立法會
Legislative Council

LC Paper No. CB(1)1964/05-06
(These minutes have been seen
by the Administration)

Ref : CB1/PL/TP/1

Panel on Transport and
Panel on Financial Affairs

Minutes of joint meeting held on
Monday, 22 May 2006, at 4:30 pm
in the Chamber of the Legislative Council Building

Members present : Members of the Panel on Transport

Hon LAU Kong-wah, JP (Chairman)
Hon Andrew CHENG Kar-foo (Deputy Chairman)
Hon LAU Chin-shek, JP
Hon Miriam LAU Kin-yee, GBS, JP
Hon TAM Yiu-chung, GBS, JP
* Hon Abraham SHEK Lai-him, JP
Hon LI Fung-ying, BBS, JP
Hon Tommy CHEUNG Yu-yan, JP
Hon Albert CHAN Wai-yip
Hon WONG Kwok-hing, MH
Hon LEE Wing-tat
* Hon Jeffrey LAM Kin-fung, SBS, JP
Hon CHEUNG Hok-ming, SBS, JP
* Hon Albert Jinghan CHENG

Members of the Panel on Financial Affairs

Hon Bernard CHAN, JP (Chairman)
Hon Ronny TONG Ka-wah, SC (Deputy Chairman)
Hon James TIEN Pei-chun, GBS, JP
Hon LEE Cheuk-yan
Hon James TO Kun-sun
Hon CHAN Kam-lam, SBS, JP
Hon Andrew LEUNG Kwan-yuen, SBS, JP
Hon WONG Ting-kwong, BBS
Hon CHIM Pui-chung

Hon TAM Heung-man

(*also a member of the Panel on Financial Affairs)

Member attending : Dr Hon Fernando CHEUNG Chiu-hung

Members absent : Members of the Panel on Transport

* Ir Dr Hon Raymond HO Chung-tai, S.B.St.J., JP
Hon Mrs Selina CHOW LIANG Shuk-yee, GBS, JP
Hon LEUNG Kwok-hung

Members of the Panel on Financial Affairs

Dr Hon David LI Kwok-po, GBS, JP
Hon SIN Chung-kai, JP
Hon Emily LAU Wai-hing, JP

(*also a member of the Panel on Financial Affairs)

Public Officers attending : Dr Sarah LIAO
Secretary for the Environment, Transport and Works

Mr Joshua LAW
Permanent Secretary for the Environment, Transport and Works

Mr Patrick HO
Deputy Secretary for the Environment, Transport and Works

Mr Martin GLASS
Deputy Secretary for Financial Services and the Treasury

Attendance by invitation : MTR Corporation

Mr C K CHOW
Chief Executive Officer

Mr Lincoln LEONG
Finance Director

Mrs Miranda LEUNG
General Manager – Corporate Relations

Mr Eddie SO
Transport Planning Manager

Kowloon-Canton Railway Corporation

Ir James BLAKE
Chief Executive Officer

Mr Lawrence LI
Director – Finance

Mrs Grace LAM
General Manager – Corporate Affairs

Clerk in attendance : Mr Andy LAU
Chief Council Secretary (1)2

Staff in attendance : Ms Connie FUNG
Assistant Legal Adviser 3

Ms Sarah YUEN
Senior Council Secretary (1)6

Mr Anthony CHU
Council Secretary (1)2

Miss Winnie CHENG
Legislative Assistant (1)5

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I Election of Chairman

Mr LAU Kong-wah was elected Chairman of the joint meeting.

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II Merger of MTR and Kowloon-Canton Railway Systems —— Fare-related issues

(LC Paper No. CB(1)1291/05-06(01)	-	Information paper entitled" Merger of MTR and Kowloon-Canton Railway Systems - Proposed Way Forward" provided by the Administration for the joint Panel meeting on 12 April 2006
LC Paper No. CB(1)1541/05-06(01)	-	Administration's response to members' questions on the rail merger proposal raised at the joint Panel meeting on 12 April 2006)

2. Members noted the submission from the Islands Branch of the Democratic Alliance for the Betterment and Progress of Hong Kong on "Merger of MTR and Kowloon-Canton Railway System – Fare-related issues" which was tabled at the meeting.

(*Post-meeting note*: The submission was subsequently issued vide LC Paper No. CB(1)1564/05-06 on 23 May 2006).

3. The Chairman advised members that this meeting was scheduled for discussion of the fare issues of the merger proposal of MTR and Kowloon-Canton Railway (KCR) Systems.

Fares and property developments

4. Mr LEE Wing-tat said that railway operation had not been very profitable. Citing Kowloon-Canton Railway Corporation (KCRC) as an example, the net assets of the Corporation as reported in its 2004 annual report was $60 billion but it could only generate a profit of $337 million and the return on equity was only less than 1%. Indeed, income from property development had all along been used to cross-subsidize railway operations and stabilize railway fares. Noting that the proposed fare adjustment mechanism (FAM) would not take into consideration the profit from property development, he was worried that railway fares would be subject to fluctuations. He asked whether the Administration would consider incorporating the profit from property development as one of the factors in the proposed FAM.

5. The Secretary for the Environment, Transport and Works (SETW) advised members that property development had all along been used to bridge the funding gap for the construction of railway projects but not to subsidize rail fares. For new railway line, the funding gap required had been worked out, having regard to the estimated internal rate of return of the project. Given that income from property developments was subject to fluctuations, SETW considered that any FAM which took into account the income from property developments would create uncertainty and expose railway fares

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to severe fluctuations. On the other hand, a formula linked to changes in the composite Consumer Price Index (CCPI) and the Nominal Wage Index (Transport Sector) would improve transparency and objectivity, and reflect changes in the general economic conditions and the wage level of the working public. She further said that the rail and property model had the advantage of synchronizing railway development with property developments to ensure the long-term sustainability of the railway.

6. The Chief Executive Officer, MTR Corporation Limited (CEO/MTRCL) said that property was a significant part of the Company's business, providing an important source of income to support the cost of construction of railway projects as well as contributing to future rail patronage from the immediate catchment areas created by property developments. Notwithstanding that MTRCL had fare autonomy and could set its fares in accordance with prudent commercial principles, MTRCL had agreed to adopt a more open and transparent FAM which would allow both downward and upward adjustment of fares according to a fare adjustment formula after the rail merger. Regarding the regulatory framework for fare adjustment, he pointed out that there were two approaches, a scheme of control agreement with an agreed rate of return for the corporation or a price cap model as presently proposed. Compared with the former approach which would give rise to fluctuations in railway fares, the latter approach would be more easily understandable by the public and any upward adjustment of fares would be below the increase in the CCPI and wage index.

7. In response to the Chairman's enquiry on the relationship between property developments and railway fares, CEO/MTRCL replied that MTRCL achieved an overall average return of 6% on assets, including fare revenue and profit on property developments. This return rate was lower than those of many other public utilities in Hong Kong. Notwithstanding, MTRCL had made great efforts to stabilize railway fares.

Fare adjustment mechanism

8. Mr LEE Wing-tat pointed out that the Administration had sent a message to the public that if they wished to enjoy fare reduction, they would have to accept the rail merger proposal. However, in his opinion, the fare reduction should have long been implemented due to the cumulative deflation over the past few years. Although MTRCL had fare autonomy, the Administration had all along been playing an active role in the public transport service market by imposing various restrictions on other public transport modes to freely compete with the two railway corporations. Based on previous experience, he was worried that CCPI would be increased at a faster pace than the salary rate of employees, and hence, railway fares would go beyond the affordability of the general public. He enquired whether the Administration would consider setting up a fund by adopting a revenue-sharing mechanism for the property package to stabilize railway fares for the post-merger corporation (MergeCo).

9. SETW said that at present, both MTRCL and KCRC had fare autonomy and they set their fares in accordance with prudent commercial principles. After the rail merger,

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an objective and transparent FAM would be introduced to replace fare autonomy. As such, there was no need to set up a fare stabilization fund. As the travelling public would benefit from fare reduction on Day One of the rail merger, she wished the merger deal could be completed as soon as possible. Upon rail merger, railway fares would be reduced in accordance with the fare reduction package and thereafter fares would be adjusted according to theFAM.

10. Mr LEE Wing-tat enquired whether a cap would be introduced to ensure that railway fares would not go beyond a certain level after applying the fare adjustment formula. He remarked that as CCPI measured the relative change over time in the total cost of a specified basket of consumer goods and services such as rental, upward adjustment of CCPI did not necessarily mean that there was a corresponding increase in the salary of general households. In order to ensure that the general public could afford to pay the railway fares set according to the formula, it was necessary to introduce a cap to confine the maximum permitted level of increase.

11. SETW said that the proposed fare adjustment formula was linked to the rates of change of CCPI and a wage index. The FAM would be more objective and transparent as the two indices were well established and were verifiable. On Mr LEE's suggestion to impose a cap on fare increase, she remarked that the adoption of a fare increase limit would necessitate the adoption of a fare reduction limit as well which the Administration considered unacceptable.

12. Noting that the fare adjustment formula included a productivity factor which would allow passengers to share the benefits of productivity gain of MergeCo, Mr LEE Wing-tat queried the rationale for pitching the productivity factor at such a low level of 0.1%. As the relative strength of MTRCL and KCRC could supplement each other, MergeCo should be able to improve efficiency and productivity after the rail merger. In order to ensure that passengers could gain productivity benefits from the rail merger, the productivity factor in the fare adjustment formula should be adjusted to at least 2% to 3%.

13. SETW advised members that the scope of productivity gain for railways was limited due to heavy investment for constructing, maintaining and upgrading the railway systems. The proposed pitching of the productivity factor at 0.1% was recommended taking into account studies by economists on the characteristics of the railway market in Hong Kong. The Chairman highlighted that the proposed rate of productivity factor in the fare adjustment formula for railway was different from that of franchised bus. At the request of Mr LEE Wing-tat, the Administration agreed to provide further details about the basis of pitching the productivity factor at 0.1%

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14. In response to members' enquiry of the base year for the FAM, SETW and CEO/MTRCL replied that on the first day of the rail merger, the railway fares including those for the KCR services would be reduced in accordance with the proposed fare reduction package. Thereafter, the railway fares would be adjusted in accordance with

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the proposed FAM, on the basis of the reduced fare level. SETW further advised that the FAM would be reviewed every five years upon request by either MergeCo or the Government. However, mutual agreement between MergeCo and Government would be required for any amendment to the FAM.

15. Mr WONG Kwok-hing requested the Administration to provide examples to illustrate the working of the proposed fare adjustment formula. In response, the Permanent Secretary for the Environment, Transport and Works (PS for ETW) said that the formula was straightforward and the resultant figures could be calculated by simply substituting the corresponding figures in the formula.

Policy on railway development

16. Ms LI Fung-ying held the view that in considering the fare reduction package and future railway fares, there was a need to consider the wider transport policy as a whole. At present, Government accorded priority to railway development and hence, expansion of other public transport services might be restricted. She was worried that after the rail merger, MergeCo would have an advantage over other public transport modes. In the absence of a clear blueprint for ascertaining the state of competition in the public transport market after the rail merger and whether revenue from property developments would be used for fare reduction, it would be difficult for members to render its support for the merger deal under such circumstance. She sought the Administration's explanation on the wider policy objective.

17. SETW said that the merger was proposed as a strategic plan for the long-term sustainable development of the two railway corporations. She clarified that the proposed fare reduction package was not meant to gain public acceptance and support of the merger deal. The merger would bring different advantages. A combined railway network would achieve economies of scale and facilitate the abolition of second boarding charge. The respective strength of MTRCL and KCRC could supplement each other to bring MergeCo a stronger rail operator. Hong Kong would be much more competitive both in the Mainland market and in the international arena. As profit generated from railway operations was not high and in order to attract private funding for implementing railway projects so as to save Government funding support in the form of subsidy, a reasonable rate of return should be offered to railway operators. She further remarked that property was a significant part of MTRCL's business, providing an important source of income to support the cost of construction of railway projects. She envisaged that MergeCo would continue to engage in property-related business after the rail merger.

Fare reduction

18. Mr LEE Cheuk-yan pointed out that there were grievances among the public against the high transport costs. Even at the time of a deflationary period, there was no reduction in railway fares despite repeated requests from the public. He considered that

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the benefits of the proposed fare reduction of 5% to 10% brought to the public were very limited and insufficient to meet the public demand for a meaningful reduction in transport costs. There should be a minimum of 10% fare reduction for short-haul passengers and 20% for long haul passengers. Mr LEE opined that with a cumulative deflation of more than 10% over the past few years, the two railway corporations should first reduce their fares accordingly.

19. SETW said that the two railway corporations had offered different concessionary fare schemes during the past deflationary period. She further added that at present, both MTRCL and KCRC had fare autonomy and they could set their fares having regard to prevailing market conditions. With indication of rising inflation in the next few years, the railway corporations might have arguments to adjust their fares upward. However, under the merger proposal, there would be no fare increase for the next 24 months following the signing of the Memorandum of Understanding (MoU). The travelling public would also get immediate benefit out of the rail merger as there would be fare reduction on the first day of the rail merger. The Chairman remarked that the Administration should provide the exact deflation figures for the past few years to facilitate members' discussion.

20. Mr LEE Cheuk-yan asked whether the Administration would reduce railway fares, having regard to changes in the CCPI and the wage index over the past few years when a cumulative deflation of more than 10% was recorded. SETW replied that the FAM was proposed in the context of the rail merger to replace the existing fare autonomy enjoyed by the two railway corporations. It was not appropriate to apply the proposed formula retrospectively for assessing railway fares in the past.

21. Mr Ronny TONG considered that the synergies arising from the rail merger should enable MergeCo to reduce its fares. He did not agree that railway operations should be subsidized by property developments as KCRC's assets were owned by the public, the disposal of which should be in an open and transparent manner monitored by the public. If railway operations needed to be subsidized, the Administration could consider putting KCRC's properties up for auction or tender and using the proceeds for subsidizing railway operations. He enquired about the details of synergies of the rail merger.

22. CEO/MTRCL said that synergies of the rail merger would amount to about $450 million per annum, which would take MergeCo a few years to realize. The majority of such synergies would come from three areas, namely, transfer of best practice, procurement and reduction of duplicated support functions. On the other hand, MergeCo would provide fare reduction from Day One of the merger which would cost about $600 million per annum.

23. In response to the Chairman's enquiry on the details of the fare reduction of $600 million, SETW clarified that deflation over the past few years did not imply that the railway corporations had made excessive profit during that period. The proposed fare

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reduction amounting to $600 million per annum was made possible only because of synergies of the rail merger and not related to the deflation over the past few years.

24. Mr Andrew CHENG said that in view of the deflation over the past few years and the high transport costs faced by the travelling public, railway fares should have been reduced long ago. He therefore could not see the reason why the fare reduction package would have to be made in the context of the rail merger. Given the time required for seeking approval from Legislative Council (LegCo) and the minority shareholders of MTRCL, the fare reduction package could not be materialized in the near future. He called on the Administration, being the majority shareholder of MTRCL and the sole owner of KCRC, to urge the two railway corporations to expeditiously reduce railway fares to relieve the burden of the travelling public. On the other hand, he also commented that the scope and the extent of the proposed fare reduction package were not adequate and should be reviewed to benefit more passengers.

25. SETW said that MTRCL had fare autonomy. In order to uphold the rule of law and contract spirit, the Administration could not unilaterally require MTRCL to adopt the proposed FAM or offer fare reduction. Whilst the two railway corporations had agreed to the terms and structure of the merger deal, the merger had yet to be approved by LegCo and the minority shareholders of MTRCL. On the extent of the proposed fare reduction, SETW said that the Administration had taken into account the public need in deliberating on the fare reduction package, and considered that priority should be accorded to long-haul passengers.

26. Noting that MTRCL had made a profit of $8.4 billion as reflected in the 2005 annual report, Mr Albert CHAN opined that part of the profit should be ploughed back to increase the extent of fare reduction for public benefit. He asked whether MTRCL would show goodwill by first reducing the railway fares before proceeding with the rail merger exercise. He also expressed concern that after the rail merger, MergeCo would make use of its position to reap excessive profit.

27. CEO/MTRCL clarified that, of the $8.4 billion profit, MTRCL had made a profit of only $6.1 billion in 2005, the other $2 billion profit was attributed to change in accounting practices. Considering MTRCL's total investment of $100 billion, the rate of return was only 6%, which was relatively low in comparing with other public utilities, not to mention the fact that there was a need for continued investment in upkeeping the sustainable operation of the railway system. As such, there was no room for MTRCL to reduce its fares. Nevertheless, with the benefit of the synergies of the rail merger, MergeCo would be able to offer some form of fare reduction to passengers.

28. Mr LAU Chin-shek considered that the proposed fare reduction was very limited and some passengers, such as those of LRT, could not benefit at all. Given that the two railway corporations had not reduced their fares during the past deflationary period, he asked whether the two railway corporations would first consider reducing their fares. He also expressed concern that as the proposed fare reduction package was made in the

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context of the merger deal and it took time for LegCo and the minority shareholders to scrutinize the proposal, it would mean that the public could not immediately benefit from the fare reduction. Worse still, in anticipation of the rising inflation, railway fares would be increased after 24 months in accordance with the fare adjustment formula. He suggested the Administration to consider lowering the payments from MTRCL to KCRC so that a higher rate of fare reduction could be offered.

29. SETW said that it took time for MergeCo to realize the synergies arising from the rail merger but MergeCo was prepared to offer fare reduction to its passengers on Day One of the rail merger. Under the fare reduction package, there would be a minimum of 10% fare reduction for all passengers travelling on journeys with fares at $12 or above and a minimum of 5% fare reduction for all passengers travelling on journeys with fares between $8.50 and $11.90. Taking into account the benefits from abolition of second boarding charge and the global fare reduction, altogether 2.8 million daily rail trips would benefit from fare reduction on Day One of the rail merger. About 340 000 of them would benefit from a minimum of a 10% fare reduction and another 1.16 million would benefit from a minimum of a 5% fare reduction. She appealed to members to appreciate the proposed fare reduction package would benefit the community at large and was the result of extensive discussion between the Government and the two railway corporations. In order to enable the public to enjoy the fare reduction at the earliest opportunity, she hoped members would render support to the Administration's proposal.

30. Mr LEE Cheuk-yan expressed disappointment that Government, being the majority shareholder of MTRCL and the sole owner of KCRC, was only focusing on the interest of the two corporations. As a result, the two railway corporations had not reduced their fares in line with the trend of deflation over the past few years to safeguard public interest. He pointed out that unlike the fare increase applications from franchised bus companies, Government would have no control over the future fare adjustments of MergeCo. Both Mr LEE and Mr LAU Chin-shek opined that the public and LegCo should be empowered to scrutinize fare increase applications from MergeCo.

31. SETW said that Government had no intention to raise revenue from the rail merger. She reiterated that the rail merger would bring overall benefit to the community at large. At present, MTRCL and KCRC had fare autonomy. In the context of the rail merger, the two railway corporations had agreed not to increase rail fares for two years notwithstanding indications of rising inflation. Fare reduction would also be implemented on Day One of the rail merger. In future, fare would be adjusted according to a FAM which comprised an objective and transparent formula.

Two years' commitment not to increase fare

32. Referring to the commitment by the two railway corporations that there would be no fare increase in the next 24 months following the signing of the MoU, Mr LEE Cheuk-yan remarked that the travelling public could not get much benefit out of the said arrangement, given the time required for LegCo and the minority shareholders to

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scrutinize and approve the merger proposal, and the rising inflation in the years ahead which would enable MergeCo to increase its fares according to the fare adjustment formula. In the extreme case that if it took two years to complete the necessary steps for the merger deal, the public would have to pay for a higher railway fare shortly after the rail merger. He therefore suggested that railway fares should not be increased for two years starting from Day One of the rail merger.

33. SETW said that the agreement of not to increase the railway fares for the next 24 months was made after extensive consultation with the two railway corporations. The agreement was endorsed by the Management Boards which were responsible for managing the corporations. The proposed service concession agreement would also be subject to the approval of the minority shareholders of MTRCL. In this respect, Government would not take part in the voting on the proposal as MTRCL's majority shareholder. Regarding the timing of fare increase after the rail merger, SETW advised that it was unlikely that railway fares would be immediately increased after the rail merger as it took time to assess changes in the CCPI and the wage index.

Light Rail Transit

34. Mr WONG Kwok-hing expressed concern that more than one million residents in North West New Territories who used the Light Rail Transit (LRT) could not benefit from the fare reduction arising from the proposed rail merger. Mr WONG pointed out that as transport cost constituted a large part of the income of these residents, it would be unfair to deprive them of the benefits from the rail merger. He asked whether the Administration and KCRC would consider providing fare reduction for LRT passengers. Mr LEE Cheuk-yan enquired about the rationale for excluding LRT from the fare reduction package. He remarked that whilst LRT was operating at a loss, fare reduction should be considered from the perspective of the corporation as a whole and not just the performance of individual lines.

35. SETW said that nearly one-third of LRT passengers were already enjoying free light rail service for interchange with West Rail. Some frequent users could also benefit from other fare concession schemes. The Chief Executive Officer, KCRC (CEO/KCRC) added that LRT had been in deficit requiring cross-subsidization from KCRC's other operations and had to face with keen competition from other public transport modes. To sustain its operation, substantial investment was also put in to improve and upgrade the system. As such, there was little scope for fare reduction which would affect the sustainability of the system.

36. Mr WONG Kwok-hing remarked that whilst he considered a need to maintain the existing free West Rail interchange for LRT passengers, he strongly requested that the Administration and KCRC should also provide fare reduction for other LRT passengers who did not need to interchange with West Rail in the context of the proposed rail merger. Mr LEE Cheuk-yan echoed the view of Mr WONG and requested the Administration to reconsider the fare reduction package.

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Concessionary fares for senior citizens and persons with disabilities

37. Mr WONG KWOK-hing considered that the concessionary fare scheme for senior citizens on Sundays and public holidays should be made permanent.

38. Mr WONG Kwok-hing and Mr Ronny TONG took the view that the Administration should, in the context of the merger deal, request the two railway corporations to provide half-fare concession to persons with disabilities (PwDs) as repeatedly requested by Members. Mr Ronny TONG also remarked that this was an important factor affecting his decision on the merger deal.

39. SETW said that the decision for MergeCo to offer concessionary fare of $2 per trip in the first year after the rail merger for senior citizens travelling on the railway network on Sundays and public holidays was made after careful consideration. It also aimed at allocating savings in resources arising from the synergies in an equitable way. On transport arrangements for PwDs, SETW said that the two railway corporations and franchised bus companies had made substantial investment in providing barrier-free access, such as the procurement of buses with low-platform and installation of lift facilities for access to railway platforms. As the provision of concessionary fares for PwDs was more than a transport issue, it would be more appropriate for the Administration to consider the subject matter from a welfare perspective.

40. Mr WONG Kwok-hing said that as a gesture to show respect to senior citizens, the proposed concessionary fare scheme for senior citizens should be made permanent. He considered it unacceptable for the Administration to leave the decision to MergeCo as to whether the scheme would be continued after the first year of the rail merger. Regarding the provision of concessionary fare for PwDs, Mr WONG opined that it was the social responsibility of the two railway corporations and franchised bus companies to provide suitable facilities for PwDs to access their services, and hence, it should not be mixed up with the issue of granting concessionary fares for PwDs. Given the special needs of PwDs, consideration must be given to providing some form of financial relief to them so as to facilitate their integration into the community.

41. SETW advised that the concessionary fare for senior citizens was part of the fare reduction package which had been thoroughly considered by the Administration. In order to provide greater flexibility to MergeCo, it would be more appropriate to leave it to the company to decide whether the concessionary fare scheme for senior citizens should continue after the first year of the rail merger. SETW said that the fare reduction was considered as an overall package and it was difficult to consider revising individual components at this stage.

Tung Chung Line and Airport Express Line

42. With a single journey fare of $23 between Central and Tung Chung, Mr TAM Yiu-chung considered that the fare for Tung Chung Line (TCL) was on the high side. As

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a result, transport expenditure for residents in Tung Chung was relatively high. Despite the repeated calls from Tung Chung residents to lower the railway fares to relieve their burden, they could not gain much benefit out of the proposed rail merger. He enquired whether MTRCL had considered offering monthly concessionary tickets for passengers travelling on TCL, just as the existing offer on West Rail.

43. CEO/MTRCL said that having considered the synergies of the rail merger, a lump sum had been set aside for implementing the fare reduction package as agreed between the Government and the two railway corporations. He recapped that a minimum of 10% reduction would be offered for all journeys charging $12 above and a minimum of 5% for all journeys charging between $8.5 and $11.9. There would be the abolition of second boarding charge ranging form $1 to $7 and the global fare reduction of $0.2 for all Octopus card users paying full fares. The fare structure of MTR was based on distance which was more equitable. As for the monthly ticket scheme, it was more a promotional measure and MTRCL would only consider such measure if it would increase the net revenue of the company.

44. Noting that KCRC had offered monthly ticket schemes for some of its railway lines which were well received by the travelling public, Miss TAM Heung-man considered it unacceptable if such schemes were withdrawn in the context of the rail merger.

45. CEO/MTRCL reiterated that monthly ticket scheme was a kind of promotional measure and MTRCL would review regularly the possible commercial benefits associated with such measures and implement relevant schemes as appropriate. CEO/KCRC pointed out that the existing concessionary fare schemes offered by KCRC were promotional in nature and would last until the end of 2006. In considering whether the concessionary fare schemes would be extended, KCRC would consider from a commercial perspective, having regard to the likely commercial benefits that could be generated by these offers.

46. Mr Albert CHAN said it was deplorable that while the top management executives of MTRCL had been offered significant pay rise, it had claimed on the other hand that there was no room for fare reduction. MTRCL had not heeded the heavy burden of transport costs on the general public. By way of illustration, he pointed out that TCL fares were on the high side. Under the proposed fare reduction package, passengers travelling between Tung Chung and Central could not benefit from abolition of second boarding charge, and hence, their fares could only be reduced by 10% which fell short of the expectation of residents. On the other hand, he noted that MTRCL had offered concessionary fares to staff of airlines travelling on Airport Express Line (AEL). The differential treatment was unfair to passengers travelling on TCL and other railway lines, bearing in mind that construction of AEL was also funded by public monies. He sought details of the promotional/concessionary fares currently provided by MTRCL to airline staff and opined that similar offers should be granted to the travelling public at large.

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47. Mr Albert CHENG was of the view that fare increase applications from railway corporations and franchise bus companies should all be subject to approval by the Government. He also remarked that provision of concessionary fares to airline staff travelling on AEL but not ordinary passengers travelling on TCL was unfair, not to mention the fact that residents in Tung Chung had to use a great proportion of their income on transport.

48. CEO/MTRCL and the Transport Planning Manager, MTRCL (TPM/MTRCL) clarified that there was no monthly ticket scheme for AEL but instead there were arrangements that allowed airport staff to use a special octopus card to travel on AEL at a concessionary rate of $36 per trip between Central and the Airport instead of the normal rate of $100. CEO/MTRCL also pointed out that various promotional fare schemes had been launched for general users of AEL. For example, promotional tickets were available for passengers travelling in a group of two, three or four persons. At the request of Mr Albert CHAN, CEO/MTRCL agreed to provide details of concessionary fares provided to passengers travelling on AEL, including any special fares provided to workers working in the airport.

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49. Mr Albert CHENG opined that the special discount provided by MTRCL to workers working in the airport travelling on AEL should also be offered to the public. Mr WONG Ting-kwong shared the views of Mr CHENG. Mr WONG further remarked that despite the fare autonomy enjoyed by MTRCL, MTRCL should not selectively offer promotional fare schemes to a particular group of passengers. The arrangement for bulk purchase of fare tickets at concessionary rates should be made available to the public so long as the purchase order could meet the required volume. This offer should not be arbitrary and restricted to a selected few.

50. Mr Albert CHAN said that as a corporation which provided public transport service, MTRCL should fulfil its social responsibility to reduce railway fares, in particular for TCL. He considered MTRCL's refusal to reduce fare on TCL regretful.

51. CEO/MTRCL emphasized that it was a commercial practice that special rate was offered for bulk purchase of selected products. In fact, the special concessionary fare on AEL was offered to all parties if the requirements for bulk purchase were met. However, as far as railway service was concerned, bulk purchase of fare tickets was only applicable to AEL. SETW supplemented that AEL was one of the Airport Core Programme projects. Given its uniqueness that it was not used by commuters as a form of daily travel, its fare structure was different from other domestic lines. The concessionary AEL fare of $36 offered to airport workers who were frequent users of AEL was still higher than the single journey fare of $23 for TCL service between Central and the Airport. In response to Mr Albert CHAN's further enquiry, TPM/MTRCL confirmed that all staff working at the Airport could enjoy the concessionary fares on AEL.

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Second boarding charge

52. On the abolition of second boarding charge ranging from $1 to $7, Mr TAM Yiu-chung sought the Administration's explanation on the mechanism to determine the actual amount of deduction.

53. In response, SETW advised that there was a boarding charge for passengers travelling on the MTR and KCR lines respectively. At present, passengers had to pay a second boarding charge at the interchange point when passing through the ticket gates of the two networks. A journey that involved an interchange would therefore cost more than a journey of a similar length operated by one single operator. If the second boarding charge was abolished upon the rail merger, passengers could save the boarding charge for the second leg of the journey. TPM/MTRCL added that for MTR lines, the second boarding charge varied for journeys of different distances. For example, for journeys within two to three stations, the minimum fare was $3.8 while for journeys between four and six stations, the minimum fare was $4.6. The reduction resulting from the abolition of second boarding charge would therefore vary according to journeys of different distances. In gist, the relative savings would be greater for short-haul journeys and smaller for long-haul journeys.

Monitoring of MergeCo and fares after the rail merger

54. Noting the existing transport policy that railway would form the backbone of Hong Kong's transport system, supplemented by other transport modes, Miss TAM Heung-man was worried that after the rail merger, MergeCo would have an edge over other public transport modes, bearing in mind the restriction imposed by the Administration to confine the scope and operations of other public transport modes. She enquired about the Administration's measures to monitor the railway fares after the rail merger to ensure that the fare levels were kept at a reasonable level.

55. SETW said that at present, public transport services accounted for almost 90% of all transport passenger trips in Hong Kong. The Railway Development Strategy 2000 had provided a blueprint for future railway development. Railway and franchised buses carried about 30% and 37% of all passenger trips in 2004 respectively. Under the merger package, an objective and transparent FAM would be introduced to replace fare autonomy. In future, fares could go up or down according to the formula that was linked to changes in the CCPI and the relevant wage index, and a productivity factor. SETW emphasized that the proposed FAM was an improvement to the existing fare autonomy. The proposed FAM would also pose a challenge to MergeCo in particular when there was an increase in operating costs due to fluctuation in exchange rate.

56. Mr Albert CHAN expressed concern that MergeCo might use financial techniques to manipulate the financial figures in order to bypass public scrutiny on its fare policy. MergeCo might, on grounds of preserving commercial sensitive information, refused to divulge information on transactions with business consortia,

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which might involve transfer of benefits. In this connection, he asked about the details of the mechanism for monitoring MergeCo.

57. In response, SETW highlighted that the adoption of an objective FAM was intended to avoid the disputes associated with the adoption of other approaches in determining the return on investment in railway operations, and hence the target fares. She trusted the public would give support for introducing a more objective and transparent FAM which was linked to the rates of change of the CCPI and the wage index. In order to attract investments from the private sector to sustain the continued growth and operation of railway services which were capital intensive, it was necessary to allow railway corporations to earn a reasonable rate of return.

58. Mr LEE Cheuk-yan remarked that MTRCL was a listed company and it would only aim at maximizing its profit at the expense of the public. At present, railway fares were not subject to public scrutiny, and hence, railway corporations were unwilling to reduce their fares over the past few years when a cumulative deflation of more than 10% was recorded. Without an effective monitoring mechanism to control railway fares, he had reservation on the merger proposal, bearing in mind KCRC would no longer be a public body and would become a commercial entity under the control of MTRCL.

59. SETW said that there were great economic benefits associated with the privatization of MTRCL. Railway services were able to operate in a more efficient manner. MTRCL was also able to grasp better development potential. With the benefit of market force, a world-class metro system was developed. Under the merger proposal, the relative strength of MTRCL and KCRC could supplement each other. It could create a world-class rail company with enhanced potential for expansion into the Mainland and overseas markets.

60. Mr WONG Kwok-hing enquired the measures that the Administration or LegCo Members could resort to in the event that the public had grave dissatisfaction with the increase in railway fares after the rail merger. Citing the case of The Link Management Limited, he was concerned that the MergeCo would not heed the views of the public and LegCo after the rail merger and enquired about the monitoring role of the Government and LegCo after the rail merger.

61. PS for ETW and SETW said that in future, LegCo could still invite MergeCo to attend Panel meetings to account for its decision on fare increase and other operational issues. At present, MTRCL had fare autonomy and both the Government and LegCo could not do much to interfere its decision. However, in future, MergeCo was required to adjust its fare according to the proposed FAM which comprised an objective and transparent fare adjustment formula. To this end, the data used in a fare increase application would be verified. SETW also added that it was unlikely that the minority shareholders would accept the introduction of a FAM with the requirement for seeking approval by either LegCo or Government. Such FAM would also affect the view of the financial service market on the future of MTRCL.

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62. Mr WONG Kwok-hing expressed his grave concern on the lack of a fare approval mechanism after the rail merger. A substantial increase in railway fares would cause grave public dissatisfaction and grievances. He opined that the Panels should follow up on this matter at a future meeting. The Chairman pointed out that members could raise this issue at the meeting of the Panel on Transport on Friday, 26 May 2006 when the proposed steps for the legislative exercise for the rail merger would be discussed.

63. The Chairman advised members that the next joint meeting of the Panel on Transport and Panel on Financial Affairs on the rail merger was scheduled for Wednesday, 23 May 2006 to discuss the financial and property packages.

III Any other business

64. There being no other business, the meeting ended at 6:35 pm.

Council Business Division 1
Legislative Council Secretariat
11 July 2006