

Legislative Council Panel on Transport
**Subcommittee on matters relating to the
implementation of railway development projects**
MTR Penny's Bay Rail Link – Project Agreement

INTRODUCTION

At the special meeting of this subcommittee held on 16 July 2002, we undertook to provide a written response to the analysis prepared by the Legal Service Division of the Legislative Council Secretariat relating to the waiving of dividend from Mass Transit Railway Corporation Limited (MTRCL) to provide funding support for the Penny's Bay Rail Link (PBRL) project. This paper further elaborates on Government's position.

LEGAL BASIS OF DIVIDEND WAIVER

2. As we said at the last meeting, the dividend waiver option is entirely lawful. Nevertheless, arising from the concerns expressed by Members, we have further consulted the Department of Justice and sought the views of an outside Senior Counsel. We maintain that there is sound legal basis for the option. The explanation is set out at Annex.

WAIVER OF DIVIDEND FROM KCRC

3. The Legal Service Division of the Legislative Council Secretariat suggested Members to seek explanation on whether waiving dividends from KCRC in the past is in line with Section 14 of the Kowloon-Canton Railway Ordinance (Cap. 372) and whether the present dividend waiver for PBRL is a departure from what has been stated in the letter issued by the then Secretary for the Treasury on 16 May 2002. We wish to clarify that according to Section 14(2) of Cap. 372, the Financial Secretary can direct KCRC to declare dividend in the amount of the whole or part of the profits of the Corporation in any financial year. Since the Financial Secretary did not exercise his power to direct the declaration of dividend from KCRC, no dividend was declared by KCRC and therefore the question of whether dividend declared by KCRC should be paid into general revenue does not arise. As regards the letter of 16 May 2002, we wish to clarify that only dividends actually paid to the Government will become part of the general revenue. By exercising the dividend waiver, the Government will not receive any dividend from MTRCL. This is in line with what we informed the Legislative Council before.

ADVANTAGES OF DIVIDEND WAIVER OVER EQUITY INJECTION

4. The Government has in the past injected equity into the two railway corporations for implementation of various railway projects.

Equity, however, is not without its cost as the recipient needs to earn a suitable return thereon. For a publicly-listed company like MTRCL, investors can be expected to require a return on their equity investment at a level commensurate with the business risk of the company in particular and the risk of the stock market in general. As explained in the paper submitted to this subcommittee on 12 July 2002, the cost of capital of a company is made up of its cost of debt and cost of equity. Since equity involves a higher risk than debt (as the latter is given a higher priority for repayment), cost of equity is usually higher than the cost of debt. Therefore, the more equity that is injected into MTRCL, the higher will be its cost of capital and the higher will be the return required for new projects. Paradoxically, this will lead to a larger funding gap for such projects. Equity may therefore only be considered when the project return is in an acceptable range.

URGENCY OF THE PROJECT

5. The construction programme of PBRL is very tight. MTRCL has already identified contractors for the tunnel and Yam O Station contracts which are on a critical path. The award of these two contracts has already been deferred due to the deferral of execution of the Project Agreement. Construction works cannot commence unless the Project Agreement has been signed.

6. The present target operating date of the PBRL and the construction cost estimates are based on the assumption that construction works commence in early July 2002. If the PBRL Project Agreement is not signed very shortly, this may affect the estimated construction cost as

a result of the need for acceleration cost, and more importantly, it may not be possible to recover the time lost and the operating date of PBRL may need to be deferred correspondingly.

7. Given that the PBRL is an integral part of the overall Hong Kong Disneyland development, there are a lot of interface issues between the PBRL works and the works being carried out by Civil Engineering Department for the Hong Kong Disneyland development. Some of their works are actually carried out on the same piece of land but during different periods of time. Deferral of PBRL works may therefore affect the cost and schedule of other works of the Hong Kong Disneyland.

CONCLUSION

8. We hope with these further explanations we have given Members the necessary reassurance that the funding arrangements in the Project Agreement are both lawful and the most appropriate under the circumstances.

Environment, Transport and Works Bureau
19 July 2002

Annex

1. As we said at the last meeting, the dividend waiver option is entirely lawful. Nevertheless, arising from the concerns of this subcommittee we have further consulted the Department of Justice and sought the views of an outside Senior Counsel. There is sound legal basis for the option. We trust that the explanation below will allay Members' doubts. The **Public Finance Ordinance (Cap. 2)**("PFO") and the **Mass Transit Railway Ordinance (Cap 556)**("MTRO") are the two relevant Ordinances requiring consideration.

Public Finance Ordinance

2. **Section 3(1)** of the **PFO** provides that: -

"**Except** where otherwise provided by or under this Ordinance or any other enactment any **moneys raised or received** for the purposes of the Government shall form part of the general revenue".

Section 4 of the **PFO** provides that:-

"No expenditure shall be charged on the general revenue except as provided by or under this Ordinance or any other enactment".

Section 8(1) of the **PFO** provides that:-

"Subject to this section, no change shall be made to the approved estimates of expenditure except with the approval of the Finance Committee upon a proposal of the Financial Secretary".

3. Thus, the general revenue does not extend to cover monies which have not been "raised or received" within the meaning of **section 3(1)**.

4. **Section 10** of the **PFO** provides that –

"The Financial Secretary shall, subject to this Ordinance and any other enactment, have the management of the finances of the Government and the supervision, control and direction of all matters relating to the financial affairs of the Government".

5. One of the provisions in the **PFO** to which the Financial Secretary ("FS") is subject is **section 38(1)**, namely:-

“... the Financial Secretary may –

- (a) abandon, remit or **waive** any **claims** by or on behalf of the Government.”
6. The Finance Committee’s powers do not therefore extend to monies which may be so claimed by the Government but which have been “waived” by the FS under **section 38** of the **PFO**.
7. Accordingly, an exercise of the FS’s power or discretion under **section 38** of the **PFO** can in no way properly be characterised as an act bypassing the control, or checks and balances, put in place by the **PFO** in regulating the expenditure out of the general revenue since, by definition, the “claims” waived under **section 38** would not form part of the general revenue subject to the jurisdiction of the Finance Committee. Further, **s. 38(1A)** of the **PFO** provides that in cases involving “fraud or negligence”, the FS needs to comply with conditions specified by the Finance Committee in waiving any claims. In cases not involving fraud or negligence, the FS will not therefore be subject to those conditions.
8. A further query has been raised as to whether **section 38(1)(a)** of the **PFO** empowers the Government to waive “claims” to dividends which have yet to be declared by the Corporation. In the first place, the concept of “claim” is a broad one. It has, for example, been defined as “... embracing every species of legal demand, not necessarily limited to money demands; and, particularly when used in connection with property, ‘claim’ has been used to signify a demand and nothing more”. (**Re Prudential Assurance Co Ltd v Walwyn, Stodgell, Cochran, Murray Ltd** 50 OR (2d) 609). There is no doubt that the word “claims” in **section 38(1)(a)** of **PFO** covers the right of the Financial Secretary Incorporated (“FSI”) to dividends as shareholder of the Corporation. They arise, at the latest, when dividends are being declared by the Corporation. At such time, the FS may direct that such right to dividends be waived. There is, however, nothing to prevent the FS from indicating, in any agreement to be reached with the Corporation, that he will exercise such power at the relevant time, provided such agreement is in no way inconsistent with his duties and functions as the FS and such exercise of the power is in the public interest.

Whether such agreement to exercise such power is acceptable is a commercial matter for the Corporation. If the parties reach agreement on such basis, the FS will be contractually bound to exercise his power under **section 38(1)(a)** from time to time as and when dividends are declared by the Corporation.

9. Doubt has been cast on whether the FSI as holder of the shares, can exercise the powers under **section 38(1)** of the **PFO** to waive the dividend claims on behalf of the Government. The concern is unwarranted. The FSI is established by the **Financial Secretary Incorporation Ordinance (Cap. 1015) (“FSIO”)** which is intended to provide for “perpetual succession” and the “capacity” to acquire and hold properties of all kinds. It is a “corporation sole” with a separate legal identity from the FS to enable him to discharge his duties as the FS in the most expedient fashion (i.e. where perpetual succession and ability to bind successors to the office are required). The FS and the FSI have their respective functions and powers. The power to waive claims under **section 38(1)(a)** of the **PFO** is vested in the FS, not FSI, as it is something which the FS is capable of doing in his “natural or personal capacity” as a public officer. It is not necessary for the FSI to purport to exercise the power under **section 38(1)(a)**. Once the FS has exercised his power of waiver, he can then implement such decision in his other capacity as FSI in entering into such formal arrangements as may be necessary regarding the shares held in the name of FSI. There is no conflict of roles as between the FS and the FSI so far as the powers and functions under the provisions in the PFO and the MTRO are concerned.

Mass Transit Railway Ordinance

10. **S.58(1)** of the **MTRO** provides that:-
“Except as provided in subsection (2), **monies received** by the Financial Secretary Incorporated as the person holding shares in the Corporation, or from the sale of or other dealing in shares in the Corporation which are held by the Financial Secretary Incorporated, **form part of the general revenue**”.

11. The expression “monies received” mirrors the phrase “monies raised or received” in **section 3(1)** of the **PFO**. The subsection does not impose any duty on the part of FSI either to require dividends to be paid by the Corporation or to pay any declared dividends under the MTRO into the general revenue. Any “monies received” by FSI will form part of the general revenue, regardless of whether the same has been paid into the general revenue.
12. The purpose of **section 58(1)** of the **MTRO** is not to be confused with **section 14A** of the repealed **Mass Transit Railway Corporation Ordinance** (Cap. 270) which provided that a “dividend declared” by the Corporation shall be paid into the general revenue. It is also mistaken in suggesting that since the latter provision required declared dividends of the defunct MTRC to be paid into the general revenue, and since section 58(1) does not expressly detract from such intention, the same must still be operative even though **section 14A** has been repealed. There is no doctrine of automatic succession or migration of legislative intent. The words “monies received”, whether under **section 3(1)** of the **PFO** or **section 58(1)** of the **MTRO**, mean precisely what they say, namely, monies actually received by the Government and not monies to which it is entitled but which it had not received. They do not therefore cover dividends declared by the Corporation but waived by the Government as there will not be “monies received” within the meaning of **section 58(1)** of the **MTRO**.
13. A query has also been raised on whether a true trust (as opposed to a mere governmental obligation) has been created with the FSI acting as the trustee of the MTRCL shares under the MTRO. The question, however, is of little relevance. If there is no true trust created, there will be no question of ordinary trustee obligations. Even if it were to be a true trust, it would not prevent the FS or Government as a beneficiary of the shares from exercising his statutory power to waive claims of dividends otherwise payable by the Corporation. This will not be inconsistent with the role of the FSI under the MTRO.