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Panel on Transport
Meeting on 11 April 2014

**Updated background brief on
fare adjustment arrangement for franchised buses**

Purpose

This paper provides updated background information on the existing fare adjustment arrangement ("FAA") for franchised buses and summarizes the discussions of Legislative Council ("LegCo") Members on FAA.

Background

2. Under Section 13(1) of the Public Bus Services Ordinance (Cap. 230) ("PBSO"), fares of franchised bus services are to be charged according to a scale of bus fares determined by the Chief Executive-in-Council ("CE-in-Council"). The Administration would take into account a basket of factors known as the Modified Basket of Factors ("MBOF") approach in assessing bus fare adjustment for the purpose of making recommendations to CE-in-Council.

3. In January 2006, the Administration refined MBOF approach to enhance the objectivity of FAA and enable upward and downward fare adjustments in accordance with economic conditions. These changes included making reference to the Median Monthly Household Income ("MMHI") in addition to change in Composite Consumer Price Index ("CCPI") to reflect public affordability, and introducing a formula as an additional factor in MBOF approach. The Administration applies on a quarterly basis the fare adjustment formula and would proactively initiate a comprehensive fare review if the formula outcome reaches -2%. The revised MBOF approach includes the following factors –

- (a) changes in operating costs and revenue since the last fare adjustment;
- (b) forecasts of future costs, revenue and return;
- (c) the need to provide the operator with a reasonable rate of return – in considering the reasonable rate of return to franchised bus operators, the Administration will make reference to the Weighted Average Cost of Capital of the bus industry¹;
- (d) public acceptability and affordability – the Administration will make reference to changes in MMHI and CCPI;
- (e) service performance; and
- (f) a formula (supportable fare adjustment rate = $0.5 \times \text{Change in Wage Index} + 0.5 \times \text{Change in CCPI} - 0.5 \times \text{Productivity Gain}^2$) – the formula does not operate as an automatic determinant of the fare adjustment outcome. The Administration uses the outcome of the formula as a reference indicator in considering whether the fare adjustment rate is supportable and justifiable at a given juncture.

4. In assessing the financial performance of bus operators, the Administration has to consider and ensure that bus operators have sound financial capability in providing efficient and quality public bus services. Under FAA, the Administration does not set any guaranteed minimum level nor ceiling of rate of return for the bus operators. The Administration will make reference to the above basket of factors, as well as the comments made by members of the Panel on Transport ("the Panel") and the Transport Advisory Committee ("TAC") before submitting its recommendations to CE-in-Council. CE-in-Council retains the ultimate power in determining the scale of bus fares in accordance with PBSO.

¹ It is the average cost of debt and equity weighted by their respective proportion in the bus industry as a whole. The Weighted Average Cost of Capital can be regarded as the expected rate of return of the investors in general for the bus industry under the prevailing economic conditions. It is derived based on an established and widely used formula which takes into account financial data of the market reflecting the cost of debt and cost of equity.

² As approved by CE-in-Council in 2009, the value of productivity gain in the formula has been set at zero until the next review.

Review of FAA for franchised buses in 2009

5. The modifications to MBOF approach made in January 2006 specified that FAA would be reviewed in three years' time (i.e. 2009). In October 2009, the Administration completed a review of FAA for franchised buses and reported to the Panel on the outcome at the Panel meeting on 23 October 2009. The Administration advised that the bus fare adjustment formula had provided an objective starting point for considering applications for fare adjustment. It also decided not to accede to a request from bus operators for inclusion of a fuel price change element to the bus fare adjustment formula which served as the reference indicator in bus fare adjustment. The Panel members in general expressed support for the Administration's decision, as passengers would otherwise have to bear frequent and drastic fare adjustments due to short-term changes in fuel costs and that bus operators might pass their fuel cost to passengers. In December 2009, CE-in-Council approved that FAA should continue to be adopted pending a review in three years' time. The Panel asked the Administration at the meeting on 14 December 2012 about the schedule of the review on FAA for franchised buses and made several comments on the review. The Administration has been working on the review and would report the outcome of the review to the Panel in due course.

Discussion of LegCo Members on implementation of the current FAA for franchised buses

6. As a result of soaring fuel prices, all franchised bus operators applied for fare increases in 2007-2008. At the Council meeting on 17 October 2007, Hon LEE Wing-tat moved a motion on FAA and the bus fare increase applications. Members generally considered the rate of bus fare increase too high, and the following suggestions were made during the motion debate –

- (a) more sectional fares and bus-bus interchange concessions should be provided;
- (b) special elderly concessions on bus services, particularly during Sundays and public holidays should be provided;
- (c) daily, weekly or monthly bus passes should be provided;
and

- (d) appropriate assistance to people with disabilities, including the introduction of half-fare concessions to people with disabilities, should be provided.

Discussion of the Panel members

7. In January 2006, the Administration approved the granting of new franchise to the Kowloon Motor Bus Company (1933) Limited ("KMB") to continue operating the bus services from 1 August 2007 to 1 July 2017. From 2007 to 2012, KMB had made three applications for fare increases and the Panel discussions on such fare increase applications are summarized in the ensuing paragraphs.

Fare increase applications from franchised bus operators in 2007-2008

8. When the Panel was briefed on the fare increase applications from KMB, Long Win Bus Company Limited ("LW"), New Lantao Bus Company (1973) Limited ("NLB"), Citybus Limited and New World First Bus Services Limited at the meetings on 22 February and 25 April 2008, some members expressed concern that the rates of bus fare increases were always higher than those worked out according to the bus fare adjustment formula, and that the formula had failed to reflect the actual profit situations of the bus operators. The Panel was keen to ensure that public affordability would be adequately taken into account in any bus fare adjustments. Some members considered it unfair that at time of economic downturn, the bus companies could refuse to adjust the fare downwards whereas, when there was a slight economic recovery, these companies would immediately seek to increase bus fare. At the meeting on 22 February 2008, the Panel urged the bus operators to show their social responsibility and refrain from significantly increasing their fares. The Panel then passed the following motion –

"This Panel objects to the applications for substantial fare increases by franchised bus companies, and urges the Government to, when vetting the applications for fare increases by these companies, fully take into account the fact that they had never reduced fares during the period when a cumulative deflation rate of over 11.4% was recorded, and to reject the applications for fare increases by these companies, including the Kowloon Motor Bus Company Limited, on the basis of this fact; this Panel also urges the Government to further improve the relevant fare adjustment formula."

9. At the above meetings in February and April 2008, the Panel also explored various possible measures to stabilize bus fares, including the provision of fuel and operation subsidy, operation of bus services by the Government, setting up of a fare stabilization fund, granting of property development rights to bus operators, introduction of improvements to network efficiency, relaxation of restrictions on bus body and shelter advertising and so on.

10. At the meeting of the Executive Council on 20 May 2008, six fare increase applications made by five bus companies were considered. CE-in-Council approved five applications to increase fare level with effect from 8 June 2008. The relevant LegCo Brief [File Ref.: THB(T)L 2/4/120] was issued on 21 May 2008. All the approved fare increase rates, except that of NLB, were lower than the applied fare increase rates.

Fare increase applications from KMB and LW in 2010-2011

11. The Panel discussed the justifications for the fare increases by KMB and LW at the proposed rates of 8.6% and 7.4% respectively on 26 November 2010. The Panel stressed that under an inflationary environment, bus fare increases would have a great impact on the livelihood of the general public. The Panel expressed strong opposition to the applications on grounds that the proposed fare increase rates were much higher than the inflation rate. The Panel members opined that the fare increase applications, if approved, would trigger a spate of increases in public utility charges and transport costs. Some members also pointed out that KMB/LW had not reduced fares during the time when a cumulative deflation rate of over 11.4% was recorded, and KMB's profits from converting its depots into property development should also be taken into account in considering the fare increase applications. The Panel considered the fare increase applications unacceptable, and passed the following motion on 26 November 2010 –

"That this Panel opposes the applications for substantial fare increase made by KMB and LW, and urges the Government to, when vetting the fare increase applications by the bus companies, take into account the extremely unfair factor that the rates of increases applied for are more than three times the inflation rate."

12. After the Administration had consulted the Panel and TAC on the applications, CE-in-Council decided on 19 April 2011 that an overall average fare increase of 3.6% was approved for KMB and an overall average fare increase of 3.2% was approved for LW. The new fares took effect on 15 May 2011. Compared with the proposed fare increase rates

applied by KMB and LW, the approved fare increase rates were lowered by over 50%.

Fare increase application from KMB in 2012-2013

13. KMB briefed the Panel on 14 December 2012 that the company had been incurring financial losses due to factors beyond the company's control, including high fuel prices and substantial drop in ridership due to the shift of passengers to the expanded railway network. In order to restore KMB's financial viability for the provision of sustainable quality services, the company had applied for a fare increase of 8.5%. Members in general were dissatisfied with KMB's fare increase application and considered the proposed fare increase rate of 8.5% excessive.

14. Some members pointed out that KMB's fare increase application, if approved, would definitely increase the financial burden of the public and lead to a spate of increases in the fares of other public transport services. Members urged the Administration to review the formula adopted under FAA for franchised buses.

15. Some members also considered bus route rationalization necessary to avoid bus fare increase. The Administration stated that they had made sustained efforts on bus route rationalization; whereas KMB's representative attending the meeting explained that KMB had also been trying to implement bus route rationalization through redirecting resources from under-utilized routes to routes with keen demand and hoped that more discussions would be held with the Administration and District Councils.

16. As regards the service performance of KMB, the Panel suggested that the Transport Department ("TD") should measure the lost trip rate at a certain stop or end of the bus journey instead of at the start of the trip as the relevant figure would be more realistic from the view of passengers; and that the Administration should consider conducting surprise checks on bus frequency and the results be announced to the public. It was also suggested that bus companies should use information technologies to record the bus arrival time at bus stops to facilitate measurement of the lost trip rate.

17. At the meeting on 14 December 2012, the Panel passed the following two motions –

"That as the Kowloon Motor Bus Company (1933) ("KMB") has applied for fare increase without disclosing its financial

information in detail and providing sufficient justifications, this Panel objects to the fare increase application from KMB at this stage."

and

"That this Panel objects to the application for substantial fare increase by 8.5% from the Kowloon Motor Bus Company (1933) ("KMB"), and requests that the Government should place public acceptance and affordability, as well as the performance of KMB as the primary considerations when vetting the latter's fare increase application, and that the Government should urge KMB to expeditiously implement comprehensive bus routes rationalization, introduce section fares, and solve the serious problem of lost bus trips. Meanwhile, the Government has the responsibility to initiate a review of the existing fare adjustment arrangement, with a view to including the proceeds obtained by KMB and its parent company from their leasing and media business in fare level consideration."

18. After the Administration had consulted the Panel and TAC on the application made by KMB, CE-in-Council decided on 19 February 2013 that an overall average fare increase of 4.9% was approved and the new fares to become effective on 17 March 2013. Compared with the fare increase rates applied by KMB, the approved fare increase rates were lowered by over 40%.

Relevant motions/questions moved/raised at Council meetings and other relevant papers

19. The hyperlinks to relevant motions and questions moved/raised at Council meetings and other relevant papers are in **Appendices I and II** respectively.

Latest development

20. KMB submitted a fare increase application to TD on 29 November 2013. The proposed fare increase is 4.3%, which represents an average increase of 28 cents per passenger-trip. The Administration proposed to consult the Panel on KMB's fare increase application at the meeting on 11 April 2014.

Council Business Division 1
Legislative Council Secretariat
8 April 2014

Relevant motions and questions moved/raised at Council meetings

Motions

At the Council meeting on 14 November 2001, Hon LAU Kong-wah moved a motion urging the Administration to discuss with various public transport operators with a view to expeditiously reducing the fares of public transport services.

(<http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm1114ti-translate-e.pdf>)

2. At the Council meeting on 23 October 2002, Hon Andrew CHENG moved a motion urging the Administration to discuss with various public transport operators with a view to reducing expeditiously the fares of transport services and, at the same time, establishing a fare adjustment mechanism, so as to alleviate the burden on people's livelihood.

(<http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm1023ti-translate-e.pdf>)

3. At the Council meeting on 12 November 2003, Hon Andrew CHENG moved a motion urging the Administration to refine the public transport fare system.

(<http://www.legco.gov.hk/yr03-04/english/counmtg/hansard/cm1112ti-translate-e.pdf>)

4. At the Council meeting on 14 December 2005, Hon Andrew CHENG moved a motion urging the Administration to expeditiously implement a fare adjustment mechanism that allowed the fares to go upward and downward.

(<http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm1214ti-translate-e.pdf>)

5. At the Council meeting on 4 November 2009, Hon CHEUNG Hok-ming moved a motion urging the Administration to discuss with various public transport operators and adopt effective measures to alleviate the burden of travelling expenses on the public.

(<http://www.legco.gov.hk/yr09-10/english/counmtg/hansard/cm1104-translate-e.pdf>)

Questions

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| 5.3.2003 | Hon Abraham SHEK raised a written question on the progress of the Administration's study on public transport fare adjustment mechanism (http://www.legco.gov.hk/yr02-03/english/counmtg/hansard/cm0305ti-translate-e.pdf) |
| 5.5.2004 | Hon Andrew CHENG raised an oral question on measures to alleviate the burden of travelling expenses on students (http://www.legco.gov.hk/yr03-04/english/counmtg/hansard/cm0505ti-translate-e.pdf) |
| 8.6.2005 | Hon TAM Yiu-chung raised an oral question on public transport fare adjustment mechanism (http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0608ti-translate-e.pdf) |
| 22.6.2005 | Hon LAU Kong-wah raised an oral question on fare concessions offered by public transport operators (http://www.legco.gov.hk/yr04-05/english/counmtg/hansard/cm0622ti-translate-e.pdf) |
| 22.3.2006 | Hon CHEUNG Hok-ming raised a written question on the delayed implementation of fare discounts on jointly operated cross-harbour routes (http://www.legco.gov.hk/yr05-06/english/counmtg/hansard/cm0322ti-translate-e.pdf) |
| 25.4.2007 | Hon CHEUNG Hok-ming raised a written question on bus fare concession initiatives (http://www.legco.gov.hk/yr06-07/english/counmtg/hansard/cm0425-translate-e.pdf) |
| 2.5.2007 | Hon Andrew CHENG raised an oral question on fare adjustments of public transport (http://www.legco.gov.hk/yr06-07/english/counmtg/hansard/cm0502-translate-e.pdf) |

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| 19.12.2007 | Hon Albert CHAN raised a written question on sectional fares for franchised bus routes (http://www.legco.gov.hk/yr07-08/english/counmtg/hansard/cm1219-translate-e.pdf) |
| 11.3.2009 | Hon Frederick FUNG raised a written question on fares of KMB and fare adjustment mechanism (http://www.legco.gov.hk/yr08-09/english/counmtg/hansard/cm0311-translate-e.pdf) |
| 13.1.2010 | Hon CHEUNG Hok-ming raised an oral question on measures to alleviate economic pressure on members of the public (http://www.legco.gov.hk/yr09-10/english/counmtg/hansard/cm0113-translate-e.pdf) |
| 18.5.2011 | Dr Hon PAN Pey-chyou raised a written question on fare concessions offered by franchised bus companies (http://www.legco.gov.hk/yr10-11/english/counmtg/hansard/cm0518-translate-e.pdf) |
| 2.11.2011 | Hon Starry LEE raise an oral question on measures to alleviate the burden of travelling expenses on the public (http://www.legco.gov.hk/yr11-12/english/counmtg/hansard/cm1102-translate-e.pdf) |

Appendix II

Fare adjustment arrangement for franchised buses

List of relevant papers of the Panel on Transport

| Date of meeting | Minutes/Paper | LC Paper No. |
|-----------------|---|--|
| 27.10.2000 | Minutes of the meeting | CB(1)208/00-01 http://www.legco.gov.hk/yr00-01/english/panels/tp/minutes/tp271000.pdf |
| | Administration's paper on review of the basis for considering bus fare adjustments | http://www.legco.gov.hk/yr00-01/english/panels/tp/papers/a100e03.pdf |
| 23.2.2001 | Minutes of the meeting | CB(1)1260/00-01 http://www.legco.gov.hk/yr00-01/english/panels/tp/minutes/tp230201.pdf |
| | Administration's paper on New World First Bus Services Limited's application for fare increase – background information | http://www.legco.gov.hk/yr00-01/english/panels/tp/papers/a622e03.pdf |
| 14.1.2003 | Minutes of the meeting | CB(1)940/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030114.pdf |
| 21.3.2003 | Minutes of the meeting | CB(1)1456/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030321.pdf |

| Date of meeting | Minutes/Paper | LC Paper No. |
|--|---|--|
| | Administration's paper on the progress of implementation of bus-bus interchange schemes | CB(1)1132/02-03(03) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0321cb1-1132-3e.pdf |
| | Administration's information note on deduction of bus-bus interchange fares | CB(1)26/03-04(01) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0321cb1-26-1e.pdf |
| 1.8.2003 | Minutes of the meeting | CB(1)2435/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp030801.pdf |
| | Administration's paper on public transport fares | CB(1)2291/02-03(02) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0801cb1-2291-2e.pdf |
| | Administration's supplementary note on public transport fares | CB(1)2335/02-03(02) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp0801cb1-2335-2e.pdf |
| 28.11.2003 | Minutes of the meeting | CB(1)589/03-04 http://www.legco.gov.hk/yr03-04/english/panels/tp/minutes/tp031128.pdf |
| 14.1.2004 | Minutes of the meeting | CB(1)1021/03-04 http://www.legco.gov.hk/yr03-04/english/panels/tp/minutes/tp040114.pdf |
| 17.11.2005 25.11.2005 16.12.2005 | Minutes of the meetings | CB(1)549/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051117.pdf |

| Date of meeting | Minutes/Paper | LC Paper No. |
|------------------------|---|---|
| | | <p>CB(1)694/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051125.pdf</p> <p>CB(1)713/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/minutes/tp051216.pdf</p> |
| | Administration's paper on review of the basis for considering bus fare adjustments | <p>CB(1)309/05-06(01) http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-309-1e.pdf</p> |
| | Administration's paper on "Application for New Franchises by Citybus Limited (Franchise for Hong Kong Island and Cross Harbour Routes), New Lantao Bus Company (1973) Limited and Kowloon Motor Bus Company (1933) Limited" | <p>CB(1)309/05-06(02) http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-309-2e.pdf</p> |
| | Background brief on "Review of the basis for considering bus fare adjustments" | <p>CB(1)310/05-06 http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/tp1117cb1-310-e.pdf</p> |
| 1.2006 | Legislative Council brief on "Review of the basis for considering bus fare adjustments" | <p>http://www.legco.gov.hk/yr05-06/english/panels/tp/papers/etwb0601e.pdf</p> |
| 22.2.2008 | Administration's paper on fare increase applications by franchised bus companies | <p>CB(1)828/07-08(01) http://www.legco.gov.hk/yr07-08/english/panels/tp/papers/tp0222cb1-828-1-e.pdf</p> |

| Date of meeting | Minutes/Paper | LC Paper No. |
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| | Minutes of the meeting | CB(1)1123/07-08 http://www.legco.gov.hk/yr07-08/english/panels/tp/minutes/tp080222.pdf |
| 25.4.2008 | Administration's paper on fare increase applications by Citybus Limited and New World First Bus Services Limited | CB(1)1317/07-08(05) http://www.legco.gov.hk/yr07-08/english/panels/tp/papers/tp0425cb1-1317-5-e.pdf |
| | Minutes of the meeting | CB(1)1975/07-08 http://www.legco.gov.hk/yr07-08/english/panels/tp/minutes/tp080425.pdf |
| 24.4.2009 | Administration's paper on rectification of the wage indices and consequential revision to fare adjustment formula outcomes | CB(1)1337/08-09(06) http://www.legco.gov.hk/yr08-09/english/panels/tp/papers/tp0424cb1-1337-6-e.pdf |
| | Minutes of the meeting | CB(1)2541/08-09 http://www.legco.gov.hk/yr08-09/english/panels/tp/minutes/tp20090424.pdf |
| 23.10.2009 | Administration's paper on review of fare adjustment arrangement for franchised buses | CB(1)65/09-10(03) http://www.legco.gov.hk/yr09-10/english/panels/tp/papers/tp1023cb1-65-3-e.pdf |
| | Minutes of the meeting | CB(1)922/09-10 http://www.legco.gov.hk/yr09-10/english/panels/tp/minutes/tp20091023.pdf |

| Date of meeting | Minutes/Paper | LC Paper No. |
|------------------------|--|---|
| 26.11.2010 | Administration's paper on fare increase applications from the Kowloon Motor Bus Company (1933) Limited and the Long Win Bus Company Limited | CB(1)482/10-11(06) http://www.legco.gov.hk/yr10-11/english/panels/tp/papers/tp1126cb1-482-6-e.pdf |
| | Updated background brief on "fare adjustment arrangement for franchised buses" | CB(1)481/10-11 http://www.legco.gov.hk/yr10-11/english/panels/tp/papers/tp1126cb1-481-e.pdf |
| | Minutes of the meeting | CB(1)1159/10-11 http://www.legco.gov.hk/yr10-11/english/panels/tp/minutes/tp20101126.pdf |
| - | Press release published by the Kowloon Motor Bus Company (1933) Limited on its fare increase application on 29 November 2012 | http://www.kmb.hk/en/news/press/archives/news201211291802.htm 1 |
| 14.12.2012 | Administration's paper on fare increase application from the Kowloon Motor Bus Company (1933) Limited | CB(1)249/12-13(05) http://www.legco.gov.hk/yr12-13/english/panels/tp/papers/tp1214cb1-249-5-e.pdf |
| | Updated background brief on "fare adjustment arrangement for franchised buses" | CB(1)249/12-13(06) http://www.legco.gov.hk/yr12-13/english/panels/tp/papers/tp1214cb1-249-6-e.pdf |
| | Administration's response to the motions passed and supplementary information on fare increase application from The Kowloon Motor Bus Company (1933) Limited (Follow-up paper) | CB(1)763/12-13(01) http://www.legco.gov.hk/yr12-13/english/panels/tp/papers/tp1214cb1-763-1-e.pdf |

| Date of meeting | Minutes/Paper | LC Paper No. |
|------------------------|---|---|
| | Minutes of the meeting | CB(1)689/12-13 http://www.legco.gov.hk/yr12-13/english/panels/tp/minutes/tp20121214.pdf |
| - | Press release published by the Kowloon Motor Bus Company (1933) Limited on its fare increase application on 29 November 2013 | http://www.kmb.hk/en/news/press/archives/news201311291972.html |
| - | Administration's response to the letter from Hon TANG Ka-piu on the fare increase application from the Kowloon Motor Bus Company (1933) Limited as set out in LC Paper No. CB(1)468/13-14(01) | CB(1)590/13-14(01) http://www.legco.gov.hk/yr13-14/english/panels/tp/papers/tpcb1-590-1-e.pdf |

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