

Legislative Council Panel on Transport

Review of Fare Adjustment Mechanism of MTR Corporation Limited

Purpose

The purpose of this paper is to seek Members' views on the review of the Fare Adjustment Mechanism ("FAM") of MTR Corporation Limited ("MTRCL").

The FAM of MTRCL and the Review

2. Since the merger of the railway networks on 2 December 2007, an objective and transparent FAM has been adopted to replace the fare autonomy of pre-merger MTRCL. The current FAM is a direct-drive formula as follows:

Overall Fare Adjustment Rate =

*0.5 x Change in Composite Consumer Price Index ("CCPI") + 0.5
x Change in Nominal Wage Index (Transportation Section)
("NWI(TS)) – Productivity Factor*

*where Productivity Factor is a pre-determined value set at 0% before
2013 and 0.1% from 2013*

The details and operation of the FAM, and adjustments of MTR fares since the rail merger are set out in the consultation paper at **Annex**.

3. An objective, transparent and direct-drive formula for MTRCL's fare adjustment is meant to provide all parties concerned with greater certainty and predictability. In turn, it should facilitate MTRCL in planning its business to deliver and sustain high service quality. Over the past few years, however, there is an increasingly growing body of opinions that factors such as MTRCL's profit level, service performance, as well as public affordability and acceptability should also be taken into consideration when MTR fares are reviewed each year. We are alive to such views.

4. The Operating Agreement between the Government and MTRCL stipulates that either party may request a review on the FAM once

every five years following the rail merger in December 2007. We served a written notice to MTRCL in early August 2012 requesting a review on the FAM, with a view to completing the exercise by early 2013.

5. In the meantime, we are conducting a public consultation exercise to further gauge the views of the community on the subject through various channels including :

- (a) posting of the consultation paper at Annex on the websites of the Transport and Housing Bureau, and the Transport Department to invite views from the public from 17 September to 31 October 2012 (extended to 18 November 2012); and press releases were issued on 17 September and 24 October 2012 for the purpose;
- (b) sending letters with the consultation paper to all Traffic and Transport Committees of the District Councils, and attending meetings for discussion on the subject as appropriate;
- (c) posting the consultation paper on the Public Affairs Forum website of Home Affairs Bureau to invite public discussions; and
- (d) consulting this Panel and the Transport Advisory Committee.

The Review in Progress

6. In the light of past public views on the FAM, we are studying whether and how new possible components might be introduced into the FAM. The main areas under study include the following:

- (a) Existing Components – There are different views on possible variations to the existing components, namely, CCPI, NWI(TS) and Productivity Factor. Examples include whether CPI(A) and/or CPI(B) should be used; whether other forms of wage index should be adopted (such as the wage index for all industries, rather than that for the transportation section alone); etc.
- (b) Affordability – There are views that the household income may not be able to keep pace with inflation. Should there be an affordability check? If so, how should that be factored in the FAM?

- (c) Profitability – Given MTRCL’s sizable profits in recent years, some members of the public suggest that the profit level of MTRCL should be taken into account when considering whether MTRCL may adjust its fares. How could profitability be introduced in the FAM? Would that create a disincentive for MTRCL to be efficient and cost-effective in transport operation?
- (d) Service Quality – If service quality is to be factored in the FAM, the questions to be considered include the criteria and measures that should be selected, and how it should be linked to the formula. It is important to consider issues such as the availability, objectivity and integrity of the data needed for the evaluation of the operator’s service performance. The service quality factor should also be simple and easy to understand by the travelling public.

7. Conceptually, it is possible to have a combined FAM which includes the major components (i.e. inflation index, wage index, income index, profit cap/sharing factor and service quality factor). However, this could make the FAM quite complex and difficult to understand by the general public. Also, the possible implications on MTRCL’s financial sustainability and railway operations should be considered. One may argue that the interest of the minority shareholders should not be overlooked as well.

Advice Sought

8. Members are invited to offer advice on the review of the FAM. We will take into account Members’ advice, and the views collected in the public consultation exercise, in formulating the possible new FAM in conjunction with MTRCL.

**Transport and Housing Bureau
Transport Department
October 2012**

Review of the Fare Adjustment Mechanism of the MTR Corporation Limited

Purpose

The Government is conducting a review of the Fare Adjustment Mechanism (“FAM”) of the MTR Corporation Limited. This paper sets out the relevant information and invites views from the public on the FAM.

MTRCL

2. The MTR Corporation (now the MTR Corporation Limited (“MTRCL”)) was established in 1975 with a mission to construct and operate, under prudent commercial principles, a safe, reliable and efficient urban metro system to help meet Hong Kong’s public transport requirements. At that time, the sole shareholder was the Government. The Corporation was listed on the Stock Exchange of Hong Kong through an Initial Public Offering by the Government in October 2000. The Government now owns around 77% of the shares of MTRCL.

3. The rail merger of MTRCL and the Kowloon-Canton Railway Corporation (“KCRC”) took effect on 2 December 2007, which involved, among other things, the expansion of the MTRCL’s franchise under the MTR Ordinance (Cap. 556) to provide MTRCL with the right to operate both the MTR and KCR railways for an initial period of 50 years from the merger date. The merged rail network comprises nine railway lines serving Hong Kong Island, Kowloon and the New Territories. In addition, a Light Rail network serves the local communities of Tuen Mun and Yuen Long in the New Territories while a fleet of buses provide convenient feeder services.

The Current FAM of MTRCL

4. Before the rail merger, MTRCL had autonomy in setting their fares in accordance with prudent commercial principles, having regard to, inter alia, economic conditions, competition from other public transport modes and whether the service was value for money. At that time, there was general public concern that the basis on which the rail companies adjusted fares was not clear. During discussions on terms of the rail merger, MTRCL committed not to increase fares until June 2009. Since the rail merger, an objective and transparent formulaic approach, namely the FAM, for determining future fare adjustments has been adopted to replace the fare autonomy of the pre-merger

MTRCL. The existing FAM was formulated after extensive discussion in the community and the Legislative Council (“LegCo”) during the merger.

The Formula

5. The FAM is a direct-drive formula that takes into account changes in the Composite Consumer Price Index (“CCPI”), and the Nominal Wage Index (Transportation Section) (“NWI(TS)”), as well as a pre-determined productivity factor:

$$\text{Overall Fare Adjustment Rate} = 0.5 \times \text{Change in CCPI} + 0.5 \times \text{Change in NWI(TS)} - \text{Productivity Factor}$$

where –

- Overall fare adjustment rate is the weighted average figure by which all adjustments to individual fares taken together shall equal to;
- Change in CCPI is the year-on-year percentage change in CCPI for December of the preceding year;
- Change in NWI(TS) is the year-on-year percentage change in NWI(TS) for December of the preceding year; and
- Productivity Factor is a pre-determined factor of 0% before 2013 and 0.1% from 2013.

6. Based on the data of these objective indices under the FAM, fares will be maintained, or adjusted upward or downward. If, in a given year, the outcome of the calculations on the overall fare adjustment rate under the FAM is within the range of $\pm 1.5\%$, there shall be no fare adjustment and the unadjusted percentage shall be rolled over to the next annual fare review for calculation.

7. The adoption of CCPI and NWI(TS) seeks to align fare adjustments with economic conditions and wage levels. The CCPI reflects the macroeconomic environment and public affordability to a certain extent, whereas the NWI(TS) reflects MTRCL’s non-managerial staff cost. These two indices are published data of the Census and Statistics Department and are objective and verifiable.

8. The productivity factor is set at zero for the first five years starting from the rail merger (i.e. before 2013) and will have a value of 0.1% starting from the 6th year (i.e. from 2013). The 0% productivity factor for the first five years took into consideration of the general reduction of MTR fares on the day of the merger on 2 December 2007, before any synergies could be realized for the merger. In other words, MTRCL was returning the initial productivity

benefits of the rail merger to passengers by way of a fare reduction immediately upon the rail merger before it could fully realize the benefits of the synergies from the merger. The fare reduction implemented upon the merger had benefitted 2.8 million passengers each day with lowered fares ranging from 5% to 20%. The productivity factor of 0.1% to be applied from the 6th year onwards has been so determined taking account of the fact that the scope for productivity gain would be limited due to heavy investment by the merged MTRCL, particularly as the railway network is expanding.

Adjustments of Individual Fares

9. The FAM is applicable to all Controlled Fares including:
 - (a) Adult, Elder, Student and Child fares for one way journeys on all MTR lines, excluding the Airport Express but including Airport Workers' fares;
 - (b) East Rail Line First Class Premium fares; and
 - (c) all Light Rail and MTR Bus fares.

10. In calculating individual fares, the following guiding principles have been applied:
 - (a) adjustments to Octopus fares are in units of 10-cents;
 - (b) adjustments to Single Journey Ticket fares are in units of 50-cents; and
 - (c) the weighted average of all individual fare adjustments must equal to the overall fare adjustment rate calculated from the formula.

11. In accordance with the Operating Agreement between the Government and MTRCL, MTRCL is required to provide the Government with two independent third party certificates certifying that the fare adjustments are in compliance with the FAM. MTRCL is also required to formally notify the Panel on Transport of the LegCo and the Transport Advisory Committee three weeks prior to implementation of the new fares in June each year.

Operation of the FAM and Adjustments to MTR Fares

12. As part of the merger deal, the first MTR fare increase could only take place on or after 1 July 2009. In 2009, the overall fare adjustment rate calculated according to the formula was +0.7%. No fare adjustment was made in 2009 and the +0.7% was carried over to 2010.

13. In 2010, the outcome of the fare adjustment under the FAM was +1.35%. Together with the +0.7% carried forward from 2009, the overall fare adjustment rate for 2010 was +2.05%. Adjustments to MTR fares took effect on 13 June 2010 accordingly.

14. 2011 was the second year of fare increases under the FAM. The overall fare adjustment rate was calculated to be +2.2%. Adjustments to MTR fares took effect from 19 June 2011. MTR fares were also increased under the FAM in 2012 with the overall fare adjustment rate calculated as +5.4%. The adjusted fares took effect on 17 June 2012.

15. Whilst MTR fares were adjusted in 2010, 2011 and 2012 according to the FAM formula, at the same time, MTRCL has been offering a wide range of fare concession and promotion schemes, including fare concession for children, Student Travel Scheme, fare concession and \$2 fare promotion for the elderly on Wednesdays, Saturdays and public holidays (excluding Sundays), fare concession for Persons with Disabilities, fare savers offering discounts at pre-designated MTR stations, Monthly and Day Passes; free Light Rail and MTR bus interchanges; as well as inter-modal interchange discounts between MTR and some MTR Feeder Bus, New Lantao Bus, Green Minibus routes, etc.

16. Apart from these fare concessions, each year there were also additional short-term fare promotions in conjunction with the MTR fare adjustments as follows –

- (a) In 2010, a “Ride \$100 Get \$5 MTR Shop Coupon” promotion scheme was launched for a period of about two months.
- (b) In 2011, MTRCL offered the “Ride \$100 Get 1 Free” promotion scheme for a period of about six months.
- (c) In 2012, MTRCL offered a package of new fare promotions valued at some \$670 million with a view to benefitting an even wider range of passengers. The additional fare promotion schemes include the “Ride 10 Get 1 Free” scheme for a period of more than six months, “10% Discount for Same-day Second Trips” scheme for about six months, as well as the new Tung Chung – Hong Kong Monthly Pass for about nine months. MTRCL, for the first time, offered free weekend and public holiday travel for children on MTR services for a period of about five months. In addition, for a period of six months for each Monthly Pass, a \$20 MTR Shops Coupon was offered to Monthly Pass purchase.

Review of the FAM of MTRCL

17. Notwithstanding that the FAM and its components in the formula were thoroughly discussed and considered by the community and the LegCo during the rail merger, the Government is alive to the recent views that factors such as MTRCL's profit level, service performance, as well as public affordability and acceptability should also be taken into consideration when MTR fares are reviewed each year according to the FAM.

18. The Operating Agreement stipulates that either party may request a review on the FAM once every five years following the rail merger in December 2007. We have served a written notice to MTRCL to conduct a review on the FAM, with a view to completing the exercise by early 2013.

Public Consultation

19. We would like to invite views from the public on the FAM review. Any views should be addressed in writing to the Transport Department **on or before 31 October 2012** by the following means:

By Mail: The Bus and Railway Branch,
Transport Department
40/F., Immigration Tower,
7 Gloucester Road, Wan Chai, Hong Kong

By Fax: 2802 2679

By Email: fam-review@td.gov.hk

Please state "FAM Review" on the envelope or in the submission. For any enquiry on this consultation, please call 2829 5500.

20. It is voluntary for any member of the public to supply his/her personal data upon providing views on the consultation paper. Any personal data provided with a submission will only be used for the purpose of this consultation exercise.

21. The names and views of individuals and organisations which put forth submissions in response to the consultation paper ("senders") may be published for public viewing after conclusion of the public consultation exercise. We will respect the wish of senders to remain anonymous and/or keep the views confidential in relation to all or part of a submission; but if no such wish is indicated, it will be assumed that the sender can be named.

**Transport and Housing Bureau
Transport Department
17 September 2012**