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19 May 2016

Secretary General
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong
(Attn. : Ms Sophie Lau)

[Fax no.: 2978 7569]

Dear Ms Lau,

Legislative Council Panel on Transport

Review of Fare Adjustment Arrangement for Franchised Buses

Thank you for your letter of 21 April 2016, enclosing with it the comments of Hon Tang Ka-piu on the review of the fare adjustment arrangement for franchised buses ("FAA").

The Government has been closely monitoring the impact of fluctuations in oil price on public transport fares. There is no fuel surcharge for all public transport modes fuelled by oil products with regulated fares (including franchised buses). Fare adjustments have all along been made with reference to changes in costs and revenue in overall terms (instead of changes in fuel prices alone) and they have no retrospective effect. The FAA is a mechanism for the Government to process applications for fare adjustment from franchised bus operators. Upon receipt of an application for fare increase from an operator, the Government will take into account a basket of factors under the FAA in considering the need of any fare adjustment and the rate of adjustment. Such factors include :

(a) outcome of a fare adjustment formula. The formula is (0.5 × Change in Nominal Wage Index for the Transportation Section) + (0.5 × Change in Composite Consumer Price Index ("CCPI")) - (0.5 × Productivity Gain));

(b) changes in operating costs and revenue since the last fare adjustment;

(c) forecasts of future costs, revenue and return;

(d) the need to provide the bus operator with a reasonable rate of return;

(e) public acceptability and affordability; and

(f) quality and quantity of service provided.

It should be noted that the formula does not operate as an automatic determinant of the fare adjustment outcome. In processing an application for fare increase, due consideration will be given to the six factors mentioned above.

The formula is only one of the six factors. As the formula is a measurement of the changes in wages for the transportation sector and the CCPI (which includes the impact of oil price), its outcome generally reflects the macro-economic situation. Although changes in fuel price will inevitably affect the operating costs of franchised buses, their operating costs comprise various components apart from fuel cost. The components include wage expense, maintenance and insurance, etc. The expenditures on various cost components (particularly labour cost[1]) have basically been increasing in recent years. The introduction of any new component under the FAA or the formula will have to be handled carefully and given prudent consideration since fare level will be affected when the component fluctuates either upwards or downwards. If a new component reflecting changes in oil price is to be introduced such that it will directly affect fare level, the FAA will lose its stability and fail to provide a buffer. Also, the Government will then no longer be able to perform its gate-keeping role for the public.

Under the FAA, the Government applies the formula on a quarterly basis. If the formula outcome reaches -2% (equivalent to about a $0.1 difference in bus fare), the Government will proactively initiate a fare review. The formula outcome and all other relevant factors as mentioned above will be taken into account in doing so.

Under the FAA, there is a passenger reward arrangement. The arrangement will be triggered when the rate of return on average net fixed assets for an operator reaches or exceeds the threshold of 9.7% as a result of changes in the overall costs and revenue. The operator will then have to share the profit above the threshold as fare concessions with the passengers on an equal basis. Some operators have been offering fare concessions to passengers under this arrangement and the amount came to over $160 million in the past

[1] All franchised bus operators have granted pay rise to their staff in each of the past three years. The cumulative rate of increase ranges from 13% to 17% on average.

three years. The passenger reward arrangement is applicable to profits arising from, amongst other things, the drop in oil price. In other words, passengers can already benefit when there is a considerable drop in oil price such that the above threshold for sharing of profits with passengers is reached.

The Government will review the FAA from time to time to ensure that it will continue to work well. A new round of review is underway. As the existing arrangement can basically strike a balance between the sound operation of bus service as well as public affordability and acceptability, we do not envisage a need for an overhaul of the FAA. Rather, the current review will examine whether there is room to improve the individual factors of the FAA, with a view to ensuring that public interests will continue to be properly protected, and that the long-term healthy development of bus service can be sustained.

In March 2015, we indicated that we expected to report the overall outcome of the FAA review to the Panel on Transport in early 2016. However, there has been new development since then. The Government has started the Public Transport Strategy Study ("PTSS") to examine the overall strategic arrangements of the public transport system for enhancing the complementarity amongst the various public transport services. This is to ensure that the public can enjoy efficient services with reasonable modal choices on the one hand, while our public transport services can enjoy sustainability on the other. Against this background, the Role and Positioning Review of the PTSS will study the long-term development of franchised bus service. Fare level and the FAA would be of relevance to the long-term development of franchised bus service. The Government therefore considers it appropriate to put the FAA review under the PTSS. At the meeting with the Chairman and Deputy Chairman of the Panel held in the fourth quarter of last year on the Panel's work plan for the 2015-16 session, the Government had explained the aforesaid arrangement and advised that the FAA review would not be submitted to the Panel for discussion in 2015-16 as the PTSS would only be completed by mid-2017. We have also explained the aforesaid arrangement in our written reply to a question in the course of examination of the Estimates of Expenditure 2016-17 by the Finance Committee of LegCo in early April this year (please refer to *Reply Serial No. THB(T)300* at <u>Annex</u>). The PTSS is expected to be completed by mid-2017. Upon completion of the review, the Government will report the outcome to the Panel and listen to Members' views.

Yours sincerely,

(Louis Leung)

for Secretary for Transport and Housing

<u>c.c.</u>

Commissioner for Transport (Attn. : Miss Rachel Kwan)

Examination of Estimates of Expenditure 2016-17

Reply Serial No.

THB(T)300

CONTROLLING OFFICER'S REPLY

(Question Serial No. 4248)

Head: (158) Government Secretariat: Transport and Housing Bureau (Transport Branch)

Subhead (No. & title): (-) Not Specified

Programme: (2) Land and Waterborne Transport

Controlling Officer: Permanent Secretary for Transport and Housing (Transport) (Joseph YT LAI)

Director of Bureau: Secretary for Transport and Housing

Question:

The existing franchise for the bus network of the Kowloon Motor Bus Co. (1933) Limited (KMB) will expire in 2017 and the Government will continue to review the fare adjustment arrangement for franchised bus service. What are the estimated expenditure, manpower arrangement and details of the work? Will the Government monitor the advanced review of the fare adjustment arrangement conducted by the MTR Corporation Limited (MTRCL)? If yes, what are the estimated expenditure, manpower arrangement and details of the work? If no, what are the reasons for that?

Asked by: Dr Hon LAM Tai-fai (Member Question No. 49)

Reply:

The current franchise of the KMB commenced on 1 August 2007 and will expire on 1 July 2017. Under the Public Bus Services Ordinance (Cap 230), the Chief Executive-in-Council may grant to a company a franchise conferring the right to operate a public bus service for a period not exceeding ten years. According to the established practice, an incumbent operator which is able to prove its ability to provide a proper and efficient service, and is willing to further invest in franchised bus operation, may be considered for being granted a new franchise for a period of ten years. In this connection, the KMB has indicated an interest to apply for a new ten-year franchise. Taking all things into account and as reported to the Legislative Council Panel on Transport in January 2016, the Government will discuss with the KMB on a new ten-year franchise so that the KMB can continue to operate its existing bus network. The new franchise will take effect immediately upon expiry of the current one in 2017, and we aim to conclude the discussion with the KMB within 2016. Meanwhile, the Government is inviting views from the public on the requirements of the new franchise for the bus network of the KMB until mid-April 2016.

Separately, the Fare Adjustment Arrangement for Franchised Buses (FAA) is a mechanism for the Government to process applications for fare adjustment as and when made by the franchised bus operators. The Government will review the FAA from time to time to ensure that it would continue to work well. The last review was completed in 2009. A review is underway. As the existing arrangement can basically strike a balance between the sound operation of the bus services as well as public affordability and acceptability, we do not envisage a need for an overhaul of the FAA. Rather, the current review would examine whether there is room for improvement in the individual factors of the current FAA mechanism, with a view to ensuring that public interests will continue to be properly protected, and that the long-term healthy development of bus services can be sustained. The on-going review on the FAA is being covered under the Role and Positioning Review of the Public Transport Strategy Study, which is expected to be completed by mid-2017.

The work involved in the new franchise for the bus network of the KMB and the FAA review will be absorbed by the existing staffing resources of the Transport Branch (TB) of the Transport and Housing Bureau and the Transport Department (TD) as part of their normal duties, and there is no separate breakdown of expenditure for the purpose. To assist in the FAA review, the Government has commissioned a consultancy study at a fee of around $1.4 million.

As regards the Fare Adjustment Mechanism (FAM) of the MTRCL, according to the Operating Agreement signed between the Government and the MTRCL in 2007, the FAM should be reviewed every five years. The last review of the FAM was conducted in 2013 and completed in April of the same year. According to the Operating Agreement, the next scheduled review of the FAM is due for completion in 2018. In the light of the public opinions towards the FAM, the Government issued a letter to the MTRCL on 22 March 2016, asking the MTRCL to advance by one year a joint review with the Government on the FAM. The experience gained so far since the last review suggests that there is possible room for an early review of the FAM, so that the operation of the FAM can further respond to the public concern about the MTRCL's overall profitability and passengers' affordability, whilst still respecting the financial prudence required of the MTRCL as a listed company. It is the Government's objective to advance the review by one year, so that the new FAM can take effect in 2017. The task is undertaken by the staff of the TB and the TD as part of their normal duties. There is no separate breakdown of expenditure for the purpose.

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