

**Provisional Legislative Council  
Panel on Transport**

**Kowloon Motor Bus Company (1933) Limited (KMB) Franchise**

**Introduction**

On 15 July 1997, the Chief Executive in Council granted KMB a new franchise to operate a public bus service on 368 routes for nine years and 11 months to take effect on 1 September 1997.

**Franchise Terms**

2. KMB's new franchise is not subject to a Profit Control Scheme (PCS), as in the case of all other bus franchises.

3. Improved terms have also been added to reinforce the Administration's monitoring arrangements and to pave the way for more competition in the provision of bus services. These include -

(a) **Non-exclusivity of Routes**

Similar to other bus franchises, KMB's bus routes have been specified as non-exclusive routes in its new franchise.

(b) **Disclosure of Operational and Financial Information**

New requirements for more information on KMB's bus services have been added in order to increase the transparency of its operation.

(c) **Mid-term Review**

Under the new franchise, the Administration will conduct a mid-term review after the fourth year of the franchise to evaluate KMB's performance.

4. The details of the franchise are set out in the attached Provisional Legislative Council Brief, which was circulated to Members on 15 July 1997.

### **Abolition of KMB's PCS**

5. On 27 August 1997, the Provisional Legislative Council passed a resolution to disapply the PCS to KMB's new franchise.

Transport Bureau  
8 September 1997

**File Ref: TBCR 3/5591/(94)97 Pt.9**

## **PROVISIONAL LEGISLATIVE COUNCIL BRIEF**

Public Bus Services Ordinance  
(Chapter 230)

### **GRANT OF A NEW FRANCHISE TO KOWLOON MOTOR BUS COMPANY (1933) LIMITED**

#### **INTRODUCTION**

At the meeting of the Executive Council on 15 July 1997, the Council ADVISED and the Chief Executive ORDERED that -

- (a) the terms of a new franchise\*, conferring upon Kowloon Motor Bus Company (1933) Limited the right to operate a public bus service on 368 routes for nine years and 11 months from 1 September 1997, should be granted under section 5 of the Public Bus Services Ordinance (the Ordinance); and
- (b) the Schedule of Routes (Kowloon Motor Bus Company)(No.2) Order 1997\*, specifying the 368 routes covered by the new franchise, should be made under section 5(1) of the Ordinance.

#### **BACKGROUND**

##### **General Background**

2. Kowloon Motor Bus Company (1933) Limited (KMB)'s current franchise will expire on 31 August 1997. It has applied for a new ten-year franchise.

3. With a fleet of 3700 buses, KMB currently operates 308 exclusive bus routes in Kowloon and the New Territories and 60 cross-harbour services on a non-exclusive basis.

Note : The franchise document and the Schedule of Routes Order are available for Members' reference at the Provisional Legislative Council Secretariat.

## **Assessment of Performance**

4. KMB's performance has been assessed against a number of well-established indicators. Its bus availability remained over 100% throughout the past two years, whilst the number of lost trips dropped from 4.9% in 1995 to 3.5% in 1996. According to the Transport Complaints Unit, an average of 1.3 complaints against KMB were received for every million of passengers it carried in 1996. This is the lowest among the four bus franchisees.

5. KMB has made an excellent effort in disclosing its financial and operational information, and is the first bus franchisee to publish performance pledges and service charters. In the coming five years, it aims to introduce 40 new routes, 1183 improvement items and expand its fleet from the present 3700 buses to 4000. It also proposes to cancel 12 routes and introduce 108 items to rationalize services which are under-utilized or serving areas with a declining population.

6. In the light of the above assessment, the Chief Executive in Council agreed that KMB should be granted a new franchise of about ten years. The new franchise shall expire on 31 July 2007, instead of 31 August 2007, so as not to coincide with the start of a new school year (i.e. 1 September).

## **Franchise Negotiations**

### **(A) Abolition of KMB's Profit Control Scheme**

7. KMB's current franchise is subject to a Profit Control Scheme (PCS), which caps the annual 'permitted return' that KMB may earn to a sum equivalent to 16% of its average net fixed assets (ANFA). Profit exceeding the permitted return in any year will be retained in a development fund. When profit falls below the permitted return, the company may make good the shortfall by drawing money from the development fund, thereby reducing pressure on fares.

8. Throughout the franchise negotiations, we have made known to KMB our intention to abolish the PCS. We have taken a longer time than expected to complete this exercise because of the difficulty in negotiating a new franchise without a PCS or any other replacement scheme.

9. KMB has raised strong objections. The company considers it crucial that, in any fare determination process, there should be a proper balance between the interests of commuters and those of the investors. In order to maintain this balance, KMB has devised and proposed various possible replacement schemes for incorporation into its new franchise, but we feel unable to recommend any of those proposals. As no other franchise is subject to a PCS, there is no justification for making an exception for KMB.

10. Following protracted negotiations, KMB has indicated its acceptance of a new franchise without the PCS, but asked Government to consider four points. **First**, a new franchise provision should be included such that, in determining KMB's fares, the Executive Council would have regard to the need to enable KMB to make a reasonable return on its investment. **Second**, KMB should be given the right to seek arbitration if this return is not attainable. **Third**, its bus routes should remain exclusive in the new franchise. **Fourth**, KMB should be given permission to reflect in its bus operations the market value of the six permanent bus depot sites it had acquired on the open market with shareholders' funds. The Administration's response to KMB's requests are set out in the following paragraphs.

#### **(B) Factors to be Considered in Fare Determination**

11. As regards KMB's first point, we have always intended that any new bus franchises should balance the requirement of a franchisee to provide a satisfactory service and for the franchisee to make a reasonable return on its investment. The Chief Executive in Council therefore agreed that a new provision should be incorporated into the new franchise to the effect that, in determining KMB's fares, the Chief Executive in Council may have regard, inter alia, to the need to provide the company with a reasonable return.

#### **(C) Bus Franchisees' Right to Arbitration**

12. As to KMB's arbitration proposal, we note that, prior to the enactment of the Ordinance in 1975, bus fares could be varied by agreement between the franchisees and the Executive Council in circumstances specified in the relevant legislation and, in default of such an agreement, by arbitration. On enactment of the Ordinance in 1975, the arbitration provision was removed and bus fares have since been determined by the Executive Council as the sole approving authority. At

the same time, the PCS, which was seen to give franchisees a degree of an assurance of a reasonable return on their investment, measured in terms of a specified percentage over their ANFA, was applied to CMB and KMB.

13. Currently, operators of the Cross Harbour Tunnel, the Tate's Cairn Tunnel and the Eastern Harbour Crossing are not subject to any PCS, and an arbitration provision is included in the relevant Ordinances. We have informed KMB, without commitment, that we shall examine whether and how far a right to arbitration should be provided in the Ordinance.

**(D) Exclusivity of KMB's Bus Routes**

14. We have explained to KMB that all other existing bus franchisees are now operating their bus routes on a non-exclusive basis. In the interest of fairness and to prepare for the opening up of the bus services market, there is no justification for retaining the exclusivity of its bus routes. Following further discussion, KMB has now accepted that, similar to other bus franchisees, its bus routes will be specified as non-exclusive routes in the franchise.

**(E) Reflecting the Market Value of Bus Depot Sites in KMB's Bus Operations**

15. Currently, bus depot sites are divided into three categories - **first**, permanent sites acquired by franchisees on the open market using shareholders' funds; **secondly**, permanent sites granted by private treaties; and **thirdly**, sites held under short term tenancies. KMB's bus operations are supported by six sites under the first category (the Land), two under the second category and eight under the third category.

16. Under the PCS and KMB's current franchise, the value of the Land is frozen at cost or at the July 1959 valuation to calculate the permitted return. Now that we shall be seeking a Provisional LegCo resolution to exclude the application of the PCS to the KMB's new franchise, KMB wishes to reflect the market value of the Land in its bus operations.

17. We have difficulties in acceding to KMB's proposal. As all the Land is essential to KMB's operations, accounting for 40% of its

maintenance and parking capacity, reflecting the market value of the Land would increase KMB' s operating costs and lead to higher fares.

18. Following further negotiations, the company has now agreed not to pursue this proposal but sought permission to transfer ownership of its Lai Chi Kok depot site.



**(F) Transfer of Ownership of the Lai Chi Kok Depot Site**

19. Built in 1965 to accommodate 9-metre buses, the depot can no longer cope with KMB's modern fleet of 12-metre buses. Its design is also outdated in terms of internal vehicle circulation, layout of parking and working bays as well as built-in facilities and equipment. The location of the depot is also a source of constant complaints of environmental nuisance by residents in Mei Foo Sun Chuen. The site was rezoned in 1993 as 'Comprehensive Development Area' under the Town Planning Ordinance.

20. KMB proposes to transfer, after the new franchise has commenced, ownership of the Lai Chi Kok site to its wholly-owned subsidiary company, which would lease the site back to KMB for its franchised bus operations at a nominal rent, until such time as the Commissioner for Transport (the Commissioner) is satisfied that a replacement site is available on the West Kowloon Reclamation, and a new depot constructed there to cope with its modern fleet is ready for operations. KMB's shareholders will bear all the costs arising from the transfer, and the construction cost of the new depot, and will not pass these on in applications for fare increases. KMB's current temporary depot facilities at Butterfly Valley and Yuet Lun Street will also be reprovisioned to this new depot which would, on completion, provide about 400 spaces for parking and maintenance purposes. Once the construction and the relocation is completed, the Lai Chi Kok site will be released from KMB's franchised bus operations and will therefore be available for redevelopment or disposal by KMB.

21. We find this an acceptable arrangement, based on the following reasons -

- (a) the site has been rezoned as a Comprehensive Development Area and the relocation exercise will go a long way towards rectifying the long standing environmental nuisance generated by the depot to residents in its vicinity;
- (b) as one of the pre-conditions to the transfer, KMB will construct a modern replacement depot at no additional costs to commuters; and

- (c) where practicable, there is merit in moving bus depot facilities away from populated areas to permit better use of land.

22. Under the Ordinance, the Commissioner has the authority to ensure that franchisees maintain adequate depot facilities to support their bus operations. Accordingly, we have included a provision in the new franchise requiring KMB to obtain the Commissioner's prior written consent for any transfer or disposal of its depot facilities, including in this case the Lai Chi Kok site. Under the new franchise, the Commissioner may also impose reasonable conditions in granting the consent. The Commissioner will give consent to the transfer proposal of the Lai Chi Kok site according to the following principles -

- (a) KMB's subsidiary company will execute a legally binding undertaking in favour of Government to the effect that -
  - (i) following the transfer of ownership, the Lai Chi Kok depot will be leased back to KMB for its bus operations at a nominal rent which is no more than the current depreciation value of the depot, until such time as the Commissioner is satisfied that the replacement depot on the West Kowloon Reclamation is ready for operation;
  - (ii) the subsidiary company will not terminate or forfeit, or cause or permit the termination or forfeiture of, the lease in respect of the Lai Chi Kok depot until such time as the Commissioner is satisfied that the replacement depot on the West Kowloon Reclamation is ready for operation; and
  - (iii) the subsidiary company will not assign, transfer or otherwise dispose of its legal or beneficial ownership in the Lai Chi Kok depot until such time as the Commissioner is satisfied that the replacement depot is ready for operation.
- (b) KMB will execute a legally binding undertaking in favour of Government that it will not surrender or cause or permit the termination, forfeiture or surrender of its rights and interests in the lease in respect of the Lai Chi Kok depot until such

time as the Commissioner is satisfied that the replacement depot is ready for operation.

- (c) all costs arising from the transfer, the construction and use of the new depot will be fully borne by KMB's shareholders and will not be passed on to passengers in the form of higher fares.

23. Government's intention is to grant the replacement site on the West Kowloon Reclamation to KMB under a short term tenancy, at market rent, for a term of seven years initially. An extension of the tenancy will be considered, provided KMB remains a franchisee under the Ordinance.

#### **(G) The New franchise**

24. KMB has indicated that it will accept the new franchise which is similar to franchises granted to other bus companies in the past two years. Major franchise terms are highlighted at Annex for Members' reference.

25. We shall seek a Provisional LegCo resolution under section 5(3) of the Ordinance for not applying a PCS to KMB's new franchise. We did this in respect of Citybus Limited's new franchise on 5 June 1996, and New Lantao Bus Company (1973) Limited's new franchise on 26 February 1997.

26. We will, in due course, take steps to repeal the relevant provisions of the Ordinance which govern the operation of the PCS.

#### **THE NEW SCHEDULE OF ROUTES ORDER**

27. KMB's existing Schedule of Routes Order was approved by the previous Executive Council on 31 May 1995. The 368 bus routes specified in the new Order, together with any other temporary routes introduced between now and 31 August 1997, would form KMB's new network under the new franchise.

#### **FINANCIAL AND STAFFING IMPLICATIONS**

28. There are no financial or staffing implications for Government.

#### **PUBLIC CONSULTATION**

29. The previous LegCo passed a motion on 23 April 1997, urging Government to abolish KMB's PCS when its current franchise

expired. Those who spoke during the debate supported the grant of a new franchise to KMB without a PCS.

## **PUBLICITY**

30. A press release will be issued and a spokesman will handle media enquiries.

### **Enquiries**

31. Enquiries concerning this brief should be directed to the following officer -

Ms Zina Wong  
Assistant Commissioner for Transport  
Tel No. : 28295210.

Transport Bureau  
Government Secretariat  
July 1997

**Summary of Major Terms of KMB' s New Franchise**

**Part I (Clauses 1 to 5)**

None of the routes to be operated by KMB is specified in the Schedule of Routes Order as an exclusive route. This, by virtue of **Clause 3**, means that KMB does not have the exclusive right to operate those routes under the new franchise.

**Clause 5** retains the requirement that a majority of KMB' s directors shall be ordinarily resident in Hong Kong, though they are not required to be Commonwealth citizens as well.

**Part II (Clauses 6 to 16)**

**Clause 6** provides for KMB' s shares to be listed on the Stock Exchange if so requested by the Financial Secretary.

Under **Clause 9**, the Commissioner may direct KMB to share with, or transfer to, another franchisee its Facilities, or to accept the transfer of Facilities from another franchisee. Detailed terms of the sharing or transfer of Facilities are to be negotiated in good faith between the franchisees, and in default of such an agreement, to be determined by the Commissioner.

**Clause 15** requires KMB to establish passenger liaison groups and enables the Commissioner to direct and approve rules for membership and meetings of the groups, and to demand reports from KMB on follow-up action.

Under **Clause 16**, the Commissioner, after consulting KMB, may direct KMB to use specified premises for the construction, repair, maintenance and parking of buses and other vehicles used by the company in connection with the new franchise.

**Part III (Clauses 17 to 22)**

**Clause 18** specifies the depreciation rates for KMB's fixed assets. This will facilitate the assessment of fare revision applications. As is currently the case for all bus franchisees, no amortisation of land is permitted for the purposes of assessing fare adjustments.

The depreciation rate for buildings is set at 40 years which KMB considered to be more appropriate to reflect their actual useful life. We have no objection to this as the rate is compatible with that applies to Government buildings and some other public utilities.

**Clause 19(1)** requires KMB to disclose in a schedule ( ``the Schedule'' ) the list of assets which it will use or keep at the commencement of the new franchise for its franchised bus operations. **Clauses 19(2) and (3)** provide that KMB shall obtain the Commissioner or the Financial Secretary's prior consent before disposing of or developing any land or buildings specified in the Schedule.

Under **Clause 20(1)**, KMB's contingency and retirement funds are subject to actuarial examination. The qualifications of the appointed actuary are spelt out. At the expiry of the new franchise, if the Financial Secretary so directs, the balance of the contingency fund shall be deposited with a trustee or custodian until ten years after expiry of the new franchise to meet third party claims against KMB during that ten years period. During the franchise period, KMB may, based on the findings of the actuary, apply to the Financial Secretary for approval to write back any amount certified by the actuary to be over provided in the contingency fund to the profit and loss account. In determining the amount of fares that KMB may charge, the Executive Council may have regard, inter alia, to the amount so written back.

**Clause 21** specifies that, upon the expiry of KMB's current franchise in August 1997, any credit balance in the Development Fund shall be applied to offset pressure on fares in assessing the first fare increase application made by KMB following the grant of the new franchise.

**Clause 22** lists the factors that the Executive Council may have regard, inter alia, in exercising the powers under section 13 of the Ordinance to determine the amount of fares that may be charged by KMB. On KMB's request, we



have included as one of such factors the need to provide the company with a reasonable rate of return on its investment of the public bus services.

**Part IV (Clauses 23 to 26)**

**Clause 23** requires KMB to disclose operational and financial information in order to increase the transparency of its operations.

Under **Clause 26**, the Commissioner and the Financial Secretary may conduct a 'mid-term' review after the fourth year of the new franchise to evaluate KMB's performance. Based on the results of such a review, the Executive Council could, with the consent of KMB, amend its franchise.

**Schedule 1 to the franchise**

This schedule lists the assets which KMB has declared will be used or kept by the company on 1 September 1997 for the purposes of its franchised bus operations.