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Panel on Transport

**Background brief on
the governance of Kowloon-Canton Railway Corporation**

Introduction

The rift between the senior management and the Chairman of Kowloon-Canton Railway Corporation (“KCRC”) has aroused wide public concern. According to press reports, on 9 March 2006, Mr Samuel LAI, acting Chief Executive Officer (“CEO”) of KCRC submitted a letter to the KCRC Managing Board (“the Board”), in which he alleged problems within the management due to the Chairman, Mr Michael TIEN Puk-sun’s leadership style. Five KCRC senior directors/directors, and 19 general managers and four department heads signed letters of support for Mr LAI and criticized the Chairman for putting undue pressure on staff with his high-transparency approach. About 4,000 KCRC staff also signed a letter urging the company to pay attention to the matter. On 11 March 2006, Mr Michael TIEN tendered his resignation to the Chief Executive so as to keep the impacts of the incident on the Corporation, the public and the Government to the minimum. On 14 March 2006, the Board held a special meeting to discuss the dispute between the CEO and the Chairman. During the board meeting, 20 general managers/department heads, who signed a letter to the board criticizing TIEN’s management style, held a media briefing at a conference room next to the venue of the Board meeting to openly declare their support for Mr LAI.

2. On 15 March 2006, a report was submitted to the Chief Executive from the Board with regard to the dispute between the Chairman and the CEO. Both the CEO and the Chairman agreed to remain in the current posts. The Board maintains that it is most important for KCRC to maintain the high degree of transparency, a strong sense of accountability as well as good corporate governance which is led by the Chairman and CEO. The Board has come up with a set of guidelines which is within the corporate operation that the duties of the CEO and the Chairman should be more clearly defined.

3. The Chief Executive accepted the report submitted by the Board and asked the Chairman to withdraw his letter of resignation. He however remarked that during the course of resolving the dispute between the Chairman and the CEO, there were serious personnel and disciplinary issues within KCRC. He had requested the Board to look into the matter. Subsequently, the Board decided to take disciplinary action against Mr Michael LAI, General Manager – Marketing, and terminate his employment with immediate effect. Mr Samuel LAI also tendered his resignation to reflect his responsibility under the accountability system.

4. On 16 March 2006, the Government appointed Mr James BLAKE, former Secretary for Works and Senior Director, Capital Projects of KCRC as the CEO.

5. There are worries that this crisis may pose a threat to the governance of KCRC and may affect its services. The Panel on Transport has therefore scheduled a special meeting on 21 March 2006 to meet with the Administration and KCRC to discuss the related issues. This paper provides background information on the governance structure of KCRC, and the governance practice of separating the duties and functions of chairman and CEO as adopted by other public bodies.

Review of the governance structure of KCRC in 2001

Separation of the duties and functions of the Chairman and the Chief Executive of KCRC

6. In October 2001, the Administration introduced the Kowloon-Canton Railway Corporation (Amendment) Bill 2001 (the Bill) into the Council. The Bill sought to separate the duties and functions of the Chairman and the Chief Executive of KCRC by creating the office of the CEO in KCRC. With the expansion of the railway programmes, there was a growing need to separate the strategic planning function and day-to-day management responsibility of KCRC.

7. According to the Legislative Council Brief issued by the Administration in September 2001, the respective duties and functions of the Chairman and the CEO were as follows:

8. The Chairman should concentrate on the following tasks:

- (a) reviewing and guiding corporate strategy and business development plans;
- (b) overseeing financial planning, major capital expenditure, acquisition and divestiture;
- (c) setting performance objectives and monitoring the achievement of such objectives by the executives;
- (d) ensuring the adequacy and integrity of the accounting, financial

reporting and risk management systems; and

- (e) identifying candidates for key executive positions, overseeing succession planning and determining executive remuneration.

9. The CEO of KCRC, who would be a member of the Board, should focus on :

- (a) implementing the business strategies determined by the Board;
- (b) delivery of operational and financial performance objectives set by the Board;
- (c) day-to-day management of the rail operation and rail construction; and
- (d) internal administration of the Corporation.

10. With the separation of the functions and duties of the Chairman and the CEO, the supervision of the wide range of tasks facing KCRC would be more effective. The Chairman, separate from the executives, would strengthen the independence of the Board and hence its ability to discharge its supervisory functions. The CEO could devote full attention to the day-to-day management of the railway operation and the implementation of committed railway projects. This was in keeping with the universal trend in good corporate governance. It was also the model in most public corporations e.g. Airport Authority and Hospital Authority.

11. In the course of deliberation, the Bills Committee formed to study the Bill had enquired whether the Administration would consider setting out in the Bill the duties and functions of the Chairman and the CEO or at least their respective areas of responsibility.

12. The Administration's view was that this would not be appropriate as it was important for KCRC, which operated along prudent commercial principles, to retain the flexibility to determine and fine-tune the relationship between the Board (led by the Chairman) and the executives (led by the CEO) to suit its operational needs and the prevailing corporate governance practices which changed overtime. Apart from statutory functions specifically assigned by the principal Ordinance, the functions of the Chairman and the CEO should be functions assigned to them by the Board as in the case of any other normal commercial entity.

Roles and responsibilities of the Board

13. Regarding the responsibilities of the Board, the Bills Committee noted from the Administration that the Board was responsible, inter alia, for overall company strategy, acquisition and divestment policy, approval of the Corporation's annual estimates of revenue and expenditure, major financing arrangements, passenger fares and freight charges, and for ensuring that sound administrative systems and procedures were in

place. It also reviewed monthly the Corporation's operating results, safety record, and the progress made towards annual targets. The Chairman and Members of the Board jointly carried out the duties and functions of the Board. The Board delegated day-to-day operations to the executives (led by the CEO) for implementing the company's mission and strategies.

14. Given the heavy responsibilities of the Board, the Bills Committee had examined whether it was viable for a part-time Chairman to supervise the senior management of KCRC in an effective manner, and exercise objective judgement on corporate affairs.

15. The Administration's view was that a part-time Chairman would suffice, given the workload of the Chairman and the common practice in the business sector. Being the governing body of the Corporation, the Board was the ultimate legal authority within the Corporation. All corporate powers were exercised by or under the authority of the Board. To help oversee specific aspects of the Corporation's operations, five committees, namely Audit Committee, New Railway Projects Steering Committee, Committee on Senior Executive Remuneration, Property Development Committee, and Finance Committee were formed under the Board¹. These Committees reviewed and made recommendations to the Board on various matters. Whilst the Chairman had the power to set agenda, approve issue of Board papers, chair Board meetings, call extraordinary Board meetings and chair the annual strategic planning conference, the functions of the Board were jointly exercised by all Members of the Board.

16. To ensure openness, integrity and accountability, the Administration accepted the Bills Committee's recommendation for adding a new provision in the Bill, requiring the Chairman and the CEO to attend meetings of committees and subcommittees of the Legislative Council upon request.

Composition of the Board

17. In the course of deliberation, the Bills Committee had requested the Administration to review the size and composition of the Board so as to ensure a balanced composition of the Board to handle its activities. The Administration pointed out that in making appointments to the Board, the Government would carefully assess the suitability of prospective candidates having regard to relevant factors such as personal abilities, leadership qualities, expertise, experience, integrity and commitment to public service. The Government would review the composition of Board members from time to time to ensure that the Board was served by the best available candidates and had a good mix of expertise and experience.

18. Regarding the Government's representatives in the Board (i.e. Secretary for the

¹ In December 2002, KCRC advised the Panel that there were five Committees under the Board, viz. Property Committee, Pay and Conditions Committee, Capital Projects Committee, Finance Committee and Audit Committee.

Environment, Transport and Works and Secretary for Financial Services and the Treasury), some members held the view that they should perform a monitoring role to oversee the Corporation's affairs for the purpose of safeguarding the public interest. They should also be held accountable to the Legislative Council for any serious policy failure and mismanagement in KCRC.

19. The Bill was passed by the Council on 19 December 2001.

Appointment to the Board

20. On 24 December 2001, the Government announced the appointment of Mr Michael TIEN Puk-sun as the Chairman of KCRC for two years. Since then, Mr TIEN's appointment had twice been renewed. The current term of appointment of Mr TIEN as the Chairman will expire in December 2006.

Review of the size and composition of the Board

21. During the deliberations of the Bills Committee on the Bill, some members opined that the Board membership should be expanded to include individuals from green groups and grass roots organizations as well as Members of the Legislative Council to ensure a balanced composition of the Board. In November 2002, the Administration informed the Panel of the results of the review and appointments to the Board.

22. The Administration pointed out that in considering appointments to the Board, it had taken into account the views expressed by the Bills Committee members carefully. The Administration agreed that it was important for the Board to have a balanced and appropriate composition so that it could perform its functions effectively. For this purpose, the Administration had carefully assessed the suitability of prospective candidates having regard to relevant factors such as personal capabilities, leadership, expertise, experience, integrity and commitments to public service. Taking these factors into account, the Chief Executive had decided to appoint four new members and reappoint two serving members to the Board. These members possessed the necessary knowledge and experience in such areas as banking, accounting, legal profession, business management, property development and large-scale development projects. All these were required to meet the functional needs of the Board.

23. Some members expressed regret that the Administration had failed to honour its undertaking given during the course of deliberation of the Bills Committee on KCRC (Amendment) Bill 2001 that it would review the size and composition of the KCRC Managing Board and consider appointing individuals from green groups and grass root organizations, as well as Members of the Legislative Council so that the Board would give due regard to the views and aspirations of the community in its decision making. Some criticized the Administration for failing to maintain an equitable balance

between the considerations of public interest and commercial operations of the Corporation when making appointments to the Managing Board as its new membership was even more business-oriented than before.

Support from committees of the Board

24. The Panel however welcomed the Corporation's move to appoint outside members to the committees of the Board so that the Board would be able to benefit from the advice of the committee members in its decision making.

Corporate structure

25. The organization structure of the Corporation is shown in **Appendix I**.

Membership list of the Board and honorarium of Board members

26. A press release issued by the Administration in December 2005 showing the latest membership list of the Board is in **Appendix II**.

27. According to KCRC Annual Report, in 2004, the Chairman received an honorarium of \$220 000 per annum and other members of the Board, excluding the CEO, received an honorarium of \$110 000 per annum.

Senior management of KCRC and their emoluments

28. The CEO is delegated the authority to carry out all of the Corporation's activities other than those reserved by the Managing Board under the Rules for Conduct of Corporation Business. The CEO has established the Management Committee (MCOM) to enable him to obtain a collective Management view on important issues. The CEO chairs MCOM and other members comprise the Senior Directors and Directors, General Manager – Corporate Affairs, and Company Secretary and General Counsel.

29. The emoluments of the top senior management of KCRC in 2004 are as follows:

	Base pay and other benefits (\$ million)	Variable pay (\$ million)	Total (\$ million)
Acting CEO	4.89	0.51	5.40
Senior Director - Capital Projects	3.83	0.40	4.23
Senior Director - Transport	3.91	0.37	4.28
Director-West Rail	3.49	0.39	3.88
Director-Property	3.72	0.41	4.13

30. A separate background brief on KCRC top management's variable pay was issued vide LC Paper No. CB(1) 1082/05-06.

Separation of the roles and functions of the Chairman and CEO in other public bodies

31. Although the origins of corporate governance can be found in the desire to improve the transparency and accountability of financial reporting by listed companies to their shareholders, it has since developed far beyond this and embraced, amongst other things, effective communications with a more diverse range of stakeholders, both internal and external, on a wider range of issues. For public sector organizations, good corporate governance practices could assist and encourage their governing boards and management to establish and maintain a clear focus on performance, transparency and accountability.

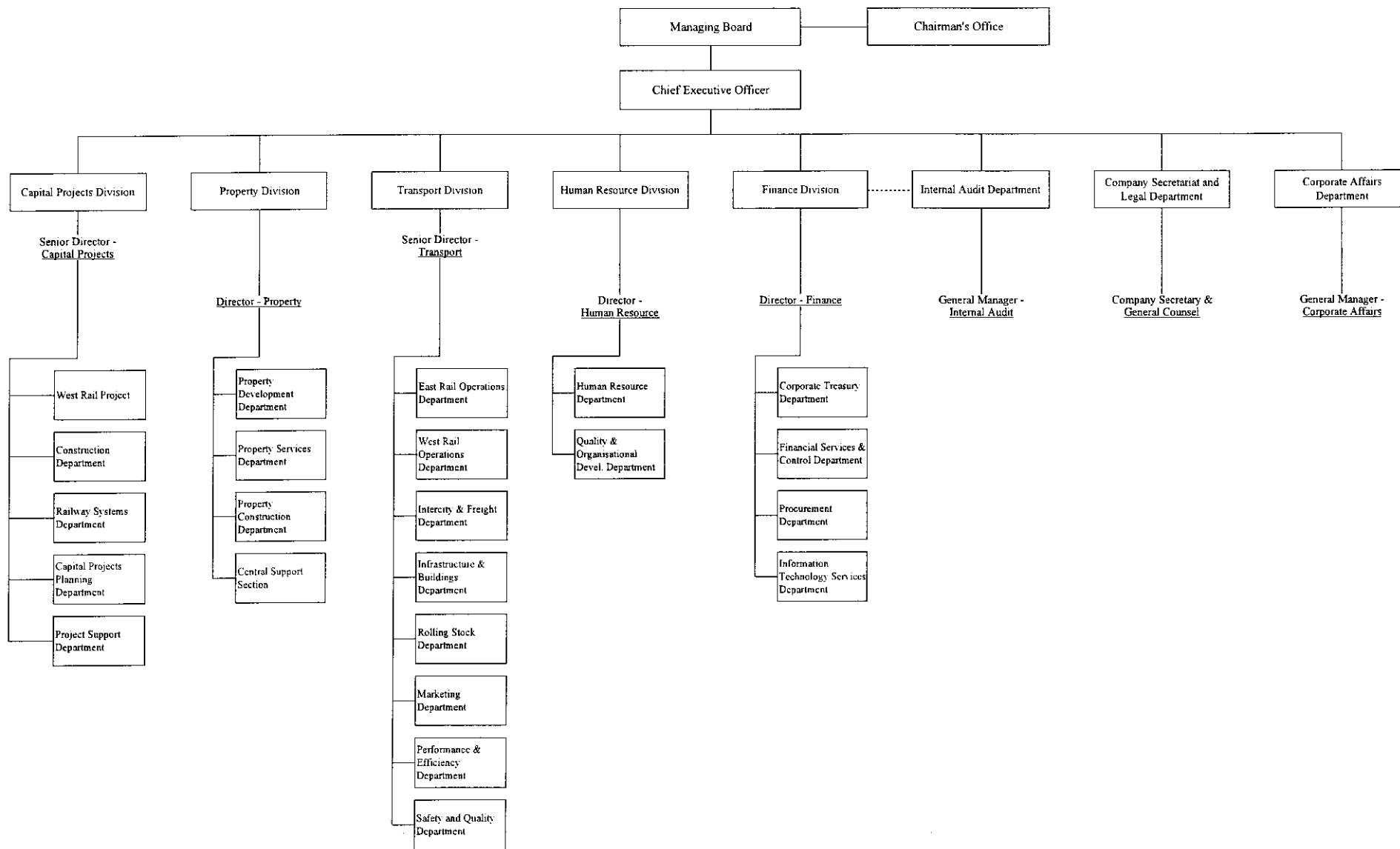
32. Alongside with the best practice for the boards of public bodies to separate the roles of chairman and chief executive, the Government has been implementing similar corporate governance practices in a number of public bodies, e.g. the Hong Kong Exchanges and Clearing Limited, the Mandatory Provident Fund Schemes Authority, the Airport Authority, the MTR Corporation Limited and KCRC.

33. The Legislative Council is considering the Securities and Futures (Amendment) Bill 2005 which seeks to provide for the removal of executive director status of the Chairman of the Securities and Futures Commission (SFC), the power of the Chief Executive to appoint a CEO for SFC, an excess of non-executive directors over executive directors on the SFC, and related and incidental matters.

34. A list of relevant documents is in **Appendix III**.

SECTION 1
Organization Chart

Appendix I



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Appointments to the KCRC Managing Board

The Government announced today (December 19) the Chief Executive's decision on the following re-appointments to the Managing Board of the Kowloon-Canton Railway Corporation ("KCRC"):-

(a) Mr Michael Tien Puk-sun, BBS, JP. to be the Chairman of KCRC for a period of one year with effect from December 24, 2005; and

(b) the Honourable Abraham Shek Lai-him, JP. and Professor Richard Wong Yue-chim, SBS, JP. to be Members of the Managing Board of the Kowloon-Canton Railway Corporation for a period of one year with effect from February 1, 2006.

In welcoming the decision, the Secretary for the Environment, Transport and Works, Dr Sarah Liao said, "We are confident that the Managing Board, with these re-appointments, will continue to successfully lead KCRC to meet the challenges ahead."

In considering appointments to the KCRC board, the Government had carefully assessed the suitability of candidates having regard to relevant factors such as personal capabilities, leadership, expertise, experience, and commitment to public service.

Under the KCRC Ordinance (Cap.372), KCRC shall have a managing board comprising a chairman, a chief executive officer and not less than four nor more than eight other members appointed by the Chief Executive. The membership of the board is at Annex.

Annex

Membership List of Managing Board of the Kowloon-Canton Railway Corporation

Chairman

Mr Michael Tien, BBS, JP

Acting Chief Executive Officer

Mr Samuel Lai

Members

Mr Vincent Lo Wing-sang, JP

Mr Wan Man-yee, BBS, JP

Mr Patrick Blackwell Paul, CBE

Hon Abraham Shek Lai-him, JP

Prof Richard Wong Yue-chim, SBS, JP

Mr Ng Leung-sing, SBS, JP

Secretary for the Environment, Transport and Works

Secretary for Financial Services and the Treasury

List of relevant documents
on the governance of Kowloon-Canton Railway Corporation (KCRC)

Committee	Papers, reports and minutes of meetings	LC Paper No.
Bills Committee on Kowloon-Canton Railway Corporation (Amendment) Bill 2001	An information paper provided by the Administration on issues raised by members at the meeting held on 15 November 2001	CB(1)389/01-02(01) http://www.legco.gov.hk/yr01-02/english/bc/bc02/papers/bc21123cb1-389-1e.pdf
	An information paper provided by the Administration on issues raised by members at the meeting held on 23 November 2001	CB(1)444/01-02(01) http://www.legco.gov.hk/yr01-02/english/bc/bc02/papers/bc21129cb1-444-1e.pdf
	An information paper provided by the Administration on issues raised by members at the meeting held on 29 November 2001	CB(1)480/01-02(01) http://www.legco.gov.hk/yr01-02/english/bc/bc02/papers/bc21204cb1-480-1e.pdf
	Paper entitled "Property Development Plan at the Northern Part of KCRC Hung Hom Station" provided by KCRC	CB(1)389/01-02(02) http://www.legco.gov.hk/yr01-02/english/bc/bc02/papers/bc21123cb1-389-2e.pdf
	Minutes of meeting on 15 November 2001	CB(1)388/01-02 http://www.legco.gov.hk/yr01-02/english/bc/bc02/minutes/bc021115.pdf
	Minutes of meeting on 23 November 2001	CB(1)1147/01-02 http://www.legco.gov.hk/yr01-02/english/bc/bc02/minutes/bc021123.pdf
	Minutes of meeting on 29 November 2001	CB(1)1148/01-02 http://www.legco.gov.hk/yr01-02/english/bc/bc02/minutes/bc021129.pdf

Committee	Papers, reports and minutes of meetings	LC Paper No.
	Minutes of meeting on 4 December 2001	CB(1)1149/01-02 http://www.legco.gov.hk/yr01-02/english/bc/bc02/minutes/bc021204.pdf
	Report of the Bills Committee on Kowloon-Canton Railway Corporation (Amendment) Bill 2001 to House Committee on 7 December 2001	CB(1)508/01-02 http://www.legco.gov.hk/yr01-02/english/hc/papers/hc1207cb1-508.pdf
Council	Hansard of the meeting on 19 December 2001	http://www.legco.gov.hk/yr01-02/english/counmtg/hansard/cm1219ti-translate-e.pdf
Panel on Transport	Paper entitled "Appointments to the Managing Board of the Kowloon-Canton Railway Corporation" provided by the Administration	CB(1)247/02-03(01) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp1122cb1-247-1e.pdf
	Supplementary paper entitled "Appointments to the Managing Board of the Kowloon-Canton Railway Corporation" provided by the Administration	CB(1)351/02-03(01) http://www.legco.gov.hk/yr02-03/english/panels/tp/papers/tp1122cb1-351-1e.pdf
	Minutes of meeting on 20 December 2002	CB(1)772/02-03 http://www.legco.gov.hk/yr02-03/english/panels/tp/minutes/tp021220.pdf