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LEGISLATIVE COUNCIL BRIEF

REVIEW OF THE FARE ADJUSTMENT MECHANISM OF THE MTR CORPORATION LIMITED

INTRODUCTION

At the meeting of the Executive Council on 16 April 2013, the Council ADVISED and the Chief Executive ORDERED that pursuant to the completion of a five-yearly review on the Fare Adjustment Mechanism ("FAM") between Government and MTR Corporation Limited ("MTRCL"), the package of proposals, with the following key features, be accepted and formally agreed to between Government and MTRCL for implementation as from the fare adjustment for 2013 –

(a) the existing direct-drive FAM formula will be retained, **but with the calculation of the Productivity Factor ("PF") value being subject to a new, objective and transparent methodology** (to be explained in paragraph 10 below). The formula being:

overall fare adjustment rate =

0.5 x change in CCPI (in December of the previous year) + 0.5 x change in Wage Index (in December of the previous year) – PF[1]

where –

CCPI = Composite Consumer Price Index
Wage Index = Nominal Wage Index (Transportation Section)

Fares will continue to be adjusted according to the formula outcome in June every year, without the need of further approval by any authorities. With the adoption of the new methodology, the PF value will be 0.6% for the next five years (compared with 0.1% in the original FAM formula)[1]. In effect,

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[1] PF = a pre-determined value set at 0% before 2013 and 0.1% from 2013 under the existing FAM.

compared with the existing FAM formula, this enhanced PF value will moderate any fare increase by 0.5% point each year for 2013 to 2017. For 2013 where data for computation of the FAM formula outcome are available, the fare increase rate taking effect in June 2013 would thus become +2.7%, instead of +3.2%, representing a 16% off the original rate for all passengers;

(b) a **new MTR City Saver ticket scheme** will be introduced to benefit medium or long-distance frequent travellers commuting within the "urban" zone, i.e. essentially the zone not covered by existing monthly passes. Under the scheme, passengers may enjoy a 7 to 22% discount for typical journeys. The target effective date for the launch is not later than the second quarter of 2014, given the lead time required for MTRCL to make all the **necessary technical preparations**;

(c) a **new Tung Chung – Nam Cheong Monthly Pass Extra** will be introduced with effect from 1 July 2013, on top of the existing Tung Chung Line Monthly Pass (Tung Chung – Hong Kong). Frequent travellers of the Line who do not need to travel the full distance of the Line may enjoy about 30% fare discount using the new Pass;

(d) a **new Monthly Pass Extra scheme** will be introduced with effect from 1 July 2013 to work in tandem with monthly passes (new and existing), such that the holder of a monthly pass can enjoy a 25% fare discount for onward domestic journeys[2] reaching stations not covered by the pass. The combined discount afforded by a monthly pass and the Monthly Pass Extra scheme could be up to around 30% for some typical

2 "Onward domestic journey" refers to the additional journey to destination by interchanging another railway line while using a certain railway line's Monthly Pass. For example, setting off at East Rail Line Sheung Shui Station using the Sheung Shui – East Tsim Sha Tsui Monthly Pass, if needed to interchange at Kowloon Tong Station for the Kwun Tong Line to Mong Kok Station, the journey between Kowloon Tong Station and Mong Kok Station will be the "onward domestic journey". Besides, the current Tuen Mun – Nam Cheong Monthly Pass and the new Tung Chung – Nam Cheong Monthly Pass Extra are both sectional passes. Holders of these Monthly Passes can enjoy a 25% fare discount without interchanging another railway line under the new Monthly Pass Extra scheme. Taking the example of travelling from Tung Chung Station to Kowloon Station, Tung Chung – Nam Cheong Monthly Pass Extra holders can enjoy a 25% fare discount for the journey between Nam Cheong Station and Kowloon Station.

long-distance journeys;

(e) a **profit sharing mechanism** will be introduced to enable MTRCL to share its yearly profit with passengers starting from 2013, by way of the "10% Same Day Second Trip Discount" scheme. For this purpose, a pre-determined tiered table will be used to decide on the amount to be shared with passengers under different profit levels with such amount put into a fare concession account;

(f) an **affordability cap** will be introduced whereby any future fare increase rate starting from the one in 2013, as per the FAM formula outcome, will not be higher than the change in the Median Monthly Household Income ("MMHI") for the corresponding period; and

(g) a **service performance arrangement** will be introduced to address public concerns that MTRCL should be penalised for serious service disruptions, having regard to similar practices adopted overseas. Proceeds of the fine thus imposed would be used to help finance the "10% Same Day Second Trip Discount" scheme.

JUSTIFICATIONS

2. The existing FAM whereby MTRCL's fare adjustment is made through a direct-drive formula which was put in place in 2007 as part of the rail merger which took place that year, to replace the fare autonomy MTRCL hitherto enjoyed. The main attraction of a direct-drive formula is that it frees the yearly fare adjustment process from unnecessary political influences, while being objective and transparent. However, experiences of the past five years show that the FAM is inadequate in taking into account three factors of wide public concerns, namely, MTRCL's profitability and service performance, as well as passengers' affordability. Indeed, when processing fare adjustment applications by other key public transport services such as franchised buses and taxis, the Government does take these three factors into account. MTRCL should be no exception. Against this background, the Government requested MTRCL to jointly conduct a review on the FAM in August 2012, pursuant to the Operating Agreement entered into between Government and MTRCL in 2007 governing operation and fare adjustment for MTR services. As announced by the Chief Executive in the 2013 Policy

Address, our objective for the review is to "incorporate service performance and profitability of the MTRCL, as well as public affordability as additional factors for consideration in the Fare Adjustment Mechanism." At the same time, we are conscious of the desirability of preserving the direct-drive nature of the FAM formula, subject to the overall outcome of the review. We are also mindful of the need to ensure MTRCL operates according to prudent commercial principles.

3. The FAM formula was introduced during the rail merger exercise to answer a demand from the community that fares should be able to come down, not just go up, in the wake of the deflationary environment from 1999 to 2004. During the first two years after the merger (2008 and 2009), in accordance with the terms of the rail merger, fares were frozen and MTRCL offered fare reduction upon the merger. For the three subsequent years, the FAM formula outcome all resulted in upward fare adjustment because of inflation. Although the increase rates were, at least arguably, not prohibitively high (+2.05% in 2010, +2.2% in 2011 and +5.4% in 2012), these fare adjustments all caused a public outcry because the Corporation was making handsome profit, amounting to $8.7 billion in 2010, $10.5 billion in 2011, and $9.8 billion in 2012 (all figures excluding property revaluation). Given MTRCL's handsome profits in recent years, there is clear and strong community pressure to find means to moderate fare increases for future years, and to address MTRCL's profitability.

4. While MTRCL's service reliability is among the best in the world, serious service disruptions do happen from time to time. Since railways are our largest public transport mode (accounting for some 40% of daily commuters), such service disruptions create inconvenience to many members of the public. For example, in 2012, there were eight disruptions of 31 minutes or above. A widely shared notion in the community is that MTRCL's service performance should be factored into in the FAM, and that there should be some form of penalty against MTRCL for serious service disruptions, similar to some practices adopted overseas, such as in Singapore and Melbourne[3].

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[3] In Singapore, a railway operator can be fined up to S$1 million per incident (presently equivalent to around HK$6.2 million), if the operator fails to comply with the operating performance standards and other regulatory requirements. Serious service disruptions exceeding 30 minutes are subject to such financial penalty. In assessing whether and what penalty amount should be imposed on each serious service disruption, the Singaporean authority will consider the facts of the case, severity of the incident and any relevant mitigating factors that may apply.

5. Given the inflationary environment and that MTR fares were increased each year over the past three years as set out in paragraph 3 above, there are also wide public concerns about passengers' affordability. There are quite strongly held demands to the effect that adjustment to MTR fares should be benchmarked against the change in household income for the corresponding period.

6. In conducting the review, we are mindful that MTRCL, while being a listed company, is not just another private enterprise. It is a public utility supporting development of Government's mass transport policy, with Government holding about 77% of its shares. The Corporation's success, both inside and outside Hong Kong, is due in no small measure to Government's pro-rail policy and the "rail plus property" model under which Government grants the Corporation property development rights of sites along railway lines to help the Corporation bridge the funding gap for railway projects financed and owned by the Corporation. All in all, MTRCL is a company set up and run with a public purpose. Its growth and development in the long term would depend on whether this public purpose is properly served, while continuing with its business in a commercially prudent manner.

PACKAGE OF PROPOSALS

7. With the need to meet the review objective outlined in paragraphs 2 to 6 above in mind, we embarked on the review with MTRCL in August 2012. After rounds of discussion, a package of proposals which met our objective was reached with MTRCL. The key features of the package are set out in paragraphs 8 to 20 below.

(A) Direct-drive FAM Formula and Productivity Factor

8. An outcome of the merger of the railway networks in December 2007 was the adoption of an objective and transparent FAM formula to replace the fare autonomy of the pre-merger MTRCL. The current formula, set out in the Operating Agreement, operates on a direct-drive basis.

In Melbourne, there is a penalty scheme for the operator to compensate passengers with free travel in form of complimentary tickets if it has failed to meet service performance requirements. The scheme takes into account the service performance requirements on punctuality and reliability.

9. The adoption of CCPI and Wage Index (which are published by the Census and Statistics Department periodically) primarily seeks to link fare adjustment to the costs of MTRCL. On review, both Government and MTRCL agree that the formulaic approach and its direct-drive nature are objective and transparent. As well, it is easy to understand and be monitored by the public, and should therefore be retained.

10. At the same time, it is proposed that a new, objective methodology be put in place to compute the PF value for the FAM formula. Productivity is measured as a ratio between output and input in MTRCL's business operation. The Government and MTRCL agree that the ratio should be arrived at based on historical financial data of the Corporation over the past five years. Once a ratio is computed, a PF value would be arrived at, for application for the following five years. The value would be updated once every five years, using the same methodology. With the adoption of this methodology, and using the data from 2008 to 2012, the PF value for the five years starting from 2013 is 0.6%, instead of the original 0.1%. In effect, compared with the existing FAM formula, this enhanced PF value will moderate any fare increase rate by 0.5% point each year for 2013 to 2017. For 2013 where data for computation of the FAM formulaic outcome are available, the fare increase rate would thus become +2.7%[4], instead of +3.2%[4], representing a discount of 16% off the original rate for all passengers. The resetting of PF value is a significant change to the FAM formula and will benefit all passengers as it will lead to moderation of fare levels in fare tables across the board, affording lower fares to all passengers, irrespective of travel patterns and journey distance. Details of the methodology are set
A out in **Annex A**.

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[4] Under the existing FAM formula, the overall fare adjustment rate for 2013 is:

0.5 x change in CCPI (in December of 2012) + 0.5 x change in Wage Index (in December of 2012) – PF
= 0.5 x 3.7% + 0.5 x 2.9% - 0.1%
= 3.2%

Adopting the new PF value as agreed with MTRCL, the overall fare adjustment rate for 2013 is:

0.5 x change in CCPI (in December of 2012) + 0.5 x change in Wage Index (in December of 2012) – PF
= 0.5 x 3.7% + 0.5 x 2.9% - 0.6%
= 2.7%

(B) New Monthly Pass Schemes

11. At present, MTRCL offers four Monthly Passes on three railway lines, namely, East Rail Line, West Rail Line and Tung Chung Line. The Monthly Passes offer fare discounts of about 12 to 30%[5] to long-distance frequent travellers living in North District, Tuen Mun, Tin Shui Wai, Yuen Long and Tung Chung. While useful to some, the existing passes are not without limitations. First, they are quite restrictive. Passengers would have to separately pay a full fare for any onward journey reaching stations not covered by the Monthly Pass the passengers hold. Second, in the case of the present Tung Chung Line Monthly Pass, passengers not travelling the full distance of the Line would find the Monthly Pass too expensive to be beneficial. Third, there are no monthly passes for any of the urban lines, namely, Tsuen Wan Line, Island Line, Kwun Tong Line and Tseung Kwan O Line. The following three proposals should be able to address these issues, moderating the impact of fare increase for some passengers.

<u>(i) MTR City Saver Ticket Scheme</u>

12. MTRCL will offer a new MTR City Saver ticket scheme that caters for medium or long-distance frequent travellers within the "urban" zone, covering all stations on Tsuen Wan Line, Island Line, Kwun Tong Line and Tseung Kwan O Line, as well as the urban stations of Tung Chung Line, East Rail Line and West Rail Line, such as Tsing Yi Station, Mong Kok East Station and Tsuen Wan West Station. The MTR City Saver will also cover stations of all future local railway lines located in the urban area. As far as committed projects with operating rights granted to MTRCL are concerned, these new lines are West Island Line, South Island Line (East) and Kwun Tong Line Extension (planned for commissioning in 2014 and 2015). The MTR City Saver will be set at a price of $400, and ticket holders are entitled to 40 rides within 30 days from the day of first use between designated stations in the urban area. To overcome technical constraints and to make it more user-friendly, the MTR City Saver will be a multi-ride smart card, separate from an ordinary Octopus card. Based on existing travel patterns of their

5 The discounts are based on the assumption that Monthly Pass holders take 40 trips in a calendar month. More uses mean lower fares per trip and hence higher discounts.

passengers, MTRCL expects that the scheme will benefit some 75 000 passengers each month, who can enjoy a 7 to 22% discount for typical journeys. This number of beneficiaries amounts to about 50% of the frequent riders (35 rides or above per month) travelling within the zone. The key features of the MTR City Saver and examples of fare discounts B for some common journeys within the urban area are set out in **Annex B**. Since the MTR City Saver is a brand new product, it would take time for MTRCL to work out all necessary technical configuration and operational handling. The target launch date of this scheme is not later than the second quarter of 2014.

(ii) Tung Chung – Nam Cheong Monthly Pass Extra

13. In addition to the existing Tung Chung – Hong Kong Monthly Pass, MTRCL will introduce a new Tung Chung – Nam Cheong Monthly Pass Extra, allowing unlimited rides on the Tung Chung Line between Tung Chung Station and Nam Cheong Station for a calendar month. The new Monthly Pass is set at a price of $360, translating into a discount of up to about 30%[6]. It will be available from 1 July 2013. Based on existing travel patterns of their passengers, MTRCL expects that some 15 000 passengers will benefit each month. This number of beneficiaries together with the Tung Chung – Hong Kong Monthly Pass users represent about 40% of incoming passengers at Tung Chung Station and Sunny Bay C Station during weekdays. Details are set out in **Annex C**.

(iii) Monthly Pass Extra Scheme

14. MTRCL will introduce a new Monthly Pass Extra ("MPE") scheme with effect from 1 July 2013, under which all Monthly Pass users (including the new Tung Chung – Nam Cheong Monthly Pass Extra) would enjoy a 25% discount on every onward domestic journey reaching stations not covered by the Monthly Pass the passengers hold. All Monthly Pass holders, presently totalling 110 000, will benefit from this scheme. Based on existing travel patterns, MTRCL expects that some 50 000 passenger trips, switching lines for onward journeys, will benefit each day. Examples showing the fare savings for some common journeys under the Monthly Pass and MPE schemes are shown in **Annex**

[6] The Octopus fare (2013) of Tung Chung – Lai King/Nam Cheong is $12.9. Assuming Monthly Pass users take 40 rides per month, the average fare per ride is $9.0, which is a saving of $3.9 (30%).

D **D**.

15. It should be noted that while MTRCL has, as outlined in paragraphs 12 to 14 above, projected possible numbers and passenger percentage shares of beneficiaries of the various new ticket Schemes based on existing travel patterns of passengers, the actual numbers and percentage shares may go up on implementation as the Schemes may induce demand.

(C) Profit-sharing by MTRCL

16. To address the issue of MTRCL's profitability, there will be a mechanism for fare concessions based on the Corporation's underlying business profit per year, which includes profit from all businesses of MTRCL, except profit arising from investment property revaluation. In other words, profit from Hong Kong transport operations, Hong Kong station commercial business, Hong Kong property rental and management businesses, property developments, as well as profit from the Corporation's overseas ventures, will all be covered. Such profit data are readily available in MTRCL's annual reports, accessible by the public.

17. For the purpose of this mechanism, a pre-determined tiered table will be used to decide on the amount to be shared with passengers each year under different profit levels. The sum would go to a fare concession account each year, and triggered for sharing with passengers when there is fare increase under the FAM for that particular year subject to a cap of half of the total additional revenue generated by the corresponding fare increase for that year. Passengers would then benefit through the time-limited "10% Same Day Second Trip Discount" scheme. The Corporation's post-tax underlying business profit is $9,775 million for 2012. Using the tiered table, an amount of $150 million will be shared with passengers in 2013, which could fund the operation of the "10% Same Day Second Trip Discount" scheme for about four months.
E Details are set out in **Annex E**.

(D) Affordability Cap

18. Effective from the fare adjustment in 2013, an affordability cap will be introduced whereby fare increase according to the (new) FAM formula outcome will always be capped by the change in MMHI for the

corresponding period. The fare increase not made because of the cap would not be effective until after the economy subsequently improves to the extent that the MMHI rises above the FAM result for the subsequent year(s). Any fare increase not made because of the cap will be recouped over two years, but always subject to the cap of the change in MMHI in the subsequent years. Further details on the affordability cap are set out in **Annex F**.

F

(E) Service Performance Arrangement

19. Under the package of proposals, there will be a service performance arrangement whereby a fine, ranging from $1 million to $15 million, will be imposed on MTRCL for serious service disruptions, defined as disruptions of 31 minutes or above. There were eight such disruptions in 2012. We agree with the argument advanced by MTRCL that disruptions of a shorter duration should not be counted for this purpose in order not to put undue pressure on MTRCL's frontline staff who otherwise might be tempted or pressured into rushing their repair works to avoid the penalty, putting quality or safety at risk. It should also be noted that disruptions caused by factors outside MTRCL's control such as passengers' behaviours and bad weather, will not be counted either. The proposed arrangement is similar to some practices adopted overseas, such as in Singapore and Melbourne. Any fine imposed will be credited to a fare concession account for fare concessions through the time-limited "10% Same Day Second Trip Discount" scheme. Further details of the arrangement are set out in **Annex G**.

G

(F) Impact on MTR Fares in 2013

20. Under the existing FAM formula where the PF value is pre-set at 0.1%, fare increase rate would be +3.2% for 2013. With the PF value computed to be 0.6% under a new methodology as agreed with MTRCL (see paragraph 10 above), the fare increase rate would be reduced to +2.7%, representing a 16% off the original rate. This moderated increase will benefit all passengers. Further, as some 95% of MTR passengers use Octopus cards and the majority of them are also frequent travellers, most MTR passengers can also benefit from the time-limited "10% Same Day Second Trip Discount" scheme. The various new ticket Schemes will benefit to various extent medium and long-distance commuters living in remote areas and frequent medium and long-distance travellers in the urban area. Implementation of (a) the new ticket

schemes, (b) profit-sharing by MTRCL and (c) service performance arrangement would, according to MTRCL's estimate, result in revenue foregone of $219 million in 2013. As a result of the various concessions mentioned above, the effective fare increase rate for 2013 would be lower than the outcome of the FAM formula (i.e. +2.7%) for some groups of passengers, the frequent medium and long-distance riders in particular.

IMPLICATIONS OF THE PROPOSAL

21. As a result of the new PF value at 0.6% under the new FAM formula, together with the implementation of the various concessions, MTRCL estimates that the revenue foregone in 2013 amounts to $289 million. The Corporation's revenue for subsequent years will also be reduced. As a result of the reduction in MTRCL's fare revenue of $289 million for the 2013 new FAM, the profit tax payable by MTRCL to Inland Revenue Department will drop by $40 million. In addition, the potential dividend income to Government which holds about 76.5% of MTRCL's shares will be reduced, ranging from $103 million (assuming a 66% dividend payout ratio based on past average of dividend payout ratios on recurrent business profit from 2008 to 2012) to $156 million (assuming 100% payout ratio). How the FAM should work and what its financial implications for Government would be beyond the next five years would be subject to the next FAM review due in end 2017.

22. The recommendation is in conformity with the Basic Law, including the provisions concerning human rights. The proposal has no productivity, civil service, environmental and Mainland relations implications, but has economic, family and sustainability implications,
H which are set out at **Annex H**.

PUBLIC CONSULTATION

23. The Government issued a public consultation document in September – November 2012 on the FAM review, and a total of 177 written submissions were received. The consultation paper was also posted on the Public Affairs Forum website of the Home Affairs Bureau to invite public discussion, and a total of 457 views and 28 replies were posted on the website. We held an expert panel discussion session to solicit views from academics and experts in the field in September 2012. The Legislative Council ("LegCo") Panel on Transport and the Transport Advisory Committee were consulted on 30 October 2012. Views of

LegCo were also expressed during a motion debate held on the subject on 5 December 2012. The community generally considered that the three factors of MTRCL's profitability, service performance, as well as public affordability should be taken into consideration when MTR fares are adjusted. There were also demands for the introduction of monthly passes applicable to the entire MTR network, and suggestions that MTR fare adjustments be approved by the Executive Council and/or LegCo.

PUBLICITY

24. A press release and this LegCo brief are issued in the afternoon of 16 April 2013, after the closing of the stock market. A joint press conference of the Government and MTRCL will be held in the afternoon of 16 April 2013 to introduce the new FAM package and answer media enquiries.

ENQUIRIES

25. Any enquiries can be directed to the following officer of the Transport and Housing Bureau –

> Mr José Yam
> Principal Assistant Secretary for Transport and Housing (Transport)
> (Tel. No. : 3509 8174)

Transport and Housing Bureau
April 2013

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OF THE MTR CORPORATION LIMITED

Annex A

Productivity Factor

For the purpose of determining the productivity gain of its railway operation, MTRCL has provided the historical financial data of its output and input, as follows –

	2008	**2009**	**2010**	**2011**	**2012**
Output ($M)	11,620	11,664	12,635	13,509	14,523
Input ($M)	6,567	6,651	6,821	7,354	7,829
Output/Input Ratio	**1.769**	**1.754**	**1.852**	**1.837**	**1.855**

"Output" is defined as the revenue from the Corporation's Hong Kong transport operations, as set out in the Corporation's audited financial statements.

"Input" is defined as the operating expenses (before depreciation, amortisation and variable annual payment expenses) relating to Hong Kong transport operations, as set out in the Corporation's audited financial statements.

2. Mainly due to strong patronage growth, the output/input ratio has improved from 1.769 (of 2008) to 1.855 (of 2012) by +4.84% in four years with compound annual growth rate of +1.19% per year. Half of it – 0.6% (rounded to the nearest one tenth of a percent) – will be shared with passengers for each of the next five years.

<u>**Annex B**</u>

<u>MTR City Saver Ticket Scheme</u>

The MTR City Saver is implemented through a new multi-ride smart card, physically and operationally separate from an Octopus card. Its main features are set out below –

Main Feature	**Details**
Station coverage	All stations on Tsuen Wan Line, Island Line, Kwun Tong Line and Tseung Kwan O Line, as well as the urban stations of Tung Chung Line, East Rail Line and West Rail Line, such as Tsing Yi Station, Mong Kok East Station and Tsuen Wan West Station (please refer to map at <u>Appendix</u>). Stations of future local railway lines situated in the urban area – as far as committed projects with operating rights granted to MTRCL are concerned, these new lines are West Island Line, South Island Line (East) and Kwun Tong Line Extension (planned for commissioning in 2014 and 2015).
Price (2013)	$400
No. of rides	40
Average fare per ride	$10.0
Validity period	30 days from date of first use

2. When a MTR City Saver passenger takes a ride within the urban area, one ride will be deducted off the MTR City Saver smart card. The remaining number of rides and expiry date for any MTR City Saver are displayed at both the entry and exit gates. Users of the MTR City Saver will enjoy a 7 to 22% discount for typical journeys.

3. Some selected common journeys showing the fare savings to passengers using the MTR City Saver are set out below –

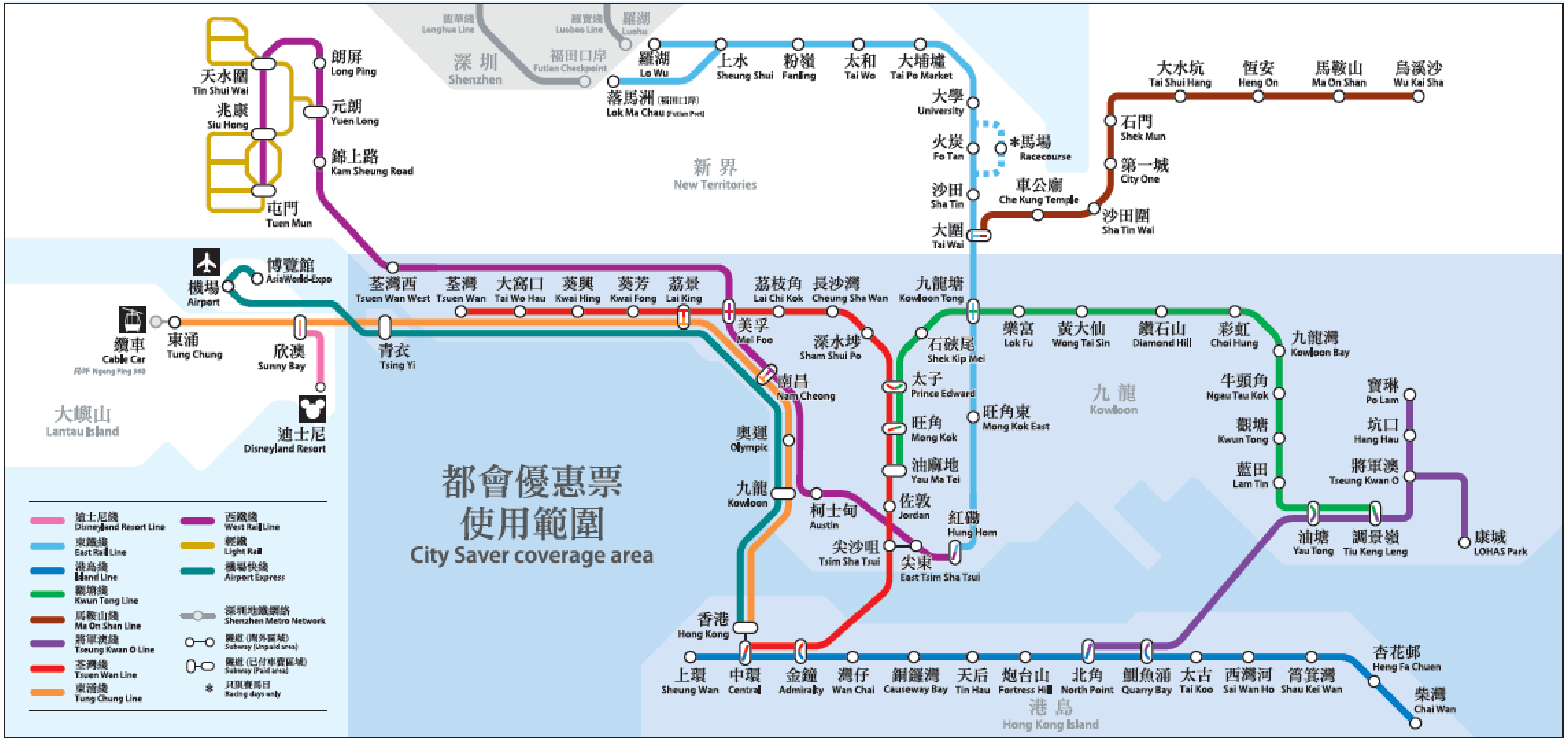
	Octopus Fare (2013)[Note]	**MTR City Saver Fare (2013)**	**Fare Savings**

	Octopus Fare (2013)[Note]	**MTR City Saver Fare (2013)**	**Fare Savings**
Hung Hom – Central	$10.3	$10.0	$0.3 (3%)
Tsuen Wan West – Kwun Tong	$10.4	$10.0	$0.4 (4%)
Mong Kok – Wan Chai	$10.8	$10.0	$0.8 (7%)
Po Lam – North Point	$10.8	$10.0	$0.8 (7%)
Sham Shui Po – Tin Hau	$10.8	$10.0	$0.8 (7%)
Olympic – Wan Chai	$10.8	$10.0	$0.8 (7%)
Tsing Yi – Causeway Bay	$12.8	$10.0	$2.8 (22%)
Choi Hung – Central	$12.8	$10.0	$2.8 (22%)
Mong Kwok East – Chai Wan	$14.0	$10.0	$4.0 (29%)
Tsuen Wan West – Chai Wan	$15.3	$10.0	$5.3 (35%)

Note: The Octopus fares (2013) provided in the above table are calculated based on a +2.7% overall fare adjustment rate for 2013 on top of the existing Octopus fares for illustrative purpose only. The actual Octopus fares are subject to changes upon the completion of the 2013 FAM process, a complex exercise taking some time to complete as the weighted average of the adjustment to all individual fares (numbering over 40 000) must add up to +2.7% and the results must be verified by independent experts for submission to Government.

<u>Appendix to Annex B</u>

Coverage of Stations under the MTR City Saver



Annex C

Tung Chung – Nam Cheong Monthly Pass Extra

A Monthly Pass will be introduced for passengers using the Tung Chung Line within the section between Tung Chung Station and Nam Cheong Station (the Tung Chung – Nam Cheong Monthly Pass Extra). This Monthly Pass will entitle its holder to an unlimited number of trips on the Tung Chung Line between Tung Chung Station and Nam Cheong Station and vice versa for a one calendar month period.

Railway Line	Monthly Pass	Price (2013)	Estimated No. of Passengers Benefitted, based on Existing Travel Patterns
Tung Chung Line	Tung Chung – Nam Cheong	$360	15 000 per month

Annex D

Monthly Pass Extra Scheme

Holders of all existing Monthly Passes and the new Tung Chung – Nam Cheong Monthly Pass Extra will be entitled to further fare discounts offered under the Monthly Pass Extra ("MPE") Scheme. The MPE will give each holder a 25% discount on the fare for all onward domestic journeys (excluding journeys to or from Lo Wu and Lok Ma Chau stations) beyond the valid stations for the relevant Monthly Pass.

2. Some selected common journeys showing the fare discounts to passengers using the Monthly Passes and MPE (based on 40 trips per month) are set out below –

	Octopus Fare (2013) Note 1	**Monthly Pass (2013)** Note 2 **and MPE**	**Fare Savings** Note 3
Tung Chung – Hong Kong Monthly Pass			
Tung Chung – Causeway Bay	$20.3	$17.9	$2.4 (12%)
Tung Chung – Quarry Bay	$23.5	$18.7	$4.8 (20%)
Tung Chung – Nam Cheong Monthly Pass Extra (new)			
Tung Chung – Sha Tin	$20.3	$14.3	$6.0 (30%)
Tung Chung – Tsuen Wan West	$16.7	$12.8	$3.9 (23%)
Tuen Mun – Nam Cheong Monthly Pass			
Tuen Mun – Central	$24.8	$19.4	$5.4 (22%)
Yuen Long – Kowloon Bay	$21.0	$16.9	$4.1(20%)
Tuen Mun – Hung Hom Monthly Pass			
Tuen Mun – Kwun Tong	$21.0	$18.5	$2.5 (12%)
Tin Shui Wai – Tung Chung	$26.4	$23.0	$3.4 (13%)
Sheung Shui – East Tsim Sha Tsui Monthly Pass			
Sheung Shui – Central	$18.4	$17.4	$1.0 (5%)
Fanling – Quarry Bay	$20.5	$18.9	$1.6 (8%)

Note 1: The Octopus fares (2013) provided in the above table are calculated based on a +2.7% overall fare adjustment rate for 2013 on top of the existing Octopus fares for illustrative purpose only. The actual Octopus fares are subject to changes upon the completion of the 2013 FAM process.

Note 2: The prices of Monthly Passes (2013) adopted in the above table are calculated based on a +2.7% overall fare adjustment rate on top of the existing prices of Monthly Passes rounded to nearest $5 for illustrative purpose only. The actual prices of Monthly Passes are subject to changes upon the completion of the 2013 FAM process.

Note 3: The calculation of fare savings per trip is based on the use of 40 trips per month. **The Monthly Passes allow unlimited rides within a calendar month, hence the more the uses, the higher the fare savings per trip**.

Annex E

Profit-sharing by MTRCL

The profit-sharing mechanism for further fare concessions is based on MTRCL's underlying business profit per year. MTRCL's underlying business includes (a) Hong Kong transport operations; (b) Hong Kong station commercial business; (c) Hong Kong property rental and management businesses; (d) Hong Kong property developments; (e) Mainland of China and international businesses; and (f) other businesses (principally Ngong Ping 360, railway consultancy and project management).

2. MTRCL will give back to passengers a pre-determined amount of its underlying business profit of the preceding financial year, in the form of "10% Same Day Second Trip Discount", as follows –

Underlying Business Profit per Year	Amount for Fare Concessions
Below $5B	0
$5B to <$6B	$50M
$6B to <$7B	$75M
$7B to <$8B	$100M
$8B to <$9B	$125M
$9B to <$10B	$150M
$10B to <$11B	$175M
$11B to <$12B	$200M
$12B to <$13B	$225M
>=$13B	$250M

3. The giving back of profit to passengers is on the conditions that: (a) an increase in fares is triggered under the FAM for that particular year; and (b) the fare concession amount is subject to a cap of half of the total additional revenue generated by the corresponding fare increase for that year.

4. In the event that (a) a fare increase is not triggered under the FAM for a particular year, or (b) the fare concession amount is capped at half of the total additional revenue generated by the corresponding fare increase for a particular year, the unspent sum of fare concessions (or the remaining amount, as the case may be) to be given back to passengers according to the arrangement set out in the table above will be rolled over

to the subsequent year(s) for distribution to passengers in the same way as outlined in paragraph 3 above.

5. The "10% Same Day Second Trip Discount" to be provided under this "profit-sharing" arrangement also applies to onward journeys of Monthly Pass holders, who also benefit from the discount offered under the Monthly Pass Extra Scheme as detailed in Annex D.

6. Using MTRCL's financial performance over the past five years from 2008 to 2012 as an illustrative example, the amount for fare concessions is as below –

Year	**Underlying Business Profit**	**Amount for Fare Concessions**	**Concession as % of Profit**
2008	$8,185 million	$125 million	1.5%
2009	$7,303 million	$100 million	1.4%
2010	$8,657 million	$125 million	1.4%
2011	$10,468 million	$175 million	1.7%
2012	$9,775 million	$150 million	1.5%
Total (2008-2012)	**$44,388 million**	**$675 million**	**1.5%**

Annex F

Affordability Cap

The Median Monthly Household Income ("MMHI") represents the average monthly domestic household income so calculated that 50% of the total number of domestic households had income above that figure and the other 50% had income below it. The year-on-year change in MMHI for the fourth quarter of the prior year is incorporated in the new package as a cap on the FAM rate to address the issue of public affordability.

2. When the FAM rate falls within the range of -1.5% and +1.5%, MTRCL's fare adjustment will be deferred with the FAM rate rolled over to the next year, i.e. the FAM rate will be added onto that for the next year for implementation (as per existing arrangements). For situations where fare increase is to take effect in accordance with the FAM, the affordability cap will become the gatekeeper and will be triggered under scenario (c) below –

(a) when FAM results in fare reduction, the FAM reduction rate will be used. No discount or promotion will be introduced, as the travelling public will already be benefitting from fare reduction;

(b) when FAM results in fare increase and such increase rate is lower than the change in MMHI, the FAM increase rate will be used; and

(c) when FAM results in fare increase and such increase rate is higher than the change in MMHI, the FAM increase rate will be used to adjust the fare table, but effective fares will be capped at the change in MMHI rate by offering discounts to Octopus fares. When the rate of change in MMHI is negative, the MMHI change will be deemed as 0%.

3. To enforce the affordability cap under paragraph 2(c) above by adopting the change in MMHI rate for fare increases, the following steps will be taken –

(a) an "affordability discount" will be introduced to effectively reduce the rate of fare increase for that year to the rate of change in MMHI (zero as floor). For example, if the FAM rate is +3.2% and the rate of change in MMHI is +1.2%, a 2% affordability discount will be introduced in Year 1. In other words, the effective fare increase rate in Year 1 will be 2% point off the original +3.2%, i.e. +1.2%;

(b) subject to (c) below, this discount will be halved in the second year and removed entirely in the third year. Using the same example as in paragraph 3(a) above, the affordability discount will be 1% in Year 2 and 0% in Year 3. In other words, the effective fare increase rate for each of Year 2 and Year 3 will be 1% point on top of the original rate derived from the FAM;

(c) the discount will not be withdrawn if, when combined with the increase in fares calculated under the FAM for the second and third year, such withdrawal would result in an effective increase in fares which was higher than the rate of change in MMHI for those years. In such circumstances, the effective increase in fares would be capped at the rate of change in MMHI for that year by deferring the withdrawal of the whole or a portion of the discount to following years; and

(d) the discount will also not be withdrawn if no change or a reduction in fares for subsequent years is triggered under the FAM.

4. An example on how affordability discount of 2% will apply is illustrated below –

Year	**FAM Rate**	**MMHI Change**	**Process**	**Effective Change in Fares over Previous Year**
1	+3.2%	+1.2%	● Fare table will be adjusted by +3.2% ● As a promotion, fares will be increased by +1.2% by offering affordability discounts to Octopus fares, i.e. 2% points (difference between FAM Rate and MMHI Change) off the FAM Rate; the 2% points discount will be recouped, where permissible, by half in Year 2 and the remaining half in Year 3 respectively	+1.2% (i.e. +3.2% – 2%)
2	+2.5%	+4.0%	● Fare table will be adjusted by +2.5%	+3.5% (i.e. +2.5% + 1%)

Year	**FAM Rate**	**MMHI Change**	**Process**	**Effective Change in Fares over Previous Year**
				To recoup half of the fare discount for Year 1, Octopus fares will be increased +1%, on top of the FAM Rate
3	+2.5%	+4.0%	● Fare table will be adjusted by +2.5%	+3.5% (i.e. +2.5% + 1%) To recoup half of the fare discount for Year 1, Octopus fares will be increased +1%, on top of the FAM Rate

Annex G

Service Performance Arrangement

The levels of financial penalty to be imposed under the service performance arrangement are as follows –

Train Service Disruptions	**Level of Penalty per Incident (subject to a maximum of $15M per incident)**
Equal to or more than 31 minutes but less than or equal to one hour	$1M
More than one hour but less than or equal to two hours	$2M
More than two hours but less than or equal to three hours	$3M
More than three hours but less than or equal to four hours	$5M
Each additional hour (or part thereof) exceeding four hours	$2.5M

"Exemption Events" (i.e. events which are outside MTRCL's control, such as passengers' behaviours and bad weather) are excluded under the arrangement.

2. In 2012, there was a total of eight service disruptions equal to or more than 31 minutes. The total penalty sum will be $13 million. It will be given back to passengers through the "10% Same Day Second Trip Discount" scheme (see also Annex E).

<u>**Annex H**</u>

<u>Economic, Family and Sustainability Implications</u>

(A) Economic Implications

MTRCL's transport service accounts for about 40% of the public transport passenger flow in Hong Kong, and railway service is an important determinant of cross-district labour movements and in turn a series of economic activities. Maintaining a transparent and objective regulatory framework that ensures affordable and high quality railway service would be conducive to higher labour mobility and thus economic growth in the long run.

2. Under the package of proposals, the three existing components of the FAM formula will be maintained and would continue to be based on the changes in CCPI and Wage Index as well as an agreed PF in deriving the fare adjustment rate. By setting the PF to be half of the historical productivity gain, the new arrangement will give MTRCL the incentive to keep on improving productivity whilst passing some of the benefits to passengers through lower fare increase. Also, capping the fare increase by the change in MMHI will help ensure that fares are affordable to the public.

3. With MTR fares constituting 1.56% of average household spending, the increase in MTR fares by 2.7% (through change to fare tables) to be effective in June 2013 consequential to an agreement of the new FAM package is estimated to lift the CCPI by 0.02 of a percentage point for CCPI in 2013 and another 0.02 of a percentage point in 2014. As a result of the various fare concessions covered under the new FAM package, the effective fare increase rate for 2013 would be lower than 2.7% for passengers enjoying such fare concessions.

(B) Family Implications

4. The new FAM package will offer a moderated fare adjustment rate and a number of concessions for passengers, and this may encourage more families to travel around and organise more activities. This will in turn enhance the relationship amongst family members, e.g. inter-generational relationships, and enable families to better balance work and family commitments.

(C) Sustainability Implications

5. The new FAM package helps moderate the MTR fare adjustment rate and provides various concessions for long-distance and frequent riders. This may encourage more passengers to take MTR rides and relieve the traffic congestions in some areas. The new FAM package with more concessions will also facilitate better social integration of the needy groups. It may also encourage more people to participate in community activities and enhance social cohesion.