

28 February 2002

Mr. Andrew Cheng Ka Fu
Secretariat of Legislative Councilors of
the Democratic Party
Rooms 401-410,
Central Government Offices, West Wing,
11 Ice House Street,
Central,
Hong Kong.

Dear Mr. Cheng,

Enquiries About KCRC Issues

I refer to your fax letter dated 26 February 2002 to Mr. Michael Tien, Chairman of KCRC, on whose behalf I am making this reply. The answers to your questions are enclosed with this letter together with copies of contract DB-1500 General Conditions of Contract and General Specification (English version only).

Yours sincerely,

(David Fleming)
Company Secretary

DF/MJA/cl
Encl.

Question 1

- Q. Concerning the Siemens incident, KCRC appointed KPMG to carry out an investigation, and later appointed a Steering Committee to oversee its work. What is the progress of the Steering Committee's work? When the investigation results are published, what would the Steering Committee do to address the public doubt that KPMG had a conflict of interest?
- A. **At the first meeting of the Steering Committee held on 15 February 2002, Members were fully briefed as to the nature and extent of the Committee's terms of reference. The Committee has agreed with KPMG that it will review the progress of KPMG's investigation on a regular basis, with the first of such reviews taking place on 1 March 2002. Upon completion of the investigation by KPMG, the Committee will review the final report and, in the light of the KPMG's findings and recommendations (if any), recommend either acceptance of the report and its recommendations, or recommend alternative actions to be taken by the KCRC's Managing Board. Any indication that there is a conflict of interest during the course of the investigation, be it apparent or real, shall be addressed immediately with the committee making known its concerns to the Managing Board, together with such recommendations as it deems appropriate.**

Question 2

- Q. According to a document provided by KCRC to LegCo (No. CB(1)1138/01-02(01)), in the final technical evaluation, the second lowest conforming bid is better than Siemens (the former scored satisfactory in 8 items and the latter only in 5 items). Hence, did the tender evaluation panel form their recommendation purely on the basis of price in reaching the decision not to make the award to the second lowest bid? If not, what were the weightings of the technical and financial evaluations?
- A. **The comparison between Siemens and the second lowest tenderer, confirms that both tenderers achieved a pass for every one of the assessment criteria. Having done so there was no requirement for a weighting factor to be applied against the criteria, because the contract award was based upon the lowest tender price. The financial evaluations likewise were not weighted, but simply confirmed that each tenderer had adequate financial strength to undertake the contract.**

Question 3

- Q. In answer to question (a), paragraph 10 stated that the financial evaluation showed the tender prices submitted by the two bidders were considerably lower than KCRC's estimate. Hence, in relation to the 27 supplemental agreements, what were KCRC's pre-estimates of the contract prices.
- A. **The 27 Supplemental Agreements arise from 19 contracts. The KCRC pre-estimate of the contract price versus the tender price for each of the contracts is set out in the table below –**

West Rail Phase I - Supplemental Agreements
Status at 31 January 2002

| No. | Civil/ ROS | Contract No. | Contract Description | Pre-Tender Estimate (\$ million) | Tender Total (\$ million) |
|-----|---------------|-----------------|----------------------------------|--|---------------------------------|
| 1 | Civil | CC-201 | Viaduct-Kam Sheung Rd to TSW | 2,246.63 | 1,212.94 |
| 2 | Civil | CC-202 | Yuen Long and Long Ping Stations | 1,999.22 | 1,761.57 |
| 3 | Civil | CC-203 | Tin Shui Wai Station | 1,185.32 | 1,125.64 |
| 4 | Civil | CC-211 | Viaduct-Tin Shui Wai to Siu Hong | 1,496.79 | 904.46 |
| 5 | Civil | CC-212 | Siu Hong Station | 1,705.88 | 1,385.74 |
| 6 | Civil | CC-213 | Tuen Mun Station | 1,590.74 | 1,352.69 |
| 7 | Civil | CC-300 | Tsuen Wan Station | 2,996.48 | 1,778.79 |
| 8 | Civil | CC-402 | Nam Cheong Station | 3,131.24 | 2,237.81 |
| 9 | Civil | CC-403 | Tunnel-Mei Foo to Nam Cheong | 943.27 | 651.04 |
| 10 | Civil | CC-404 | Mei Foo Station | 1,727.58 | 1,242.87 |
| 11 | Civil | CC-601 | Pat Heung Maintenance Centre | 1,703.56 | 948.35 |
| 12 | Civil | CC-602 | Kam Sheung Road Station | 592.86 | 494.66 |
| 13 | Civil | CC-604 | West Rail Building | 979.96 | 693.00 |
| 14 | Civil | DB-320 | Kwai Tsing Tunnels | 3,150.00 | 1,903.38 |
| 15 | Civil | DB-350 | Tai Lam Tunnels | 2,614.48 | 1,789.79 |
| 16 | ROS | CC-1820 | Permanent Way (North) | 469.44 | 430.61 |
| 17 | ROS | DB-1500 | Telecommunications | 847.57 | 286.76 |
| 18 | ROS | DB-1700 | Platform Screen Doors | 379.19 | 180.76 |
| 19 | ROS | SI-1120 | Escalators | 494.00 | 255.03 |

Question 4

Q. In answer to question (e), paragraph 7 stated that in July 2001 KCRC management held follow-up meetings with ONL and Siemens. The answer made no reference to the progress or outcome of these meetings? Hence, what were the progress and outcome of these meetings?

A. **The outcome of these meetings was an agreed action plan as set out in the table below –**

Visit to ONL Offices (2 – 4 July 2001)

| <u>Action</u> | <u>Date for Completing Action</u> |
|--|--|
| <u>ONL Programme</u> | |
| 1. ONL to prepare fully resourced works programme for DB-1500. | 17 July 2001 |
| <u>ONL Planning & Control</u> | |
| 2. ONL to increase the resources in the area of the Programme Planning and Control. | 31 July 2001 |
| 3. ONL to adopt the KCRC Software Development Monitoring System which would provide a more precise status of software and hardware development on a bi-weekly basis. | 06 July 2001 onwards |
| <u>ONL Technical Issues</u> | |
| 4. ONL to review the amplifier design to be compatible with speaker specification. | 31 July 2001 |
| 5. ONL to air freight the sample PA speakers to Hong Kong. | 06 July 2001 |
| <u>Technical Issues Requiring KCRC Clarification</u> | |
| 6. KCRC to clarify two technical issues on PAS. | 31 July 2001 |
| <u>ONL Software Development Progress</u> | |

| | |
|---|----------------------|
| 7. ONL to expedite the appointment of the software supplier. | 31 July 2001 |
| 8. It was agreed that the ONL and Siemens management team shall meet prior to KCRC teleconference on Mondays to ensure that commercial and technical issues between them were resolved beforehand to expedite the teleconference. | 06 July 2001 onwards |
| 9. ONL to hold software design workshop to resolve all outstanding issues followed by a PA final design workshop. | 17/18 July 2001 |

Visit to Siemens Office (6 July 2001)

| <u>Action</u> | <u>Date for Completing Action</u> |
|---|-----------------------------------|
| <u>Platform-to-train CCTV</u> | |
| 1. KCRC / Siemens to seek approval of frequencies from OFTA. | 20 July 2001 |
| 2. Siemens to obtain a detailed procurement / manufacturing programme from equipment supplier to enable more close monitoring. | 31 July 2001 |
| <u>Siemens Management Issues</u> | |
| 3. Siemens to implement their new organisation for DB-1500 with the new Project Director being given full authority to deliver the project on time. | 20 July 2001 |
| 4. Siemens to improve their communication lines with their subcontractors as evidence showed during the ONL visit that numerous correspondence took months to reach the relevant party. | 06 July 2001 onwards |

| | |
|--|----------------------|
| 5. Siemens to obtain detailed resourced programmes from their subcontractors. | 20 July 2001 |
| 6. Siemens to ensure that technical matters are separated from the commercial matters, such that progress is not affected by protracted discussions related to resolution of commercial matters. | 06 July 2001 onwards |

Question 5

- Q. In answers to (g) and (f), the document mentioned that in negotiations with Siemens, the then KCRC Chairman raised the ceiling to \$100 million, the payment offer that the negotiating team could make. Where did the Chairman derive his power in relation to compensation payment from? Would the Managing Board's endorsement of such payment be required after the settlement had been reached. What was the payment timetable in respect of the \$100 million sum.
- A. **The composition of the KCRC's negotiating team, and a settlement limit of \$98 million for the negotiations, was endorsed by the Corporate Tender Board (CTB) and made known to the KCRC Managing Board (MB) before the start of negotiations. The MB and Siemens were both aware that, if agreement was reached during the negotiations, it would be subject to approval by the MB which retained the right of refusal.**

The negotiations reached an impasse, with Siemens having agreed to be bound by the conditions set by KCRC for settlement, but still holding out for an amount close to but beyond the negotiating team's limit. The Chairman (of CTB and KCRC) instructed the negotiating team to inform Siemens that, if settlement was not reached at a figure of \$100 million, which amount would still be subject to approval by the KCRC MB, the negotiations should cease. Siemens then settled at \$100 million.

Against the \$100 million, Siemens received payment of \$40 million in January 2002, and is due to receive further payments in February, April, July and September of 2002. Payment will be made only if specified actions relating to the passenger address system, the passenger information display system, and the CCTV system are achieved by dates set down in the Supplemental Agreement.

Question 6

- Q. Apart from West Rail supplemental agreements, are there any other supplemental agreements in relation to other railway projects? If yes, please provide a list of those contracts, contract sums and compensation amounts?
- A. **The entering into supplemental agreements with contractors is a normal activity within approved contract administration procedures. As we have pointed out in our earlier submissions to the Legislative Council, reasons for supplemental agreements include unforeseen ground and other conditions (contractor's entitlement under the contract conditions), programme protection measures (where contractors are entitled to extensions of time under the contract and additional resources are employed to protect the original programme), and remeasurement (where final measured quantities differ from those in the contract).**

Apart from the 27 supplemental agreements entered into by West Rail, there are to date no other supplemental agreements in respect of other railway projects, including the East Rail Extensions. There might be other claims and variations in future. These will be assessed on a case-by-case basis. We are, however, confident that the total project budget of \$46.4 billion will not be breached.

Question 7

- Q. Even though the KCRC documents give an account to the Siemens contracts. Copies of those contracts and supplemental agreements have not been provided (including the terms to work out the liquidated damages). Please provide copies of those documents?
- A. **As with all West Rail, Phase I, contracts, the Siemens contract contains confidentiality provisions.**

Clause 29.3 of the General Conditions of Contract states –

“The Employer and any third party referred to in Clause 4.3 may use any information provided by the Contractor in accordance with the Contract, but the Employer shall not, and the Employer shall use reasonable endeavours to procure that any third party referred to in Clause 4.3 shall not, divulge that information except for any purpose connected with the Project.” [Note: Clause 4.3 refers to the assignment provisions.]

Clause 8.1 of the Supplemental Agreement states –

“Without prejudice to the generality of Clause 29 of the General Conditions of Contract, the existence and contents of this Supplemental Agreement are confidential and shall not be disclosed save in accordance with the provisions of Clause 29.”

Save and except for the General Conditions of Contract and the General Specification which are generic in nature, the contract documents contain information provided by the Contractor which is commercially sensitive and subject to the confidentiality provisions referred to above. For this reason, copies of the contract documents and Supplemental Agreement cannot be provided other than copies of the General Conditions of Contract and General Specification, which are provided under cover of this response.

Question 8

- Q. In light of the award of a number of construction contracts and property development rights to a consortium by single source tendering, would KCRC consider stop awarding contracts by this method so that there will be open and fair competition by those who are interested in bidding for such construction contracts and development rights.
- A. **KCRC, as a Government-owned corporation, is an entity under (i.e. it is bound by) the World Trade Organisation's Agreement on Government Procurement (WTO-GPA). KCRC's own Procurement Rules must therefore conform with the provisions of the WTO-GPA.**

Both the WTO-GPA and the Corporation's Procurement Rules make it clear that KCRC should seek to procure goods, construction and services as far as possible through open competitive tendering.

Circumstances demanding single source tendering should, as far as possible, be avoided, and single source tendering may only be adopted when circumstances do not permit competitive tendering. Some examples of such circumstances are given below –

- (a) **where there is extreme urgency brought about by unforeseeable events, and where the delay that would arise as a result of open tendering or restricted tendering would seriously harm KCRC's interests;**
- (b) **where, for the protection of copyright or other technical reasons, the products and services can only be supplied by a particular supplier, and where no reasonable alternative or substitute exists;**(c) **where, following open tendering, no conforming tender has been forthcoming;**
- (c) **where equipment, products or services to be purchased must be compatible with existing equipment or interchangeable with existing equipment or services;**
- (d) **where it can be demonstrated that patent or proprietary items are the only items which can meet the KCRC's specifications;**
- (e) **where the required services can only be provided by the utility companies or Government Departments;**

- (f) where maintenance is to be executed on patent or specialized equipment, and where the warranty of the equipment gives the supplier of the equipment the exclusive right to carry out the maintenance service;**
- (g) where lease terms require that work must be executed by a particular firm.**

It follows from this that competitive tendering is normally used. In the KCRC, the authority to approve single source tendering is the KCRC's CEO acting on the advice of Directors and the Corporate Tender Board. Equally, the methods to be used in evaluating the single tender, and of entering into negotiations with the potential single supplier, have to be approved at each stage by Directors or the Corporate Tender Board. Given that the value of most major capital projects exceed the limit of powers delegated to the CEO by the KCRC's Managing Board, the final outcome of the negotiations are almost invariably reported to the Managing Board for it to decide whether or not the negotiated contract –

- (a) falls within the circumstances which would justify procurement by single source tendering; and**
- (b) represents value for money.**

If the Managing Board is satisfied on both counts, the contract is awarded accordingly and KCRC would routinely publish the details of such contracts in the Government Gazette in accordance with Article XVIII of the WTO-GPA.