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Panel on Transport

Subcommittee on matters relating to the implementation of railway development projects

Minutes of meeting on
Tuesday, 9 July 2002, at 4:30 pm
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 LAU Kong-wah
Hon Andrew CHENG Kar-foo
Hon Tommy CHEUNG Yu-yan, JP
Hon Albert CHAN Wai-yip
Hon LAU Ping-cheung

Members absent : Hon CHAN Kwok-keung
Hon LAU Chin-shek, JP
Hon TAM Yiu-chung, GBS, JP
Hon Abraham SHEK Lai-him, JP
Hon LEUNG Fu-wah, MH, JP
Hon WONG Sing-chi

Non-Subcommittee members attending : Dr Hon David CHU Yu-lin, JP
Hon Emily LAU Wai-hung, JP

Public officers attending : **Agenda item I**

Environment, Transport and Works Bureau

Mr Stephen LAM
Acting Secretary for the Environment, Transport and Works

Mr Paul TANG
Deputy Secretary for the Environment, Transport and Works (Transport and Works)

Financial Services and the Treasury Bureau

Mr Martin GLASS
Deputy Secretary for Financial Services and the Treasury (Treasury)

Highways Department

Mr Matthew HO
Acting Government Engineer/Railway Development

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

Staff in attendance : Ms Alice AU
Senior Assistant Secretary (1)5

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I. Briefing by the Administration on the MTR Penny's Bay Rail Link Project Agreement

(Ref: TBCR 3/5/511/98 - Legislative Council Brief on the MTR Penny's Bay Rail Link Project Agreement provided by the Administration)

The Chairman advised that this special meeting was convened at the request of the Administration to enable them to brief members on the Mass Transit Railway Penny's Bay Rail Link (PBRL) Project Agreement (the Project Agreement).

2. Mr CHENG Kar-foo commended the Administration for briefing the Subcommittee on the Project Agreement before it was made known to the public.

3. The Acting Secretary for the Environment, Transport and Works (SETW (Ag)) thanked members for attending the meeting at such short notice. He said that PBRL was a single-track system, connecting the existing Tung Chung Line at Yam O, and the future Hong Kong Disneyland (HKD) Station. The journey time would be less than 4 minutes with a journey distance of about 3.5 km long. The target completion date of PBRL was set at July 2005 to tie in with the target opening date of HKD in 2005. The estimated capital cost of PBRL was $2 billion. He then briefed members on the Project Agreement approved by the Chief Executive in Council which set out how the

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PBRL project would be undertaken, and the respective obligations of Government and MTR Corporation Limited (MTRCL) for the design, construction, operation and financing of PBRL. In order to bring the project rate of return to a minimum acceptable commercial level, it had been estimated that Government support to fill a funding gap of $798 million was required. In order to close the funding gap, Government had agreed to waive its claim for $798 million worth of dividends otherwise payable by MTRCL to Government as a shareholder over the next few years.

Completion date of PBRL

4. Noting that the Executive Council took note of the Administration's undertaking in 1999 to contract with a railway operator to implement PBRL, Ir Dr Raymond HO queried why it took almost three years for the Administration to finalize the Project Agreement. He was worried that any construction delays might give rise to possible claims against the Government by The Walt Disney Company.

5. In response, SETW (Ag) explained that soon after the Government entered into an agreement with The Walt Disney Company on the development of HKD, the Administration had started to implement the necessary infrastructure and government, institution and community facilities to support its development. The Administration also discussed with MTRCL on how to take forward the PBRL project. He advised that PBRL was now planned for completion in July 2005 to tie in with the target opening date of HKD in October 2005.

6. The Deputy Secretary for the Environment, Transport and Works (Transport and Works) (DS/ETW(T&W)) further explained that it took time for the Administration to complete the statutory requirements under the Railways Ordinance (Cap. 519) and negotiate with MTRCL over the design and financing arrangement for PBRL before the Project Agreement could be finalized. On possible claims by The Walt Disney Company against Government for construction delays of PBRL, he said that in accordance with the agreement signed between Government and The Walt Disney Company, adequate transport services should be provided to serve HKD. In case MTRCL could not complete PBRL in time, it had to provide alternative feeder services to HKD. SETW (Ag) added that The Walt Disney Company was aware of the said arrangement agreed between the Government and MTRCL.

The PBRL railway system

7. Ir Dr Raymond HO enquired about the basis for adopting a single-track railway system, bearing in mind that it had never been used in Hong Kong. He was concerned about the compatibility of different systems which would restrict the interconnection of different railway lines in the end. He enquired about the Government policy in this regard and sought information on how the estimated capital cost of $2 billion was derived at. Mr Albert CHAN also remarked that in view of the small size of Hong Kong, it was doubtful as to whether it was necessary and

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appropriate to introduce different types of railway systems into Hong Kong. He therefore cast doubt on the cost-effectiveness of the proposed single-track railway system.

8. DS/ETW(T&W) advised that having regard to the projected patronage and the uniqueness of PBRL, MTRCL considered that a single-track railway system would be the most cost-effective option for implementation. He said that with the deployment of a four-car train, the design flow would be up to 10 000 passengers per hour per direction. Unlike other heavy railway systems in urban areas, the present system was designed to cater for the demand generated by visitors to HKD.

9. Mr David CHU also queried the cost-effectiveness of PBRL. He pointed out that as PBRL was a unique system, necessitating the provision of a designated depot and the engagement of a specialized team to service the railway system, it would be more cost-effective to provide alternative bus service to cater for the demand generated by HKD. A railway system was also not flexible as demand during weekdays and rainy days would not be great.

10. SETW (Ag) said that a railway system was proposed after careful examination. It was also in line with the arrangement for other theme parks in the world such as Paris or Tokyo Disneyland. Whilst the PBRL project per se might not be very attractive, it could bring added value to the overall economy and enhance the growth of tourism in Hong Kong. As such, it was considered a valuable investment to Hong Kong.

11. Mr David CHU was not convinced of the Administration's reply. He said that in terms of cost, the procurement of Cadillac limousine for the purpose might be less than that of the railway. Mr CHENG Kar-foo however said that the Democratic Party supported in principle the provision of a railway line to HKD.

12. DS/ETW(T&W) advised that without PBRL, it would require a large fleet of buses to serve HKD from different parts of the territory. The additional traffic would have implications on North Lantau Highway and Tsing Ma Bridge.

13. The Acting Government Engineer/Railway Development clarified that PBRL and Tung Chung Line were using the same type of train. As such, no additional depot would be required for PBRL.

Financing arrangements

14. Mr Albert CHAN remarked that the granting of the development right for PBRL to MTRCL without going through a public tender might not be in the best interest of the general public. Worse still, the Administration now proposed to waive its claims for $798 million worth of dividends that it could otherwise expect to receive as a shareholder from MTRCL from time to time during the next few years. Taking all these into consideration, the Administration's proposal was considered too generous

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and looked like a bonus granted to MTRCL to compensate for its loss in not getting the development right for the Shatin to Central Link.

15. Mr LAU Kong-wah opined that in view of the huge budget deficit, it would be quite generous for Government to waive its claim for $798 million worth of dividends that it could receive from MTRCL. He enquired about how this sum of monies was derived at and queried the basis for pitching the project rate of return at 11.25%. He also sought information on whether the induced fare revenue on other MTR lines as a result of the implementation of PBRL had been taken into account when arriving at the present proposal.

16. Mr CHENG kar-foo shared the view of Mr LAU. He added that as MTRCL, a listed company, was making a profit whilst Government was facing a budget deficit, the proposed waiver option might not be in the best interest of the general public.

17. Mr Tommy CHEUNG said that in the absence of projected capital cost and patronage, it would be difficult to judge whether PBRL was financially not viable. He also cast doubt on the rationale for the Government to waive its claim for $798 million worth of dividends that it could receive from MTRCL, bearing in mind MTRCL was no longer a Government wholly-owned corporation. Citing the reduction of the construction costs of the MTR Tseung Kwan O Extension from the original estimates of $30.5 billion to $18 billion, he also enquired whether the amount of waived dividend would be reduced if the capital cost of PBRL fell short of $2 billion in the end.

18. SETW (Ag) advised that PBRL was an essential element of the associated infrastructure in support of HKD development which would provide an efficient and environmentally friendly means of transportation to and from HKD. As PBRL was a natural extension of the Tung Chung Line, it would be more cost-effective for MTRCL to take up the project. A decision was made back in 1999 to grant the development right for PBRL to MTRCL. The present proposal had nothing to do with the tender result of the Shatin to Central Link.

19. SETW (Ag) further said that over the years, Government had been in full support of the infrastructural development in Hong Kong. It also took various initiatives to promote tourism development. The waived dividend was indeed a kind of investment in Hong Kong and would bring substantial economic benefits to Hong Kong.

20. On the justifications for the proposed financing arrangements, the Deputy Secretary for Financial Services and the Treasury (Treasury) (DS/FS&T(T)) said that when MTRCL was privatized in 2000, the Government undertook in the Initial Public Offering Prospectus for MTR Shares and in its Operating Agreement with MTRCL that the Government would not require the company to construct and operate any future railway project without its agreement. The Government had also recognized that MTRCL would require an appropriate commercial rate of return on its investment

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in any new railway projects, which was considered to be between 1% and 3% above the estimated weighted average cost of capital of the company. For PBRL, all its revenues net of capital and operating expenditures over the franchise period were estimated and then discounted at the minimum rate of return to derive the net present value. Since the net present value was negative $798 million, the Government was required to provide funding support of this amount. The financial support to be provided to MTRCL in the form of waived dividends had been estimated based on a thorough check on MTRCL's assumption including both cost items and patronage. Government's financial advisors also checked MTRCL's financial assumptions and advised that they were reasonable. Indeed, funding support through a dividend waiver was not a cost to the Government but should be treated as retention and enhancement in value of the Government's investment in MTRCL.

21. DS/FS&T(T) confirmed that the additional fare revenue induced by passengers travelling on the MTR system from other parts of Hong Kong to Yam O had already been taken into account when arriving at the funding gap of $798 million. The internal rate of return of 11.25% was calculated over a period of 40 years.

22. DS/FS&T(T) further said that before arriving at the decision to support PBRL through waiving Government's claim to MTRCL dividends, the Administration had considered the option of granting property development rights at Yam O to MTRCL as funding support. However, due to engineering, planning and other land use restrictions, this option was not feasible. Since the funding gap was not solely calculated on the basis of capital cost but the long term operating cost as well, a reduction in capital cost would not significantly affect the amount of waived dividends.

23. DS/ETW(T&W) added that equity injection into MTRCL was considered but it was decided that this would not be useful given that any further equity injection into MTRCL would itself require a return and therefore not improve the project financial viability.

24. In response to Mr LAU Kong-wah's question as to whether MTRCL refused to implement PBRL if Government did not waive its claim for the dividends. SETW(Ag) said that the draft Project Agreement was a result of a lengthy discussion between MTRCL and the Government. Both sides considered that PBRL could be taken forward on the basis of the draft Project Agreement. As Government was the majority shareholder of MTRCL, the present proposal could be seen as a move to support its own investment. For the benefits of the community, it was considered appropriate to proceed with the project on this basis.

Dividend waiver as funding support: Principles

25. Mr CHENG Kar-foo pointed out that he was concerned about the guiding principles behind the choice of dividend waiver as a means of funding support for railway development. As the amount of waived dividend constituted a large part of

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the capital cost for PBRL, he cast doubt on the assessment criteria in applying this option for financing future railway projects. He cautioned that similar request could be put forward by the general public requesting Government's subsidy to lower the fares of railway service. As waived dividend was akin to Government equity, the Administration should not bypass the Legislative Council (LegCo) for funding approval. Rather, it should put forward a funding proposal for members' consideration.

26. SETW (Ag) said that Government was very concerned about the fares of railway service and had made an effort to encourage railway companies to consider measures such as fare reduction or concessions. He trusted the general public would support Government's move to proceed with the project.

27. Regarding the principles for funding support of railway development, DS/ETW(T&W) said that Government would not subsidize the operation of existing railway lines. However for new railways, Government would explore various options of funding support on a case-by-case basis.

28. The Chairman remarked that she was not aware of the application of the dividend waiver option for the implementation of the West Rail and East Rail Extensions projects. DS/FS&T(T) replied that relevant information was contained in the Annual Reports of the Kowloon-Canton Railway Corporation (KCRC) but special briefing had not been given to LegCo. Ir Dr Raymond HO remarked that LegCo was not fully informed of the arrangement. As a result, the Administration could deploy this option to bypass LegCo for funding approval.

29. Mr CHENG Kar-foo requested the Administration to provide information on the guiding principles for applying the dividend waiver option for railway development project. The Chairman also requested the Administration to provide information on the declaration of dividends of the two railway corporations in the past.

(P*ost-meeting note*: The requested information was circulated to members vide LC Paper No. CB(1)2279/01-02(01).)

30. SETW (Ag) replied that both railway corporations were operated in accordance with commercial principles. Government would not inject monies into the corporation so as to suppress railway fares. However, it would ensure the provision of an efficient railway service and maintain healthy competition in the transport sector. The Administration would consider each request for funding support on its own merits. In the present case, granting of property development rights was considered not feasible. For Government equity, the Administration would put forward a funding request to the Finance Committee (FC) for consideration.

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Legal basis of dividend waiver

31. Mr Albert CHAN queried whether the dividend waiver option was legally in order as FC would be deprived of the right to examine expenditure of this kind which was indeed one form of Government equity. He therefore requested the Legal Service Division of the Secretariat to prepare an analysis on the legal basis for providing funding support for PBRL in the form of waived dividends. Members agreed.

> *(Post-meeting note*: The legal opinion was circulated to members vide LC Paper No. LS 133/01-02.)

32. DS/FS&T(T) informed members that under section 39 of the Public Finance Ordinance (Cap. 2), the Government had the power to waive its claim for dividends payable by MTRCL. Similar waiver of dividends had been done in the past in respect of the railway development projects undertaken by KCRC.

> (*Post-meeting note*: The Administration subsequently clarified that the provision they relied on should be section 38(1)(a) of the Public Finance Ordinance instead of section 39 of that Ordinance.)

Indemnity clauses in the Project Agreement

33. Mr LAU Kong-wah said that the Project Agreement was not concluded on equal terms. On one hand, it provided for an increase in the size of the funding gap identified and to be filled by further dividend waiver by up to $5 million per month (at present value) in the event that opening of HKD was more than three months after its target completion date of October 2005, up to a period of 12 months. On the other hand, if MTRCL could not complete PBRL as scheduled, it would not be subject to penalty but was merely required to provide alternative feeder services as appropriate.

34. DS/FS&T(T) explained the rationale behind the inclusion of indemnity clauses in relation to the delay in the opening date of HKD. He said that at present, all works were programmed towards a target completion date of HKD in October 2005. To tie in with this target and to cater for interfaces between government works and PBRL construction works, Government had requested MTRCL to complete PBRL in July 2005. If MTRCL could not complete PBRL in time, they would have to provide temporary bus service to HKD instead. On the other hand, in the unlikely situation that there was a delay in the opening date of HKD, MTRCL would have invested in building a railway which was not fully utilized. Government therefore agreed that for the first three months, MTRCL would bear the cost of that. Thereafter and to a further period of nine months, Government agreed that if HKD was still not opened during that time, Government would allow MTRCL to reduce its losses though further waived dividends. The risk of fixing a target date for completion of HKD beyond October 2006 was considered remote. The indemnity clause would only apply thereafter.

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35. SETW (Ag) added that the crux of the issue was to ensure the provision of an efficient transport system before the opening of HKD. There was no question of Government signing an unequal agreement with MTRCL. As PBRL was solely built for HKD, losses would be incurred by MTRCL if HKD was not opened by the target opening date. On the other hand, there was a need to provide alternative form of transport in case PBRL could not be completed in time. Therefore Government had requested MTRCL to provide feeder bus service, if necessary.

36. Mr LAU was not convinced of the reply and maintained his view that the Project Agreement was not signed on equal terms.

37. Mr Tommy CHEUNG opined that in case the return rate of PBRL was higher than the estimated internal rate of return, he asked if Government could redeem its claim for dividend. Given that the provision of PBRL was not a prerequisite and taking into account the indemnity arising from the delay in the opening of HKD, Mr Tommy CHEUNG opined that there was no case to rush for the completion of PBRL. If the project was not cost-effective, it should not be allowed to proceed. Instead, alternative feeder service to HKD could be provided.

38. SETW(Ag) advised that in order to maintain Hong Kong's status as a premiere city in Asia, Government should aim at providing the best facilities in Hong Kong. With reference to overseas experience, direct rail link had been provided to the Disney theme parks. Taking into account the hourly patronage of PBRL, it would not easily be absorbed by buses. The Administration therefore concluded that the railway should be provided at the first instance to tie in with the opening of HKD.

39. DS/FS&T(T) advised that an indemnity clause in relation to the opening date of HKD was necessary as PBRL was specifically designed to cater for the demand generated by HKD. If HKD could not be completed in time, MTRCL should be compensated for the loss so incurred. The Project Agreement provided for an increase in the size of the funding gap identified and to be filled by further dividend waiver by up to $5 million per month in the event that opening of HKD was more than three months after its target completion date of October 2005, up to a period of 12 months. If HKD could not be completed beyond October 2006, Government would have to give an indemnity to MTRCL in respect of the losses including capital cost of PBRL.

40. Mr Tommy CHEUNG remarked that the first Disneyland at Anaheim was not served by railway. In view of the substantial risk faced by Government in case HKD could not open as scheduled in 2005, there was no reason to rush for the project. The Administration should consider the downside risk in the project.

41. SETW(Ag) advised that The Walt Disney Company was one of the investors of HKD. Government was confident that HKD could be completed in time. The Government's downside risk had been fully considered and Government was satisfied

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that the present arrangement was appropriate. If the performance of PBRL was better than forecast, Government, being the majority shareholder of MTRCL, could also gain return on its investment.

42. DS/ETW(T&W) advised that the projected fare of PBRL from Yam O to the theme park would be below $10.

Economic benefits of HKD

43. Referring to paragraph 13 of the LegCo Brief on the economic benefits associated with the development of HKD, Ir Dr Raymond HO sought clarification on whether the quoted economic benefit of $148 billion over 40 years was still valid.

44. SETW (Ag) advised that when HKD project was presented to LegCo in 1999, the Administration had set out clearly the economic benefits of the theme park, which involved the additional spending of attendees and the value added or income, as well as additional employment that could be derived from such additional spending. The forecast conducted previously was still valid. DS/ETW(T&W) added that the net economic benefits estimated for HKD was worked out on the basis of a 40-year horizon. As such, it was unlikely that the assessment result would change after a few years' time.

Sustainability assessment of PBRL

45. On the sustainability assessment of PBRL, DS/ETW(T&W) confirmed that the Environmental Impact Assessment study for HKD and its associated infrastructure including the construction and operation of PBRL was completed. The sustainability impact assessment report of PBRL was also examined by the Sustainable Development Unit. In response to Ir Dr Raymond HO, the Administration undertook to provide a copy of the sustainability assessment report of PBRL for members' information.

(*Post-meeting note*: The requested information was circulated to members vide LC Paper No. CB(1)2279/01-02(01).)

Competition

46. Members noted that the Project Agreement set out Government's intention with respect to the level of franchised bus services serving HKD and obliged the Government to consult MTRCL before raising the level of bus services. Mr LAU Kong-wah was worried that this might have implication on future provision of bus service to HKD, thereby imposing an obstacle to market entry. In other words, real competition would not exist and passengers' choice would be restricted.

47. DS/ETW(T&W) pointed out that a proper balance would need to be maintained. Given the huge investment of railway development, there was a need to ensure the

optimal use of resources. On the other hand, healthy competition should be maintained to ensure commuters' choice. It was expected that around 35% of HKD visitors would be travelling on PBRL. Regarding the requirement to consult MTRCL before raising the level of bus services, he clarified that this was not a new arrangement. Indeed, upon consultation, the decision power rested with the Administration, taking into account a basket of factors such as passenger demand and impact on traffic flow, etc. There was no question of Government protecting the interest of MTRCL.

48. Members agreed to convene another meeting on 16 July 2002 at 8:30 am to follow up on the matter. SETW (Ag) also undertook to provide further information in relation to the Project Agreement and the funding arrangement of the PBRL project.

(*Post-meeting note*: The requested information was circulated to members vide LC Paper No. CB(1)2279/01-02(01).)

II. Any other business

49. There being no other business, the meeting ended at 6:00 pm.

Council Business Division 1
Legislative Council Secretariat
15 November 2002