

**立法會**  
**Legislative Council**

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**Legislative Council**  
**Panel on Transport**

**Subcommittee on matters relating to the  
implementation of railway development projects**

**Minutes of meeting on  
Thursday, 16 May, 2002, at 10:45 am  
in the Chamber of the Legislative Council Building**

- Members present** : Hon Miriam LAU Kin-ye, JP (Chairman)  
Ir Dr Hon Raymond HO Chung-tai, JP  
Hon CHAN Kwok-keung  
Hon LAU Chin-shek, JP  
Hon LAU Kong-wah  
Hon Andrew CHENG Kar-foo  
Hon Tommy CHEUNG Yu-yan, JP  
Hon Albert CHAN Wai-yip  
Hon WONG Sing-chi  
Hon LAU Ping-cheung
- Non-Subcommittee members attending** : Dr Hon David CHU Yu-lin, JP  
Hon Albert HO Chun-yan  
Hon Eric LI Ka-cheung, JP  
Hon James TO Kun-sun  
Hon Mrs Sophie LEUNG LAU Yau-fun, SBS, JP  
Hon Emily LAU Wai-hing, JP  
Hon Henry WU King-cheong, BBS
- Members absent** : Hon TAM Yiu-chung, GBS, JP  
Hon Abraham SHEK Lai-him, JP  
Hon LEUNG Fu-wah, MH, JP

**Public officers  
attending**

**: Agenda item II**

Transport Bureau

Mr Paul TANG  
Acting Secretary for Transport

Mr Arthur HO  
Deputy Secretary for Transport

**Attendance by  
invitation**

**: Kowloon-Canton Railway Corporation (KCRC)**

Mr Michael TIEN  
Chairman, KCRC

Mr K Y YEUNG  
Chief Executive Officer, KCRC

Mr James BLAKE  
Senior Director, Capital Projects, KCRC

Mr Ian THOMS  
Director, West Rail, KCRC

Mr David FLEMING  
Company Secretary and General Counsel, KCRC

Mrs Irene YAU  
General Manager, Corporate Affairs, KCRC

Mr Leo MAK  
Acting General Manager, Railway Systems, KCRC

KCRC Investigation Steering Committee

Sir John SWAINE  
Member

Ernst and Young

Mr Anthony WU  
Chairman

Mr Clive SAUNDERSON

Mr Glenn HALEY

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

**Staff in attendance** : Miss Connie FUNG  
Assistant Legal Adviser 3

Ms Alice AU  
Senior Assistant Secretary (1)5

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**I Confirmation of minutes and matters arising**  
(LC Paper No. CB(1)1649/01-02 - Minutes of meeting held on  
4 February 2002)

The minutes of meeting held on 4 February 2002 were confirmed.

**II Briefing by the Kowloon-Canton Railway Corporation Chairman on the findings of the investigation of the West Rail contracts**

(LC Paper No. CB(1)1738/01-02 - Background brief on Kowloon-Canton Railway Corporation West Rail Contracts prepared by Legislative Council Secretariat;

LC Paper No. CB(1)1747/01-02(01) - Information note on "Investigation Report on KCRC West Rail Contracts";

LC Paper No. CB(1)1747/01-02(02) - Report on the Review of Payments to Contractors for the West Rail Project; and

LC Paper No. CB(1)1747/01-02(03) - Introduction and Executive Summary on the Review of Payments to Contractors for the West Rail Project)

2. The Chairman welcomed representatives of the Kowloon-Canton Railway Corporation (KCRC) and the Administration to the meeting.

3. The Chairman recapped that since the incident in connection with KCRC's handling of the West Rail (WR) telecommunications systems contract (DB-1500) awarded to Siemens Limited (Siemens) and the other 26 supplemental agreements (SAs) with contractors for WR contracts came to light, the Subcommittee had held a series of meetings to discuss relevant issues with KCRC and the Administration. In order to address public concern about these SAs, KCRC had engaged its external auditors, KPMG, to conduct an independent review on the Corporation's tender

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evaluation and contractual performance monitoring systems in connection with contract DB-1500 and other SAs. Following KPMG's withdrawal from the investigation, Ernst & Young (E&Y) were engaged by the Managing Board of KCRC on 8 March 2002 to undertake the review. The present meeting was convened to receive a briefing by the Chairman of KCRC on the findings of E&Y's investigation.

4. The Chairman informed members that the Administration had issued a set of documents, including an information note provided by the Administration (LC Paper No. CB(1)1747/01-02(01)), the Report on the Review of Payments to Contractors for the West Rail Project by E&Y (the Report) (LC Paper No. CB(1)1747/01-02(02)) and the Executive Summary of the Report (LC Paper No. CB(1)1747/01-02(03)), to members shortly before the present meeting at 9:00 am. In this connection, Mr Michael TIEN, the Chairman of KCRC, apologized for the late submission of papers.

### Statements made by KCRC personnel

5. At the invitation of the Chairman, the following personnel from KCRC took turn to address the Subcommittee on the Report:

- (a) Sir John SWAINE, a member of the Investigation Steering Committee (Steering Committee) formed by KCRC to guide and oversee the independent review (a copy of his statement was at **Appendix I**);
- (b) The Chairman of KCRC (a copy of his statement was at **Appendix II**);
- (c) Mr K Y YEUNG, the Chief Executive Officer of KCRC (CEO of KCRC) (a copy of his statement was at **Appendix III**);
- (d) Mr James BLAKE, Senior Director, Capital Projects of KCRC (SD/CP, KCRC) (a copy of his statement was at **Appendix IV**); and
- (e) Mr Ian THOMS, Director, West Rail of KCRC (D/WR, KCRC) (a copy of his statement was at **Appendix V**).

### The Administration's stance and involvement

6. The Acting Secretary for Transport (S for T (Ag.)) stated that after reviewing the Report, the Administration took the view that a thorough investigation had been conducted by E&Y and it also welcomed and supported the Managing Board's decision to implement the recommendations set out in the Report for strengthening the Corporation's systems and procedures for contract procurement, monitoring and management. He further said that at this stage, it would be most important for the Corporation to focus its attention on taking forward all necessary improvement measures so that it would be better prepared to face the challenges ahead arising from new railway projects and expanding patronage. In this respect, the Administration would render full support to the Corporation in its endeavours. In particular, when

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reviewing the appointment of Board members later this year, the Administration would consider E&Y's suggestion of appointing persons with knowledge and experience of major projects to complement the existing Managing Board's knowledge and experience.

7. As a related issue, Mr CHENG Kar-foo asked whether the Report would be considered by the Administration during its assessment on the bidding proposals for the Shatin to Central Link (SCL). In response, S for T (Ag.) advised that the proposals from the two railway corporations would only be considered against the criteria set down in the Project Brief. Notwithstanding the Siemens incident, he said that satisfactory progress had generally been achieved for the WR project. All in all, the Administration believed that valuable experience would be gained by the Corporation from the construction of the WR.

8. Mr Albert CHAN referred to recent press reports about the involvement of the Chief Executive of the Special Administrative Region (CE) in the matter and sought clarification from both the Administration and KCRC. Given CE's involvement, he was particularly dissatisfied with the misleading reply given by the then S for T to a relevant question he raised at a previous Subcommittee meeting.

9. In response, CEO of KCRC recalled that at that time, Siemens' delay had started to threaten the scheduled opening of WR. He was informed by SD/CP, KCRC that Dr BAUMANN, the Chairman of Siemens, was coming to Hong Kong to attend CE's Council of International Advisers meeting in November 2001. As such, the Management decided that it might be helpful to enlist CE's help in ensuring that Siemens' delay in the telecommunications contract was brought to the highest level of attention in the company. A note conveying such request was subsequently sent by SD/CP, KCRC to the Private Secretary to CE. As it was a practice commonly adopted internationally, CEO of KCRC said that he did not see a problem with seeking CE's help in this matter and the Corporation was merely trying its best to save the project. This matter had also been reported to the Managing Board when the proposed negotiation plan was discussed in November 2001.

10. S for T (Ag.) also confirmed that at the request of the Corporation, CE had emphasized to Dr BAUMANN that the WR was a major infrastructural project for Hong Kong and that Siemens should complete the contract on schedule. Except for such exchange with Dr BAUMANN, CE was not aware of KCRC's subsequent negotiation of the SA with Siemens on the contract and the Government had played no part in the negotiations. He also recapped that when invited to respond to a question from Mr Albert CHAN as to whether CE was aware of KCRC's decision on the SA and whether he supported the decision, the then S for T had clarified that negotiations relating to the SA were commercial decisions of KCRC and he had also emphasized that it had not been necessary to involve CE in such decisions.

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Integrity of E&Y's review

11. Referring to the statement made by E&Y in paragraph 2.1.6 of the Report that “[i]t is possible that some of our conclusions on the three contracts might be different if we had access to the personnel and records of the relevant contractors”, Mr LAU Chin-shek raised serious doubts about the integrity of the E&Y's investigation which was conducted under such deficiencies. He did not accept that investigation into the Siemens incident should be concluded with the completion of the Report. He asked whether the Administration would consider conducting a full investigation into the matter to uncover the whole truth.

12. Echoing similar views, Mr CHENG Kar-foo criticized the Report for failing to give members and the public a comprehensive picture of the Siemens incident. Without any access to the personnel and records of the contractor, the investigation was by no means complete. He was particularly concerned that the senior management of KCRC were willing to accept responsibility for the incident only after the Report came out so as to pre-empt any further investigation into the matter which might uncover more serious wrongdoings on their part. Under the circumstances, he opined that there was a strong case for invoking the powers under the Legislative Council (Powers and Privileges) Ordinance (Cap. 382) to summon relevant personnel of the contractors to attend public hearings.

13. Mr James TO pointed out that in various places throughout the Report, E&Y had highlighted the problem about the lack of proper assessment or documentation for certain important events or decisions in connection with the Siemens incident, such as the determination of the settlement amounts, the absence of any written record on the legal advice tendered by the Company Secretary and General Counsel, KCRC to the Corporate Tender Board (CTB) about the possibility of terminating contract DB-1500, the unavailability of alternative options, other than commercial settlement, for the Managing Board to consider, etc. As such, Mr TO expressed serious doubts as to whether all these omissions were merely acts of negligence which happened by coincidence or did they represent a deliberate cover-up attempt on the Management's part. Hence, he also considered that further enquiry might be required to ascertain the whole truth.

14. In reply, Mr Anthony WU, Chairman of E&Y, explained that according to the agreed terms of reference (TOR), the review was to be conducted on the basis of KCRC's own records. On this premise, the E&Y team had reviewed the documents submitted by KCRC and held a number of meetings with various KCRC personnel. Notwithstanding the absence of any documents from the relevant contractors, E&Y believed that based on all evidence and documents received and reviewed, the Report had presented as balanced a view as possible and the opinion formed by the team was fully founded and properly supported. In this respect, he drew members' attention to paragraph 2.1.7 which stated that the contractors' position had also been presented as far as possible. While stressing that it would be outside the scope of its TOR to review records maintained by the contractors, Mr WU confirmed that during the

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course of its review, the E&Y team did not have any reason to believe that documents relevant to the review had been withheld by the Corporation.

15. The Chairman of KCRC responded that given the limited time and by virtue of the TOR which had been provided to members for information earlier on (vide LC Paper No. CB(1)1138/01-02(01)), the scope of review could only cover those records maintained by the Corporation. The statement made by E&Y in paragraph 2.1.6 was merely some sort of disclaimer intended to state the limitations in the scope of its review. While acknowledging members' concerns about the integrity of the review, he stressed that as confirmed by E&Y to himself and the Steering Committee, they did not see any gap in the documents that were provided by the Corporation. Hence, he believed that the quality of the review had not been undermined in any way. Moreover, while considering that interviews with Siemens' personnel might help to understand certain aspects of its non-performance, he did not see this as a major problem because its perspective and views could also be reflected from the correspondence it exchanged with KCRC, which was also kept by the Corporation and made available to E&Y.

16. Addressing members' concern about the depth of E&Y's investigation, the Chairman of KCRC said that while he had the same query as members after reading the Executive Summary initially, he was satisfied that a thorough investigation had been conducted after going through all the facts and events presented in the full Report. As the extent of E&Y's review would only be revealed by the full length of the Report, he invited members to go through the contents in detail before drawing any conclusions. If members still had any doubts after that, he would be most willing to discuss them further with members.

17. In response to Mr James TO's enquiry, Mr Clive SAUNDERSON confirmed that the Corporation did have a substantial amount of documentation in relation to its process for reviewing the claims submitted by the contractor and working out its own internal assessment. The point intended to be made in the Report was that while such documentation existed, the quality and manner in which that documentation was organized could be improved to facilitate an independent review on these calculations.

18. In this connection, the Chairman of KCRC stated that after carefully reviewing the Report, both the Steering Committee and himself did not consider that there had been any deliberate attempt by anyone to withhold the truth. As a general practice, the Corporation would prepare an internal assessment to support the calculation of the maximum amount payable under the proposed SA before negotiation with the contractors commenced. In fact, as indicated in paragraph 20.6.3 of the Report, the amount finally agreed in the SA for contract CC-213 for Tuen Mun Station was substantially less than the contractor's original claims and was also less than KCRC's internal estimates of the value of the contractor's claims. Notwithstanding, he acknowledged that the calculations for settlement claims in the Siemens contract might not have been documented to a high standard. There was a need to review the Corporation's procedures for documenting contractors' claims to ensure that an

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adequate “audit trail” was recorded in determining the amounts that should be paid to the contractors.

19. To supplement, CEO of KCRC affirmed that such documentation was available in the WR Division. However, when reporting the matter upwards, say to CTB or even the Managing Board, detailed analysis might not be properly recorded in the minutes of meetings. In this respect, he assured members that immediate actions would be taken to rectify such procedural deficiencies. But he called for members’ understanding that while the massive WR project was being taken forward, the Corporation would also need to maintain the normal operation of the existing railway lines and plan for the East Rail Extensions projects. It had therefore been necessary for senior management to establish new systems and procedures, and to recruit additional management resources with the necessary experience of construction and major infrastructure project management to handle the substantial additional responsibilities. As the head of the Management, he had also instituted many reforms over the past few years. As the WR project was progressing to an advance stage, he would focus his attention on implementing the recommendations made in the Report.

20. Miss Emily LAU expressed concern that E&Y’s findings on liquidated damages (LD) had been deleted from the Report. In this connection, the Chairman invited members to note that the issue was addressed by Sir John SWAINE in his statement which stated that “[the Steering Committee] note that there are a certain number of references in the auditors report which have been deleted in the report to be provided by the Corporation to the Government. We are satisfied that these deletions ... relating to liquidated damages are appropriate having regard to the commercial sensitivity of the information contained therein, which if disclosed would prejudice the Corporation’s ability to act in a prudently commercial manner”.

The original contract strategy

21. Ir Dr Raymond HO referred to the limited number of conforming tenders for contract DB-1500 and sought E&Y’s view as to whether the Corporation should have broken up the original contract into smaller work items and conducted a separate tendering exercise for participation of more companies. In addition, he also considered that the drafting of the contract could be improved to include provisions that could better safeguard the Corporation’s right to re-tender the contract in case of non-performance by the contractor.

22. In reply, Mr Glenn HALEY advised that after reviewing the documents, he was of the view that the form of contract used by the Corporation was in order and it was in fact similarly adopted in both Hong Kong and overseas countries. In addition, the terms of the contract were sufficient and were usual for a project of this kind. Hence, he did not think there was anything wrong with the drafting of the General Conditions of the contract. He cautioned that if tougher terms were specified, the Corporation might run the risks of having a higher tender price or even less tenderers to bid for the project. Addressing the member’s concern about putting additional safeguards in the



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contract where different systems were grouped together, Mr HALEY said that one of the recommendations made in the Report was that the Corporation should consider the establishment of key dates under such contract in a manner that would give it additional project management options (such as earlier access to contractual remedies) should the contractor not perform. For example, it would help if earlier and extra milestones could be set to monitor progress, while separate and different key dates could be established for each system under the contract.

23. Regarding the Corporation's right to re-enter, Mr HALEY stated that at that time, Siemens was having difficulties on three out of the seven subsystems grouped under contract DB-1500. In addition, Siemens also had some claims for extra money and time under the contract. So, although there were difficulties, he did not think that the Corporation had a right to re-enter the contract and that was not because of any deficiency in the contract. But in any event, if there had been a power to re-enter, his estimate was that the time it took to re-enter and re-tender so that a new contractor could be brought in would have put the project back for about a year.

24. On the grouping of the seven subsystems under a single contract, SD/CP, KCRC stated that as explained previously, these seven subsystems were lumped together when the contract was being prepared as they were integrated with each other and the installation work was also common in many areas. To avoid some of the mistakes of system incompatibility, for example in the case of the Airport Core Projects, he assured members that careful consideration had been given on the pros and cons of bundling the seven subsystems together under a single contract. While acknowledging that the decision might be different for similar projects in future, he emphasized that the decision was considered appropriate in the circumstances at the time.

25. As regards the limited number of conforming tenders for contract DB-1500, SD/CP, KCRC explained that as a pre-qualification exercise had been conducted, the number of tenderers would still be basically the same if the Corporation had attempted to re-enter at that time because all the likely tenderers had already been included in the tender list. Moreover, it would result in further delays in the project because the telecommunications contract was a key item in the programme and it had to be dealt with expeditiously.

26. Referring to the Secretary for the Treasury (S for Tsy)'s comment about the Corporation, as an employer, was compensating its contractor for poor performance, Mr LAU Kong-wah reiterated his concern that given the Corporation's prime concern was always to ensure the timely completion of railway projects, this incident might prompt other contractors to make use of the loophole to bid for contracts at low price, and then deploy the same delaying tactics in the hope of getting extra payment for delay recovery measures. In this respect, he sought E&Y's view on how to prevent a recurrence of similar incidents.

27. In reply, Mr Clive SAUNDERSON advised that going forward, KCRC had to

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consider the balance of likely risks and benefits in deciding whether to group a number of systems under one contract, such as in terms of tender price and system integration. The decision on the structure of the contracts should be taken on a case-by-case basis.

### Monitoring and management procedures

28. Ir Dr Raymond HO reiterated that in terms of contract management, an early warning system should be put in place so that formal warnings could be issued to the contractor whenever slippage was detected. If that had been done for contract DB-1500, the Corporation might have been able to terminate and re-enter the contract while there was still time to prevent the situation from escalating into a crisis which threatened the whole WR project. In this respect, he considered that if more meetings could be held between the Corporation and Siemens so that various issues of concern could be followed up, the situation might have been different. Highlighting the inadequacy of the Corporation's traffic light system, he pointed out that if a red light (indicating a 12-week delay) was shown in an advance stage of work, the problem would indeed be very serious. In this regard, he sought clarification on the progress of the Siemens contract at the time the red light was shown.

29. In response, Mr Clive SAUNDERSON said that E&Y's review on the actions taken by the Corporation was set out in detail in Chapter 6 of the Report. In particular, he drew members' attention to the fact that under the General Conditions of Contract of KCRC, the Corporation had sent two Rate of Progress letters to Siemens identifying their concerns as regards the rate of progress under the contract. There were also regular meetings at various levels between KCRC Management and Siemens management commencing late 2000 in order to endeavour to address the various issues under the contract. To supplement, Mr Glenn HALEY confirmed that from his experience in project work, the number and frequency of meetings that were held was equal to what he could expect of a contract of this kind. There was perhaps even a closer monitoring in this project than a number of other projects that he had come across.

### Commercial settlement by way of a SA

30. Referring to E&Y's statement in paragraph 2.6.9 that "[the supplemental agreement approach] resulted in a commercial settlement which appears to have been in the best interests of KCRC", Miss Emily LAU expressed utmost concern about whether commercial settlement did represent the best way forward for the Corporation from the point of view of prudent use of public funds because an additional payment of \$100 million to Siemens was invariably incurred and the Management Board had practically no other alternative course of action to choose from. As such, she sought the basis on which E&Y came to such a conclusion and asked whether in E&Y's view, the settlement sum was in fact appropriate.

31. In reply, Mr Clive SAUNDERSON advised that during the review, possible solutions under the Siemens contract had been carefully examined. In coming to the

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conclusion that entering into the SA was in the best interests of the Corporation, the E&Y team had particularly taken into account the fact that there were a number of contracts which interfaced with the Siemens contract. No matter what actions were taken to resolve the progress of the Siemens contract, it would impact significantly upon these other contracts in relation to the WR project. Looking from KCRC's perspective, they were also concerned that if no solution was found for the Siemens contract such that its progress was put back on schedule, there was a risk that delays on this series of other contracts might occur resulting in claims from other contractors.

32. Considering the financial impact of the proposed SA vis-à-vis other options such as re-entering, Mr LAU Ping-cheung accepted that commercial settlement by way of a SA was the correct decision under the circumstances because most of the problems previously encountered were satisfactorily addressed and the contract was brought back on schedule following the execution of the SA. Notwithstanding Siemens' fault in the matter, he pointed out that the cost of the original contract together with the SA was only \$387 million, much less than the price submitted by the second lowest conforming tenderer. Hence, he considered that the Management's decisions to award the contract to the lowest conforming tenderer and to negotiate a commercial settlement were acceptable from the point of view of safeguarding public interest.

33. Mr James TO however held a different view. Notwithstanding the substantially low tender price for the Siemens contract, he considered that as a corporation funded by public monies, KCRC should make every effort to ensure that its works contracts were properly monitored and no unnecessary payment was incurred. In this connection, he called on the Corporation to critically review whether a 10% LD was sufficient to cover the loss that might incur in case of non-performance by the contractor. His view was noted by the Chairman of KCRC.

34. Mr LAU Ping-cheung called on the Corporation to give due regard to the recommendations set out in paragraphs 4.7.42 and 4.7.43 of the Report about the need to establish a system of independent review of the calculations in relation to contractors' claims so as to ensure that such claims were assessed in the appropriate manner. In reply, SD/CP, KCRC affirmed that this recommendation would be taken forward by the Management. Consideration would be given to the appointment of an independent engineer to overview the work of the Engineer for the contracts.

35. On the amount of settlement, the Chairman of KCRC reiterated that the settlement limit of \$98 million comprised \$35.05 million of committed and potential variations and claims, and \$62.95 million as a negotiating allowance for delay recovery, acceleration and commercial settlement. This amount was further split into \$29.9 million as the amount required to settle claims in dispute and \$35.05 million as payment for delay recovery measures. The contention was really about the \$35.05 million paid to Siemens for recovery the delay on the three problematic subsystems. Learning from this incident, he pledged that the Corporation would exercise more stringent monitoring in respect of any contracts where different systems

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were grouped together so that whenever delay was detected in any individual systems, early warning could be issued.

Responsibility of senior management personnel of KCRC

36. Mr CHENG Kar-foo noted that one of major criticisms in the Report was the Management's late reporting of the Siemens problem to the Managing Board. However, the Report did not seem to contain any specific recommendations for improvement in the respect. Notwithstanding the apologies made by CEO of KCRC, SD/CP, KCRC and D/WR, KCRC in their statements, he considered that for the purpose of strengthening the Management's accountability to avoid a recurrence of similar incidents, suitable sanctions should be imposed against those senior management personnel who were responsible. Otherwise, it would be very difficult to convince the public that the Chairman of KCRC was really determined to change the culture of the Corporation and that the Corporation was indeed capable of meeting the challenges ahead with the operation of new lines. As such, he sought the Chairman of KCRC's view as to whether such a gesture of apology would suffice or whether other sanctions should be imposed.

37. Echoing similar views, Mr Albert CHAN called on the CEO of KCRC, SD/CP, KCRC and D/WR, KCRC to consider donating part of their salary to the Community Chest to show their sincerity in accepting responsibility for the matter. Mr James TO also suggested that the Corporation should review whether part of the contract gratuities or performance bonus of those responsible senior management staff should be forfeited.

38. Mr LAU Kong-wah also pointed out that throughout the development of the incident, CEO of KCRC as the then Chairman-cum-Chief Executive of KCRC had never made any attempt to bring the Managing Board's attention to the delay in the Siemens contract which was critical to the timely completion of WR. It was not until November 2001 that the Managing Board was first advised of the severity of the problem, when it was already too late to consider any alternative course of action. He opined that to a certain extent, it was tantamount to deliberately withholding this important piece of information from the Managing Board. Looking from that perspective, he seriously queried the degree of responsibility to be borne by CEO of KCRC and his directors, i.e. SD/CP, KCRC and D/WR, KCRC, in the late reporting of the Siemens problem to the Managing Board. If a similar incident were to happen in the private sector, the responsible personnel would be faced with some serious actions such as a salary cut, demotion or even dismissal. In this respect, Miss Emily LAU asked whether the responsibility of those responsible senior management personnel would be followed up by the Managing Board.

39. While noting members' views and suggestions, the Chairman of KCRC replied that for him as the Chairman of the Corporation, it would be most important for the responsible staff to come out and acknowledge responsibility in the matter. In this connection, CEO of KCRC had already apologized twice on behalf of the management

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team, once when the negotiation outcome was discussed by the Managing Board in December 2001, and again when the Board met recently to discuss the Report. Earlier on, public apologies had also been made by CEO of KCRC, SD/CP, KCRC and D/WR, KCRC when making their statement and they had individually accepted responsibilities for the errors of judgment they made which had resulted in the Managing Board not fully and timely informed of the critical nature of the delays in the Siemens' contract.

40. The Chairman of KCRC further said that in considering whether other sanctions should be imposed against the responsible senior management personnel, he would take account of the nature and severity of the mistakes made. In the present case, he pointed out that notwithstanding the shortcomings identified by E&Y, it was quite clear that tremendous efforts had been made by the senior management to deal with Siemens' delay as they believed that they could resolve the problem on their own without resorting to the Managing Board. While he would put it down to arrogance on the Management's part, he did not see this as a deliberate attempt by the Management to conceal or withhold the problem from the Managing Board. Looking forward, he believed that staff of the Corporation should be delegated with additional responsibilities and encouraged to take ownership of their problems and as a balance, he would also strive to ensure that an effective chain of reporting within the Corporation was maintained.

41. The Chairman of KCRC also informed members that the matter had already been discussed by the Managing Board. Considering that the senior management team was acting in the best interests of the Corporation and not for any personal gains, the Managing Board accepted the sincere apologies expressed by the responsible senior management personnel and considered that appropriate actions had already been taken in this case. He also called on members' understanding that at this moment, it would be most important for the Corporation to maintain a proper and efficient service to the public while ensuring progress for all its on-going construction projects, in particular the scheduled opening of WR. All this would hinge on the stability and continuity of the Management as well as the morale of the staff. In addition, the Corporation would also need to concentrate its efforts on taking forward all necessary improvements recommended in the Report. Hence, for the best interests of Hong Kong and the Corporation, he did not agree that any tougher actions should be taken against the responsible senior management personnel. He hoped that members would support the Managing Board's decision in this respect. However, he assured members that the performance of the responsible senior management personnel would be critically reviewed when their contracts were due to expire towards the end of next year.

42. Addressing members' concern about the kind of information made available to the Managing Board on the Siemens contract, CEO of KCRC explained that for the purpose of contract management, a traffic light system was adopted whereby the status of each contract was indicated by a green, amber or red traffic light, which showed whether the contract was on schedule or not. Within the Corporation, there were two

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levels of reporting, i.e. the Weekly Progress Review Charts (WPRCs) for monitoring by the WR Division and the Fortnightly Situation Reports (FSRs) for discussion in the weekly Directors' Meetings chaired by himself and for submission to the Managing Board. In other words, the information received by himself as the then Chairman-cum-Chief Executive of the Corporation was the same as members of the Managing Board.

43. CEO of KCRC added that however, as highlighted in the Report, the problem of late reporting to the Managing Board was attributable to different criteria used for these two sets of reports. As such, the FSRs which were sent to the Board did not indicate the serious delays in the Siemens contract. While acknowledging the inadequacies of the reporting procedures as well as the errors of judgement made by the Management in failing to report the full gravity of the delays in Siemens' performance, he pledged that all necessary improvements would be made as a matter of priority. As to whether any sanctions should be imposed against himself, he would leave the matter to the Managing Board to decide.

### Role and responsibility of the Managing Board

44. Expressing dissatisfaction with the inactive role played by the West Rail Steering Committee (subsequently renamed as the New Railway Projects Steering Committee (NRP Steering Committee) in 1999), Mr Albert CHAN opined that if this Steering Committee had dutifully performed its monitoring role, the Management's late reporting of the Siemens problem might have been detected much earlier. In this respect, he put forth the strong view that members of this Steering Committee should accept responsibility for such serious dereliction of duty. In addition, Mr CHAN observed that except for the stern remarks made by S for Tsy (paragraph 7.5.4 refers), it did not seem that much concern had been raised by other members of the Managing Board when the Siemens incident was discussed by the Board on 19 November and 17 December 2001. As such, he queried whether the severity of the problem were fully appreciated by other members of the Managing Board and whether they had duly performed their role in safeguarding public interest. In particular, Mr LAU Kong-wah enquired about S for T's involvement in these discussions held by the Managing Board.

45. Acknowledging members' concerns about the role and responsibility of the Managing Board and its committees, the Chairman of KCRC said that prior to 2002, the roles of Chairman and Chief Executive of the Corporation were held by the same person. As such, the NRP Steering Committee was likewise chaired by the then Chairman-cum-Chief Executive. This was clearly not desirable from a good corporate governance point of view. For the purpose of strengthening the corporate governance structure of the Corporation as well as the functions of the Managing Board, legislative amendments were introduced by the Administration last year to separate the duties and functions of the Chairman and the Chief Executive of KCRC and he was subsequently appointed by CE to take up the office of non-executive Chairman of KCRC. Since the split of the two positions, he as the Chairman of

Action

KCRC had become the chairman of the NRP Steering Committee. He would take the lead in ensuring that the NRP Steering Committee would, as recommended in the Report, take on an enhanced monitoring role. More regular meetings would also be held. As such, he was confident that the same problem would not happen again in future.

46. The Chairman of KCRC also assured members that the dedication and commitment of his Board members were beyond question. He firmly believed that under his chairmanship, the Managing Board would ably perform its monitoring role in all future project works. In this respect, he would also take up E&Y's recommendation about appointing one or two non-executive directors with specific knowledge and experience of major projects with the Administration.

47. As regards the discussions held by the Managing Board, Mr Clive SAUNDERSON invited members to note that by the time the relevant information paper was discussed on 19 November 2001, both S for T and S for Tsy had left the meeting due to other commitments (paragraph 7.4.7 refers). He also confirmed that the relevant paragraphs in the Report had reflected the complete discussion that was held at the meeting on 17 December 2001. In this connection, S for T (Ag.) drew members' attention to the fact that the SA with Siemens was finally approved by the Managing Board on 17 December 2001 after long and thorough discussions. At that time, the then S for T noted that the approvals from the Board were given extremely reluctantly.

**III Any other business**

48. Members agreed that another meeting would be held on Wednesday, 22 May 2002, at 8:00 am to continue discussion with the Administration and KCRC.

49. There being no other business, the meeting ended at 1:00 pm.

Legislative Council Secretariat

28 October 2002

Statement by Sir John Swaine,  
Member of the Steering Committee  
On 16 May 2002

Please be advised that we, the members of the Investigation Steering Committee, do hereby certify that in our considered opinion the auditors, Messrs Ernst & Young, have submitted a report in accordance with the terms of reference agreed to between the auditors and the Corporation.

2. We further confirm that we, in accordance with our terms of reference, have reviewed the content of the report and satisfied ourselves that the report is a thorough and fair review of all relevant aspects of contract DB-1500 and the supplemental agreements entered into in respect of contracts DB-1500, CC-213 and CC-404.

3. We note that there are a certain number of references in the auditors report which have been deleted in the report to be provided by the Corporation to the Government. We are satisfied that these deletions are necessary and appropriate having regard to the Corporation's legal obligations to each of the contractors and third parties who have been referred to in the report and that those relating to liquidated damages are appropriate having regard to the commercial sensitivity of the information contained therein, which if disclosed would prejudice the Corporation's ability to act in a prudently commercial manner.

4. Having reviewed the auditor's recommendations, we are satisfied that they are appropriate and recommend to the Corporation that it takes such steps as are necessary in order to implement the same.

- End -



Statement by Mr Michael Tien, KCRC Chairman

16 May 2002

Ernst & Young have completed their investigation into KCRC's tender evaluation and contractual performance monitoring systems in respect of the Siemens telecommunications contract and two other West Rail contracts. They submitted their report on 30 April 2002, and the report has been accepted by the Steering Committee and the Managing Board.

2. I would now like to invite Sir John Swaine to say a few words on behalf of the Steering Committee.

3. Before going into details of the report, I should point out that after being the Chairman for more than four months, I have found that the Corporation's senior management is on the whole dedicated and professional. Ernst & Young have by and large come to the same view, concluding that KCRC has developed sound systems and procedures, and a contract philosophy which reflects current international best practice in contract management and dispute resolution.

4. The investigation focused on a number of issues and I will highlight some of them:

5. For the Siemens contract, Ernst & Young pointed out that KCRC management was very concerned about the impact that any delay on this contract would have on the timely completion of West Rail, and the financial impact on a number of other West Rail contracts. Management was also concerned that, even if it had been possible to replace Siemens, there would have been significant time and cost implications. The investigation concluded that the decision to negotiate a supplemental agreement with Siemens was the correct one in the circumstances.

6. As for the other supplemental agreements, Ernst & Young point out that the use of such agreements is favoured by recent industry reports, and is commonly used in many countries including the USA and the UK. The Ernst & Young team concluded that it was almost inevitable that a large number of supplemental agreements would need to be negotiated with

contractors, but it did not mean that the existence of such agreements represented higher overall costs to KCRC.

7. The Ernst & Young team also concluded that the systems and procedures developed by KCRC for contract procurement and monitoring compare favourably with industry norms and best practices. But this does not mean that the Corporation has been given a completely clean bill of health.

8. For the Siemens contract, Ernst & Young emphasised that the first time KCRC's Managing Board was advised of the severity of the problem was when it was informed of the negotiation plan for the proposed supplemental agreement, when it was already too late to consider any alternative course of action. For this late reporting of the problem, our CEO had already apologised twice on behalf of the management team --once when the negotiation outcome was discussed by the Managing Board in December last year, and again when the Board met recently to discuss this investigation report. Management has pledged that these reporting procedures will be improved.

9. The Ernst & Young team also discovered that different criteria were used for two sets of internal reports monitoring progress of various contracts. Because of the different criteria used, the internal reports which went to the Managing Board did not indicate the serious delays in the Siemens contract. This is clearly not acceptable and Management has taken immediate steps to ensure that the same criteria are used for all reports from now on.

10. The Managing Board has expressed displeasure in the late reporting by management. It acknowledged the problems which could arise from extremely low bids, and will ensure that in future management will put in place systems which can exert greater control over contractors in respect of contractually binding milestones and key dates, and strengthen the ability to re-enter if necessary. For its part, the Managing Board will exercise a greater degree of vigilance when it examines proposals and reports from management.

11. The Ernst & Young team also noted that the composition of the Managing Board included only one executive director (the CEO) and that it generally met once a month. The team felt that the Board had a heavy

workload because of the size and complexity of the issues which it had to deal with for KCRC as a whole, and that Members should have been given adequate opportunities to assess and discuss specific problems arising from individual West Rail contracts. It suggested that the Government should consider complementing the existing Managing Board's knowledge and experience in contract management by appointing one or two non-executive directors with specific knowledge and experience of major projects. It also suggested that the New Railway Projects Steering Committee, a committee of the Managing Board, should be strengthened to include expert members from outside KCRC, and that the Committee should meet much more regularly. This Committee would provide a forum for summary and exception reports in contract management, and for senior management to present problems on individual contracts with alternative courses of action. It would then be able to consider and recommend to the Managing Board appropriate solutions.

12. Apart from these, Ernst & Young recommended a number of constructive changes to the Corporation's contract monitoring and management procedures. We accept these recommendations and will be taking steps to put them in place.

13. Ladies and gentlemen, before I invite questions, I would like to invite Mr K Y Yeung to speak on behalf of the management team.

Statement by Mr K Y Yeung, Chief Executive Officer

16 May 2002

I speak for the Management team of the Corporation.

2. The Ernst & Young report makes for a comprehensive and fair description and assessment of our corporate governance and the way we manage our capital works programme. I accept it in its entirety.

3. In the case of the three contracts covered in the report, it is clear that our reporting procedures have not been adequate. I also admit that the chain of reporting, from middle management to senior management and from senior management to the Managing Board, was unsatisfactory. For all this I accept responsibility.

4. I am sorry that, as a result of these procedural deficiencies, the Managing Board has not been consulted as fully as it would like or in a timely manner. I am also sorry that this may have played a part in bringing about this investigation.

5. That said, with West Rail substantially completed on time and within budget, there is little cause to question the intrinsic soundness of our contracting strategy or our project management. They have worked well and the report says so.

6. Nevertheless there is always room for improvement. I agree with the Chairman that we will need to beef up the New Railway Projects Steering Committee and possibly extend this to other committees of the Board. For the future monitoring and management of new railway projects, I will seriously consider and put in place the recommendations made by Ernst and Young. I will treat this as a priority task. And I will consult the Managing Board with proposals to change existing procedures and to introduce new ones.

7. I would now like to pass on to Mr Blake and Mr Thoms for any comments they would wish to make.

Statement by Mr James Blake, Senior Director, Capital Projects

16 May 2002

I have listened to my Chairman and my Chief Executive Officer, and accept without hesitation the substance of their remarks.

2. The shortcomings identified by Ernst and Young indicate errors of judgement on my part, and on the part of my colleagues in West Rail Division. We should have brought out to the Managing Board earlier the fact that the contractor's performance was going wrong, and consulted them on various remedial measures. Secondly, specifically in the case of the Siemens contract, I and my West Rail Division colleagues tried very hard to deal with Siemens in achieving delay recovery. We believed that we could solve the problem on our own under the contract, but events have shown that we failed. For this I take responsibility.

3. The result has been that the Managing Board felt that the proposal to enter into negotiations and the proposal to effect a supplemental agreement with Siemens left them with little choice. I admit we could have done better, and I apologise for our errors of judgment.

4. I must emphasise that we were only trying to do our best. Our actions reflect no attempt at concealment or wrongdoing. We genuinely believed, and still believe, that we were acting in the best interests of the Corporation. The report confirms this.

5. I look forward to working more closely with the Managing Board and its committees, in presenting summary and exception reports to members. We will of course also continue to work at resolving problems, as they arise.

6. I shall now pass on to Mr Thoms for any comments he would wish to make.

Statement by Mr Ian Thoms, Director West Rail

16 May 2002

I am in total agreement with the statements made by my Chairman, Chief Executive Officer and Senior Director.

2. As Director, West Rail I take full responsibility for reporting the progress status of all West Rail contracts to the Managing Board. The reporting system has been fully described in the Ernst and Young report. This shows up inconsistencies, which we will take immediate steps to cure.

3. I admit that there was an error of judgement in failing to report the full gravity of the delays in Siemens' performance. For this I bear responsibility. I add my apologies in respect of the timing when the Managing Board was fully informed of the critical nature of the delays to Siemens' contract.

4. West Rail is progressing well. I am pleased to confirm that the DB1500 supplemental agreement and all of the other supplemental agreements have had the desired effect. Siemens' performance is now back on track. Their first key date was achieved on time and I am confident their second key date, due at the end of May, will be achieved.

5. I am also fully confident that the project will be delivered safely, on time, within budget and to the right quality.