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**Paper for the House Committee meeting
on 7 December 2001**

**Report of the Bills Committee
on Kowloon-Canton Railway Corporation (Amendment) Bill 2001**

Purpose

This paper reports on the deliberations of the Bills Committee on Kowloon-Canton Railway Corporation (Amendment) Bill 2001 (the Bill).

Background

2. The Kowloon-Canton Railway Corporation (KCRC) was established in 1982 under the Kowloon-Canton Railway Corporation Ordinance (Cap. 372) (KCRC Ordinance). Section 3(2) of the KCRC Ordinance provides that KCRC shall consist of a Chairman appointed by the Chief Executive of the Hong Kong Special Administrative Region (HKSAR) and not less than 4 nor more than 8 other members appointed by the Chief Executive of HKSAR. Section 3(2A) provides that the Chairman of KCRC shall also be the chief executive of KCRC.

The Bill

3. The Bill seeks to separate the duties and functions of the Chairman and the chief executive of KCRC by creating the office of the Chief Executive Officer (CEO) in KCRC.

The Bills Committee

4. The House Committee agreed at its meeting on 2 November 2001 to form a Bills Committee to study the Bill. Chaired by Hon Miriam LAU Kin-ye, the Bills Committee held a total of four meetings to discuss the Bill. The membership list of the Bills Committee is in **Appendix I**.

Deliberations of the Bills Committee

5. The Bills Committee has been informed of the need for the timely introduction of the new corporate governance arrangements proposed by the Bill to tie in with the expiry of the service contract of the incumbent Chairman-cum-Chief Executive before the end of 2001. The Bills Committee has also been advised that the proposed change has the full support of the KCRC Board and the executives of KCRC.

6. The Bills Committee notes that the intention of separating the functions and duties of the Chairman and the CEO is to put in place an effective governance structure to ensure transparency, accountability and responsibility. With the expansion of the railway programmes, there is a growing need to separate the strategic planning function and day-to-day management responsibility of KCRC. By strengthening the independence of the KCRC Board and providing clear lines of reporting, there would be improved checks and balances over senior management.

7. In the course of deliberation, the Bills Committee has examined whether and how the proposed separation of the functions and duties of the Chairman and the CEO could help achieve the said objectives. The Bills Committee has also reviewed the monitoring role played by the Secretary for Transport (S for T) and the Secretary for the Treasury (S for Tsy) in the KCRC Board, and whether and how Government officials could help safeguard the public interest, particularly in the course of fare determination and in monitoring the way in which KCRC uses public funds. The deliberations of the Bills Committee are summarized below.

Strengthening of the corporate governance structure of KCRC

8. The Bills Committee has examined the benefits and changes to be brought about by the proposed separation of the functions and duties of the Chairman and the CEO. Members have particularly focused on how the new structure would address the wide public concern over the lack of checking of expenses on fringe benefits for senior staff as well as KCRC's decision to dispense with an open tendering system in the development of the northern part of KCRC Hung Hom Station.

9. According to the Administration, the KCRC Board has all along maintained high standards of corporate governance. Although there is no legal requirement to do so, KCRC has complied with the Code of Best Practice as set out in the Listing Rules of the Stock Exchange of Hong Kong Limited. In the past few years, KCRC has also taken a series of measures to strengthen its corporate governance. These include the introduction of a set of manuals governing all major areas of activities, the review of the rules of public tendering and contract management to make them in line with the requirements for government-owned corporations under the World Trade Organization's Agreement on Government Procurement, the introduction of a new set of budgetary control system, and the adoption of a quality management system leading to ISO 9001 certification. With the challenges in the years ahead both on the service side and the network expansion side, there is a need to further strengthen the

corporate governance structure of KCRC to ensure that both strategic planning and day-to-day management receive the undivided attention they deserve. Upon the separation of the functions and duties of the Chairman and the CEO, the supervision of the wide range of tasks facing KCRC will be more effective. The Chairman, separate from the executives, will strengthen the independence of the Board and hence its ability to discharge its supervisory functions. The CEO can devote full attention to the day-to-day management of the railway operation and implementation of committed railway projects. The proposed separation is also in line with the universal trend in good corporate governance and is also the model in most public corporations e.g. Airport Authority and Hospital Authority. The Administration also indicates that as a policy direction, similar governance structure will be extended to the MTR Corporation Limited to strengthen its corporate governance.

Demarcation of responsibilities between the Chairman and the CEO

10. To ensure accountability, the Bills Committee has examined whether there is a need to define the duties and functions of the Chairman and the CEO in the Bill. The Administration's view is that it might not be appropriate to set out in the Bill the duties and functions of the Chairman and the CEO as it is important for the Corporation, which operates along prudent commercial principles, to retain the flexibility to determine and fine-tune the relationship between the Board (led by the Chairman) and the executives (led by the CEO) to suit its operational needs and the prevailing corporate governance practices which change overtime.

11. The Bills Committee notes that apart from statutory functions specifically assigned by the KCRC Ordinance, the functions of the Chairman and the CEO should be functions assigned to them by the Board as in the case of any other normal commercial entity. The Board is responsible, inter alia, for overall company strategy, acquisition and divestment policy, approval of the Corporation's annual estimates of revenue and expenditure, major financing arrangements, passenger fares and freight charges, and for ensuring that sound administrative systems and procedures are in place. It also reviews monthly the Corporation's operating results, safety record, and the progress made towards annual targets. The Chairman and Members of the Board jointly carry out the duties and functions of the Board. The Board delegates day-to-day operations to the executives (led by the CEO) for implementing the company's mission and strategies.

Chairmanship

12. In view of the responsibilities of the Board, the Bills Committee has examined whether it is viable for a part-time Chairman to supervise the senior management of KCRC in an effective manner, and exercise objective judgement on corporate affairs. The Bills Committee notes that upon separation of the duties and functions of the Chairman and the CEO, the remuneration of the new CEO would be suitably adjusted downward. The total financial commitment of the remuneration of the Chairman and the CEO would not be greater than the existing one for the Chairman-cum-Chief

Executive. The Administration's intention is to provide an honorarium of about \$30,000 per month for the Chairman as the incumbent will be expected to work part-time.

13. The Bills Committee notes that the law, as presently drafted, does not prohibit the Chief Executive of the HKSAR to appoint a Chairman to work on a full-time basis. The Administration's view is that a part-time Chairman would suffice, given the workload of the Chairman and the common practice in the business sector. The Administration stresses that being the governing body of the Corporation, the Board is the ultimate legal authority within the Corporation. All corporate powers are exercised by or under the authority of the Board. To help oversee specific aspects of the Corporation's operations, five committees, namely Audit Committee, New Railway Projects Steering Committee, Committee on Senior Executive Remuneration, Property Development Committee, and Finance Committee are formed under the Board. These Committees review and make recommendations to the Board on various matters. Whilst the Chairman has the power to set agenda, approve issue of Board papers, chair Board meetings, call extraordinary Board meetings and chair the annual strategic planning conference, the functions of the Board are jointly exercised by all Members of the Board.

14. The Bills Committee notes that the Chairman would receive support from the Corporation and Government in discharging his duties. There are also established procedures to avoid possible abuse of power by the senior management. The Board also retains the power to dismiss the CEO, if considered justified, subject to the approval of the Chief Executive of the HKSAR. Some members however remain of the view that a part-time Chairman could be easily manipulated by the senior management or the Government, rendering him not able to exercise objective judgement on corporate affairs and discharge his supervisory functions in an effective manner. There might also be a case where the part-time Chairman would put himself in a position where his official duties in KCRC are in conflict (or may be seen to conflict) with his private interests. It is suggested to the Administration that the controlling shareholder (i.e. Government and, in turn, taxpayers) should provide professional support to the Chairman so that he would be able to act independently towards the policy objectives of the controlling shareholder rather than for the interests of the senior management.

15. On the appointment criteria for the Chairman, the Bills Committee notes that the Administration will take into account the appointee's ability, expertise, experience, local knowledge, and whether he would be able to devote sufficient time to discharge his duties. Some members consider that it will be difficult for the Administration to find a high calibre person who will be willing to take up the appointment at an honorarium of about \$30,000 per month for such great responsibilities. Some members however take the view that it is not appropriate to grant the Chairman with a full remuneration package as this will lead to an expansion of the management structure.

Remuneration of the CEO

16. The Bill provides that the terms and conditions of the CEO would be determined by the Corporation subject to the prior approval of the Chief Executive of the HKSAR. The Bills Committee notes that in determining the remuneration of the CEO, the Corporation would take into account his performance and the market rate for similar posts in the business sector so as to ensure the appointment of a high calibre officer to work with the Corporation.

17. The Bills Committee has requested the Administration to consider providing in the Bill for the disclosure of the remuneration of the new CEO to enhance transparency. The Administration's view is that KCRC maintains the same standard of disclosure observed by companies listed on the Hong Kong Stock Exchange, the Listing Rules of which require the disclosure of the aggregate amount of employees' remuneration, together with banding analysis for the five highest paid employees in a number of bands in multiples of \$500,000. The Corporation will disclose information on the remuneration of the new CEO on the same basis.

18. Mr CHENG Kar-foo is not convinced of the Administration's explanation. To increase transparency, he will consider moving a Committee Stage amendment (CSA) to require the Corporation to disclose the remuneration of the CEO to the general public. Mr CHENG has also indicated that he, or another Member of the Democratic Party, may consider moving a CSA to the effect that any determination by the Corporation of the terms and conditions of the CEO would be subject to the approval of the Legislative Council. This could ensure that public spending could be put under proper control by the legislature. The initial view of the Administration is that this may affect the capability of the Corporation to compete for talents with the business sector.

Attendance at meetings of the Legislative Council

19. At the request of the Bills Committee, the Administration agrees to move a CSA to include a new provision in the Bill requiring the Chairman and the CEO to attend meetings of committees and subcommittees of the Legislative Council upon request to enhance accountability.

Composition of the Board

20. The Bills Committee notes that the KCRC Board currently has nine members including the Chairman. The proposed creation of the CEO office who shall be a member of the Board, if approved by Legislative Council, will increase the number of Board members to ten. To ensure a balanced composition of the KCRC Board to handle its activities, the Administration has accepted the Bill Committee's suggestion to review the size and composition of the Board, taking into account the need to include representatives from Green Groups, grass-root organizations and Legislative Council. The Administration also undertakes to report to the Transport Panel in one

year's time.

Role of the Government in KCRC

21. The Bills Committee has also examined the specific responsibility of the Government and KCRC in the event of a serious policy failure or mismanagement.

22. The Bills Committee notes that the Government's responsibility is to ensure that the transport policy and the railway development strategy are formulated properly to serve the transport needs of the community. For railway projects undertaken by KCRC, the Government has a monitoring responsibility to ensure that the projects would be completed by KCRC on time and within budget. As regards the existing railway systems operated by KCRC, the Government has the responsibility to take action as a regulator in accordance with the relevant rules and regulations to ensure that the necessary arrangements are put in place by KCRC to prevent or resolve operational problems that may occur. As the delivery agent of new railway projects, KCRC has the responsibility to complete the projects on time and within budget. It will also ensure that the new railways are in all aspects ready to provide a safe and reliable service to the public upon commissioning. For its existing railway systems, KCRC has the management and operational responsibility to ensure that it can provide a safe and reliable train service to the public. KCRC is also responsible for its property development activities and commercial matters.

23. Some members of the Bills Committee are concerned about the effectiveness of appointing policy secretaries to the Board to play a monitoring role, particularly in the course of fare determination and in monitoring the Corporation's spending. The Administration advises that similar to other KCRC Board Members, S for T and S for Tsy are required to act honestly and in good faith for the benefit of the Corporation and exercise a reasonable standard of skill and care in the performance of their powers. The functions of the Board are jointly exercised by all Members of the Board. As such, S for T and S for Tsy have the same roles and responsibilities as other Board Members.

24. On balancing the interests of the Corporation and the general public, the Administration's view is that keen competition in the transport sector and market force will act as a constraint on fare increases. In the course of fare determination, the Board would need to consider a wide range of factors including general economic condition, public acceptability and affordability, the financial position of the Corporation for financing its planned railway developments, and maintaining the quality and quantity of service provided. A proper balance would be made having considered all relevant factors. Individual cases of the Corporation's extravagant spending are to be taken up by the Board.

25. Some members are not convinced of the Administration's explanation. They are of the view that S for T and S for Tsy, being Government's representatives in the KCRC Board, should perform a monitoring role to oversee the Corporation's affairs

for the purpose of safeguarding the public interest. They should also be held accountable to the Legislative Council for any serious policy failure and mismanagement in KCRC.

Transitional arrangements

26. The Bills Committee notes that in order to preserve the efficiency of the present operation and to maintain the stability of the Corporation, the existing Chairman-cum-Chief Executive has been invited to serve as the new CEO for another two years, subject to the passage of the Bill by the Legislative Council. The proposed arrangement is also accepted by the KCRC Board. Some members maintain the view that the proposed arrangement is undesirable as it will preempt the Chairman's power to determine the appointment of the CEO, and, in turn, affect his power and working relationship with the CEO.

Matters to be considered further outside the context of the Bill

27. During the scrutiny of the Bill, the Bills Committee has identified a number of issues worth further pursuing outside the context of the Bill. These include :

- (a) the factors taken into consideration in determining the remuneration and fringe benefits for senior management of statutory bodies;
- (b) the effectiveness of appointing policy secretaries to the managing boards of statutory bodies to play a monitoring role;
- (c) whether statutory bodies should be put under the scrutiny of the Director of Audit; and
- (d) the feasibility of setting up a professional team to oversee Government equity on various statutory bodies.

Committee Stage amendments

28. The Bills Committee notes that the Administration has accepted the Bills Committee's suggestions to include a provision in the Bill requiring the Chairman and the CEO to attend meetings of committees and subcommittees of the Legislative Council upon request to enhance accountability. A full set of the CSAs from the Administration is in **Appendix II**. The Bills Committee has not proposed any CSAs but individual members have indicated that they may consider moving CSAs on their own.

Recommendation

29. The Bills Committee recommends the resumption of the Second Reading debate on the Bill on 19 December 2001.

Advice sought

30. Members are requested to take note of the contents of the report and support the recommendation of the Bills Committee in paragraph 29 above.

Council Business Division 1
Legislative Council Secretariat
6 December 2001

**Bills Committee on
Kowloon-Canton Railway Corporation (Amendment) Bill 2001**

Membership list

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| Chairman | Hon Miriam LAU Kin-yee, JP |
| Members | Hon Cyd HO Sau-lan Ir Dr Hon Raymond HO Chung-tai, JP Hon Eric LI Ka-cheung, JP Hon LAU Chin-shek, JP Hon LAU Kong-wah Hon Emily LAU Wai-hing, JP Hon Andrew CHENG Kar-foo Dr Hon TANG Siu-tong, JP Hon Abraham SHEK Lai-him, JP Hon LI Fung-ying, JP Hon Audrey EU Yuet-mee, SC, JP |
| | (Total : 12 Members) |
| Clerk | Mr Andy LAU |
| Legal Adviser | Miss Connie FUNG |
| Date | 15 November 2001 |

KOWLOON-CANTON RAILWAY CORPORATION (AMENDMENT) BILL 2001

COMMITTEE STAGE

Amendments to be moved by the Secretary for Transport

| <u>Clause</u> | <u>Amendment Proposed</u> |
|---------------|---|
| 3(3) | In the proposed section 3(2A), by deleting “所委予或” and substituting “授予他們及”. |
| New | By adding – “3A. Section added The following is added – “6A. Attendance at the Legislative Council The committees and subcommittees of the Legislative Council may request the Chairman and the Chief Executive Officer to attend its meetings and they shall comply. The Chairman and the Chief Executive Officer shall answer questions raised by the Members of the Legislative Council at the meetings.”.”. |