

Legislative Council Panels on Transport and Financial Affairs

Merger of MTR and Kowloon-Canton Railway Systems - Proposed Way Forward

Purpose

The Government has reached an understanding with MTR Corporation Limited (MTRCL) on the structure and the terms, as summarised at **Annex A**, for the proposed merger of the MTR and Kowloon-Canton Railway (KCR) systems. The Government has entered into a non-binding Memorandum of Understanding (MOU) with MTRCL on this basis. This paper seeks Members' views on the Government proceeding with the rail merger on the basis of the proposed merger package.

Annex A

Background

2. In February 2004, the Government invited the MTRCL and Kowloon-Canton Railway Corporation (KCRC) to commence discussion on a possible rail merger on the basis of the following parameters -

- (a) adoption of a more objective and transparent fare adjustment mechanism (FAM);
- (b) abolition of the second boarding charge and review of the fare structure with the objective of reducing fares;
- (c) early resolution of interchange arrangements for new rail projects under planning, notably the Shatin to Central Link (SCL);
- (d) ensuring job security for frontline staff at the time of merger; and
- (e) provision of seamless interchange arrangements in the long run.

Outcome of Merger Discussions between MTRCL and KCRC

3. MTRCL and KCRC completed their discussions on a possible merger in September 2004. The outcome of the merger discussions indicates that a merger of the MTR and KCR systems is feasible and the five parameters set by the Government for the merger discussions can be addressed positively. After further discussions between MTRCL and the Government over the transaction terms for the rail merger, MTRCL has put forward a package of proposals for meeting the five parameters.

Proposal by MTRCL

Compliance with the five parameters

4. MTRCL's proposal is explained and assessed in detail in paragraphs 5 to 17 below. The proposal has met the five parameters and will provide significant benefits to the general public.

Parameter 1: Adoption of a more objective and transparent fare adjustment mechanism (FAM)

5. At present, both MTRCL and KCRC have fare autonomy, and they set their fares in accordance with prudent commercial principles having regard to, inter alia, prevailing market conditions, competition from other transport modes and the corporations' financial objectives. In the context of the rail merger exercise, the Government has proposed the introduction of an FAM that could address -

- (a) the public concern that the process for adjustment of transport fares should be more objective and transparent and should allow for reduction as well as increase in fares;
- (b) the concern of public transport operators that once fares are reduced, public pressure will render fare increases difficult if not impossible, even when the economy is improving; and

(c) the common concern of public transport operators and the Government that fare adjustments should not be politicised as it is not conducive to efficiency and social harmony.

6. Against this background, MTRCL and KCRC have proposed a formulaic approach for determining future fare adjustments to replace fare autonomy after the rail merger. After further detailed discussions between MTRCL and the Government, MTRCL's proposal is that the FAM should be based on the following formula -

$$\text{Overall fare adjustment rate} = 0.5 * \Delta \text{CCPI} + 0.5 * \Delta \text{Wage Index} - \text{Productivity Factor},$$

where ΔCCPI is the change in the composite Consumer Price Index and $\Delta \text{Wage Index}$ is the change in Nominal Wage Index (Transport Sector). Both indices are published data of the Census & Statistics Department.

7. A formula having regard to changes in the CCPI and the wage index would improve transparency as future fare adjustments would be determined based on published indices, and it would improve objectivity as the formula adopts well-established indices which are objective and verifiable. The FAM would allow both downward and upward adjustment of fares according to the formula.

8. The formula includes a productivity factor which would allow passengers to share the benefits of productivity gain of the post-merger corporation (MergeCo). The productivity factor would be a pre-agreed fixed number. It would be set at 0.1% starting from the 6th year of the rail merger, taking into account that MergeCo would be returning the productivity benefits to passengers by way of a fare reduction immediately upon the rail merger before it could fully realise the benefits of the synergies identified, and the scope for productivity gain is limited due to heavy investment particularly as the railway network is expanding.

9. Fares would be assessed and adjusted on an annual basis under the proposed FAM. There would be a trigger mechanism under which overall fare reduction or increase of less than 1.5% would be carried over to the next annual fare review. The overall fare adjustment rate

calculated from the formula would apply to the fares of MergeCo as in one basket.

10. The proposed FAM¹ would be subject to a review every five years upon request by either the Government or MergeCo.

Parameter 2: Abolition of second boarding charge and review of the fare structure with the objective of reducing fares

11. The present MTR and KCR networks are operated as separate systems. A combined railway network would achieve some degree of economies of scale and facilitate the abolition of second boarding charge. Nevertheless, it should be noted that the abolition of second boarding charge or any general fare reduction would impact adversely on fare revenue of MergeCo in the long run.

12. According to the joint assessment of MTRCL and KCRC, synergies could be realised from both revenue and operating costs, with the former mainly achieved through the broadening of the sales and distribution network and from railway/station-related businesses such as advertising, and the latter principally through the achievement of economies of scale in railway operation over time. The two corporations have reviewed their existing fare structures with a view to rationalising the fare levels for MergeCo in the light of the potential synergies arising from the rail merger, and they proposed a fare reduction comprising abolition of second boarding charge, global fare reduction for all Octopus card users paying full fares and additional fare reduction for selected journeys.

13. After further discussions between MTRCL and the Government, MTRCL has proposed the following fare reduction package

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(a) abolition of second boarding charge ranging from \$1 to \$7;

¹ The FAM would apply to all existing MTR and KCR services and new railway lines which are natural extensions of the MTR and KCR railways, with the exception of Airport Express Line (AEL), Tung Chung Cable Car, and intercity services.

- (b) further global fare reduction of \$0.20 for all Octopus card users paying full fares²;
- (c) an extra \$1 reduction for medium / long distance journeys charging \$12 or above;
- (d) for all journeys charging \$12 or above, if (a), (b) and (c) above when combined result in less than a 10% reduction, there would be a further reduction to achieve a minimum of a 10% reduction for all these journeys³; and;
- (e) for all journeys charging between \$8.50 and \$11.90, if (a) and (b) above when combined result in less than a 5% reduction, there would be a further reduction to achieve a minimum of a 5% reduction for all these journeys⁴;

Under this fare reduction package, there would be a minimum of a 10% fare reduction for all passengers travelling on journeys with fares at \$12 or above and a minimum of 5% fare reduction for all passengers travelling on journeys with fares between \$8.50 and \$11.90. Taking into account the benefits from abolition of second boarding charge and the global fare reduction, altogether 2.8 million daily rail trips⁵ will benefit from fare reduction on Day One of the rail merger. About 340,000 of them would benefit from a minimum of a 10% fare reduction and another 1.16 million would benefit from a minimum of a 5% fare reduction. This fare reduction would encourage employment, as cross-district travelling to work would become cheaper, and would complement the Government's other efforts to encourage employment.

14. There will be no fare increase for the next 24 months following the signing of the MoU. MergeCo would also provide a concessionary fare of \$2 per trip in the first year after the rail merger for senior citizens

² The global fare reduction will be reduced by the corresponding concessionary rates for specific passenger categories enjoying concession, e.g. \$0.1 for children as they enjoy 50% concessionary fares.

³ For Single Journey Tickets, this would subject to the rounding of the fares.

⁴ For Single Journey Tickets, this would subject to the rounding of the fares.

⁵ The proposed fare reduction would apply to all domestic MTR and KCR railway lines. There would be no change to the fares of the AEL and the Lo Wu and Light Rail services because of the rail merger.

travelling on the railway network on Sundays and public holidays. The existing student fare discount would be maintained, i.e. students would continue to enjoy half fares when travelling on the MTR.

Parameter 3: Early resolution of interchange arrangement for new rail projects under planning, notably the Shatin to Central Link (SCL)

15. The SCL is a committed, new railway project in the pipeline for implementation. The project was awarded to KCRC in 2002 after a competitive bidding exercise. In response to Government's request, the two corporations have examined in detail, during their discussions on the possible rail merger, the interchange arrangement for the SCL. The proposed SCL scheme in the context of the rail merger would provide for fully integrated interchange stations and interchanging passengers would not be required to pay any second boarding charge. We will further discuss with MTRCL on the funding and implementation details of the SCL.

Parameter 4: Ensuring job security for frontline staff at the time of the rail merger

16. MergeCo shall provide job security to all frontline staff as it relates to merger. The two corporations have agreed on a definition of frontline staff⁶ for the purpose of the rail merger and they would explain the details to their staff. Further details about the plan for human resource integration are explained in paragraphs 36 to 39.

Parameter 5: Provision of seamless interchange arrangements in the long run

17. The integration of the operation of the two railway systems would improve passenger convenience and reduce journey time. Within the first year after the rail merger, ticket gates in the three existing interchange stations (viz. Kowloon Tong, Nam Cheong and Mei Foo

⁶ As agreed between MTRCL and KCRC, frontline staff means "those full-time non-managerial staff who are employed regularly and directly in the operations and maintenance of trains, stations, buses and vehicles; infrastructure maintenance; stores operations and security operations. Non-managerial staff refer to staff below Grade MG1 in the case of MTR and staff below Grade 8 in the case of KCRC, who are employed on either continuous terms or contract terms for a duration of two years or more."

Stations) would be removed and the interchange arrangements would be improved. These planned changes would involve restructuring the stations concerned to improve the passenger flow.

Proposed transaction structure

18. MTRCL's listing status would be maintained and it would be the legal entity of the future MergeCo. MTRCL would be granted a service concession by KCRC to make use of the latter's assets to operate the existing and new KCR railway lines under construction including the Lok Ma Chau Spur Line and the Kowloon Southern Link (KSL), as well as KCRC's other transport-related businesses such as bus operation in the North-west Transit Service Area. Under a service concession arrangement, a government/public body which is the grantor of the concession (KCRC in this case) enters into contractual arrangements to convey a right to the concession operator (MTRCL under the proposed deal) to provide specified services to the public.

19. Under the service concession agreement, MTRCL would be granted the right to use certain KCRC assets and railway land to operate the KCR system. MergeCo would be responsible for the operation, maintenance and improvement of the KCR system, including the replacement of the concession assets, during the concession period. It would exercise control over all the operational arrangements of the two networks as an integrated whole and be responsible for the performance of the total system. Upon expiry or termination of the service concession, MergeCo would be required to return an operating KCR system to KCRC that meets the prevailing operating standards. Under the service concession arrangement, KCRC would not be disposing of the railway system to MTRCL, and MTRCL would not be acquiring KCRC assets (except for certain low value items such as spare parts and consumables).

20. The service concession would be coterminous with the franchise of MergeCo with an initial term of 50 years. Under the merger proposal, that KCRC would retain legal title to the assets covered in the service concession, although Government will discuss further with

MTRCL the latter's wish to have the legal title to certain replacement and improvement assets, provided that these are returned to KCRC together with the initial assets upon expiry or termination of the service concession. Further, KCRC would continue to retain certain assets such as cash, receivables, shareholding in Octopus etc. and some \$19.7 billion of debt.

21. In addition, KCRC would retain the obligations for their cross-border leases (CBLs) covering rolling stock and related hardware, such as signalling systems. MTRCL will co-operate with Government and KCRC to assist KCRC in meeting the obligations in respect of the CBLs provided that MTRCL receives protection from Government and KCRC in a form satisfactory to the Corporation so that MTRCL shall be in no worse a position as a result of such co-operation. In this regard, Government may consider the need to provide indemnity to MTRCL.

22. Apart from the service concession arrangement, MTRCL has proposed to acquire property-related interests of KCRC as well as the development rights for the property sites on KSL and the other commercial interests of KCRC as part of the deal. Details of the property package for the proposed rail merger are explained in paragraphs 23(d) and paragraphs 28 - 30 below.

Proposed financial terms

23. The financial terms proposed by MTRCL for the rail merger are as follows -

- (a) an upfront payment of \$4.25 billion for the service concession and for acquisition of certain short-lived railway assets of KCRC such as stores and spares;
- (b) fixed annual payments of \$750 million for the duration of the service concession;
- (c) starting from the fourth year of the service concession, an annual share of the actual revenue generated from the KCR

system based on a pre-agreed set of sharing ratios. The sharing ratios are –

- (i) 10% for revenue exceeding \$2.5 billion and up to \$5 billion;
 - (ii) 15% for revenue between \$5 billion and \$7.5 billion;
 - (iii) 35% for revenue beyond \$7.5 billion; and
- (d) a payment of \$7.79 billion for the acquisition of property and other related commercial interests. Separately, MTRCL will reimburse KCRC for enabling works costs already paid for by the latter in relation to the development properties to be sold to MTRCL. The payments for the costs of these works not yet received by KCRC are currently valued at \$2.31 billion.

Valuation

24. In agreeing the financial terms with MTRCL, the Government has sought to structure the financial terms in order to capture the likely future performance of the KCR System. Under the proposed revenue-sharing method as set out in paragraph 23(c) above, KCRC would share the upside benefits of the financial performance of the KCR system within MergeCo, and is partially protected from lower performance by the fixed payment components. At the moment, many parts of the KCR system are newly commissioned or under construction, and these parts will see an increase in patronage and revenue some time after they are commissioned and in operation. In that event, KCRC will enjoy the upside under the revenue-sharing mechanism

25. Under the financial terms in paragraphs 23(a) and 23(b) above, KCRC will receive an upfront payment and fixed annual payments with an aggregate value over the initial period of the service concession of \$41.8 billion in money-of-the-day (MOD).

26. The value of the annual variable payments to be received by KCRC will depend on the actual revenues generated by the KCR system within MergeCo. The Government has reviewed the likely outcomes of a range of growth and development projections for the KCR system.

Based on these alternative scenarios, the NPV of the total of annual fixed and variable payments that KCRC could be expected to receive will be in the range of \$30 billion to \$56.5 billion. While the value of variable payments ultimately could be higher or lower than these figures, it would reflect the actual performance of the KCR System.

27. In considering the deal structure, Government also examined the alternative of adopting an outright sale model. However, in any outright acquisition, it is very likely that the potential buyer would emphasize any under-performance by KCRC while downplaying the long-term potential of the system. This is particularly important as many projects of the KCR railway system are either newly completed or still under construction. It will take quite some time before the full earning potential of the system can be realized. As such, to avoid disposal of KCRC's assets at a severely diminished valuation, Government has therefore sought a structural solution under which KCRC could retain ownership of the assets, capture the upside of KCR railway's performance under a revenue-sharing mechanism and can get back a fully operational railway system at the end or upon early termination of the service concession.

Property package

28. The property package of the rail merger proposal comprises the following:

(a) MTRCL to purchase KCRC's investment properties, property management business and property development rights in respect of six existing KCRC property sites, plus two property sites along KSL currently held by Government (a list of the properties and businesses is at **Annex B**);

(b) introduction of a railway property development control mechanism to enable Government to exercise control under exceptional circumstances on the level of flat production arising from the tender programme for railway property developments; and

Annex B

(c) MergeCo to replace KCRC as the agent of Government for the development of the property sites along West Rail (WR) on the basis of an incentive scheme.

29. Given that the property package is an integral part of the whole deal, after negotiation with MTRCL and taking into account the advice of the independent valuer, we consider that MTRCL's latest offer of \$7.79billion to purchase the properties as a package is acceptable. Separately, MTRCL will reimburse KCRC for enabling works costs already paid for by the latter in relation to the development properties to be sold to MTRCL.

30. Under the proposed property development control mechanism, the Government and MTRCL would conduct an annual exercise to discuss and draw up a three-year rolling programme on the level of flat production arising from tenders for railway property development by MergeCo, with provision for subsequent adjustment to the level of flat production upon mutual agreement by the Government and MergeCo.

New Railway Development and Financing

31. The rail merger would reduce duplication of effort in railway development, the time required for protracted negotiations between the two corporations on project interface issues for future railway projects, and the likely project cost. This would be conducive to the timely delivery of railway projects and would improve interchange arrangements.

32. Under the rail merger proposal, Government would have the right in future to determine whether the 'ownership approach' (under which MergeCo would fund, construct and operate the new railway) or the 'concession approach' (under which Government would fund the construction of the new railway and MergeCo would be granted a service concession to operate the new railway based on financial terms to be determined according to a pre-agreed mechanism) should be adopted for individual new railway projects which are not natural MTR-extension projects. For the SCL, we would further discuss with MTRCL on the

funding and implementation details and consider under which approach the project should be taken forward. For future projects which are natural MTR-extension projects, the status quo would apply i.e. Government would discuss the financial arrangement for the new project with MergeCo on the basis of the ownership approach.

33. In considering the financing arrangements for future new railway projects, the Government would continue to examine carefully whether financial support should be provided having regard to the circumstances of individual cases, so as to ensure that maximum benefits for the public would be achieved from railway development. The Government would take a view on the most suitable mode of financing, including the grant of property development rights within the precinct of the railways or other measures, on a case-by-case basis.

Regulatory Regime

34. Under the proposed rail merger, MergeCo would be granted a franchise to operate the MTR and KCR railways. The existing regulatory regime for MTRCL would be adopted with suitable modifications to incorporate the changes required for the inclusion of KCR services. The existing Operating Agreement between MTRCL and the Government would be expanded into an integrated Operating Agreement (IOA) to cover the regulation of the operation of the KCR railways by MergeCo. MergeCo would be subject to the existing requirement to maintain proper and efficient service and to meet the required service and safety standards as prescribed in the IOA. The Hong Kong Railway Inspectorate would retain the statutory powers to inspect the railways and investigate into railway incidents/accidents with a view to ensuring the safety of railways and railway premises.

35. The existing provisions for extension, suspension and revocation of franchise would largely be followed. The franchise of MergeCo would be extendable by application or by reason of the amount of capital expenditure invested by MergeCo on the railway network, subject to approval by the Chief Executive in Council. The franchise could be suspended or revoked by the Chief Executive in Council on

specified grounds as prescribed in the MTR Ordinance. New provisions would be added to provide, upon franchise revocation or expiry, for the access arrangements to enable KCRC to access the assets owned by MTRCL but which are used commonly by the MTR and KCR systems (and vice versa). In view of the service concession arrangement to enable MTRCL to use KCRC assets to operate the KCR system after the rail merger, in future a major default by MergeCo in fulfilling its obligations in the service concession agreement with KCRC could trigger revocation of the franchise as it relates to the KCR railways.

Human Resource integration into “One Company, One Team”

36. In parallel to our negotiations with MTRCL on the terms for the rail merger, there have been on-going discussions between the two corporations and the Government on matters concerning human resource integration. The two corporations have agreed that all serving staff would be employed by MergeCo on their prevailing terms and conditions upon the rail merger. The two corporations would conduct further studies on the setting of one set of terms and conditions for all serving staff after the rail merger and they would consult staff during the process. The transfer of employment to MergeCo would be deemed for all purposes to be a single continuous employment.

37. The two corporations have reaffirmed that they are committed to looking after the interests of all staff. They have agreed that future staff arrangements would be handled fairly and equitably in the rail merger exercise. They would step up discussions to develop the procedures and guidelines for the process of selection of staff into positions in MergeCo in due course after final approval of the rail merger. In future, the staff of MTRCL and KCRC would work as one team in the same company.

38. The two corporations have estimated that there would be net increase in job positions after the rail merger. They estimated that there would be more than 1,300 staff vacancies in the first three years arising from new jobs created due to business growth of MergeCo, in particular the opening of new railways, and from natural wastage and turnover of

existing staff. This number exceeds the corporations' estimate of an overall staff synergy of 650 - 700 full-time equivalents (FTE)⁷ expected to be achieved over a number of years as a result of the rail merger. Therefore from the overall perspective, there would be more career development opportunities to staff after the rail merger. To address any potential mismatches in skills, MergeCo would offer re-training and redeployment for affected staff.

39. The two corporations would conduct thorough and comprehensive studies in various human resource areas in preparation for a smooth integration. They have undertaken that they would maintain direct communication with staff and their staff would be consulted on matters affecting them in the rail merger exercise.

Top-level appointments to MergeCo

40. The Chairman (designate) of MergeCo would be selected by the Government, and the Chief Executive Officer (designate) would be selected by the Government in consultation with the Chairman (designate). On the selection of the other members of the Executive Directorate of MergeCo, the arrangements would be as follows:

- (a) the Chief Financial Officer (designate) and the Chief Operations Officer (designate) (or their equivalent in MergeCo) would be selected by an appointment panel consisting of the Secretary for the Environment, Transport and Works, the Secretary for Financial Services and the Treasury, the Chairman (designate) and the Chief Executive Officer (designate); and
- (b) the other Executive Directors (designate) would be selected by the Chairman (designate) and the Chief Executive officer (designate).

41. The Government would determine the number of additional non-executive directors to be appointed in forming the Board of Directors

⁷ "Full-time equivalent" refers to the equivalent number of full-time posts.

of MergeCo. The additional non-executive directors would be selected by the Government in consultation with the Chairman (designate). All these selections would be conducted before the rail merger package is put to the minority shareholders of MTRCL for approval.

Legislative Exercise and Necessary Approval by MTRCL's minority shareholders

42. There would need to be amendments to the MTR Ordinance as well as the Kowloon-Canton Railway Corporation Ordinance to provide for the implementation of the rail merger. For example, legislative amendments would be required to empower MergeCo to operate the KCR services, with the intention that the operation of the MTR and KCR systems after implementation of the rail merger would be regulated in substantially the same way as the MTR before the rail merger. There would also be suitable amendments in relation to the existing provisions on the suspension, expiry and revocation of franchise as a consequence of the expansion of the scope of the franchise to cover both the MTR and KCR railways.

43. The rail merger package also needs approval by the minority shareholders of MTRCL. Government, being the majority shareholder of MTRCL and the sole shareholder of KCRC, would be regarded as a connected party under the Listing Rules and would therefore not be allowed to vote on any resolution put forward in connection with the rail merger package.

Functions of KCRC after the rail merger

44. After the rail merger, KCRC would cease to have any railway operating function. We envisage that it would retain certain administrative, accounting and treasury functions with the Managing Board comprising solely of Government officials and with operations supported mainly by outside service providers.

Considerations for the Way Forward

45. Having regard to the five parameters we set for the merger discussions, we consider that the proposed rail merger would be able to -

- (a) address public expectation of fare reduction;
- (b) meet public demand for a more objective and transparent FAM that would allow fares to reduce as well as increase;
- (c) improve the interchange arrangement for SCL and reduce duplication of network for future railway projects;
- (d) provide a barrier-free and seamless interchange environment for rail passengers; and
- (e) allow better use of resources under an integrated railway system.

46. MTRCL has indicated that the proposal being offered is a package deal for the rail merger. Based on the proposed terms, we have entered into a non-binding MOU with the MTRCL.

47. In mapping out the way forward, the Government would take into account Members' views and comments from the public and other stakeholders. If there is general support for the rail merger, we would proceed with the necessary legislative exercise and submit a bill to the Legislative Council. There would need to be suitable amendments to the MTR Ordinance and the Kowloon-Canton Railway Corporation Ordinance to provide for implementation of the rail merger.

48. MTRCL's minority shareholders would be invited to approve the merger proposal if and after the necessary legislative amendments have been approved by the Legislative Council.

Environment, Transport and Works Bureau
Financial Services and the Treasury Bureau
11 April 2006

KEY TERMS OF MTRCL'S FINAL PROPOSAL FOR THE RAIL MERGER

A. STRUCTURE AND KEY TERMS OF THE RAIL MERGER

1. Structure of the proposal

The proposal would involve the following key elements (inter alia):

- (a) the expansion of the existing franchise under the MTR Ordinance to provide for the right to operate the MTR Railway as well as the KCRC Railway, for an initial period of 50 years from the Appointed Day and which is extendable;
- (b) the grant by KCRC to MTRCL of a Service Concession to access and use the Concession Assets (being the substantial portion of the KCRC System) to provide the KCRC Services for an initial period of 50 years from the Appointed Day and which is extendable;
- (c) the acquisition by MTRCL from KCRC of the Purchased Rail Assets;
- (d) the provision by MTRCL of the KCRC Services to the Required Standards; and
- (e) the acquisition by MTRCL of a property package (the "Property Package") involving (inter alia):
 - (i) the purchase by MTRCL of (I) certain property development rights along East Rail ("ER"), Ma On Shan Rail, Light Rail ("LR") and the Kowloon Southern Link ("KSL"); (II) certain existing investment properties related to ER and LR (on a completely freely assignable basis with no land use restriction); (III) KCRC's rights to manage certain of KCRC's properties;
 - (ii) an incentive scheme in respect of certain West Rail ("WR") property sites shall apply to MergeCo; and
 - (iii) with respect to the Property Package, the status quo regarding the basis for calculating land premium amounts

payable by MTRCL shall continue to apply to MergeCo under the integrated Operating Agreement (IOA).

2. Payments to KCRC

MergeCo will be required to pay to KCRC the following payments:

- (a) Upfront payments: an amount totalling HK\$4.25 billion being the upfront fee for the Service Concession and the consideration for the Purchased Rail Assets and a further payment of HK\$7.79 billion for the Property Package, in each case payable on the Appointed Day;
- (b) Fixed Annual Payments: a fixed annual payment for the Service Concession of HK\$750 million
- (c) Variable Annual Payments: a variable annual payment for the Service Concession calculated, on an annual basis, as a percentage of revenue generated from the KCRC System for each financial year. The applicable percentage will vary according to the amount of revenue generated from the KCRC System for each financial year as follows: for the first HK\$2.5 billion of revenue generated from the KCRC System, the applicable percentage will be 0.0%; for the next HK\$2.5 billion, the applicable percentage will be 10.0%; for the next HK\$2.5 billion, the applicable percentage will be 15%; for revenue generated from the KCRC System above HK\$7.5 billion, the applicable percentage will be 35.0%. No Variable Annual Payment shall be payable in respect of the first 36 months following the Appointed Day. Thereafter, the Variable Annual Payment will be payable annually in arrears within 60 days after the end of each financial year of the post-merger corporation (MergeCo).

3. Other terms of the rail merger

(a) Payments Relating to Enabling Works:

In relation to an agreed list of property development sites purchased by the post-merger corporation (MergeCo), amounts spent by KCRC in funding the enabling works for those sites and other related costs in an agreed amount in respect of each site (the "Payments Relating to Enabling Works") shall be recovered from the developers of those sites or MergeCo (where appropriate, as described below) and reimbursed by MergeCo in money of the day terms for such payments. The total Payments Relating to Enabling Works to be reimbursed to KCRC will be adjusted in accordance with payments received from developers for the relevant sites awarded prior to the Appointed Day. In the event

that the amount actually received from the developers is different from the relevant Payment Relating to Enabling Works for the relevant site, MergeCo will be responsible for any shortfall, and is entitled to keep any excess actually received. A mechanism dealing with changes to the timing and consequential cost deviations shall be agreed by Government and MTRCL.

(b) Land Matters

A mechanism which will enable Government to exercise control in exceptional circumstances on the level of flat production (being the number of flats which MergeCo puts out to tender to developers) arising from tender programmes for railway property development will be introduced. This mechanism is expected to involve (inter alia):

- (i) an annual exercise conducted by Government and MergeCo to discuss and draw up a three-year rolling programme on the level of flat production arising from tenders for railway property development by MergeCo for the three succeeding years (on a financial year basis);
- (ii) the level of flat production arising from tenders for railway property development in each of these three years will be reviewed, before Government's Application List for Land Sale is finalised and announced in or around February and March each year;
- (iii) the first year of such three-year rolling programme shall be binding on MergeCo;
- (iv) the agreed level of flat production arising from tenders for railway property development will be revised as and when necessary, if agreed by Government and MergeCo; and
- (v) the annual exercise will be initiated by Government in the last quarter of each year for conclusion before the end of the year (the first year to commence on or around September 2007 if the Appointed Day is before the third quarter of 2007).

(c) KCRC's debts and other obligations:

Following the integration, KCRC will continue to be responsible for its debts and other financing obligations but, in relation to the treatment of KCRC's cross-border leases, MergeCo shall co-operate with Government and KCRC provided MergeCo receives protection from Government and KCRC in a form

satisfactory to it (it being understood that MergeCo shall be in no worse a position as a result of such protection). As between MergeCo and KCRC, KCRC shall remain liable in respect of all lease payments under such cross border leases.

(d) Third party claims:

KCRC shall be responsible for non-project claims made by third parties who are unrelated to MergeCo if the relevant cause of action arose before the Appointed Day and the relevant claim is brought within the first three years following the Appointed Day. MergeCo shall be responsible for all other non-project claims made by third parties.

Subject to the provisions of relevant agreements between KCRC and MergeCo, KCRC shall be responsible for railway project claims made by third parties who are unrelated to MergeCo relating to certain agreed projects.

(e) Construction of KSL:

On the Appointed Day, KCRC shall appoint MergeCo as its agent to complete the construction of the KSL upon conditions to be agreed between MTRCL, KCRC and Government, including (i) an incentive arrangement to encourage MergeCo to complete the KSL below an agreed budget and before the planned completion date; and (ii) MergeCo will be responsible for certain costs and costs overruns.

(f) New projects:

(i) *Natural extensions:* In relation to natural extensions of the MTRC Railway, the existing arrangements contained in the existing Operating Agreement, and the commitments given by Government at the time of MTRCL's initial public offering, relating to project returns, will be preserved. In relation to natural extensions of the KCRC Railway, Government may adopt the Ownership Approach (i.e. with the operator responsible for the finance, construction and operation of the new railway) or the Concession Approach (i.e. with the operator responsible for the operation of the new railway through a separate service concession arrangement). Under the Ownership Approach, MergeCo would be exclusively invited to submit a proposal to Government. If MergeCo and Government cannot agree on principal terms within a reasonable period, Government may either invite third parties to undertake the project following the Ownership Approach or invite MergeCo to operate the railway through a

service concession arrangement. Under the Concession Approach, Government would invite MergeCo to operate the new railway through a service concession.

- (ii) *New Separate Projects*: In relation to New Separate Projects, Government may decide to adopt the Ownership Approach or the Concession Approach. Under the Ownership Approach, Government may decide to invite either MergeCo to submit a proposal, or award the new project through an open tender process. Under the Concession Approach, Government may decide to invite MergeCo and/or third parties to operate the new railway through a service concession arrangement.
- (iii) *Additional Concession Payments*: If Government invites MergeCo to operate a new project under the Concession Approach, Additional Concession Payments are to be determined on the basis of 90% of the discounted Net Cash Flow of the New Project, and are to be reflected in a similar structure as for the existing Service Concession in the form of a fixed annual payment and a variable annual payment.

Government acknowledges that MergeCo shall make a commercial rate of return to be determined on a case-by-case basis for a particular project where the Concession Approach is used.

- (iv) *Entrustment arrangement*: MergeCo shall be entrusted with the design and construction of the new projects which are to be operated by MergeCo through a service concession agreement, subject to Government's approval and MergeCo and Government agreeing on a price.

(g) Board composition and top-level appointments:

In relation to the corporate governance arrangements for MergeCo:

- (i) the majority of MergeCo's directors shall be independent non-executive directors;
- (ii) a Nomination Committee shall be established and shall be composed of seven non-executive directors (including the Chairman of MergeCo and two non-executive directors representing Government) with the majority being independent non-executive directors, and shall be chaired by an independent non-executive director;

- (iii) the Chairman (designate) of MergeCo shall be selected by the Financial Secretary Incorporated and shall become the Chairman of MergeCo upon the Appointed Day;
- (iv) the Chief Executive Officer (designate) of MergeCo on the Appointed Day shall be selected by the Financial Secretary Incorporated in consultation with the Chairman (designate) of MergeCo;
- (v) the Chief Operating Officer (designate) and the Chief Financial Officer (designate) of MergeCo on the Appointed Day shall be selected by a panel consisting of the Secretary for the Environment, Transport and Works, the Secretary for Financial Services and the Treasury, and the Chairman (designate) and the CEO (designate) of MergeCo;
- (vi) the other Executive Directors (designate) shall be selected by the Chairman (designate) and the CEO (designate) of MergeCo; and
- (vii) Government shall determine the number of additional non-executive directors to be appointed to the Board of MergeCo on the Appointed Day.

(h) Interconditionality of documents:

All transaction documents relating to the rail merger shall be inter-conditional on each other and on the enactment of the Merger Ordinance, and satisfaction of Stock Exchange approval requirements.

(i) Service Concession Agreement (SCA) and law and regulation:

(i) The SCA is to address the following:

- (A) the requirement for MergeCo to provide the KCRC Services in accordance with the Required Standards and MergeCo being responsible for the daily operation and maintenance of the Concession Assets and decision making on capital expenditure and asset replacement;
- (B) the coterminous relationship between the Service Concession and the franchise;
- (C) that the franchise shall have an initial term of 50 years from the Appointed Day and shall be extendable in accordance with the existing procedures under the MTR Ordinance and the IOA (subject to an increase in the relevant expenditure thresholds to HK\$15 billion and

the re-settling to zero of the incurred capital expenditure made by MTRCL up to the Appointed Day); and that, upon an extension of the franchise, MergeCo shall continue to make the Fixed Annual Payments and the Variable Annual Payments;

- (D) the Concession Payments being of a “hell and highwater” nature;
- (E) MergeCo to take the Concession Assets as it finds them (i.e. MergeCo shall be liable for any latent defects in any Concession Assets);
- (F) on the expiry or termination of the SCA, the redelivery of the Concession Assets to KCRC in a manner that enable KCRC to provide the KCRC Services to the Required Standards.
- (G) arrangements in relation to the ownership and use of Additional Concession Assets and for compensation, for the Additional Concession Assets, payable to MergeCo upon re-delivery or delivery of the Concession Assets (including Additional Concession Assets) on expiry or termination of the SCA in accordance with the SCA (being limited to compensation for Additional Concession Assets acquired above an agreed threshold);
- (H) restrictions on certain disposals by MergeCo of Concession Assets (and requirements as to the use of disposal proceeds), on certain acquisitions by MergeCo of Additional Concession Assets and on MergeCo creating security over its rights under the SCA;
- (I) restrictions on disposals and the granting of security by KCRC of, and in relation to, Concession Assets;
- (J) MergeCo’s right to lease Concession Assets to third parties, such as commercial and retail areas, advertising space and telecommunications equipment;
- (K) MergeCo’s right to operate the Concession Assets without interference from KCRC;
- (L) that, in relation to the KCRC land the use of which is granted to MergeCo under the SCA, MergeCo shall have no more rights than are necessary for MergeCo to provide the KCRC Services;
- (M) KCRC’s right to inspect the Concession Assets:

- (I) during the last 6 months of the Concession Period ; and/or
- (II) when MergeCo breaches its obligations under the SCA and/or the IOA materially; and/or
- (III) when MergeCo is in default under the franchise,

and to require MergeCo to carry out rectification work at its own cost;

- (N) consequences for the SCA from, and arrangements in relation to, the suspension or revocation of the franchise;
 - (O) the use of a revenue allocation system to apportion fare revenue of the Integrated Railway between the MTRC Railway and the KCRC Railway;
 - (P) arrangements in respect of liabilities arising from, or in connection with, the Concession Assets (including Additional Concession Assets); and
 - (Q) KCRC's right to assign its rights under the SCA.
- (ii) The Merger Ordinance will address the following:
- (A) franchise and regulatory matters, to empower MergeCo to operate the KCRC System, to provide for and regulate the operation of the KCRC System, to provide for arrangements in relation to suspension, default, revocation (whether relating to the Integrated Railway or the KCRC Railway only) and expiry of the franchise, and to provide for the access arrangements in relation to the access and use of the MergeCo Common Assets and KCRC Common Assets at franchise expiry or revocation;
 - (B) vesting arrangements, in order to vest in MergeCo on the Appointed Day the Purchased Assets and to provide for certain covenants and to deal with employee arrangements; and
 - (C) enabling and consequential provisions, to facilitate the completion of the possible rail merger in an efficient manner, including provisions to empower KCRC to consummate the proposed transactions under the possible rail merger and effect changes required to implement the set up and role of KCRC on and from the

Appointed Day, to deal with land matters and to provide that MergeCo's right to operate the TSA Buses shall be co-terminous with the franchise as it relates to the KCRC Railway,

with the aim that changes to the existing regulatory regime for MTRCL should be those necessary to facilitate the completion of the integration in an efficient manner.

(j) Name of MergeCo:

MergeCo will retain MTRCL's existing English name but will change its Chinese name.

B. THE FIVE PARAMETERS

1. Adoption of a more objective and transparent fare adjustment mechanism

(a) *Fare Adjustment Formula*

A "direct drive" fare adjustment formula (together with the other provisions described in this section B1, the "Fare Adjustment Mechanism", or "FAM") should be adopted. The FAM would provide that any adjustment to fares should be linked to changes in the Composite Consumer Prices Index and changes in the Nominal Wage Index (Transport Sector) published by the Census & Statistics Department, and taking into account a productivity factor.

The Fare Adjustment Mechanism would work as follows:

$$"\Delta \text{ fare} = 0.5 * \Delta \text{ CCPI} + 0.5 * \Delta \text{ wage index} - t"$$

where:

" Δ CCPI" means the percentage change in Government Composite Consumer Prices Index;

" Δ wage index" means the percentage change in the Census & Statistics Department Nominal Wage Index (Transport Sector); and

"t" is a productivity factor. "t" will be deemed to be zero in the first five years following the Appointed Day. "t" will have a value of 0.1% starting from the sixth year following the Appointed Day. The value of "t" will be subject to review in the tenth year following the Appointed Day under the agreed review mechanism

for the FAM. For the avoidance of doubt, the value of “t” will not be subject to review before then.

(b) *Applicability of the Fare Adjustment Mechanism*

The FAM would, from the Appointed Day, apply to fares of all existing and new railway lines on the Integrated Railway (other than the Airport Express Line, the TCC, the Intercity Trains and those new railway lines which are New Separate Projects not intended for the use by daily commuters for domestic travel). Government and MergeCo shall agree whether the FAM shall apply to the fares of such New Separate Projects on a case by case basis. For the avoidance of doubt, Light Rail and the TSA Buses shall be subject to the application of FAM from the Appointed Day.

For the setting of initial fares for new railway lines, MergeCo shall brief the LegCo Transport Panel and Transport Advisory Committee if the initial fares are consistent with the prevailing fare table of MergeCo; and shall consult with the LegCo Transport Panel and Transport Advisory Committee if the fares are inconsistent with the prevailing fare table of MergeCo.

For adjustments to fares of the Airport Express Line, MergeCo shall be subject to consultation requirements in accordance with the relevant provisions in the existing Operating Agreement.

The definition of “fares” for the purposes of the FAM shall include monthly passes (excluding promotions) and any “time of day” surcharge and/or discount introduced/removed by MergeCo (such as peak surcharges and non-peak discounts), but exclude any promotional fares.

“ Δ fare” shall apply to the basket of fares on the Integrated Railway as set out above. The MergeCo can adjust individual fares, within specified bands of rates of adjustment, subject to overall compliance of its fare basket with the FAM.

(c) *Trigger Mechanism of Fare Adjustment*

If, in a given year, Δ fare is within the range of $\pm 1.5\%$, there shall be no fare adjustment and the unadjusted percentage shall be rolled over to the next annual fare review.

(d) *Review of fares*

Fares subject to the FAM shall be reviewed annually in accordance with the FAM. None of the fares of MergeCo

(irrespective of whether or not they are subject to the FAM) shall be adjusted more than once in any given year.

(e) *Implementation of fare adjustment*

Within a reasonable period before making a public announcement and informing LegCo of fare adjustments, MergeCo shall provide to Government two independent third party certifications with supporting data that fare adjustments are in compliance with the FAM.

(f) *Review of FAM*

The FAM shall be subject to review every five years upon request by either MergeCo or Government.

If MergeCo and Government do not reach agreement on amendments to the FAM within a specified period after commencement of the review, the prevailing FAM shall continue to apply.

2. Abolition of the second boarding charge and review of the fare structure with the objective of reducing fares

On the Appointed Day, the following fare adjustments shall be implemented in respect of the Integrated Railway (other than the Airport Express Line, Light Rail, cross boundary trips to and from Lo Wu and Lok Ma Chau, Intercity Trains and the TCC): (a) removal of the “second boarding charge” of HK\$1-7; (b) reduction of all fares by HK\$0.20; and (c) a reduction of fares for all journeys with fares at or above HK\$12, by an additional HK\$1; (d) for each journey of HK\$12 or above, if (a), (b) and (c) above when combined result in less than a 10% fare reduction for that journey, there will be a further reduction to achieve a minimum of 10% fare reduction for that journey; and (e) for each journey between \$8.50 and \$11.90 (inclusive), if (a) and (b) above when combined result in less than a 5% fare reduction for that journey, there will be a further reduction to achieve a minimum of a 5% fare reduction for that journey.

The fare reductions referred to in (a), (b), (c), (d) and (e) above shall be applicable to Octopus card users on and from the Appointed Day. The fare reductions referred to in (a) above shall apply to single journey ticket users within one year from the Appointed Day. From (and including) the Appointed Day up to (but excluding) the date on which the integrated ticketing system for single journey ticket users is completed, the fare reductions referred to in (c), (d) and (e) above shall apply only to single journey ticket users travelling within a single system provided that each fare reduction resulting from the

application of paragraphs (d) or (e) shall be rounded up or down (as the case may be) to the nearest interval of HK\$0.50. From the date on which the integrated ticketing system for single journey ticket users is completed, the fare reductions set out in (c), (d) and (e) above shall apply for all single journey ticket users provided that each fare reduction resulting from the application of paragraphs (d) or (e) shall be rounded up or down (as the case may be) to the nearest interval of HK\$0.50. There shall be arrangements for the technical implementation of the fare reductions described above (e.g. arrangements to ensure that the fare for an Octopus card user for a particular journey will not be more than the fare for a single journey ticket user for the same journey).

MergeCo shall provide a concessionary fare of HK\$2 for the elderly on Sundays and public holidays in the first year of the rail merger. MergeCo shall maintain the status quo with respect to student fare discounts by continuing to provide a 50% discount on student fares for the MTRC Railway whilst not offering any discount on student fares for the KCRC Railway.

For the period commencing on 11 April 2006 and ending on the earlier of: (a) the date that is 24 months after 11 April 2006; and (b) the date on which merger negotiations between the parties are terminated, MTRCL or MergeCo (as appropriate) shall not increase the fares to which the FAM will or would apply.

3. Provision of seamless interchange arrangements in the long run

MTRCL will, together with KCRC and Government, agree a programme for ensuring seamless interchange, which shall incorporate:

- (a) the provision of an integrated ticketing system for Octopus card users, to be implemented on the Appointed Day;
- (b) an integrated ticketing system for single journey ticket users to be implemented within one year of the Appointed Day; and
- (c) the provision of barrier free interchange at Nam Cheong, Mei Foo and Kowloon Tong Stations, to be implemented within one year of the Appointed Day.

4. Early resolution of interchange arrangements for rail projects under planning, notably the Shatin-Central Link (SCL)

(a) *Components*

The SCL would consist of two components:

- (i) an extension of the MOSR from Tai Wai to Hung Hom; and

(ii) an extension of the East Rail from Hung Hom to Central.

(b) Interchange arrangement

The proposed SCL scheme in the context of the rail merger will provide for fully integrated interchange stations and interchanging passenger will not be required to pay second boarding charge.

(c) *Approach for implementation*

If, in its absolute discretion, the Government decides to implement the SCL, MergeCo would be invited to implement the project on the basis of the approach (i.e. Ownership Approach or Concession Approach) to be adopted for that project.

5. Ensuring job security for frontline staff of both corporations at the time of the rail merger

On the Appointed Day, MergeCo will undertake to all frontline staff that it will provide job security, as it relates to the merger (other than in the case of cause) to them. On the Appointed Day, all serving staff of MTRCL and KCRC will be employed by MergeCo on existing terms.

C. NEXT STEPS

Liaison committees will be established, consisting of members from Government, MTRCL and KCRC, which shall discuss material decisions to be taken by KCRC and the financial impact of such decisions. Upon signing of the definitive transaction documents, KCRC will not implement a material decision without prior agreement of MTRCL's members on the relevant liaison Committee .

D. DEFINITIONS

“Additional Concession Asset”	means any asset purchased by MergeCo to maintain, repair, replace or improve the Initial Concession Assets that is capitalised on the balance sheet of MergeCo, to be more particularly defined;
“Additional Concession Payments”	means concession payments in respect of new projects operated by MergeCo under a service concession;
“Appointed Day”	means the day designated pursuant to the Merger Ordinance as the day on which the rail merger is completed;
“Concession Assets”	means the assets of the KCRC System to be used by MergeCo to provide the KCRC Services including the assets of the KCRC Railway, the TSA Buses, the Intercity Trains and the assets of the KCRC Related

	Businesses;
“Concession Payments”	means the fee for the Service Concession and the consideration for the Purchased Rail Assets, which forms part of the upfront payment totalling HK\$4.25 billion payable by MergeCo to KCRC on the Appointed Day, the Fixed Annual Payment and the Variable Annual Payment;
“Concession Period”	means a period of 50 years from the Appointed Day, as may be extended pursuant to the IOA and the MTR Ordinance;
“Fixed Annual Payment”	means the payment described in paragraph A2(b) of this Annex;
“Government”	means the Government of the Hong Kong Special Administrative Region;
“Hong Kong”	means the Hong Kong Special Administrative Region of the People’s Republic of China;
“Initial Concession Assets”	means the Concession Assets as at the Appointed Day;
“Integrated Railway”	means the KCRC Railway and the MTRC Railway;
“Integrated Services”	means the KCRC Services and the MTRC Services;
“Intercity Service”	means the railway service provided through the operation of the Intercity Trains;
“Intercity Trains”	means the intercity passenger and freight rail system from time to time;
“IOA” or “Integrated Operating Agreement”	means the Integrated Operating Agreement expected to be entered into by Government and MergeCo in relation to the operation of the Integrated Railway, as amended from time to time;
“KCRC”	means the Kowloon-Canton Railway Corporation;
“KCRC Common Assets”	means assets that are owned, used, or kept by KCRC (excluding MTRC assets) and that are used both in the provision of the MTRC Services and the provision of the KCRC Services;
“KCRC Ordinance”	means the Kowloon-Canton Railway Corporation Ordinance (Chapter 372 of the Laws of Hong Kong), as amended from time to time;
“KCRC Railway”	means: (a) the “Kowloon-Canton Railway” as defined in the KCRC Ordinance (composed of ER and WR); (b) the Light Rail from time to time; (c) the Intercity Trains; (d) the ERE from time to time; (e) the MOSR from time to time; (f) each of KSL and LMCSL on the date of its completion and from time to time; and (g) any other railway which is part of the “railways” as defined in the KCRC Ordinance from time to time;
“KCRC Related Businesses”	means KCRC’s businesses related to the KCRC Railway including KCRC’s advertising,

	telecommunications, duty free, kiosk rental, station trading, car park rental, machine and terminal rental businesses from time to time (but excluding, for the avoidance of doubt, the property development, property investment and property management rights that are part of the Property Package);
“KCRC Services”	means the services provided through the operation of the KCRC System;
“KCRC System”	means: (a) the KCRC Railway from time to time; (b) the TSA Buses; and (c) the KCRC Related Businesses;
“LegCo”	means the Legislative Council of Hong Kong;
“Light Rail”	means the “North-west Railway” as defined in the KCRC Ordinance;
“LMCSL”	means the railway line known as Lok Ma Chau Spur Line;
“MTRCL”	Means the MTR Corporation Limited
“MergeCo Common Assets”	means assets that are owned, used or kept (excluding KCRC assets) by MergeCo and that are used in both the provision of the MTRC Services and the provision of the KCRC Services, to be more particularly defined in the definitive transaction documents;
“Merger Ordinance”	means the Ordinance expected to be enacted in relation to the integration;
“MOSR”	means the railway line known as Ma On Shan Rail;
“MTR Ordinance”	means the Mass Transit Railway Ordinance (Chapter 556 of the Laws of Hong Kong), as amended from time to time;
“MTRC Railway”	means the “railway” as defined in the MTR Ordinance;
“MTRC Services”	means the services provided through the operation of the MTRC Railway;
“Net Cash Flow of the New Project”	means, for the purposes of calculating any Additional Concession Payment, the incremental revenues received as a consequence of operating the new project with that of MergeCo System, minus the incremental operating cost and incremental tax charge and the on-going capital expenditure of the new project;
“New Separate Projects”	means projects that are not natural extensions of the MTRC Railway or the KCRC Railway;
“Operating Agreement”	means the Operating Agreement dated 30th June, 2000 between the Secretary for Transport (on behalf of Government) and MTRC, as amended from time to time;

“Payments Relating to Enabling Works”	means the payments defined in paragraph A3(a) of this Annex;
“MergeCo”	Means MTRCL on and from the Appointed Day;
“Property Package”	means the property interests that MergeCo will purchase from Government and the terms of such purchase, as summarised in paragraph A(1)(e) of this Annex;
“Purchased Assets”	means the Purchased Rail Assets and the Property Package;
“Purchased Rail Assets”	means: (a) certain assets of KCRC as at the Appointed Day that are used by KCRC to provide the KCRC Services as at the Appointed Day (such assets shall be agreed by Government and MTRC in the SPA); and (b) contractual rights of KCRC that are necessary for MergeCo to provide the KCRC Services (to the extent that MergeCo does not obtain the right to do so pursuant to the SCA), including certain stores, spares, equipment and tools;
“Railways Ordinance”	means the Railways Ordinance (Chapter 519 of the Laws of Hong Kong), as amended from time to time;
“Related Business”	means KCRC’s businesses related to the KCRC Railway, including advertising, telecommunications, duty free, kiosk rental, station trading, carpark rental, machine and terminal rentals;
“Required Standards”	means: (a) the safety, performance and other operational standards prescribed in the MTR Ordinance and the IOA for the Integrated Services (other than those to be provided by the TSA Buses) from time to time (but, for the avoidance of doubt, excludes the Customer Service Pledges as defined in the IOA); and (b) the safety, performance and other operational standards prescribed in such other instruments, agreements or other documents (to be agreed by Government and MergeCo) for the Integrated Services to be provided by the TSA Buses from time to time;
“SCA” or “Service Concession Agreement”	means the service concession agreement to be entered into to document the terms and conditions of the Service Concession;
“SCL”	means the Shatin to Central Link;
“Service Concession”	means a service concession that KCRC shall grant MergeCo to access and use the Concession Assets to provide the KCRC Services;
“SPA” or “Sale and Purchase Agreement”	means the sale and purchase agreement to be entered into between MergeCo and KCRC which documents the terms and conditions of the sale to MergeCo of the Purchased Assets (or any part thereof);

“Stock Exchange”	means The Stock Exchange of Hong Kong Limited;
“TCC”	means the Tung Chung Cable Car, now known as Ngong Ping 360;
“TSA bus”	means KCRC bus service within the North-west Transit Service Area as defined in the KCRC Ordinance; and
“Variable Annual Payment”	means the payment described in paragraph A2(c) of this Annex; and

11 April 2006

The Property Package

Property Development:

1. Ho Tung Lau
2. Wu Kai Sha
3. Tai Wai Maintenance
4. Che Kung Temple
5. Tai Wai Station
6. Tin Shui Wai LRT
7. Kowloon Southern Link Site C
8. Kowloon Southern Link Site D

Investment Properties:

1. Commercial accommodation and kindergarten, Royal Ascot (Plaza Ascot)
2. Commercial areas of Pierhead Plaza and 32 car parking spaces on 1/F, Tuen Mun
3. Commercial areas, kindergarten and 421 car parking spaces of Sun Tuen Mun Centre, Tuen Mun
4. Commercial areas of Hanford Plaza and 22 car parking spaces on G/F, Tuen Mun
5. 20 residential units and 20 car parking spaces, Royal Ascot, Shatin
6. Retail floor, 1/F to 6/F, Citylink Plaza, Shatin
7. Investment property in KCRC Hung Hom Building, Kowloon
8. 252 residential units and 60 car parking spaces, Trackside Villas

Management businesses and rights relating to properties at:

1. Trackside Villas
2. Pierhead Garden
3. Pierhead Plaza
4. Sun Tuen Mun Centre
5. Sun Tuen Mun Shopping Centre
6. Hanford Garden
7. Hanford Plaza

8. Royal Ascot
9. Plaza Ascot
10. The Metropolis
11. Citylink Plaza
12. KCRC Hung Hom Building
13. Ho Tung Lau
14. Wu Kai Sha
15. Tai Wai Maintenance
16. Che Kung Temple
17. Tai Wai Station
18. Tin Shui Wai LRT
19. Kowloon Southern Link Site C
20. Kowloon Southern Link Site D
21. Nam Cheong*
22. Tsuen Wan West (TW5 – Bayside)*
23. Tsuen Wan West (TW5 – Cityside)*
24. Tsuen Wan West (TW6)*
25. Tsuen Wan West (TW7)*
26. Kam Sheung Road*
27. Pat Heung Maintenance Centre*
28. Yuen Long*
29. Long Ping South*
30. Long Ping North*
31. Tin Shui Wai*
32. Tuen Mun*
33. Kwai Fong*

* West Rail property sites