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Legislative Council
Panel on Transport

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

**Minutes of meeting on
Wednesday, 22 May, 2002, at 8:00 am
in the Chamber of the Legislative Council Building**

Members present : Hon Miriam LAU Kin-yee, 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 TAM Yiu-chung, GBS, JP
Hon Abraham SHEK Lai-him, JP
Hon Tommy CHEUNG Yu-yan, JP
Hon Albert CHAN Wai-yip
Hon WONG Sing-chi
Hon LAU Ping-cheung

Non-Subcommittee : Hon Eric LI Ka-cheung, JP
members attending : Hon Howard YOUNG, JP

Member absent : Hon LEUNG Fu-wah, MH, JP

Public officers : **Agenda item I**
attending : 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

Ernst and Young

Mr Anthony WU
Chairman, Ernst and Young

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 Investigation Report on Kowloon-Canton Railway Corporation West Rail Contracts

- (LC Paper No. CB(1)1747/01-02(01) - Information note provided by the Administration 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 of the Report on the Review of Payments to Contractors for the West Rail Project)

The Chairman welcomed representatives of KCRC and the Administration to the meeting to continue discussion with members on Ernst & Young (E&Y)’s Report on the Review of Payments to Contractors for the West Rail Project (the Report).

Responsibility of senior management personnel of KCRC and the Government

2. Mr Albert CHAN said that the public generally did not accept that a mere gesture of apology from the responsible senior management personnel would suffice. Hence, he reiterated his call for Mr K Y YEUNG, the Chief Executive Officer of KCRC (CEO of KCRC), Mr James BLAKE, Senior Director, Capital Projects of KCRC (SD/CP, KCRC) and Mr Ian THOMS, Director, West Rail of KCRC (D/WR, KCRC) to consider donating part of their salary to the Community Chest of Hong Kong (Community Chest) to show their sincerity in accepting responsibility for the matter.

3. In reply, Mr Michael TIEN, the Chairman of KCRC, said that the responsible staff had already acknowledged their responsibility in the matter. Accepting the sincere apologies they had expressed, the Managing Board considered that appropriate actions had already been taken in this case.

4. In reply to Mr Albert CHAN, CEO of KCRC said that as a socially responsible corporation, KCRC had always been an ardent supporter of the Community Chest. As a member of the Board of the Community Chest, he was also personally involved in the charitable work of the Community Chest. Notwithstanding, he did not agree that he should make any donations to the Chest as a form of punishment.

5. SD/CP, KCRC said that while he fully accepted the sentiments reflected by Mr Albert CHAN, he considered it unreasonable to link his commitment to the Community Chest, which was given voluntarily, to a particular contractual incident, particularly in the light of the E&Y report. However, he pledged that he would continue to support the Community Chest for as long as he was in Hong Kong.

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6. D/WR, KCRC also said that he did not consider the member's suggestion appropriate in the circumstances. While stating his support for the Community Chest, he did not believe that it should be related to the present incident.

7. Mr Albert CHAN however cited a case he recently came across in which the Corporation had refused to renew the contract of a middle rank staff because the growth in patronage of and income from East Rail was lower than expected. He considered it highly unfair that the Corporation could refuse to take appropriate actions against those senior management personnel who had committed serious wrongdoing in the Siemens incident while taking such a severe action against a lower rank staff for something which was clearly out of his/her control. Comparing these two cases, he did not consider that a consistent policy had been applied by the Corporation in handling the mistakes committed by its staff.

8. In response, the Chairman of KCRC said that he did not know about the details of the case referred to by the member. However, he stressed that the same standard had always been consistently applied by the Corporation in handling staff matters. The Chairman advised that this specific case could be pursued in another forum.

9. In reply to Mr Abraham SHEK, the Acting Secretary for Transport (S for T(Ag)) explained that while there was Government's representation on the Managing Board and a co-ordination committee had been formed by the Government to monitor the progress of the West Rail (WR) project, the management and monitoring of individual contracts fell under KCRC's responsibility and the Administration would not interfere in the day-to-day operation of the Corporation.

Areas of improvement

KCRC contract strategy

10. Mr Albert CHAN restated his dissatisfaction that instead of holding Siemens to shoulder the responsibility for its own mistake, the Corporation had resorted to commercial settlement to resolve the matter. By yielding to the defaulting contractor's unreasonable demands, the Corporation had set a very bad precedent. Apart from sacrificing the spirit of contracts, the incident would also have far-reaching consequences on the tendering system in Hong Kong. Given the Corporation's intention to complete the WR project on schedule at all costs, it might prompt other contractors to make use of the loophole to bid for contracts at low price, and then deploy the same delaying tactic in the hope of getting extra payment for delay recovery measures.

11. In response, the Chairman of KCRC stated that while the Corporation would learn its lessons from the incident, it would adhere to the established contract strategy which was in line with current international best practice in contract management and dispute resolution. The Corporation would continue to work in partnership with its contractors as far as possible on the basis of mutual co-operation, and this approach to

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date had generally worked quite well. Should any disputes arise in future, the Corporation would still enter into supplemental agreements (SAs) where warranted to encourage early and effective settlement. In parallel, various recommendations made by the Report in respect of the Corporation's systems and procedures for contract procurement, monitoring and management would be taken forward. He was confident that with these enhancements, the same problem would not happen again in future. Ir Dr Raymond HO also said that as long as there were good reasons, he would accept the use of SAs for dispute resolution which was in fact a common industry practice.

12. S for T (Ag) stated that looking forward, the Corporation would need to ensure that proper procedures were put in place to guard against the increased risks from exceptionally low bids. In addition, the Corporation would need to be more vigilant in monitoring progress against pre-set milestones.

13. In this respect, Mr Albert CHAN cautioned the Administration and the Corporation not to over-react when faced with exceptionally low bids. Instead of rejecting such bids outright, the Administration and the Corporation should cautiously assess and balance their risks and financial benefits before making a decision. In response, the Chairman of KCRC assured members that the Corporation had a statutory obligation to operate according to prudent commercial principles. Against that principle, all tenders received by the Corporation would be fairly assessed against the criteria set out clearly in the tendering documents.

Contract preparation, tender assessment, and contract management and monitoring

14. Referring to paragraphs 12.3.1 to 12.3.8 of the Report, Mr CHENG Kar-foo referred to E&Y's observation that restrictive conditions laid down in the tender documents had effectively limited the number of conforming tenders for contract DB-1500. He thus asked about the measures to be taken by the Corporation to rectify the situation. In reply, the Chairman of KCRC said that the Corporation noted E&Y's suggestion that conditions such as experience of installing a similar system could have been specified in the tender documents as an advantage rather than as a mandatory requirement. In drafting tender documents, the Corporation would take care to ensure that such requirements were not set out in too restrictive a manner thereby limiting unduly the number of possible tenderers.

15. Ir Dr Raymond HO said that to enter into a SA at that time was considered acceptable in order that completion date for WR would not be affected. He highlighted the following areas where improvements were needed for the Corporation to consider:

- (a) Given that there were only two conforming tenders and their substantial price difference, it would be quite difficult to say for certain whether the contract should be awarded to Siemens as the Corporation had to abide by the relevant requirements of the World Trade Organization

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Agreement on Government Procurement. Notwithstanding the need to ensure integration, contracts for multiple systems should be broken down as far as possible to encourage more tenders. For this type of contracts, the Corporation should also carry out more thorough technical assessment on the tenderers before tender award.

- (b) The Corporation should review the terms and conditions of its contracts, particularly in respect of the requirements of milestones and key dates as well as the Corporation's right to re-enter in case of the contractor's under-performance. Moreover, separate and different milestones and key dates should be established for each system under the contract.
- (c) 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 to a crisis which threatened the whole WR project.
- (d) While the management of the WR project was generally of a high standard and reflected current industry norms and practices, the Corporation should develop separate systems and procedures for monitoring the progress of telecommunications as well as electrical and mechanical contracts, as against civil works contracts. In this respect, the Corporation would also need to strengthen its monitoring on the performance of the subcontractors, for example by requiring the main contractor to notify the Corporation early on the choice of subcontractors.

16. In response, SD/CP, KCRC said that Ir Dr HO's remarks were accepted. He also assured members that the lessons from the Siemens incident, particularly as regards the bundling of related subsystems under a single contract, would be taken into account. The Corporation was also reviewing its specifications and procedures in contract management and monitoring as well as dispute resolution so as to achieve best practice throughout. As regards Ir Dr HO's suggestion on separating the civil works from electrical and mechanical works, he said the matter would be reviewed on a case-by-case basis in the light of experience gained in this incident. When pursuing further improvements, he would welcome any advice from outside experts.

17. In particular, CEO of KCRC reported that during the course of implementing its new railway projects in recent years, the Corporation had started to build up a core group of professionals armed with all the necessary expertise and experience in each and every aspect of the design and construction of new railway projects.

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The Managing Board

18. Notwithstanding the late reporting by the Management, Mr LAU Chin-shek was concerned about the inactive role taken by the Managing Board in monitoring the Siemens contract. If the Managing Board could adopt a more pro-active approach, the Siemens problem and the Management's late reporting might have been detected earlier. In this respect, he enquired about the Administration's timetable for reviewing the composition and operation of the Managing Board. Furthermore, he asked whether the Corporation would consider freezing its fares so as to acknowledge the Managing Board's responsibility in this matter.

19. In order to enhance the monitoring role of the Managing Board, Ir Dr Raymond HO pointed out that when deciding on the appointment of Board members, the Administration should consider whether the candidates could afford the time and energy to fulfil the required duties while acting on a part-time basis. Expressing similar concerns, Mr Abraham SHEK also said that it was high time for the Managing Board to usher in a more pro-active culture and exercise a greater degree of vigilance when examining the proposals and reports from the Management.

20. In response, the Chairman of KCRC said that the determination of train fares was a separate issue. In fact, it was quite evident from the Report that during the two occasions when the Siemens problem was discussed, members of the Managing Board had raised strong opinions about this matter. Moreover, it was only after long and thorough discussions that the SA with Siemens was finally approved by the Managing Board on 17 December 2001.

21. S for T(Ag) said that in the Administration's view, the Managing Board had done all that it could under the circumstances. Likewise, E&Y's review had not found anything wrong with the way the matter was handled by the Managing Board. In general, he said that most members of the KCRC Managing Board were part-time non-executive members with different professional background and experience. When overseeing the operation of the Corporation, they would have to rely on the reports and recommendations made by the Management which had been delegated with the responsibility of the day-to-day management of the Corporation. As indicated in E&Y's review, the crux of the problem was the late reporting by the Management. In this respect, the Corporation would make further improvements as recommended by E&Y in the reporting process, both in terms of format and timeliness.

22. CEO of KCRC remarked that he did not agree that the Managing Board's role was inactive. KCRC's Managing Board had often performed its monitoring role by exception, i.e. they would receive reports and proposals from the Management. CEO of KCRC further said that as the head of the Management, he had instituted many reforms over the past few years with the support of the Managing Board, including the publication of a series of manuals and codes of practice to formalize the systems and procedures for the Corporation's operation. The role and functions of the Chairman,

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the Managing Board and CEO of KCRC were clearly stipulated in the Corporate Governance Manual. He stressed that while there were powers that should be exercised by the Managing Board as the highest authority of KCRC, the day-to-day management was delegated to the Management. Where appropriate, the Management would seek the Managing Board's approval on major decisions, in particular when such decisions involved the spending of sums in excess of \$50 million. For a major project like WR, almost all the contracts would require the approval of the Managing Board. As such, he believed that a balanced relationship had been achieved between the Managing Board and the Management.

23. Responding to members' comments about strengthening the corporate governance structure of the Corporation as well as the functions of the Managing Board, the Chairman of KCRC said that the Administration had taken an important step last year to separate the duties and functions of the Chairman and the Chief Executive of KCRC. The split could allow the non-executive Chairman of KCRC to look at the papers presented by the Management from an independent and impartial point of view. He also stated that since taking up the office of Chairman of the Corporation, he had been concentrating on strengthening the role and functions of the committees formed under the Managing Board. Various improvements in relation to the operation of the New Railway Projects Steering Committee had been approved by the Managing Board. As such, he assured members that this Committee as well as other committees of the Managing Board could take on a more pro-active role in monitoring the Corporation's affairs. He believed that hopefully by early next year, the Corporation would implement all the recommendations made by E&Y and the membership of the Committees of the Managing Board would be enlarged. The same problem as revealed in the Siemens incident would not happen again in future.

24. Regarding the composition of the Managing Board, S for T(Ag) advised that by the appointment of non-executive members to the Managing Board, the Corporation could benefit from their expertise and knowledge in various fields as well as their impartial and independent judgement. When 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.

The Management

25. Mr LAU Kong-wah opined that in the Siemens incident, mistakes had been made by CEO of KCRC as the then Chairman-cum-Chief Executive of the Corporation in respect of under-estimating the impact of awarding such an important contract to an exceptionally low bidder, late reporting of the Siemens problem to the Managing Board and failing to closely supervise his subordinates' work in contract management. He was concerned about the measures that could be taken by the Corporation to prevent those mistakes from happening again in other railway projects including the Ma On Shan Rail Link and the Lok Ma Chau Spur Line.

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26. Mr Abraham SHEK remarked that due recognition should be given to the efforts made by CEO of KCRC together with his management team and other KCRC staff in taking forward the massive WR project while maintaining the normal operation of the existing railway lines. Given the paramount importance of achieving the scheduled opening of WR, he considered that the Management was correct in suggesting to the Managing Board that the Corporation should seek to negotiate and enter into SA with Siemens so that the damage created by it could be contained, which was also in accordance with good construction practice. From the point of view of safeguarding public interest, he would accept the Management's decision.

27. In response, CEO of KCRC pledged that he would try his best to ensure that similar problems would not happen again. For areas where enhancements were required, the Management would take steps to implement the recommendations set out in the Report, particularly in respect of improving the systems for monitoring progress of various contracts and the reporting procedures to the Managing Board.

The Corporation's relationship with Siemens

28. Given Siemens' fault in contract DB-1500, Mr LAU Kong-wah expressed concern about the Corporation's decision to award another East Rail Extension (ERE) contract to Siemens while negotiations with Siemens were still on-going. He was particularly dissatisfied that instead of being punished for its mistakes, Siemens was "awarded" with another contract from the Corporation. In this respect, he asked whether the Corporation would consider taking appropriate actions against Siemens in future. Mr CHENG Kar-foo also remarked that a company's track record should be an important consideration when deciding the award of contracts.

29. Mr Howard YOUNG opined that it would be most important to ensure the fair and equitable use of technical weighting in tender assessment and evaluation. In this respect, he enquired about the importance of a contractor's track record with the Corporation and the Government in relation to its chance of success in bidding for the Corporation's projects.

30. While confirming that an ERE contract had indeed been awarded to Siemens when negotiations were taking place between both sides on contract DB-1500, the Chairman of KCRC said that as explained earlier, there were times during the process when the Corporation and Siemens were able to come to certain understanding on the actions that would be taken by the latter to make up for the delay in contract DB-1500. It was only when Siemens' promises and undertakings failed to materialize that the Corporation had to negotiate a commercial settlement with Siemens by an SA. He reported that subsequently, Siemens had recovered the delay and the contract was progressing on course. Siemens was also able to perform in other KCRC contracts. Noting members' concerns, he said that a contractor's track record with the Corporation and the Government would be one of the factors to be taken into account during tender evaluation.

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Need for further investigations

31. From the point of view of operating according to prudent commercial principles, Mr Tommy CHEUNG concurred with E&Y's finding that commercial settlement with Siemens might be in the best interests of KCRC because the progress of contract DB-1500 was able to be brought back on track. If the Corporation had terminated the contract with Siemens, the scheduled opening of WR would be delayed inevitably and it would not be fair to all those residents living in New Territories West. As a thorough review had been conducted by E&Y, he did not see the need for re-opening investigation into the incident by a select committee formed under LegCo. Instead, the Corporation should be given the time and space to consolidate the lessons learnt from this incident and concentrate its efforts on taking forward the WR project as well as the improvements recommended in the Report.

32. Mr Howard YOUNG shared Mr CHEUNG's view and remarked that as Siemens was an overseas company, he doubted whether the investigation of a select committee of LegCo could cover its business and activities. In that case, further investigation by a select committee might not reveal much more than E&Y's review. Mr TAM Yiu-chung also did not agree that a select committee should be formed by LegCo to further investigate into the Siemens incident. Instead, he called on the Corporation to learn from this incident and concentrate its efforts on providing a better, cheaper and more efficient service to the travelling public. Mr Abraham SHEK also did not agree to the suggestion. He considered that a thorough investigation had been conducted by E&Y who had accurately identified the true causes of the incident.

Motions

33. Mr CHENG Kar-foo reiterated that suitable sanctions should be imposed against the responsible senior management personnel. As such, he opined that the Subcommittee should condemn the Corporation for failing to do so. Looking forward, he considered that in order to address the issues in relation to the respective role and functions of the Managing Board and the Management, a clear code of best practice similar to the one adopted by the United Kingdom Parliament should be formulated by the Corporation to ensure that the performance of its staff could be properly monitored against any abuse of power or wrongdoing. In this connection, he proposed a motion as follows:

“就九鐵未能對西門子事件的犯錯人士加以懲處，本小組委員會會予以譴責，本小組委員會並促請九鐵儘快訂立明確的工作守則(Code of Practice)，監管員工的工作表現，以防止員工濫權及失誤行為。”

34. The Chairman then invited members to state their position on Mr CHENG's motion.

35. Mr Albert CHAN reiterated that given the substantial amount of financial loss

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incurred by the Corporation in the Siemens incident, it was not acceptable that the responsible senior management personnel could get away with a mere gesture of apology. Hence, he supported the motion.

36. Mr Eric LI remarked that both the Chairman of KCRC and the KCRC Managing Board had done an admirable job in handling the aftermath of the Siemens incident. Hence, he did not agree that the motion should be targeted towards the Corporation and its Managing Board. It would only be appropriate if the object of the motion was Siemens for its non-cooperative attitude throughout the incident or those senior management personnel who had acknowledged their responsibility in this matter. Looking forward, Mr LI did not believe that a code of practice as proposed could help much. Instead, the Corporation should be allowed to concentrate its efforts on taking forward the recommendations made in the Report under the Chairman of KCRC's leadership so that a better and more efficient service could be provided to the public. In this respect, the Corporation should be asked to provide regular updates to this Subcommittee or the Transport Panel.

37. While acknowledging the benefits a code of practice might have in guiding the Corporation's operation, Mr Abraham SHEK did not agree that it should be tied with the Management's responsibility in this matter. In this respect, he remarked that the Administration might however need to consider formulating a code of practice for co-ordinating and monitoring the railway development projects undertaken by the two railway corporations.

38. Ir Dr Raymond HO said that except for contract DB-1500, satisfactory progress had been achieved for the WR project as a whole. 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. It would help if the morale of the staff could be maintained. Hence, he hoped that the Corporation could learn its lessons from the incident and take all necessary steps to ensure that the recommendations made by E&Y in its report were implemented as soon as possible. In this connection, the Corporation should provide regular progress updates to the Transport Panel for follow up. Ir Dr HO thus proposed to amend Mr CHENG's motion as follows: to delete “九鐵未能對” and substitute with “今次”; to delete “事件的犯錯人士加以懲處，本小組委員會予以譴責” and substitute with “合約所取得的教訓”; to delete “並” before “促請”; to delete everything after “儘快” and substitute with “落實安永會計師報告中的建議，並定期向交通事務委員會匯報。” Mr CHENG's motion as amended by Ir Dr HO's proposed amendment would read as follows:

“就今次西門子合約所取得的教訓，本小組委員會促請九鐵儘快落實安永會計師報告中的建議，並定期向交通事務委員會匯報。”

39. The Chairman invited members to speak on Ir Dr HO's amendment.

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40. Mr LAU Ping-cheung considered that in the whole incident, the Corporation was the victim and Siemens the culprit. Hence, he did not agree with Mr CHENG Kar-foo that the Corporation should be condemned. Instead, appropriate actions should be taken against Siemens to achieve a deterrent effect. He thus proposed further amendment to Ir Dr HO's original amendment as follows: to add “並向西門子採取適當之制裁措施，以作警效，” after “報告中的建議”.

41. Mr Eric LI however said that during the course of the Subcommittee's discussion, Siemens had not participated and was not given any chance to state its case. Hence, he did not consider it appropriate for the Subcommittee to consider the amendments proposed by Mr LAU Ping-cheung. His view was shared by Mr Albert CHAN. Mr CHENG Kar-foo also did not agree with Mr LAU that the Corporation had done nothing wrong in the incident.

42. After deliberation, Mr LAU Ping-cheung withdrew his proposed amendment.

43. The Chairman put the amendment moved by Ir Dr Raymond HO to Mr CHENG Kar-foo's motion to vote. Six members including Ir Dr Raymond HO, Mr CHAN Kwok-keung, Mr LAU Kong-wah, Mr Abraham SHEK, Mr Tommy CHEUNG and Mr LAU Ping-cheung voted for. Three members including Mr CHENG Kar-foo, Mr Albert CHAN and Mr WONG Sing-chi voted against. The Chairman declared that Ir Dr Raymond Ho's amendment was carried.

44. The Chairman then put Mr CHENG Kar-foo's motion as amended by Ir Dr Raymond HO to vote. Seven members including Ir Dr Hon Raymond HO, Mr CHAN Kwok-keung, Mr LAU Chin-shek, Mr LAU Kong-wah, Mr Abraham SHEK, Mr Tommy CHEUNG and Mr LAU Ping-cheung voted for. Three members including Mr CHENG Kar-foo, Mr Albert CHAN and Mr WONG Sing-chi voted against. The Chairman declared that Mr CHENG Kar-foo's motion as amended by Ir Dr Raymond HO was carried.

45. Responding to the motion passed by the Subcommittee, the Chairman of KCRC said that he would carefully consider the sentiment reflected in Mr CHENG Kar-foo's proposed motion about the need to further strengthen the corporate governance of the Corporation. In this respect, he would welcome any suggestions from members. He also agreed that updates on the progress of implementing E&Y's recommendations would be provided to members for information.

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II Any other business

46. There being no other business, the meeting ended at 10:00 am.

Council Business Division 1
Legislative Council Secretariat
1 November 2002