to 75 toea. This might be advantageous for consumers, but it may not help the industry if effectively the price adjustment for the costs movement should be negated by the rounding rules.

A six monthly price adjustment mechanism may also be more inclined to involve price reductions as well as price increases. Thus, the fare to be charged from a PMV operator and consumer perspective could be further confused by the possibility that fares may be reduced at some point, only to be increased again after the next six months. Certainly given the cyclical pattern of some elements of the CPI series (although the Commission excludes movements in the price of beverages and betel nut), there would a real possibility of prices going down as well as up if a six monthly cycle is used².

5.2 Option B: Adopt a Trigger Mechanism

A variation of this option might be to introduce a trigger mechanism. Under a trigger mechanism, a price adjustment (other than the normal annual adjustment) could occur if there had been an underlying increase in costs such that movement in the weighted fare adjustment formula was greater than some predetermined value. Thus for example, the trigger could be set such that is the movement in the fare adjustment formula resulted in an increase greater than 5%, then an

² The Commission notes that with the reduction in fuel prices that have been evident in September 2008, the possibility of a reduction in fares if a six monthly adjustment is used is further heightened

adjustment would be made to the fares. However, if the increase was less than 5% then no adjustment would be made. A similar adjustment mechanism is built into the Regulatory Contract for the determination of electricity prices in PNG. This allows an adjustment to the charges if during the year the costs of diesel fuel exceed a certain percentage rate, whereupon prices for electricity can be increased to allow PNG Power to recover the added costs of the fuel cost increase.

This approach has the merit that it does not mean that prices need to be changing generally more frequently than once a year (as is standard practice for regulated prices), but at the same time recognises that there may be exceptional circumstances that require an adjustment to occur more frequently. However, it has the complexity of requiring a decision to be made as to what should be the trigger value. Under the Regulatory Contract for electricity, the trigger point is an increase in the overall inflation index used in the Contract of greater than 10% on a six monthly basis. If this was to be applied to the PMV industry, there would need to be increase in the tariff adjustment formula as defined in section 3.2 above of 10% over a six month period.

To assess how this might apply to the current situation, the following example is provided drawing on the CPI and fuel price index series as defined in the fare adjustment formula.

The formula is as follows:

$$\Delta P_{t+1} = (\Delta CPI_t * 0.75) + (\Delta DFI_t * 0.25) \text{ where}$$

ΔP_{t+1} = The adjustment in the fare

ΔCPI_t = Change in CPI (excluding beverages and betel nut) for the period December 2007 to March 2008 over the period June 2007 to September 2007. The change over this period applying the formula set out in the PMV Determination but over a six months period is 4.15%

ΔDFI_t = Change in diesel retail prices in Lae for the period October to March 2008 over April to September 2007. The change over this period applying the formula set out in the PMV Determination but over a six month period is 15%

In applying the formula, the resultant change in fares based on a six month adjustment to March 2008 would have been as follows:

$$\begin{aligned} \Delta P_{t+1} &= (\Delta CPI_t * 0.75) + (\Delta DFI_t * 0.25) \\ &= (4.15\% \times 0.75) + (15\% \times 0.25) \\ &= 3.11\% + 3.75\% \\ &= 6.86\% \end{aligned}$$

On the basis of this option, the adjustment would be 6.86%³. It is noted that this falls well short of the 10% trigger used in the electricity Regulatory Contract. However, given the limited financial ability of the smaller PMV operators to carry a large increase in fuel costs by comparison to a larger corporate entity such as PNG Power, it may be more appropriate to use a 5% cut off point as the trigger that would be applied should this option be adopted.

5.3 Option C: Use Different Time Periods for the Fare Adjustment Formula

It has been suggested that the Commission might use a different time period for calculating a 'six month interim' price period. That is, instead of using the six month period ending 31 March 2008, if

the Commission was to use the six month period ending June 2008, then the results may have been different and may have exceeded a trigger of say a 10% increase. Thus, for example, if the six months period to June 2008 is used over the six month period to December 2007, then the increase calculated by the formula in section 5.2 above would be 10.6%, slightly higher than a trigger of 10%.

The difficulty with this approach is that it is effectively selecting different periods while omitting others for purposes of the price adjustment. Thus this mechanism would omit the October-December period fuel price index from the series together with the December quarter CPI series. This is technically incorrect and is not an approach that the Commission would use or should seriously contemplate. If the Commission started to use selected periods for price adjustments, all integrity in the pricing methodology would be lost and effectively the Commission would return to the practices of the previous Prices Controller Office, a backward step in terms of independent and transparent price regulation in PNG, particularly as transparency and objectivity would be lost to the detriment of consumers.

5.4 Option D: Adopt an Adjustment for the Non Urban Routes Only

Under this option, urban PMV fares particularly for Port Moresby and Lae but also on other urban routes in Madang, Wewak, Kokopo and Kimbe should remain at their current level while fares for other (primarily non urban) routes should increase based on the revised adjustment formula.

The concerns raised by PMV operators in urban routes and in particular in NCD and Lae is the argument that commuters are not paying the current full maximum fares approved by the Commission which results in lost revenue for the operators concerned. To the extent that PMV operators are failing to collect the full fare as currently approved by the Commission, the urban based PMV operators have weakened their argument for a further fare increase at this time. Urban fares were increased at a higher rate than non urban fares when the amended fares were introduced at the end of 2007 and from 1 January 2008. Thus there may be greater justification in allowing some adjustment to the non urban fares and retaining the existing urban fares until the next scheduled fare adjustment for urban fares on 1 January 2009.

The Commission has discussed in section 4.2.3 action that the PMV operators in these urban areas might take to address the under recovery of fares. To some extent the ability to resolve the current underpayment problems is one that is in their own hands. While the Commission is willing to support action taken to collect fares (by publicly stating what the approved fares are and that commuters are obliged to pay these fares), it is up to the operators themselves to consider the way that they collect their fares and seek to implement arrangements which improve their overall collection. Simply by increasing the fares in these urban areas is not of itself going to resolve their cash flow problems if passengers are refusing to pay the current approved fares, or operators let passengers enter their vehicle before paying the fare.

The pertinent issue is that for both the urban and rural routes it is incumbent for the operators to ensure that all boarding passengers should pay the full fare. An increase in fares is not and should not be viewed as the only solution to addressing their profitability concerns as commuters will and may continue to pay below the maximum fare.

5.5 Option E: One-off Adjustment Based on Nine Months Data

At the time of the release of the Draft Report, the Commission was in possession of fuel pricing data to July 2008, but did not have CPI data for the June quarter 2008. Thus the Commission focussed its attention on an adjustment using six months data to March 2008.

However, it is now possible to use nine month data from October 2007 (the beginning of the next period for use in the calculation of the fare adjustment methodology set out in the November 2007 Determination) and the end of the June quarter. This would allow the Commission to take into account the effect of the price increases that have occurred over a longer period and thereby remove any month on month variability in the data that might arise if a shorter period was used.

If a longer period is to be used, it may also be more convenient and technically sound to then adopt a new start date for future annual fare adjustments under the current price Determination. This would remove the possibility of confusing and miscalculating price adjustment variations in the calculations, a problem that can emerge where there is a break in the methodology for calculating fare adjustments as is proposed in the special circumstances currently being faced in PNG. The use of more recent data, especially given the extended period allowed for this review, can also address industry concerns that the Commission has not fully factored into its calculations the cost increases that have been encountered over the last twelve months.

It should be noted that this approach does have the potential disadvantage in that it does not take into account an apparent reduction in the price of fuel that has occurred in the September month's prices. However, given the nature of price adjustment mechanisms which use historical data to set current prices, there is always a lagged effect that is included in the prices that are set by this methodology. Thus, there may be a lag in prices being adjusted up (as has been evident over the last twelve months when costs have risen rapidly), but at the same time there may be a lag in prices coming down when costs are shown to be declining.

In terms of future fuel prices, it is not possible at this time to be certain as to what might happen to fuel prices over coming months. While there has been a decline in the price in US dollar terms in international oil prices, there has also been a recent decision by the oil producing and exporting countries to reduce the production of oil. This will effectively counter any reduction in price for oil that may otherwise have occurred. In addition, the price of oil products in PNG in kina terms is directly affected by the kina/US dollar exchange rate. While the Bank of PNG has taken action to try to stabilise this exchange rate, there are forces at work in the international financial markets which may result in a change in this exchange rate in PNG. As a consequence, it is possible that any reduction in the US dollar price for oil may not equate to a further decline in the kina price of petroleum products in PNG.

The Commission is not in a position to make a judgement on these future movements in costs, particularly for oil based products. It is for this reason that the Commission uses a price adjustment methodology that effectively relies on the latest historical data to determine price adjustments over time. In considering this option, the Commission is looking at the period from October 2007 to June 2008 where fuel prices have increased to high levels. If the Commission was to adopt this approach, with revisions to the fares to come into effect from 15 October 2008, the Commission would adopt an approach of modifying the timing for future price changes for the remainder of the five years of the current Determination such that adjustments would take effect from 15 October each year rather than 1 January as is currently the arrangement. This would potentially have some impact in terms of the timing of the next full review and would require that this review which needs to be undertaken no later than 2012, would need to be completed to allow the new Determination to take effect from 15 October 2012.

5.6 Preferred Option

The Commission has identified five main options, although some of these are slight variations on the others. In considering what if any action it should take, the Commission has referred to the legislative requirements contained section 21(2A) of the PR Act to guide the Commission in its decision on this matters (see Appendix E).

Under the provisions of section 21(2A), the Commission is to have regard to several matters when making a decision on regulated prices under the PR Act. These can be broadly summarised as follows:

- the need to protect consumers and address the issues of any broader economic and social impact of a decision;
- the need to ensure that the efficient costs of providing the PMV service are recovered by service providers, including an appropriate rate of return on their investment; and
- the level of service quality and reliability that is required of the service providers and the need to send the right pricing signal for the appropriate level of supply of PMV services.

The need for the Commission to balance what might be seen as competing requirements as an inherent feature of independent economic regulation. Ultimately, the Commission must consider the facts against these requirements and make a decision as to how prices are to be set, at what levels and how they are to be adjusted over time.

The five options under consideration by the Commission are:

1. Adopt a six month price adjustment for all PMV operations using the existing price adjustment formula ;
2. Adopt a trigger mechanism based on designated changes in operating costs which, if exceeded, would then require a price adjustment using the existing price adjustment formula (the trigger could be tested quarterly or every six months and is dependent on the release of the CPI data);
3. Adopt a different six month time period to reflect the latest CPI and fuel cost information that is available;
4. Apply an adjustment for non urban routes only ;
5. Apply a one-off adjustment based on nine months of data.

In relation to each of these options, the Commission notes the following factors in terms of the section 21(2A) requirements:

Six month price adjustment for all PMV operators:

- The evidence suggests that there has been a strong increase in fuel prices, which will have an impact on the ability of PMV operators to recover their costs;
- Applying the price formula set by the Commission in its November 2007 Determination, but bringing this forward by six months, effectively passes this increase in costs on to consumers sooner than would have otherwise applied;
- Furthermore, the significance of the cost increase that has occurred and the limited ability of PMV operators to 'carry' this cost increase for a 12 month period, gives weight to the argument for a price adjustment sooner rather than later;
- However, there is concern that the level of service being offered in the urban areas has been compromised by the inability of PMV operators to recover the higher prices that were approved by the Commission in November 2007, and that there may be evidence to support a view that the inability by PMV operators to recover the current approved price suggest that their current funding difficulties are in part caused by their inability to adopt fare collection arrangements that ensure that they can collect the current approved fare levels;
- Increasing the fares will not ensure a full recovery of the higher fares, and may not resolve the problem of PMVs in urban areas not completing their routes which is anecdotally tied to PMV customers not paying the approved prices;
- Thus the Commission is not convinced that by bringing the fare adjustment forward by six months on the timing that had previously been approved will necessarily resolve the current funding problem faced by PMV operators, particularly in the urban areas;

- Furthermore, the Commission notes that there is now available additional data and other information than at the time of the release of the Draft Report that may be more relevant to consider when making any interim adjustment to fare levels.

Set a trigger mechanism whereby if an adjustment is needed it will automatically occur

- Again, it is accepted that significant cost adjustment has occurred and that these costs must ultimately be recovered from commuters using PMVs;
- Use of a trigger mechanism will possibly give some relief to PMV operators, although again there is a question in the Commission's mind as to whether increasing prices in the urban areas will of itself resolve the PMV operators' financial difficulties and will result in a return to the level of service that is required under the PMV licence conditions;
- Use of a trigger mechanism requires a degree of arbitrary determination of where the trigger should operate. As seen in the examples discussed above, a trigger mechanism may need to be reasonably low to ensure that a fare adjustment occurs at this time. There is a danger that the trigger mechanism if set too low could be activated on a regular basis, thereby removing any degree of stability for consumers in terms of price, while at the same time not guaranteeing that the PMV operators will always be compensated for their cost increases;
- The form of 'incentive regulation' used by the Commission is designed to encourage the regulated businesses to improve their overall efficiency. While a PMV operator may have little room to become more efficient (but that does not deny that there is room to improve such as to re-examine the number of trips being made each day and whether all trips are necessary in terms of maintaining an overall competitive and financially sound business);
- The Commission does not favour the use of a trigger because of the arbitrary nature of the determination of the trigger itself, and the limited knowledge about how often this trigger might be activated, limited by the availability of the CPI data which comes out quarterly with a delay of 6 to 8 weeks.

Apply different time periods in the data to be used

- This option could be used as part of one of the other options, and goes to the matter of the 'currency' of the data that is being used to make decisions on price adjustments;
- If the Commission was to use both CPI and fuel price data for the six months to June 2008 (the latest period for which CPI data is available at this time), the fuel index would not include the further cost changes (both up and down) that have occurred over the period July to September 2008, nor would the data take into account the change in the various cost indices over the period October to December 2007 (the last fare adjustment has been based on movement in the cost indices for the twelve months to September 2007) ;
- However, if the Commission was to use a combination of cost movement data for different time periods, it raises practical difficulties for later periods when the data is available, or when the next price adjustment is to occur;
- This approval also raises questions about 'selective use' of cost indices and could leave the Commission open to the charge that it has excluded some data which could have an impact on the final decision taken by the Commission;
- The Commission notes that on the basis of its estimates, if the data series for the six months to June 2008 are used then, when calculated against the price series for the six months period to December 2007, this would result in a fare increase of 10.6% by comparison to the 6.5% calculated for the six months to March. However, if a twelve month series is used to June 2008 over a twelve month series to June 2007, thereby removing any seasonality, and incorporating the level of fuel and other costs that had existed in the year to June 2007 and already included in the fares determined for PMVs, then the adjustment based on the additional cost information since the November 2007 Determination was made would be 9.7%. Thus the difference in outcomes dependent upon the periods over which the calculations are made becomes obvious and highlights the difficulties that the Commission has with selecting different periods other than a full 12 month cost data series;

- The Commission is not inclined to combine data from different time periods in the calculation of price adjustment factors. It only serves to complicate the understanding of what is happening and what allowances have been made for what costs within what time frames. Because of the complexity of the adjustments and the difficulty in providing a simple explanation to consumers, the Commission is not inclined to use the data series where one period is different than another or when movements in costs are compared over different time periods other than year on year.

Apply an adjustment for non urban routes only

- The Commission recognises that there has been a significant cost increase in fuel, and this impacts on the costs of PMV operators;
- For non urban routes, this increase is likely to be more significant in that the price increases that were granted from 1 January 2008 included allowances for cost increases up until that time, but these cost increases were not as significant as the fare increases that were granted to urban PMVs;
- Service levels are broadly being maintained on these routes notwithstanding the fact that costs have gone up;
- By comparison, for urban PMVs it is not clear whether the under recovery of costs that some are reporting at this time is not in fact self imposed in the sense that they have not taken action to recover the new fares that were approved for them from November 2007;
- Any adjustment for the period since the last fare adjustment would rely upon the available cost indices that apply to the same period (that is until the end of June 2008), thereby limiting the full flow on of any cost increase (or decrease) that has been experienced up until the time of the new fares coming into effect (and thereby encouraging the PMV operators to seek to make efficiency improvements, particularly in terms of the number of vehicles that are in operation at any one time, and also in ensuring they collect from all their passengers the previously approved fare);
- The Commission would also favourably consider making adjustments to the gazetted fare schedule for PMV destination/pick up points in non urban areas that were inadvertently omitted in the schedules gazetted earlier this year. To this end, the Commission would consider proposals for the appropriate fare to these destinations recognising the fare that currently applies to the closest gazetted location to these destinations when making a decision on the fare to allow;
- The size of non urban PMV fare rates is such that any increase likely from an adjustment based on the latest cost data will be such that the rounding rule will result in some increase in fares. For urban routes where there was a significant increase granted in November 2007 and a further increase under the rounding rules would be likely to be in excess of the increases warranted based on the movement in the cost indices, the Commission is less inclined to make an interim adjustment at this time. For these routes, the industry still has the opportunity to address issues such as the under recovery of the existing fares, and it is this issue that the industry needs to address;
- In this way, the service standards will be enhanced, the Commission will have addressed the issue of the recovery of efficient costs, and the overall economic and social impact on the economy and commuters will not be as great as might otherwise have occurred
- At the same time, the Commission notes that the cost increases that have been experienced since the last fare adjustment will ultimately flow through into all PMV fares when the next scheduled fare adjustment is made under the terms of the November 2007 Determination.

One-off adjustment based on nine month data

- The Commission recognises that there has been a significant cost increase in fuel, and this impacts on the costs of PMV operators;
- The Commission is attracted by the option of allowing an adjustment to fares applying to non urban routes while at the same time making appropriate adjustments to the gazetted

- fares and routes to correct omissions in the gazettal notice that was issued at the time of the November 2007;
- Since the release of the Draft Report, there are now available costs indices for the period to at least June 2008, and it is the Commission's view that these should form the basis for any adjustment in fares at this time;
 - At the same time, the Commission is concerned to ensure that any adjustment to fares does not become a quarterly event, but that desirably fare adjustments should occur on an annual basis;
 - Thus, any adjustment to fares to take effect at this time would also include a determination from the Commission that a further adjustment for fares for the routes concerned would not be made for a further twelve months. This avoids the dangers of double counting movements in cost indices and the possibility that fares could be adjusted both upwards and downwards on such a regular occasion as to create confusion in consumers minds as to the correct fares that apply;
 - Thus, this approach will address the issue of the unprecedented increase in costs that has occurred over the last nine months, while at the same time providing a degree of certainty for both consumers and PMV operators;
 - The Commission has also noted the technical issues involved in determining the appropriate fare adjustment. It is the Commission's view that, while using the most up to date data available (that is, up to the June quarter 2008), it would be incorrect for the Commission to determine an adjustment in fares simply on the basis of six months on six months, or nine months on nine months data. Rather the Commission will apply the movement in the cost indices for the 12 month period to June 2008 over the 12 month period to June 2007. Details of the calculation are provided in Appendix F. The adjustment for the period will be 9.7%;
 - While the mechanics of the adjustment of the fares will be in accord with the rules set out in the November 2007 Determination, the decision to grant a further fare adjustment at this time for non urban routes raises the issue of when the next fare adjustment should occur;
 - As discussed above, the Commission is not inclined to have a further fare adjustment for these routes from 1 January 2009, and thus it will alter its November 2007 Determination on this matter such that the adjustment proposed at this time will take effect from 15 October 2008, and the next adjustment will take effect from 15 October 2009. For urban routes, the fare adjustment will occur from 1 January 2009 in line with the provisions set out in the November 2007 Determination;
 - Adoption of this adjustment will ensure that non urban PMV operators are able to recover the efficient costs that they have incurred at a time of rising costs during 2008, while at the same time, urban PMV operators will only have to wait for a further three months before their next scheduled fare adjustment. This adjustment from 1 January 2009, will incorporate the movement in the costs indices over the 12 month period to September 2008, including it should be noted any decline in fuel prices (albeit from a high level) that have occurred in September. For consumers, the adjustment in fares is in line with the underlying costs incurred in providing the PMV service, while for urban consumers, any increase in fares has not been approved simply on the basis of operators being unable to recover their fares because of poor fare collection arrangements.

6 SUMMARY OF FINAL DETERMINATION

This section sets out a summary of the Commission's final determination with respect to this Review.

6.1 Retention of current fare adjustment mechanism

The Commission has considered the various submissions in relation to its Determination of November 2007 and the Draft Report, and reaffirms the November 2007 Determination both in terms of the price adjustments that have been made, and the formula that will be used to adjust fare levels over the five year period of this current determination.

However, as discussed in the Draft Report, the Commission recognises that there have been some omissions in the gazetted listing of destinations/pick up points for PMVs, particularly in the rural areas. The Commission will amend the fare schedules to include these locations based on advice that has been received from the industry during the consultation period following release of the Draft Report. The industry has taken up the opportunity to advise the Commission of these omissions and to suggest what the fare might be to the location concerned together with the distance from the closest destination/pick up point that has already been included in the gazetted fare schedule. The Commission is now reviewing each proposal and make amendments to the fare schedule as appropriate.

Final Determination 1

The Commission will make amendments to the gazetted fare schedule to include destinations/pick up points that have inadvertently been omitted from its November 2007 decision. Fares for these locations will be determined by the Commission having considered the current fares applying to nearby locations and the route distance to the additional pick up and drop off points. In terms of those locations where there was no listing for the whole route as part of the fare gazettal process, as a general guide, and consistent with what action it has already taken in relation to those non urban routes that have been gazetted, the Commission will use as the starting point the fare rates that have applied in 2007, and make adjustments as appropriate based on the decisions arising from this Report. However, the Commission will reserve the right to amend this arrangement where it is apparent that there has been any attempt to inflate the 2007 fare levels to be used by the Commission or that the fare proposed is inconsistent with fares applying for similar route lengths and under similar conditions in other places.

6.2 One-off adjustment for non urban routes

The Commission will gazette amended fares to apply to non urban routes based upon the movement in the fare adjustment formula set out in the November 2007 PMV Report, but using additional data for the nine months to the end of June 2008. This fare adjustment will apply to non-urban routes only, from 15 October 2008. The adjustment to fares for urban routes under the existing Determination to be made on 1 January 2009 will be for a full 12 months for urban routes following the procedure set out in the Commission's Determination of November 2007. As for the non urban routes, the next adjustment in 2009 will be made after a full 12 month period from September 2008 and will take effect on 15 October 2009.

As a consequence of this decision, and based on the Commission's calculations as discussed under option E above, the non urban fares will rise by 9.7%, with this fare adjustment being applied together with the rounding rule, in the manner prescribed in the Commission's November 2007 Determination, from 15 October 2008.

Final Determination 2

The Commission will apply a one-off adjustment to non urban fares covering movement in the fare adjustment formula for the nine months to the end of June 2008. The adjustment will be 9.7%, and the standard rounding rules will apply to the fares calculated using this adjustment factor. The fare adjustment will take effect from 15 October 2008.

6.3 Amendment to the Fare Adjustment Mechanism for non urban routes

The Commission has undertaken this review at this time in recognition of the recent significant increases in the price of fuel. It would not be normal practice for the Commission to apply a price adjustment mechanism that operated at anything less than twelve monthly. The Commission has taken the view that the current adjustment is warranted in the context of the significant change in fuel prices that has been experienced worldwide over the last six to nine months. The Commission is not inclined to make this six monthly adjustment a regular arrangement, and therefore it is applying this adjustment to non urban routes for one period only.

In terms of the fare adjustment formula to be used for non urban routes after the 15 October 2008 fare adjustment, this will be modified from that set out in the November 2007 Determination, and will take the following form:

$$\Delta P_{t+1} = \Delta CPI_t * 0.75 + \Delta DFI_t * 0.25$$

where;

ΔP_{t+1} = the percentage increase in fares in the next year t+1

ΔCPI_t = the percentage increase in the CPI (excluding betelnut, alcoholic beverages and tobacco) produced by the National Statistical Office (NSO) and calculated over the four quarters to June in year t over the CPI (excluding betelnut, alcohol June in year t-1.

ΔDFI_t = the percentage change in the average monthly price for diesel (including GST) in Lae as published by the ICCC for the twelve (12) month period to June in year t over the average monthly price for diesel for the twelve (12) month period to June in year t-1.

In terms of the calculation of the CPI index, the following formula is used:

$$\frac{(SeptCPI_{t-1} + DecCPI_{t-1} + MarchCPI_t + JuneCPI_t)}{(SeptCPI_{t-2} + DecCPI_{t-2} + MarchCPI_{t-1} + JuneCPI_{t-1})} - 1$$

where:

- Sept, Dec, March, June are the quarterly CPI index numbers
- t, t-1,t-2, refer to years such that t is the current year (the year in which the price adjustment analysis is performed) and t+1 is the next year for which the fare increase is to apply

In terms of the calculation of the ΔDFI_t index, the following formula is used using Lae diesel prices:

$$\left(\frac{12 \text{ month average monthly diesel fuel price to June}_t}{12 \text{ month average monthly diesel fuel price to June}_{t-1}} \right) - 1$$

Final Determination 3

The fare adjustment from 15 October 2008 adjustment will apply on a once only basis. The next adjustment to non-urban fares to take effect from 15 October 2009 will be based on the movement in the fare adjustment formula for a 12 month period as set out in this Final Report.

Appendix A: Section 25A of the Prices Regulation Act**25A. Decision to review a price control order**

- (1) In this Division, “reviewable order” means an order made under Section 21(1) that has not expired or been terminated.
- (2) At any time after a reviewable order is made, the Minister or a supplier of the declared goods or services concerned may apply to the Commission for the order to be reviewed.
- (3) An application under Subsection (2) shall state, with reasons, the variation that the application proposes should be made to the reviewable order, including the proposed new maximum price.
- (4) Prior to the expiration of 12 months from the later date on which a reviewable order took effect and the date on which the outcome of the last review of the reviewable order was published under Section 25C(3), the Commission may, in its discretion, following an application under Subsection (2) –
 - (a) Decide to conduct a review of that order; or
 - (b) Decide not to conduct a review of that order.
- (5) On or after the expiration of 12 months period from the later of the date on which a reviewable order took effect and the date on which the outcome of the last review of the reviewable order was published under Section 25C(3), the Commission shall, following an application under Subsection (3), conduct a review of that order in accordance with Section 25B
- (6) The Commission may at any time, on its own volition, decide to conduct a review of a reviewable order.
- (7) If the Commission has received more than one application under Subsection (2) in respect of the same reviewable order, the Commission may treat the applications as a single application and such application shall be deemed for the purposes of Section 25C(1) to have been received by the Commission on the date the Commission received the first application.

Section 25B: Review of price control order

- (1) If the Commission has decided, or been required by Section 25A(5), to conduct a review of a reviewable order, the Commission shall publish a notice in a daily newspaper generally circulating in Papua New Guinea-
 - (a) Specifying in reasonable detail the order to which the notice relates; and
 - (b) Specifying that the Commission intends to conduct a review of a that order generally or in respect of particular matters, in the later case specifying in reasonable detail those matters; and
 - (c) Inviting interested persons to make submissions to the Commission with respect to the review of the order, within the period specified and in the manner specified in the notice.

- (2) When conducting a review of a reviewable order, the Commission shall consider any submissions received from interested persons with respect to the review of that order.

Section 25C: Review period

- (1) In this section, “review period”, in respect of a reviewable order, means the period of 90 days immediately following the date on which the Commission received an application under Section 25A(2), as extended from time to time by the Commission in accordance with Subsection (2).
- (2) The Commission may, from time to time, by notice published in the National Gazette prior to the extension of the review period, extend the review period for a further period of 30 days from the date on which the review period would otherwise have expired.
- (3) If the Commission has decided, or been required by section 25A(5), to conduct a review of a reviewable order, the Commission shall, prior to the expiration of the review period, by notice in the National Gazette, determine that the order should-
 - (a) Continue to operate in its present form; or
 - (b) Be varied; or
 - (c) Be terminated.
- (4) An order under this section takes effect on the date specified in the order of, if no date is specified, on the date of publication of the notice in the National Gazette.
- (5) If, on the expiration of the review period, the Commission has failed to make a decision required by the applicant and the new maximum price shall be as proposed by the applicant or, if there is more than one applicant, the maximum price proposed by the first applicant.

Appendix D: Parties making Submissions to the Commission

1. Klinki PMV Association – Lae-Wau-Menyama Route;
2. Rigo Central PMV Association;
3. PMV Owners Route 300 – Barakau;
4. Hoodlagoon PMV Association; and
5. Mr. Elim Kiang.

Submissions to the Draft Report

1. Milne Bay Provincial Administration – Office of the Provincial Administrator
2. City Bus Association
3. Freddie Nanai – Sibonai – Rigo PMV Operator
4. New Island Provincial Administration
5. Eastern Highlands Provincial Land Transport Board
6. East Sepik Land Transport Board
7. New Ireland Provincial Land Transport Board
8. Madang Urban PMV Association
9. Manus Provincial Administration
10. West New Britain Land Transport Board
11. East New Britain Provincial Land Transport Board
12. Klinki PMV Association – Lae-Wau-Menyama Route
13. Route 3 PMV Association – Lae to Ramu
14. Route 4 PMV Association – Lae to Bukawa
15. Popondetta Provincial Administration

When making an order under Subsection (1), the Commission shall have regard to

- (a) the need to protect consumers and users of the declared goods or services from misuse of market power in terms of prices, pricing policies (including policies relating to the level or structure of prices) and the standard of the declared goods or services; and
- (b) the cost of making, producing or supplying the declared goods or services; and
- (c) the desirability of encouraging greater efficiency in relation to making, producing or supplying the declared goods or services; and
- (d) the need to ensure an appropriate rate of return on any investment in relation to the declared goods or services; and
- (e) the borrowing, capital and cash flow requirements of persons making, producing or supplying the declared goods or services; and
- (f) considerations of demand management and least-cost planning; and
- (g) existing standards of quality, reliability and safety of the declared goods or services, and the desirability of encouraging improvements in those standards; and
- (h) the effect any proposed order on general price inflation over the medium term; and the economic and social impact of any proposed order; and
- (i) any other matters the Commission considers relevant.

Appendix F: Calculation of Fare Adjustment

The following outlines the calculation of the adjustment in fares approved by the Commission in this final Determination for an interim fare adjustment for PMVs. The fare adjustment will apply to non urban routes only, and will take effect from 15 October 2008.

The formula is as follows:

$$\Delta P_{t+1} = (\Delta CPI_t * 0.75) + (\Delta DFI_t * 0.25) \text{ where}$$

ΔP_{t+1} = The adjustment in the fare

ΔCPI_t = Change in CPI (excluding beverages and betel nut) for the 12 month period to June 2008 over the 12 month period to June 2007. The change over this period applying the formula set out in the 2007 November PMV Determination is 5.75%

ΔDFI_t = Change in diesel retail prices in Lae for the 12 month period to June 2008 over the 12 month period to June 2007. The change over this period applying the formula set out in the PMV Determination is 21.7%

Applying the formula as set out above, the adjustment in fares is 9.7%